1954
Nov. 24, 25
Nov. 30

BETWEEN:

CANADIAN KODAK SALES LIMITED . . APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE . . . . RESPONDENT.

Revenue—Income Tax—The Income Tax Act, S. of C. 1948, c. 52, ss. 2(3), 3,4, 20(1), 20(3)(a)—Profit from a business—Disposal of depreciable property.

The appellant was formed for the purpose of taking charge of the sales in Canada of all the products of Canadian Kodak Company Limited and sells a large range of cameras and photographic equipment and supplies. In 1940 it acquired the business and assets of Recordak Limited. This company had distributed and serviced special equipment known as recordaks. These were machines equipped with cameras and used for taking reduced photographs and microfilms of documents. They were leased to users on a monthly basis and not sold and Recordak Limited had always considered them as capital assets. The appellant handled the recordak portion of its business in substantially the same manner as Recordak Limited had done. It was identified as the Recordak Division and carried separately on its books of account. In every respect it treated the machines as capital assets in the same way as Recordak Limited had done. In January, 1951, the appellant changed its policy regarding recordaks and decided to sell them. In 1951 approximately 40% of the recordaks

which users had rented were purchased by them and in 1952 approximately a further 5% were thus sold. The appellant continued to lease the recordaks which it did not sell and carried such recordaks as capital assets. The appellant's decision to sell recordaks was made by its general manager as a business decision in the course of its business. In assessing the appellant for 1951 and 1952 the Minister added the amounts of the profits made on the sale of the recordaks to the amounts of taxable income shown on its returns. The appellant objected on the ground that the machines were capital assets and any gain in their sale was a capital gain and that they were not sold in the ordinary course of its business and were not part of its profit-making activities.

Held: That the fact that the appellant's recordaks were formerly leased and treated as capital assets subject to depreciation does not prevent the profit from their sale being profit from the appellant's business once it had made the business decision to sell them and sold them in the course of its ordinary business of selling photographic equipment and supplies. There was no difference in principle between its sales of recordaks and its sales of other photographic equipment and the profit made from such sales was profit from its business and taxable income. *Gloucester Railway Carriage and Wagon Co.* v. *Inland Revenue Commissioners* [1925] A.C. 467 and 12 T.C. 720 followed.

2. That while the purpose of section 20(1) seems to be to ensure that under the circumstances specified in it some of the proceeds of the disposition of depreciable property, which, apart from the section, would not be income within the meaning of the Act, is included in income because of the fact that depreciation or capital cost allowances have been granted in respect of it, there is no need of resorting to the section for such purpose where the disposition of the property has been made in the course of the taxpayer's business as the result of a change of business policy in dealing with it and all of the proceeds of the disposition have been taken into account as income from the business and all the profit made in the disposition of the property is profit from a business.

APPEALS under The Income Tax Act.

The appeals were heard before the President of the Court at Toronto.

Stuart Thom for appellant.

Peter Wright Q.C. and *T. Z. Boles* for respondent.

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

THE PRESIDENT now (November 30, 1954) delivered the following judgment:

These are appeals against the appellant's income tax assessments for its taxation years ending November 4, 1951, and November 2, 1952.

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The facts are not in dispute. The appellant was incorporated by letters patent under the laws of Canada on December 1, 1938. It is affiliated with Canadian Kodak Company Limited which is also a Canadian corporation. Both companies are wholly-owned subsidiaries of the Eastman Kodak Company, a United States corporation. The appellant is not a manufacturing company but, as its name indicates, a selling company. It was formed for the purpose of taking charge of the sales in Canada of all the products of Canadian Kodak Company Limited, which is a manufacturing company. The appellant sells a large range of cameras and related photographic equipment and supplies as well as other products.

Prior to the incorporation of the appellant there was also another company called Recordak Limited. It was incorporated under the laws of Canada in 1929. This company was also a wholly-owned subsidiary of the Eastman Kodak Company. It was formed to distribute and service special equipment known as recordaks. These were machines equipped with cameras and used for taking reduced photographs and microfilms of documents. Recordak Limited never sold any recordaks but leased them to users on a monthly rental basis. It also supplied the necessary services to keep the machines in order and sold the necessary films and other supplies. It acquired its machines and equipment from its parent, the Eastman Kodak Company. Recordak Limited carried on business until September, 1940, when its business and assets were taken over and acquired by the appellant. Up to that time it considered its recordaks as capital assets and never sold them. In its income tax returns it always claimed depreciation allowances in respect of them. The amounts so claimed were always allowed by the taxing authority and its practice in claiming them was never questioned.

