1943 Feb. 15. — 1944 June 6.

BETWEEN:

KENNETH B. S. ROBERTSON LIMITED .... APPELLANT,

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, Chap. 97, sects. 3, 6 ss. 1 (d), 9—Reserve against contingencies—Income taxable in year in which received—Amounts held as deposits—Quality of income.

Appellant was agent for certain underwriting members of Lloyd's of London, England, in the writing of Workmen's Compensation, Employer's Liability and Occupational Disease insurance. It dealt exclusively with insurance brokers in the United States who acted for employers there and placed insurances with the underwriters through the appellant. Under such policies of insurance the underwriters undertook to indemnify the insured employers in respect of losses in excess of a specified percentage. The full amount of the premium payable by the insured employer was based upon the entire remuneration earned by all employees of the employer during the whole period of the contract and could not be ascertained until its expiry. The employer paid an advance fee at the time the contract took effect. This was based upon an estimate made by the employer

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as to what he thought his payroll for the year would be. The advance fee was to be held as a deposit by the underwriters and to be applied or refunded as specified in the contract when the amount of the earned fee based upon total payroll could be ascertained.

The policies also provided for a minimum fee which was the amount to be accepted and retained by the underwriters regardless of the earned fee developed after audit of the payroll. They also provided for refunds in the event of cancellations. The appellant's fee for its services was a percentage of the amount which the insured employer had to pay. At the end of each of the years in question in the appeal there were policies in force in respect of which refunds might have to be made either in the event of cancellations or because the estimate on which the advance fee had been based exceeded the total payroll of the employer during the policy year. The appellant set up in its books a "reserve for unearned commissions" which was really provided to enable the appellant to distribute the amounts received by it during the year into the amounts that had been earned in such year and those which had not yet been earned, in the sense that refunds might have to be made either due to cancellations or because of over-estimating of total payroll. The so-called reserve being disallowed, an appeal was taken. The appeal was allowed in part.

Held: That every reserve set up out of profits or gains of whatever kind, which seeks to provide against the happening of unascertained future events is excluded as a deduction except in so far as the Act permits. *Western Vinegars Limited* v. *Minister of National Revenue,* (1938) Ex. C.R. 39, commented upon. *Brown* v. *Helvering,* 291 U.S. 193, approved.

2. That the test of taxability of the income of a taxpayer in any year is not whether he earned or became entitled to such income in that year, but whether he received it in such year and the taxpayer has no right to have income received by him during a taxation year distributed for taxation purposes over the years in respect of which he may have earned or become entitled to such income. *Capital Trust Corporation Limited et al.* v. *Minister of National Revenue* (1936) Ex. C.R. 163; (1937) S.C.R. 192, followed and commented upon.

3. That where an amount is paid as a deposit by way of security for the performance of a contract and held as such, it cannot be regarded as profit or gain to the holder until the circumstances under which it may be retained by him to his own use have arisen and, until such time, it is not taxable income in his hands, for it lacks the essential quality of income, namely, that the recipient should have an absolute right to it and be under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

APPEAL under the provisions of the Income War Tax Act from the decision of the Minister of National Revenue.

The appeal was heard before the Honourable Mr. Justice Thorson, President of the Court, at Ottawa.

D. C. Abbott, K.C. and *Paul Casey* for appellant.

Roger Ouimet and *H. H. Stikeman* for respondent.

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

THE PRESIDENT now (June 6, 1944) delivered the following judgment:

