
BETWEEN:

CANADIAN FRUIT DISTRIBUTORS LIMITED ..... APPELLANT,

AND

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

1954

Apr. 8

June 30

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CANADIAN FRUIT DISTRIBUTORS LIMITED ..... APPELLANT,

AND

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

Revenue—Income tax—Excess profits tax—The Income War Tax Act, R.S.C. 1927, c. 97, s. 3—No right in Minister to allocate portion of expenses against portion of receipts—Accountable advances not income.

The appellant acted as broker for its parent company B.C. Tree Fruits Limited in the sale of fruit and vegetable products of members of

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B.C. Fruit Growers Association and also handled outside business acting as broker for customers other than B.C. Tree Fruits Limited in the sale of products not produced by members of B.C. Fruit Growers Association. The Minister sought to hold the appellant liable to tax only on the net income received by it from its outside business subsequently to the end of 1946 by allocating part of its total expenses to that portion of its receipts that came from its outside business and assessing it on the balance. The appellant appealed against the assessments for 1947 and 1948 thus made to the Income Tax Appeal Board which dismissed its appeals. From this decision the appellant appealed to this Court. It also appealed directly to this Court from its excess profits tax assessments for the same years.

Held: that the Minister had no right to separate the appellant's receipts from its outside business, from its receipts, from its parent company and charge the former with a portion of its operating expenses. The appellant did not conduct two separate businesses. It had only one business and one gross income and the expenses of its business were indivisible.

2. That the receipts which came to the appellant from B.C. Tree Fruits Limited were accountable advances and did not have the essential quality of income, namely, that the appellant's right to them was absolute and under no restriction, contractual or otherwise, as to their disposition, use or enjoyment. *Robertson Limited* v. *Minister of National Revenue* [1944] Ex. C. R. 170 followed.

3. That under the agreement between the appellant and its parent the only amount which it was entitled to keep as its own was the difference between the total amount of the advances and the excess of its total receipts over its total expenses and that in each of the years in question this amount plus the amount which it received from its outside business exactly equalled its operating expenses leaving it with no net income.

APPEAL from decision of Income Tax Appeal Board and appeal under Income War Tax Act.

The appeals were heard together before the President of the Court at Vancouver.

W. Murphy Q.C. and *D. C. Fillmore* for appellant.

J. L. Farris Q.C. and *F. J. Cross* for respondent.

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

THE PRESIDENT now (June 30, 1954) delivered the following judgment.

In the first of these causes the appellant appeals against the decision of the Income Tax Appeal Board (1), dated February 12, 1953, dismissing its appeal against its income

(1) (1953) 8 Tax A.B.C. 51.

tax assessments for its 1947 and 1948 taxation years. In the second it appeals directly to this Court against its excess profits tax assessments for the same taxation periods. At the hearing it was order that the appeals be heard together.

The facts are not in controversy. The appellant is an important cog in the marketing machinery of the fruit and vegetable growers of the Okanagan and Kootenay Valleys in British Columbia. As early as 1890 the growers in these valleys had organized themselves into the B.C. Fruit Growers Association. After many years of difficulty in marketing the products of its members the Association finally in 1939 organized B.C. Tree Fruits Limited as a collective bargaining or central selling agency. This entity was a non-profit organization. Only ten shares of its capital stock were ever issued, one to each of its directors who all held their qualifying shares in trust for the Association. Soon after its incorporation B.C. Tree Fruits Limited found it necessary to have brokers or agents in the several markets in which the products of the members of the Association were sold and to that end it acquired the appellant, which had been incorporated in 1925, from its prior owner. Thereupon the appellant became the wholly owned subsidiary of B.C. Tree Fruits Limited and subject to its direction.