After the appellant had taken over the business and assets of Recordak Limited in 1940 the latter went out of business and finally surrendered its charter in 1944. The appellant handled the recordak portion of its business in substantially the same manner as Recordak Limited had done. It was identified as the Recordak Division and carried separately on its books of account. The recordaks were recorded in the accounts as capital assets. They were

taken over at the same book value as had appeared on the books of Recordak Limited each with the same amount of depreciation reserve. In every respect the appellant treated the machines as capital assets in the same way as Recordak Limited had done. Subsequently, the appellant acquired additional recordaks and dealt with them in the same way as it treated the recordaks acquired from Recordak Limited. Each machine was identified on its books with its serial number and its value with the amounts allowed for depreciation in respect of it. The machines were retained as capital assets even when there was 100% reserve for depreciation and kept so long as they were in service. A machine was replaced only when it had become unserviceable or obsolete. Then it was dismantled, but not sold.

In January, 1951, the appellant changed its business policy regarding recordaks. It then decided to sell them. By a letter, dated January 8, 1951, and sent to its recordak users, the user was informed that the recordak which was then on rental to him could be purchased outright. Attached to the letter was a price list. The letter stated that if the user desired to purchase the equipment one-half of the rental which he had paid during the past 36 months could be deducted from the actual purchase price. The announcement of this change of policy was sent to every recordak user, the manager of the Recordak Division and all his salesmen. A copy of the letter was available even to non-users. There was no general advertising of the change and the appellant did not initiate any vigorous campaign. The reason for this change of business policy given by Mr. J. W. Spence, the appellant's treasurer and assistant general manager, was that the new policy would give the appellant a wider distribution of the equipment and reduce the amount of capital invested in it.

In 1951 approximately 40% of the recordaks which users had rented were purchased by them and in 1952 approximately a further 5% were thus sold. Since then there have been very few additional sales. The appellant continued to lease the recordaks which it did not sell. It is still acquiring recordaks and selling them or leasing them. If it leases them it carries them as capital assets.

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During the taxation years 1949 and 1950 the appellant claimed capital cost allowances on its recordaks as Class 8 assets under Part XI, Schedule B of the Regulations at the rate of 20% and its claims were allowed. In its returns for 1951 and 1952 it claimed capital cost allowances on all the Recordaks which had not been sold and these claims are not questioned. It is only in respect of the sales of recordaks to their former users that there is any issue.

On his cross-examination Mr. Spence admitted that the appellant was the domestic sales company for the Kodak group in Canada, that as such it sold cameras, flash bulbs, tripods, motion picture cameras, and recordak machines and films, that it carried on business in 1951 and 1952 in the same manner as it had done previously except that in these years it also sold recordaks and that they are based on principles of photography, a camera being an essential part of the machine.

Mr. Spence admitted that the appellant's decision to sell recordaks was not a decision of its board of directors or of its shareholders but was made by the general manager. He agreed that it was fair to say that it was a business decision made in the course of the appellant's business. No additional salesmen were taken on, the same representatives making the sales as had done the leasing. There was no change in the appellant's business. In its income tax returns for 1951 and 1952, as in those for previous years, it described its business as being "the sale of photographic supplies—wholesale".

Mr. R. L. B. Joynt, the appellant's comptroller, confirmed the evidence of Mr. Spence that its recordaks were recorded on its books as capital assets. They were acquired on the basis of their original cost to the Eastman Kodak Company. If they were used machines they were transferred to the appellant at their book value on the books of the Eastman Kodak Company, which was their finished cost to it less the depreciation reserve against them at the date of their transfer. If the machines were new they were acquired at the finished cost to the Eastman Kodak Company plus the additional cost of their transportation and importation. The recordaks were sold at prices substantially higher than their book value. The profit and loss statement filed with the return for the taxation year ending November 4, 1951,

showed the profit on the sales of recordaks in that year as $148,693.50. And the profit and loss statement filed with the return for the taxation year ending November 2, 1952, showed the profit on the sales in that year as $20,518. In assessing the appellant the Minister added these amounts respectively to the amounts of taxable income respectively shown by it on its returns.

The appellant objected to the assessments on the ground that the machines were capital assets and any gain on their sale was a capital gain and that they were not sold in the ordinary course of its business and were not part of its profit-making activities. The Minister notified the appellant that he confirmed the assessments on the ground that the profits from the sale of recordaks had been properly taken into account in computing the appellant's income in accordance with the provisions of sections 3 and 4 of The Income Tax Act. The appellant then brought its appeals to this Court.