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The appellant acted as agent or correspondent for certain underwriting members of Lloyd's of London, England, in the writing of Workmen's Compensation, Employer's Liability and Occupational Disease insurance, under an annual memorandum of authorization by which the appellant was authorized to accept or reject risks, fix rates of premium, issue policy contracts, collect premiums and settle claims. The appellant did not directly solicit insurance business but dealt exclusively with insurance brokers in the United States who acted for employers there. When the negotiations for a policy contract were concluded the appellant in Montreal issued an indemnification certificate to the insured employer on behalf of the underwriters, which operated as a binder until the final contract was issued and then was attached to and became part of such contract. The final contract was issued in London by the underwriters, sent to the appellant and delivered by it to the insured employer. The underwriters undertook to indemnify the employer in accordance with the terms of the certificate. There were two types of contracts; in one, the underwriters undertook to indemnify the employer against all loss in excess of 70 per cent of his normal premium and, in the other, in excess of 75 per cent. A limit of liability was imposed. The contract was really one of re-insurance whereby the employer looked after 70 or 75 per cent of his losses himself and the underwriters insured him in respect of the balance. Policies were mainly for one year but in a few instances for two years.

The provisions in the certificate relating to the normal premium, the advance fee and the minimum fee are of special importance. The amount of the "normal premium" was derived by multiplying the entire remuneration earned by all employees of the employer during the whole period of the contract by the rates provided for the various operations conducted by the employer. It could, therefore, not be ascertained until the expiry of the contract.

Under the circumstances the employer paid an "advance fee" at the time the contract took effect. This advance fee was for a specified period, either of six months or a year, and a further advance fee was paid at the end of such period. The advance fee, the amount of which was specified in the certificate, was based upon an estimate made by the employer as to what he thought his total payroll for the year would be. At the end of the specified period, the employer paid an "additional fee" computed on the remuneration earned by all his employees during the preceding period. It was also provided that if the contract was terminated prior to its expiry date the "earned fee" therefor should be computed on the total remuneration earned by all employees during its currency. The indemnification certificate contained the following important stipulation with regard to the advance fee:

> The advance fee shall be held as a deposit by Underwriters, and shall be applied against the audited fee in the annual adjustments under this contract as follows: If the earned fee on any such adjustments shall be greater than the advance fee, the Employer shall thereupon pay the difference to Underwriters: if it be less, Underwriters shall thereupon refund the difference to the Employer.

In addition to fixing the amount of the advance fee the certificate also fixed a "minimum fee", which was defined as:

> the minimum amount to be accepted and retained by underwriters as fee for this indemnity, regardless of the earned fee developed after audit of payroll.

Provision was also made for cancellation by either party on 30 days' notice. If the cancellation was at the request of the underwriters or the employer when for reasons beyond his control he was actually retiring from the business described in the declarations, the underwriters' fee was to be computed as an earned fee based on the total payroll up to the time of the cancellation and adjusted pro rata in which event the minimum fee was to be applied to such adjustment. But if the cancellation was at the employer's request and he was not retiring from business, the underwriters' fee was to be computed as an earned fee based on the total payroll and adjusted at short rates in which event the minimum fee was to apply if it was greater than the earned fee developed at such short rates.

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The indemnification certificate also required the employer to utilize the services of a service organization approved by the appellant and operating under its supervision. This service organization was charged with certain duties, such as the strict discharge of the employer's insurance obligation to his employees, the maintenance of records, the furnishing of complete inspection and safety engineering devices and the furnishing of monthly claims' records.

The relationship of the appellant to the underwriters and its authority to act for them was set out in the annual memorandum of authorization. The appellant had authority to accept insurances up to certain limited amounts and to issue policies on behalf of the underwriters, whereby the underwriters indemnified employers for losses in excess of 75 or 70 per cent of their normal premiums. Consequently the employer paid only 25 to 30 per cent of such normal premium. This was received by the appellant and distributed by it as follows: 10 per cent to the underwriters for the re-insurance, 10 per cent to the service organizations for servicing the risks, and the remaining 5 or 10 per cent was used by the appellant to pay brokerage fees and its own fees. Where 10 per cent was available, from 7 to 9 per cent was paid out for brokerage, leaving a balance of from 1 to 3 per cent for the appellant, but where only 5 per cent was available, the brokerage fees came to from 3½ to 4 per cent, leaving 1 to 1½ per cent for the appellant. The appellant's fee came out of the 25 or 30 per cent paid by the employer and was a fixed percentage of it.

