1957
Apr. 16
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May 14

BETWEEN:

PLIMLEY AUTOMOBILE COMPANY LIMITED ..... APPELLANT.

AND

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

Revenue—Income Tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 2 and 3—Income or capital—Forgiveness of debt not a trading profit—Appeal allowed.

Appellant, an importer and distributor of motor cars, purchased largely from Standard Motor Company Ltd. of England, was heavily indebted to that company. In September of 1952 Standard in order to induce appellant to continue in business and gradually pay off this debt agreed to forgive 15 per cent of the indebtedness provided that the remaining indebtedness after deduction of the 15 per cent should be paid by regular stated payments. This arrangement was carried out by both parties and all stipulated instalments on account of the indebtedness were made. Appellant was assessed for income tax on the amount of indebtedness forgiven by Standard. This assessment was confirmed by respondent and an appeal to this Court was taken by appellant.

Held: That the amount of the forgiveness of debt made by Standard to appellant does not constitute a trading receipt but is a capital gain.

APPEAL under *The Income Tax Act.*

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

D. N. Hossie, Q.C. and *A. B. Ferris* for appellant.

F. J. Cross and *G. R. Schmitt* for respondent.

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

DUMOULIN J. now (May 14, 1958) delivered the following judgment:

This is an appeal from a decision of the Minister of National Revenue, dated October 5, 1954, affirming his previous assessment of the above taxpayer's income for the taxation year, 1952.

The case was tried at Vancouver, B.C., on April 16, 1957.

I would at once point out that all matters concerning Oxford Motors Limited were decided in a separate judgment, record number 98064.

At all material times, the appellant, Plimley Automobile Company Ltd., acted as importer and distributor of Standard, Rolls Royce and Jaguar motor cars, purchased from the respective manufacturers in England, more particularly from The Standard Motor Co. Ltd., (hereinafter referred to as "Standard"), of Banner Lane, Coventry.

Especially with the hope of reducing overlapping costs, appellant and Oxford Motors, on October 1, 1951, formed a partnership under the firm name and style of "British Car Centre", thereafter carrying on their businesses jointly, each associate "being entitled to one-half of the profits and liable for one-half of the losses (cf. exhibit 4, s. 6)".

It is contended in s. 8 of appellant's Statement of Facts that official restrictions, imposed upon consumer credit in 1950-51 by the Government of Canada (exhibits 47, 48, 49, 51 of case No. 98064), were largely responsible for Plimley Automobile's ensuing predicament.

By September, 1952, the appellant was indebted to Standard in the amount of £222,480 "evidenced by numerous sight drafts drawn by Standard and accepted by Plimley Automobile Company, all of which were then past due" (Statement of Facts, s. 14), and far beyond the company's financial reach.

In the month of September, 1952, says the appellant (Statement of Facts, s. 16), so as to induce Plimley Automobile to continue its operations and gradually pay off the heavy debt owing "Standard agreed to forgive the sum of £1,668 together with a further sum of £37,146 (the latter amount being 15% of the original indebtedness of £247,642) on condition that the net indebtedness of £123,666 remaining, after certain other credits had been applied, should be paid by monthly payments of £27,500 each on the 24th days of October, November and December, 1952, on the 24th day of January, 1953, and a further amount of £13,666 on the 24th day of February", same year.

These arrangements are set out with all necessary particulars in a letter (exhibit 2) dated September 29, 1952, from Standard Motor Co. Ltd., Banner Lane, Coventry, to Horace Plimley, Esq., Vancouver, the President of Plimley Automobile Company. I would quote paras.

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1 (partially) and 4(*a*) which read:

(1) The debt was originally .....£ 249,310
We agree to cancel our Invoice for Special Charges 1,668

£247,642

And to grant you a 15% Allowance on the balance of £247,642 37,146

Leaving a balance of .....£ 210,496

. . .

(4) The foregoing offers are made on the understanding that:—

(a) The 15% Allowance of £37,146 and the Credit of £1,668 referred to at (1) will not remain as a debt after the payment by you of the balance of £123,666 on the dates indicated above.

Since £60,000 had been paid previously and another allowance of £26,830 extended for "Paint Claims", the net debt outstanding became, as per date, stabilized at a total figure of £123,666.

The conditions above were honoured upon maturity and all the stipulated instalments duly met.

Notwithstanding this satisfactory achievement, the appellant declares its trading activities for the 1952 taxation year actually show an over-all deficit of $227,969.54 (Statement of Facts, s. 19).