The appellant has branches and carries on business in six cities of Western Canada, namely, Winnipeg, Regina, Saskatoon, Calgary, Edmonton and Vancouver. In these branches it does two classes of business. Primarily, it acts as broker for B.C. Tree Fruits Limited in the sale of the products of the members of the Association controlled by it. It does this portion of its business, which is the main reason for its existence, under the direction of its parent B.C. Tree Fruits Limited pursuant to an agreement between it and its parent, dated April 1, 1944, to which further reference will be made. Secondarily, it handles what may be described as outside business, that is to say, business that comes to it from customers other than B.C. Tree Fruits Limited. It acts as broker for these customers in the sale of products that are not produced in the Okanagan or Kootenay Valleys and are not under the control of B.C. Tree Fruits Limited, such as, for example, citrus fruits and other imported fruits and vegetables. Mr. A. K. Loyd, the appellant's president and general manager, gave three reasons why the appellant

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took on this outside business. In the first place, it had to be able to provide a complete service to purchasers from it. It was also valuable to be conversant with prices and conditions in other markets. And with such knowledge it was able to advise buyers when B.C. fruits and vegetables of the same kind would probably be available. Thus, while the appellant's primary objective was to sell the fruit and vegetables produced in the Okanagan and Kootenay Valleys, its outside business was complementary to its primary business and helped it in its main purpose.

The agreement to which I have referred, which was in full force and effect in the years in question, sets out the conditions under which the appellant acted as a broker for B.C. Tree Fruits Limited. The appellant is referred to therein as the Party of the First Part and B.C. Tree Fruits Limited as the Party of the Second Part. The recitals in the agreement and its first five paragraphs are as follows:

WHEREAS the party of the Second Part is a shipper of fruit and vegetables grown in the Okanagan Valley and adjacent areas in the Province of British Columbia and has agreed to utilize the services of the Party of the First Part upon the terms hereinafter mentioned.

AND WHEREAS the Party of the First Part carries on business as fruit and vegetable brokers with branch offices at the City of Winnipeg in the Province of Manitoba, the Cities of Regina and Saskatoon, in the Province of Saskatchewan, the cities of Calgary and Edmonton in the Province of Alberta, and the City of Vancouver in the Province of British Columbia.

AND WHEREAS it has been agreed that the Party of the First Part shall permit the direction of the operation of its business during the currency of this Agreement by the Party of the Second Part, on the terms and conditions hereinafter mentioned.

AND WHEREAS the Party of the Second Part will during the term hereof be put to considerable expense through expenses incurred and the time of a number of its officials and employees occupied in the interests of the business of the Party of the First Part.

NOW THEREFORE THIS AGREEMENT WITNESSETH that in consideration of the premises the Parties hereto agree as follows:

1. The Party of the First Part agrees to conduct its said business solely as directed by and subject to the instructions of the Party of the Second Part during the currency of this Agreement. It is hereby declared, without limiting the generality of the foregoing agreement, that such instructions shall include the following:

(a) The Party of the First Part shall furnish to the Party of the Second Part before the 15th day of each and every month during the said period, a statement of the revenues and expenses of each branch during the preceding calendar month.

(*b*) Each of the said branch offices shall every ten days during the currency hereof furnish to the Party of the Second Part a statement of all products sold, and the persons or firms for whom sold, by such office during the preceding ten days.

(*c*) All accounts other than the Party of the Second Part represented by the Party of the First Part during such period shall be represented only subject to the approval of the Party of the Second Part.

(*d*) The Party of the First Part will, during such period, promptly follow and carry into effect any selling policies required of it by the Party of the Second Part.

(*e*) The staff, salaries, bonuses and operations of the Party of the First Part during each fiscal year shall be continued on the same basis as in the previous fiscal year except for such reasonable adjustment therein as may be approved or requested by the Party of the Second Part.

2. The party of the Second Part agrees during such period to utilize exclusively the services of the Party of the First Part as broker for the sale in the Provinces of Manitoba, Saskatchewan, and Alberta, and in the said City of Vancouver, of fruits and vegetables marketed by it, except as to fruit and vegetables marketed through A. Harvey Limited, of Vancouver aforesaid.

3. Subject to the determination of charges in the manner hereinafter mentioned, the Party of the Second Part agrees to pay to the Party of the First Part as an estimated charge for its services as broker during such period, in accordance with the scale of fees and charges set forth in the Schedule hereto annexed, with such variations or additions therein (if any) as may be agreed from time to time by the Parties hereto.

4. The Party of the First Part agrees that in each fiscal year during the currency hereof its estimated charges to the Party of the Second Part for its services shall be reduced by the amount by which its receipts during such fiscal year exceed its operating expenses (which shall include such sum for head office expenses as may from time to time be agreed) for such fiscal year, and such excess of receipts over operating expenses shall be repaid to the Party of the Second Part.