The issue in this case is whether the profit made by the appellant on the sale of the recordaks which it had previously leased was taxable income within the meaning of The Income Tax Act, Statutes of Canada 1948, Chapter 52. By section 2(3) of the Act the taxable income of a taxpayer for a taxation year is said to be this income for the year minus the deductions permitted by Division C. Then section 3 provides, *inter alia,* that such income includes income for the year from all businesses and section 4 goes on to say:

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

It was contended for the appellant that the profit made by it was not a profit from its business. It was submitted that its recordaks had always been regarded by it as capital assets and accepted as such by the taxing authority, that they had never acquired the characteristics of inventory or property held for sale but had always been held exclusively as revenue producing property from which income was received, that when they were sold the sale was not made with a view to making a profit but for the purpose of freeing capital and obtaining a wider distribution of machines, that they always retained their characteristics as capital assets and that when they were sold they were sold as capital assets with a resulting capital gain.

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I cannot accept these submissions. On the contrary, I agree with the argument put forward by counsel for the respondent. He contended that the appellant was organized to be the selling instrument in Canada of the products of the Eastman Kodak Company, that its recordaks were not fundamentally different in principle from the wide range of cameras and photographic equipment and supplies sold by it, that the decision to sell the recordaks was a business decision made for business reasons to increase the appellants' sales and to increase its profits, that from the time of this decision the appellant was in the business of selling recordaks and that its profit therefrom was a profit from its business and taxable income within the meaning of the Act.

Moreover, I am unable to distinguish this case in principle from the case of *Gloucester Railway Carriage and Wagon Co.* v. *Inland Revenue Commissioners* (1). In that case the Company was formed to manufacture, buy, sell, hire and let on hire wagons and other rolling stock, and for many years it manufactured railway wagons, either selling them outright or on the hire-purchase system or letting them on simple hire. In the books of the Company the wagons built to be let on hire were capitalized at a sum which included an amount added as profit on manufacture, and year by year an amount was written off the value of the wagons for depreciation. In 1920 the Company decided to cease letting wagons on hire and to sell them. It then sold the entire stock of wagons used in that branch of its business for a sum in excess of the value of the wagons in the Company's books. The surplus was included in an assessment to corporation profits tax on the Company in respect of the profits of its business, and the Company appealed contending that the surplus arose from the realization of capital assets used in its hiring business. The Special Commissioners disagreed with the contention of the Company that the profit on the sales was an accretion of capital. They found as follows, at page 734 of 12 T.C.:

We are unable to take this view. In our opinion we must have regard to the main object of the Company which is to make a profit in one way or another out of making wagons and rolling stock. We are unable to draw the very sharp line which we are asked to draw between wagons sold, wagons let on hire purchase and wagons let on simple hire, nor do we consider that this very sharp division in fact exists. We do

(1) [1925] A.C. 467; 12 T.C. 720.

not regard ourselves as precluded by the fact that as long as the wagons were let they were treated as "plant and machinery" subject to wear and tear, from deciding that they are stock in trade when they are sold, even though let under tenancy agreements, for they seem to us to have in fact the one or the other aspect according as they are regarded from the point of view of the users or the Company. In our view, shortly, it makes no difference that one way of making profit out of the wagons was given up, for the very giving up itself involved the making of a profit in another way out of the same wagons, and the purpose of the Company's trade is to make a profit out of wagons.

The decision of the Commissioners was affirmed by Rowlatt J. of the King's Bench Division. An appeal from his decision to the Court of Appeal was dismissed, Pollock M. R. dissenting. The judgment of the majority of the Court was clearly to the effect that the profit made by the Company was profit arising from the business. On an appeal being taken to the House of Lords it was unanimously dismissed. I need quote only the last paragraph of Lord Dunedin's speech, reported at page 474 of [1925] A.C.:

The appellants argue that this is really a capital increment; and to say so they call these wagons plant of the hiring business. I am of the opinion that in calling them plant they really beg the whole question. The Commissioners have found—and I think it is the fact—that there was here one business. A wagon is none the less sold as an incident of the business of buying and selling because in the meantime before sold it has been utilized by being hired out. There is no similarity whatever between these wagons and plant in the proper sense, e.g., machinery, or between them and investments the sale of which plant or investments at a price greater than that at which they had been acquired would be a capital increment and not an item of income. I think that the appeal fails.