Strangely, however, Plimley Automobile drew up its appropriate 1952 income tax return in a different light, revealing a "profit of partnership (i.e. the British Car Centre merger), for the year" of no less than $27,246.82, with a one-half share amounting to $13,623.41 (cf. Reply to Notice of Appeal, Part B, s. 2).

Accordingly, respondent levied a tax on the appellant in the sum of $3,815.06, for 1952 (Statement of Facts, s. 17).

The upshot of this imposition appears in s. 17 of the Notice of Appeal, it being claimed that "Appellant incorrectly reported its 1952 taxable income as being $13,554.20". Section 18 vouchsafes the explanation that: "As a result of the partnership with Oxford Motors (who benefited of a 25% rebate on their purchase price of each separate Morris car), the Appellant took credit for the amount of $241,592.95", or half of $483,185.91, sum total of rebate credits gained by Oxford Motors Ltd. during the 1952 fiscal year.

"Therefore," concludes appellant, "the assessment is illegal, . . . contrary to Sections 3 and 4 of the Income Tax Act in that a capital gain . . . of $241,592.95, realized by the appellant in its 1952 taxation year as a result of a forgiveness of part of a debt by a creditor, has been improperly included in the income . . . for that year . . ."

The points of law raised in the Notice of Appeal, particularly in ss. 8, 9 and 10 of Part B, are that an allowance, such as the present one, constitutes a forgiveness or release of past indebtedness which, if unconnected with the transaction when the debt was incurred, far from a trading receipt, is a capital gain dehors the ambit of taxable income.

Respondent, in turn, denies such interpretations of the law, adding that Plimley Automobile Co. was assessed upon its own computation of profits for 1952 and, at all events, pursuant to ss. 2, 3 and 4 of the Act.

In its main outline, the case hinged on facts closely allied with those of Oxford Motors, offering but little distinctive evidence.

Appellant's principal executive officer, Mr. Horace Plimley, the only significant witness heard, testified to the correctness of every statement alleged in the Notice of Appeal, specifying the company's debt "was incurred mainly in the early part of 1951 for cars shipped and received".

The question to be decided is whether or not the 15% allowance granted September 29, 1952, an aggregate £37,146 (exhibit 2), culminated in a forgiveness of debt.

In its every day acception, in nowise an unworthy criterion, the above expression usually implies an ascertainable and permanent result in contradistinction to a rebate or discount, liable to be *earned* from now on according to set terms. Normally, a release is predicated on conditions antecedent rather than subsequent.

Should it be permissible to cite the related Oxford Motors case, I might then perceive a distinguishing element. There, we had a strictly conditional discount of $250, based on the purchase price of $1,000 per car, and accruing or *"earned"* merely *"if and when"* a sale to a client took place. "No pay, no allowance (i.e. rebate)!"

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had said Mr. Horace Plimley, qualifying the Nuffield-Oxford arrangement. Presently, we have before us a somewhat different situation: a clear-cut abatement of thirty-seven thousand odd pounds sterling, untrammelled by any restrictions or posterior happenings, and summed up into a neatly tabulated balance. Should this savour of a certain subtlety, it nonetheless remains my comprehension of the jurisprudence actually obtaining.

As for the spread over payments, they do not detract from this releasing transaction, but rather tend to enhance its *ex gratia* nature.

Counsel for the respondent argued "that any benefit to appellant under this scheme could fall only during the fiscal year of 1953, starting October 1, 1952, and closing on September 30, 1953."

With this view, the facts revealed would hardly agree. September 29, 1952, ultimate day of that fiscal year, is the date of the releasing authority, viz., Standard's letter to Horace Plimley, exhibit 2, for debts,—unpaid sight drafts,—gradually incurred in the course of 1951, as reported by Mr. Horace Plimley. If this construction is accurate, it then leaves very little room for any attempt at raising a like issue.

All due allowance had between the instant matter and the leading English precedent regarding an abatement of debt, I believe this particular objection bears some similarity to one of those several features disposed of in *British Mexican Petroleum*[1], I quote from Lord Thankerton's speech:

> My Lords, I am of opinion . . . that the account to 30th June, 1921, cannot be reopened, as the amount of the liability there stated was correctly stated as the finally agreed amount of the liability and the subsequent release of the Respondents proceeds on the footing of the correctness of that statement.
>
> The Appellant's alternative contention . . . is equally unsound, in my opinion. I am unable to see how the release from a liability, which liability has been finally dealt with in the preceding account, can form a trading receipt in the account for the year in which it is granted.

[1] (1929-32) 16 R.T.C. 570 at 592.