5. In the event that the receipts of the Party of the First Part during any fiscal year during the currency hereof are not sufficient to take care of operating expenses in such fiscal year, the Party of the Second Part agrees forthwith to pay to the Party of the First Part the amount of any such deficiency.

It is plain from the agreement that the appellant was to operate its business under the direction of B.C. Tree Fruits Limited. It is also apparent from paragraph 1. (c) that it was contemplated that the appellant should handle outside business to the extent that it was approved by B.C. Tree Fruits Limited. And paragraphs 3, 4 and 5 make it clear that B.C. Tree Fruits Limited was to make advances to the appellant from time to time to cover its expenses, that the

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appellant was to refund any excess of receipts over operating expenses to B.C. Tree Fruits Limited and that B.C. Tree Fruits Limited was to guarantee the appellant against loss.

Attached to the agreement is a schedule of brokerage rates. These were for the purpose of enabling the managers of the branches to know how they stood in the matter of their remuneration since it depended on a salary plus a bonus based on the volume of sales. They were also useful for the purpose of enabling B.C. Tree Fruits Limited to determine from time to time whether its advances to the appellant, having regard to the volume of sales made, were excessive.

The manner in which the arrangements between the appellant and B.C. Tree Fruits Limited were carried out was explained by Mr. F. W. Darroch, the appellant's secretary-treasurer. It was the usual practice for the appellant's branch offices to compile a statement each month of its brokerage amounts. This was really its statement of what it considered was due to it under the agreement. The amounts were checked by B.C. Tree Fruits Limited and cheques for them sent to the branches. The branches also sent financial statements to the appellant's head office at Kelowna. Whenever it saw that a branch had more working capital than was required it asked the branch to return the excess to it and it then returned such excess to B.C. Tree Fruits Limited.

The manner in which the assessments appealed against were arrived at may now be considered. The appellant's fiscal year ended on February 28 of each year. There was no suggestion that it should be subject to tax on any of the income received by it from B.C. Tree Fruits Limited. This was considered exempt from taxation. But the Minister did seek to hold it liable to tax on the net income received by it from its outside business. Even in respect of such income it was considered that the appellant was exempt from tax up to the end of 1946 by reason of section 4(p) of the Income War Tax Act, R.S.C. 1927, Chapter 97. Consequently, it was assessed on its net income from its outside business only from January 1, 1947. This meant that for its 1947 taxation year it was assessed only on such net income from

January 1, 1947, to February 28, 1947, and for its 1948 taxation year on such net income from March 1, 1947, to February 29, 1948.

The method adopted by the Minister in calculating the appellant's net income from its outside business was explained in a memorandum, Exhibit A, prepared by Mr. D. A. Wickett, an assessor in the Income Tax Office at Vancouver. This reads as follows:

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1947 and 1948 Assessments

The 1947 and 1948 Assessments were prepared in such a manner as to tax only that income which was deemed to have been earned by the appellant company from outside sources. By "outside sources" we mean all sources of brokerage income other than B.C. Tree Fruits Limited.

The appellant submitted the amount of total brokerage income received from outside sources during the periods in question but did not show amounts of expense laid out to earn that particular income. We had details of total expenses incurred but these expenses related to dealings both with B.C. Tree Fruits Limited and with others. Since an expense allocation was not available our only alternative was to apportion the total expenses in the 1947 fiscal period on an arbitrary basis. Because revenue from outside sources was 32·49 per cent of total revenue, we considered the expenses applicable to earning that revenue from outside sources to be 32·49 per cent of the total expense.

Applying this percentage to the total expenses of $143,120.12, an amount of $46,510.09 was allocated to revenue derived from outside sources. The profit from outside sources was thus computed at $81,787.52 or 32·49 per cent of total revenue; less $46,510.09 or 32·49 per cent of total expenses. This calculation produced an amount of $35,277.43 deemed to be profit from outside brokerage. From this latter figure was deducted bad debts of $75.00 leaving a net profit on outside business for the eleven months ended February 28, 1947 of $35,202.43. A similar calculation produced the amount of $34,393.22 as net profit from outside brokerage for the year 1948.