The practice followed by the appellant in dealing with the amounts received by it from employers on behalf of the underwriters may be summarized as follows: the appellant did not wait until the full amount that each employer was required to pay under his contract had been ascertained, but distributed the fees received by it, whether advance fees, minimum fees, additional fees or earned fees, immediately upon their receipt, to the underwriters, the service organizations, the brokers and itself, in the percentages, already mentioned; if adjustments had to be made subsequently involving refunds to employers either because of cancellations or by reason of overestimated payrolls the appellant arranged with the persons who had

shared in the distribution of the fees already received for proportionate refunds out of the percentages respectively received by them. While the liability to make a refund in the event of a cancellation or the duty to refund out of the advance fee, if it developed that the payroll of the employer had been overestimated, was that of the underwriters, they looked to the appellant to see that the necessary refund was made. Since the appellant's fee was a fixed percentage of what the employer had to pay to the underwriters it followed that if the underwriters had to make a refund to the employer the appellant would have to make a proportionate refund of the percentage which it had retained for itself.

The appellant was incorporated in 1934, and during its first two fiscal years ending August 31, 1935, and 1936, respectively, it dealt with all the fees received by it during each fiscal year as income for that year. In its annual statements for these years the auditors pointed out that no provision had been made for the proportion of commissions unearned at the end of the year which might be returnable in the event of policies being cancelled. As a result of the recommendation of its auditors, the appellant altered its former practice and in each of the years ending August 31, 1937, 1938 and 1939, made provision in its books at the end of such year, which it described in its statement of liabilities as a "Reserve for Unearned Commissions". The amount of this so-called reserve was $3,000 in 1937, $5,631 in 1938 and $10,846.08 in 1939. The amount of $3,000 provided as at August 31, 1937, was a guess, but the amounts provided at the end of each of the two following years were the result of exact computation arrived at by calculating the unearned amount in respect of all the policies still in force at the end of such year, taking policy by policy, and making a deduction for the unexpired portion of each; for example, if a policy had still eight months to run, two-thirds of the fee in respect of that policy was regarded as unearned and included in the so-called reserve for unearned commissions.

While the amount thus stated to be a reserve for unearned commissions included amounts that might have to be paid to an employer in the event of a cancellation or be

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refunded to him out of the advance fee if it developed that he had overestimated his payroll, it went further than making provision for these two events. It is, I think, clear that the chief purpose of the appellant's new practice was to allot to each of its fiscal years the proportion of fees that was applicable to such year. The so-called reserve for unearned commissions was really provided to enable the appellant to distribute the amounts received by it during a fiscal year into the amounts which had been earned in that year and those which had not yet been earned. The reserve represented the amounts not yet earned in the fiscal year, although received during it. It was said that the change was made in order to show the true income position of the appellant. I have no doubt that this is true and that from an accounting standpoint the practice was a sound one, but it does not follow that, because an accounting practice is a sound one, it is permissible for income tax purposes. If there is a conflict between sound accounting practice and the clear intendment of the taxing Act, the latter governs.

Of the amount of $5,631 as at August 31, 1938, the appellant returned all except $1,627.09 during the following fiscal year. Such returns were because of both cancellations and overestimated payrolls. There is no evidence to show how much was returned for each of these reasons except the statement that there were very few cancellations, the bulk of the refunds becoming necessary through the fact that the normal premium developed at the end of the policy year was less than the amount of the advance fee. As refunds had to be made they were paid out of the current revenues of the appellant. At the end of August, 1939, the whole of the so-called reserve was then thrown back into income for the 1939 fiscal year, the net result being that out of the reserve of $5,631, only $1,627.09 was income for the fiscal year ending August 31, 1939. It made no difference, in my opinion, whether the refunds were charged directly against the reserve or paid out of current revenue for the net result was the same. The procedure in the following year was the same.