Previously, while discussing this same case on its basic merits, i.e. the essential components and legal consequences of forgiving a debt, Rowlatt, J. in the King's Bench Division, had spoken thus (at pp. 584-585):

P. 584

I do not understand it myself in the least—that in the year of release, when the business entered into a new lease of life and a new bargain was struck, the amount released must be brought into the revenue account . . .

P. 585

How on earth the forgiveness in that year of a past indebtedness can add to those profits I cannot understand. It is not a matter depending upon the form in which the accounts are kept. It is a matter of substance, looking at the thing as it happened, as a man who knows nothing of scientific accountancy might look at it—it is the receipts against payments in trading.

The salient fact in the *British Mexican Petroleum* affair was that this Company, against payment by it of £325,000 to Huasteca Limited, an oil-producing enterprise, was given a full release of the balance remaining due, viz., £945,232.

The decision above was applied, after an exhaustive perusal of its several factors, by Cameron, J., in re *Geo. T. Davie and Sons Ltd. v. Minister of National Revenue*[1].

There, appellant, Geo. T. Davie & Sons, a dry dock owner and ship builder, upon completion of certain contracts owed $914,000 to Canadian Commercial Corporation, a Crown company. By an agreement, of November 2, 1949, between the Crown and appellant, the indebtedness was abated in respect of two large amounts totalling $734,813.83. It was held that: (p. 281)

3. The mere cancellation or abatement of an undisputed trade debt does not give rise to taxable income in the hands of a taxpayer whose trade debt has been cancelled or abated. The abatement of a capital indebtedness cannot give rise to taxable income. . . .

Cogent reasons for arriving at such a result are adduced by Cameron, J., at pages 294-295 of the official report:

The facts in the *British Mexican Petroleum* case are, of course, somewhat different from those in the instant case. There the debt which was abated was incurred in the ordinary course of trading and it was held that the accounts for the earlier period in which most of the debt had been incurred could not be re-opened and those accounts readjusted because of the abatement; and also that the amount of the abatement could not be brought into account in the later period in which some part of the debt had been incurred and the abatement made. As I read

[1] [1954] Ex. C.R. 280 at 294-295.

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the judgment of Rowlatt, J., he considered the benefit received by the taxpayer as something quite outside the scope of its trading activities; something which was conferred on it "as an act of grace although business methods were behind it". Lord MacMillan, in disposing of the suggestion that the amount of the abatement should be treated as a revenue item in the taxation period in which the abatement was made, stated his reasons in these few sentences:

> I say so for the short and simple reason that the Appellant Company did not, in those eighteen months, either receive payment of that sum or acquire any right to receive payment of it. I cannot see how the extent to which a debt is forgiven can become a credit item in the trading account for the period within which the concession is made.
>
> In my view, that case is authority for the proposition that the mere cancellation or abatement of an undisputed trade debt does not give rise to taxable income in the hands of a taxpayer whose trade debt has been cancelled or abated, subject perhaps to the question reserved by Lord MacMillan and which I have referred to above. That being so, it cannot be found that the abatement of a capital indebtedness—as in the instant case—can give rise to taxable income.

A careful review impels me to signal out some connection with those above cited precedents and to conclude accordingly.

The characteristic traits of a forgiveness of debt attach to the transaction at issue; then to the extent of £38,814, computed back into Canadian currency, at exchange rates obtaining on September 29, 1952, both allowances extended to appellant in exhibit 2 do not constitute a trading receipt but a capital gain.

Appellant's claim, stated in Part B, s. 3, to a capital amount of $241,592.95 goes far beyond the basic allegations. The enabling instrument, exhibit 2, to an abatement of debt shows the pardoned amount as £38,814. How then could I subscribe to more than was really forgiven.

The decisive consideration, however, is that in the Oxford Motors' appeal, record No. 98064, "credits" for $483,185.91 were declared rebates and trading receipts. It obviously becomes impossible in another suit to contradictorily hold that half this amount or $241,592.95, assumes the dual character of also being an abatement of debt.

Tersely put the problem is: *Who* remitted *What* and *to Whom*; Who relating to Standard Motors, What standing for £38,814, and to Whom for Plimley Automobile Ltd.

The British Car Centre, a private unincorporated entity, cannot, in this respect, link the discounts extended by Nuffield Exports Co. to Oxford Motors Ltd. with a forgiveness of indebtedness granted by Standard Motors to Plimley Automobile.

For these reasons, I think the appeal must be allowed. The tax of $3,815.06 levied on appellant's income for taxation year 1952, by assessment bearing date of April 20, 1953, will be vacated, and the matter referred back to the Minister for the purpose of reassessing the appellant in accordance with these findings. The appellant is entitled to be paid his taxable costs.

Judgment accordingly.