One further calculation remains to be explained. Under the provisions of Section 4(*p*) of I.W.T.A. as it existed in 1946 and prior, this company was considered to be exempt from taxation; therefore the profits of the 1947 fiscal period as determined by our calculation to be $35,277.43 could be taxed only to the extent that it had been earned after December 31, 1946. Canadian Fruit Distributor's 1947 fiscal period was 334 days of which 59 were in the 1947 calendar year. The taxable income was therefore $\frac{59}{334}$ of $35,277.43, or $6,218.39.

The striking feature of these assessments is the Minister's arbitrary allocation of part of the appellant's total expenses to that portion of its receipts that came from its outside business. Because the receipts from the outside business, which for the taxation year ending February 28, 1947, came to $81,787.52, represented 32·49% of its total receipts,

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including the receipts from B.C. Tree Fruits Limited, the Minister decided that 32·49% of its expenses, which amount to $143,198.12, should be allocated to such outside business. The Minister made a similar arbitrary assumption for the taxation year ending February 28, 1948. Because the receipts from the outside business, which for that year came to $87,328.21, represented 34·5% of its total receipts the Minister decided that 34·5% of its expenses, which amounted to $153,119.35, should be allocated to its outside business. In the net result, the appellant was assessed for income tax and excess profits tax on an income of $6,218.39 for the taxation year ending February 28, 1947, and $34,393.22 for the taxation year ending February 28, 1948. The details of how these amounts were arrived at appear from the notices of assessments for the said taxation years, dated November 3, 1950.

The appellant gave notice of objection to the income tax assessments and filed notices of appeal against the excess profits tax assessments. It then appealed against the income tax assessments to the Income Tax Appeal Board which dismissed its appeal. From this decision the present appeal to this Court is taken. The appellant also appeals to this Court against its excess profits tax assessments for the taxation years in question.

Since the appeal to this Court from a decision of the Income Tax Appeal Board is a trial *de novo* of the issues involved it follows that this Court should deal with them as if there had never been any appeal to the Board. It is, therefore, not concerned with any findings of fact made by it or the reasons for judgment given by it.

Here the issue is whether the appellant had any taxable income in the years under review. The appellant does not take the position that it could not ever make a profit within the meaning of section 3 of the Income War Tax Act. If the amounts which it received from B.C. Tree Fruits Limited were its only receipts they would not be subject to tax. That is conceded. But if its receipts from its outside business exceeded its operating expenses so that it did not require any payments from B.C. Tree Fruits Limited then it would clearly, to the extent of such excess, have a profit that would be taxable income.

But that is not the position in the present case. It is the appellant's submission that in each of the years for which it was assessed it had no taxable income but broke exactly even in its operations neither sustaining a loss nor making a profit.

I have come to the conclusion that this submission is well founded and that the assessments appealed against cannot stand. I have no hesitation in saying, in the first place, that the Minister had no authority for his method of arriving at the assessments appealed against. He had no right to separate part of the appellant's receipts, namely, its receipts from its outside business, from the rest of its receipts, namely, those that come from its parent company and then charge such part with a portion of its operating expenses. That is not consistent with the manner in which it conducted its business and is not in accord with its income position. The appellant did not conduct two separate businesses. While its business came to it from two sources, one being B.C. Tree Fruits Limited and the other its outside customers, it had only one business and only one gross income. Nor did it have two sets of operating expenses. The expenses of its business were indivisible. Consequently, if it had any net income it could only be by reason of its gross income from all its business exceeding its total operating expenses.

What was the real position? In the first place, it must, I think, be conceded that not all the receipts which came to the appellant from B.C. Tree Fruits Limited were income in its hands at the moment of their receipt. It was always considered that they were accountable advances made by B.C. Tree Fruits Limited to the appellant on the basis of its estimated charges and subject to refund to the extent that the charges were subject to determination under the agreement. The receipts, therefore, did not have the essential quality of income, namely, that the appellant's right to them was absolute and under no restriction, contractual or otherwise, as to their disposition, use or enjoyment. I had occasion in *Robertson Limited* v. *Minister of National Revenue* (1) to consider the test to be applied in determining whether a sum of money received by a person has the quality of income in his hands. There I referred to a

(1) [1944] Ex. C.R. 170.