The balance sheet of the appellant for each of the years in question showed the amount of the "Reserve for Unearned Commissions" in its statement of liabilities and

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was filed with its income tax returns for that year. The notices of assessment for each of the three years were all dated January 20, 1941. The appellant was additionally assessed in respect of 1937 for the whole amount of the reserve of $3,000, but in respect of 1938 only for $2,631, and in respect of 1939 only for $5,215.08, as though the reserves had been cumulative. The evidence is quite conclusive that such was not the case; the reserve of $5,631 in 1938 did not include that of $3,000 in 1937, nor did the reserve of 1939 include that of 1938. At the end of August, 1939, for example, the whole of the reserve of $5,631 set up as at August 31, 1938, was accounted for, either through refunds having been made or through the net balance having been thrown back into income, so that nothing was left of the reserve set up for the year before. The same was true with regard to the following year. The additional assessments for the years 1938 and 1939 were, therefore, erroneous in their amounts.

The appellant appealed from the assessments on the ground that it should be assessed only in respect of the income from commissions earned by it during each year and that the amounts included in the reserve were not taxable income in the year in which they were received. The view of the Minister was that the amounts received by the appellant were properly taxable as income in the year in which they were received, under section 3 of the Income War Tax Act, R.S.C. 1927, chap. 97, and that the reserve set up by the appellant was not allowable under section 6.1 (*d*) of the Act. The assessments were affirmed by the Minister and from his decision this appeal is brought.

It is desirable to deal with section 6.1 (*d*) of the Income War Tax Act first. It provides as follows:

> 6.1. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> (*d*) amounts transferred or credited to a reserve, contingent account or sinking fund, except such an amount for bad debts as the Minister may allow and except as otherwise provided in this Act;

In order to come within the prohibition of deduction enacted by this paragraph there must have been a transfer or credit from profits or gains. If the amounts transferred or credited were not from profits or gains, the paragraph

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has no application at all. Only two transfers or credits from gross income in order to arrive at taxable income are permitted, one being such an amount for bad debts as the Minister may allow and the other such deductions as are "otherwise provided in this Act", such as for depreciation and depletion.

So far as I am aware, there is only one Canadian case that deals with the paragraph under discussion—*Western Vinegar Limited* v. *Minister of National Revenue* (1). In that case, the appellant sought to deduct profits charged on containers (barrels and kegs) in which it had sold its products, it being a condition of the contract of sale that on the return of the containers the purchaser would be credited with the price charged for them. The evidence was that between 75 and 85 per cent of the containers were usually returned. The appellants in the light of such experience set aside out of their profits an estimated amount to cover the losses on the return of the containers and the respondent contended that such a deduction was not allowable under section 6, ss. 1 (*d*) of the Act. Angers J. rejected this contention and held, in effect, that the estimated amount was not a reserve within the meaning of the paragraph. At page 45, he said:

> The profits on the containers are not, as I conceive, a reserve properly called; and the loss of these profits, on the returns of the containers, is not merely a contingency but a certainty. The only thing uncertain is the quantity of the containers which will be returned and the time at which the returns will be effected.

The deduction claimed by the appellant for losses on the returns of the containers was allowed, although such losses had not yet been sustained. While the importance of the decision lies in the distinction drawn between a loss that is certain and one that is merely contingent, I find it difficult to reconcile the decision with the authorities that apply the general rule that profits are to be taxed in the year in which they are received and losses borne in the year in which they are sustained.

The deductions prohibited by the paragraph under discussion would, in my opinion, not be permissible, even if the paragraph were not in the Act at all, for they are really dispositions of income after it has been received. That is

(1) (1938) Ex. C.R. 39.

clearly the effect of the English authorities. In *Edward Collins & Sons, Ltd.* v. *The Commissioners of Inland Revenue* (1), it was held that a deduction for an apprehended future loss was not permissible. At page 781, the Lord President (Clyde) stated the principle clearly:

> It is, however, quite consistent with this that a prudent commercial man may put part of the profits made in one year to reserve, and carry forward that reserve to the next year, in order to provide against an expected, or (it may be) an inevitable, loss which he foresees will fall upon his business during the next year. The process is a familiar one. But its adoption has no effect on the true amount of the profits actually made, and does not prevent the whole of the profits, whereof a part is put to reserve, from being taken into computation in the year in question for purposes of assessment. On the contrary, the balance of profits and gains is determined independently altogether of the way in which the trader uses that balance when he has got it; and, if he puts part of it to reserve and carries it forward into the next year, that has no effect whatever upon his taxable income for the year in which he makes the profit.