The principles applied in the *Gloucester Railway Carriage and Wagon Company* case (*supra*) are applicable in this one. Counsel for the appellant sought to distinguish it from the present case on several grounds one of which was that in the case cited there was only one business whereas in the appellant's case there had always been a sharp separation between its Recordak Division and its other business so that the former was really a separate business, but the fact is that in each case there was only one business. The appellant's Recordak Division was not a separate business. The manner in which the appellant kept its accounts proves this beyond dispute. Moreover, just as in the case cited the Commissioners did not regard themselves as precluded by the fact that as long as the wagons were let they were

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treated as plant and machinery from deciding that they were stock in trade when they were sold, and Lord Dunedin considered that "a wagon is none the less sold as an incident of the business of buying and selling because in the meantime before sold it has been utilized by being hired out", so the fact that the appellant's recordaks were formerly leased and treated as capital assets subject to depreciation does not prevent the profit from their sale being profit from the appellant's business once it had made the business decision to sell them and sold them in the course of its ordinary business of selling photographic equipment and supplies. It was in exactly the same position in which it would have been in if it had acquired the recordaks for resale. There was nothing of a capital nature in the sale of its recordaks and it is fanciful to say that they were realizations of investments. There was no difference in principle between its sales of recordaks and its sales of other photographic equipment. They were all sales in the course of the appellant's business.

I, therefore, find that the profit made by the appellant from the sales of its recordaks in each of the years under review was profit from its business and taxable income within the meaning of the Act.

That, in my opinion, disposes of the appeals but, in view of the submissions of counsel for the appellant that its case falls to be considered under section 20 of the Act I shall now refer to it. In order to make his submission certain figures were established. In the appellant's taxation year ending November 4, 1951, the amount of the sales of recordaks formerly leased to their users came to $177,311.87 and their net value after depreciation and capital cost allowances was $30,148.05. The difference between these amounts together with an item of $1,529.68 for parts and sundry supplies made up the total profit of $148,693.50 which I have already referred to. The undepreciated capital cost of the recordaks at the commencement of the appellant's 1951 taxation year was $99,444.37 and the capital cost to the appellant of the recordaks sold by it in 1951 computed in accordance with section 8 of Chapter 25 of the Statutes of Canada, 1949 (Second Session), was $39,732.85. In the appellant's taxation year ending November 2, 1952, the amount of the sales of recordaks formerly leased to their users came to

$22,640.00 and their net book value after depreciation and capital cost allowances was $2,122.00, resulting in the profit of $20,518.00 already referred to. The undepreciated capital cost of these recordaks at the commencement of the appellant's 1952 taxation year was $48,194.00 and the capital cost to the appellant of the recordaks sold by it computed as aforesaid was $4,105.86.

Section 20(1) of the Act provides as follows:

20. (1) Where depreciable property of a taxpayer of a prescribed class has, in a taxation year, been disposed of and the proceeds of disposition exceed the undepreciated capital cost to him of depreciable property of that class immediately before the disposition, the lesser of

(*a*) the amount of the excess, or

(*b*) the amount that the excess would be if the property had been disposed of for the capital cost thereof to the taxpayer,

shall be included in computing his income for the year.

And section 20(3) (a) provides:

20. (3) In this section and regulations made under paragraph (*a*) of subsection (1) of section 11,

(*a*) "depreciable property of a taxpayer" as of any time in a taxation year means property in respect of which the taxpayer has been allowed, or is entitled to, a deduction under regulations made under paragraph (*a*) of subsection (1) of section 11 in computing income for that or a previous taxation year;

I shall now summarize the contention of counsel for the appellant as I understood him to make it. He used the 1951 figures to illustrate what he put forward. He submitted that the recordaks sold by the appellant constituted depreciable property of the appellant within the meaning of section 20(3)(a) because capital cost allowances in respect of it had been made in 1949 and 1950 which brought it within the ambit of section 20(1). It was disposed of for $177,311.87 which amount exceeded its undepreciated capital cost to the appellant immediately before its disposition of $99,444.37. Consequently all the requirements of section 20(1) were met. The amount of the excess under paragraph (*a*) of section 20(1) was thus $77,867.50. But if the property had been disposed of for its capital cost to the appellant such amount would have been $39,732.85 in which case there would have been no excess under paragraph (*b*). And since the lesser of the excess under (*a*), namely, $77,867.50, or the excess under (*b*) namely, zero, was to be

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included in computing the appellant's income for the year, zero was the amount to be included in computing the appellant's income.

There is, I think, a brief answer to counsel's submission. While the purpose of section 20(1) seems to be to ensure that under the circumstances specified in it some of the proceeds of the disposition of depreciable property, which, apart from the section, would not be income within the meaning of the Act, is included in income because of the fact that depreciation or capital cost allowances have been granted in respect of it, it seems to me that there is no need of resorting to the section for such purpose in a case such as this where the disposition of the property has been made in the course of the taxpayer's business as the result of a change of business policy in dealing with it and all of the proceeds of the disposition have been taken into account as income from the business and all the profit made on the disposition of the property is profit from a business.

It follows from what I have said that the Minister was right in assessing the appellant as he did and that its appeals from the assessments are dismissed with costs.

Judgment accordingly.