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statement made by Mr. Justice Brandeis in delivering the opinion of the Supreme Court of the United States in *Brown* v. *Helvering* (1) where he said of certain overriding commissions in respect of which the taxpayer had sought to deduct certain reserves for contingent obligations to return part of the commissions:

> 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.

I adopted the test of income thus laid down by Mr. Justice Brandeis. At page 182, I said:

> 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?

These remarks are applicable in the present case. It was provided in paragraph 3 of the agreement that B.C. Tree Fruits Limited should pay the appellant "an estimated charge" for its services in accordance with the scale of fees and charges set forth in the schedule annexed to the agreement but this was subject to the determination of charges in the manner provided in the agreement. There is, therefore, justification in holding that the sums which B.C. Tree Fruits Limited paid to the appellant were, in the first place, really advances and that the right of the appellant to keep them was subject to determination in accordance with the agreement. Then paragraph 4 provided that the appellant's estimated charges, in respect of which the advances by B.C. Fruit Trees Limited were made, should be reduced by the amount by which its receipts during the fiscal year exceeded its operating expenses. Thus the only amount which it was entitled to keep as its own was the difference between the total amount of the advances and the excess of its total receipts over its total expenses. This was the only part of

(1) (1933) 291 U.S. 193 at 199.

the appellant's receipts from B.C. Tree Fruits Limited that had acquired the quality of income in its hands according to the test laid down by Mr. Justice Brandeis in *Brown* v. *Helvering (supra)* and adopted by this Court in the *Robertson* case *(supra)*.

On this basis the appellant's true income position may now be ascertained. Its total receipts for the year ending February 28, 1947, is shown on its profit and loss account as $251,675.28, which amount was accepted by the Minister on his notice of assessment. Mr. Darroch gave its receipts from its outside business as $81,787.52, which left $169,887.76 as the total amount received from B.C. Tree Fruits Limited. Mr. Darroch said that the total expenses amounted to $143,198.12. Thus the appellant's receipts exceeded its operating expenses by $108,477.16. If the formula provided for in paragraph 4 is applied it follows that the amount of $169,887.76 paid by B.C. Tree Fruits Limited must be reduced by $108,477.16, leaving $61,410.60 as the amount that the appellant was entitled to keep as its income. This amount and the $81,787.52 which it received from its outside business came to a total of $143,198.12, which exactly equalled its operating expenses, leaving it with no net income for the year. A similar compilation for the year ending February 29, 1948, leads to a similar result. The appellant's profit and loss statement shows total receipts of $252,879.39, which amount was adopted by the Minister on his notice of assessment. Mr. Darroch's evidence is that the outside business brought in $87,328.21, which left $165,551.18 as the amount advanced by B.C. Tree Fruits Limited. Mr. Darroch stated that the total expenses came to $153,119.35. Thus the appellant's total receipts exceeded its operating expenses by $99,760.04. Consequently, by application of the agreement formula, the amount of $165,551.18 advanced by B.C. Tree Fruits Limited must be reduced by $99,760.04, leaving only $65,791.14 as the amount that the appellant was entitled to keep as its income. This amount and the $87,328.21 which it received from its outside business came to a total of $153,119.35, which exactly equalled its operating expenses, leaving it with no net income for the year.

Counsel for the respondent urged that the agreement contemplated that the amount which B.C. Tree Fruits Limited

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was to pay the appellant should exactly equal the expense of doing its business. Put otherwise, the submission was that the term receipts in paragraph 4 of the agreement was confined to the appellant's receipts from B.C. Tree Fruits Limited and did not include any receipts from its outside business and that, consequently, all that was to be refunded to B.C. Tree Fruits Limited was the excess of the receipts from it over the operating expenses of doing its business. I am unable to agree. There is no justification for reading this limitation of meaning into the word receipts. It was contemplated that the appellant would do outside business and I am satisfied that the receipts referred to in paragraph 4 were not limited to those that came from B.C. Tree Fruits Limited but included the receipts from outside business as well.

If follows from what I have said that the Minister was in error in assessing the appellant as he did. The appeal from the decision of the Income Tax Appeal Board must, therefore, be allowed and the income tax assessments appealed against set aside. Likewise, the appeals against the excess profits tax assessments will be allowed and such assessments set aside. In each case the allowance of the appeal will be with costs but since the appeals were heard together there will be only one set of counsel fees.

Judgment accordingly.