The same principle appears in such cases as *Whimster & Co.* v. *The Commissioners of Inland Revenue* (2); and *The Naval Colliery Co., Ltd.* v. *The Commissioners of Inland Revenue* (3).

The law is the same in the United States. Losses that have been sustained are deductible but the American courts have not allowed any deductions from profits for the purpose of meeting losses or liabilities that were apprehended or contingent on the happening of an uncertain future event. The Supreme Court of the United States dealt with the matter in *Brown* v. *Helvering* (4). In that case, the facts were: a general agent of fire insurance companies received "over-riding commissions" on the business written each year, subject however to the contingent liability that when any of the policies was cancelled before its term had run, a part of the commission thereon, proportionate to the premium money repaid to the policy holder, must be charged against the agent in favour of the company. In his accounts and income tax returns involved in this case, he deducted from the accrued commissions of each year a sum entered in a reserve account to represent that part of them which, according to the experience of earlier years, would be returnable because of cancellations. It was held that he was not entitled to make any deduction

(1) 1924) 12 T.C. 773.
(2) (1925) 12 T.C. 813.
(3) (1928) 12 T.C. 1017.
(4) (1934) 291 U.S. 193.

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for such purposes. Mr. Justice Brandeis, in delivering the opinion of the Supreme Court of the United States, said, at page 199:

> The overriding commissions were gross income of the year in which they were receivable. As to each such commission there arose the obligation—a contingent liability—to return a proportionate part in case of cancellation. But the mere fact that some portion of it might have to be refunded in some future year in the event of cancellation or reinsurance did not affect its quality as income * * * When received, the general agent's right to it was absolute. It was under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

A great many United States decisions to the same effect could be cited.

The authorities, both in England and in the United States establish that, even apart from such a provision as is contained in paragraph (*d*) of subsection 1 of section 6 of the Income War Tax Act, a taxpayer cannot deduct from his income any amounts to meet contingent liabilities. The fact that it would be wise or prudent to do so has no bearing on the matter. The case against any deduction from profits or gains becomes all the stronger by reason of the language of the paragraph under discussion with its specific and imperative prohibition and I agree with the contention of counsel for the respondent that every reserve set up out of profits or gains of whatever kind, which seeks to provide against the happening of uncertain future events, is excluded as a deduction, except in so far as the Act permits.

It follows from what has been said that the appellant was not entitled to deduct from the income received by it during any fiscal year any amount for the purpose of providing for refunds that might have to be made because of cancellations in the future. Any loss resulting from necessary refunds due to cancellations must be borne in the year in which the refund was made.

Nor was the appellant, no matter how sound its accounting practice was, entitled to distribute the amounts received by it as income during any fiscal year into the amounts earned during such year and those that were not yet earned, for the test of taxability of the income of a taxpayer in any year is not whether he earned or became entitled to such income in that year but whether he received it in such year, and the taxpayer has no right to

have income received by him during a taxation year distributed for taxation purposes over the years in respect of which he may have earned or become entitled to such income. For example, if a taxpayer received in any year amounts which are income, such as arrears of salary or interest, he is taxable on the whole amount of the income received by him in that year, including such arrears, regardless of the year or years in respect of which he earned or became entitled to such salary or interest. This is clearly laid down in *Capital Trust Corporation Limited et al.* v. *Minister of National Revenue* (1). In that case, a testator by a codicil to his will had directed that his son, who was one of his executors, should be paid "the sum of $500 per month in addition to any sum which the Courts or other proper authorities may allow him in common with the other executors". The testator died on December 5, 1923, but the son did not receive any of the monthly payments of $500 until March 10, 1927; on that date, he received the sum of $19,500, representing 39 payments of $500 each from December 5, 1923, to March 5, 1927, and, subsequently, he received the monthly payment regularly until his death on July 16. 1932. His income tax returns for the years 1927 to 1932, filed by him or his executor, made no mention of these monthly payments of $500. Subsequently, his estate was assessed in respect of them in addition to the amounts mentioned in the returns made and for the year 1927 the assessment included the $19,500 received on March 10, 1927, as well as the monthly payments received during the balance of that year. An appeal was taken to this Court on the ground that the amounts of $500 per month were a bequest under a will under subsection (*a*) of section 3 of the Income War Tax Act, and that, in any event, the assessment in respect of the year 1927 should not be for more than the amount payable for that year. Angers J. held that the amounts in question were not a gift or bequest under section 3 (*a*) of the Act but constituted additional remuneration to the son for his services as executor and, as such, were taxable income. He also held that it was the intention of the legislature to assess income for the year in which it was received, irrespective of the period during which it was earned or

(1) (1936) Ex. C.R. 163; (1937) S.C.R. 192.

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accrued due, and pointed out that there was no stipulation in the Income War Tax Act providing for the apportionment of accumulated income, paid in one sum, over the period in respect of which it became receivable. The appeal to this Court was, therefore, dismissed. On appeal to the Supreme Court of Canada, the judgment of Angers J. was affirmed. Davis J., delivering the judgment of the Supreme Court of Canada, agreed that the amounts directed to be paid were additional remuneration and held that section 3 of the Income War Tax Act defined income as "income received" and that section 9 imposed the tax upon "the income during the preceding year". In the Exchequer Court, Angers J. commented on the hardship that might be caused to the taxpayer by increasing his burden, depriving him of his annual exemption, raising the rate of his income tax and rendering him liable to a surtax, and in the Supreme Court of Canada, Davis J. stated that, while the law worked an injustice to the taxpayer, that could not affect the liability plainly imposed by the statute, and that the court could not escape the conclusion, which seemed a harsh one, that the appeal must be dismissed. The injustice that may result to a taxpayer from this state of the law is obvious, but the law itself, as settled in the *Capital Trust Corporation Case* (*supra*), is clear.

It seems equally clear that if income is received in any one year it is taxable in that year, even although it has not yet been earned, and it follows that the appellant was not entitled to make any deduction from income received by it in any year on the ground that it was not earned in such year.

This does not, however, dispose of this appeal, for the question remains whether all of the amounts received by the appellant during any year were received as income or became such during the year. Did such amounts have, at the time of their receipt, or acquire, during the year of their receipt, the quality of income, to use the phrase of Mr. Justice Brandeis in *Brown* v. *Helvering* (*supra*). In my judgment, the language used by him, to which I have already referred, lays down an important test as to whether an amount received by a taxpayer has the quality of income. Is his right to it absolute and under no restriction,

contractual or otherwise, as to its disposition, use or enjoyment? To put it in another way, can an amount in a taxpayer's hands be regarded as an item of profit or gain from his business, as long as he holds it subject to specific and unfulfilled conditions and his right to retain it and apply it to his own use has not yet accrued, and may never accrue?

Applying this test, I think a distinction must be drawn between the minimum and additional fees, on the one hand, and the advance fees, on the other, received from employers by the appellant on behalf of the underwriters. The minimum fee on each contract, as has been seen, could be retained by the underwriters, regardless of what the earned fee, developed after the audit of the payroll, might be. There were, therefore, no restrictions upon the right of the underwriters to keep the minimum fees; their right to them was absolute. The same applies to the additional fees, for they were paid as the result of ascertained facts. The right of the appellant to its percentage of such minimum and additional fees was equally absolute and unrestricted. The evidence is not entirely clear whether the appellant included in its so-called reserves any amounts in respect of its percentages of minimum fees or additional fees, but, if it did, it was not entitled to do so, for such percentages had the quality of income at the time of their receipt by the appellant, in that its right of retention of them was absolute and unrestricted. They were clearly items of profit or gain to the appellant from its business and properly taxable in the year of their receipt.

The "advance fee" paid by the employer to the underwriters and received by the appellant on their behalf had, in my judgment, a different quality, for under the contract between the underwriters and the employer, as shown by the indemnification certificate, it was stipulated that the advance fee should be "held as a deposit", and dealt with in a specified manner. It was to be applied against the audited fee in the annual adjustments that had to be made, and not before then. In so far as the minimum fee was included in the advance fee the underwriters were entitled to retain it, but in respect of the excess of the amount of the advance fee over that of the minimum fee there was no certainty that the underwriters would ever have any

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right of retention. If the earned fee on an adjustment, based upon the ascertained total payroll, exceeded the amount of the advance fee, the underwriters could retain the advance fee, but if the reverse were true, the underwriters would have to refund it.

The nature of a "deposit" paid by one of the parties to a contract to the other was fully discussed by the English Court of Appeal in the leading case of *Howe* v. *Smith* (1). In that case, a sum was paid as "a deposit and in part payment of the purchase price". The court gave the term "deposit" the same meaning as that of "earnest", and regarded it as security for the completion of the contract by the payer of the deposit. It should, in my opinion, have a similar meaning in the present case, that of security by the employer that he would perform his part of the contract, namely, pay 25 or 30 per cent of the normal premium when it could be ascertained.

Where an amount is paid as a deposit by way of security for the performance of a contract and held as such, it cannot be regarded as profit or gain to the holder until the circumstances under which it may be retained by him to his own use have arisen and, until such time, it is not taxable income in his hands, for it lacks the essential quality of income, namely, that the recipient should have an absolute right to it and be under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

The difference in the stipulations with regard to the minimum fee and the advance fee indicates a difference in the nature of the payments made and received and in the rights of the recipient to their disposition, use and enjoyment. The underwriters could keep the minimum fee immediately upon its receipt on their behalf by the appellant; they could not do the same with the advance fee—they had to hold it as a deposit, with a right to retain it to their own use only under specified circumstances, which might or might not arise. Until the right of retention arose, the amount of the deposit could not be profit or gain to the underwriters. If the amounts of the advance fees did not have the quality of income in the hands of the underwriters, neither did any percentages of them have such quality in the hands of the appellant. It cannot be in

(1) (1884) 27 Ch. D. 89.

any different position with regard to percentage of advance fees than the underwriters would be with regard to the whole. The appellant was entitled to a fixed percentage of the 25 or 30 per cent which the employer had to pay; there was no right to a percentage of the advance fee as such. The fact that the appellant did not wait until the end of each policy year but distributed fees immediately upon their receipt and then worked out such adjustments as might become necessary cannot, in my judgment, affect the true character of the advance fee or any percentage of it. The right of the appellant to distribute the advance fee, except that portion which was a minimum fee, before it was known whether the underwriters might retain it or would have to refund it is highly questionable, but, if it could not be income to the underwriters, no percentage of it could be income to the appellant.

The conclusion to which I have come on this aspect of the appeal is that the appellant was not taxable in any of the years in dispute in respect of that portion of the amounts received by it during such year, which consisted of percentages of advance fees paid by employers to be held by the underwriters as deposits, excluding minimum fees therefrom, where the right of retention of such advance fees had not accrued to the underwriters during such year. To the extent that such portion was included in the so-called reserve for unearned commissions, it was not a reserve within the meaning of Section 6, ss. 1 (*d*) of the Income War Tax Act at all, for there was no transfer or credit from profits or gains, but rather a segregation of amounts received, which were not yet profits or gains from its business and, therefore, not taxable in its hands, and might never become such.

To the extent that I have indicated, the assessments were erroneously made and the appeal must be allowed with costs.

Judgment accordingly.