BETWEEN:

Toronto 1965 Dec. 9 — Dec. 22

DOMINION DAIRIES LIMITED ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—Income tax—Income—Purchase of a dairy business, its goodwill and its going concern—Goodwill cannot be purchased as a separate item of a business inseparable from assets and liabilities of a business purchased as a going concern—Capital asset not an expense of a business—Capital payments—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 12(1)(a)(b).

The appellant carried on at all material times the business of receiving, storing, processing, selling and distributing milk, cream, butter, eggs and other dairy products and allied items of merchandise.

By a written contract dated May 23, 1962 the appellant purchased from E. T. Stephens Investments Ltd., the business and goodwill of the Roselawn Dairy Division, including customers' lists for the sum of $344,000 referred to in para. 1(*d*) of said contract.

The appellant sought to charge $209,600 as an expense for the year 1962. The balance of $134,400, the appellant conceded was a capital cost being for goodwill.

Appellant submitted that the Minister erred in disallowing the deduction of $209,600 as an ordinary business expense, alleging that it was the cost of acquiring lists of customers and that such cost represented the price of a current or circulating asset made in the ordinary course of its business.

Held: That having regard to the negotiations that took place between appellant and the owners of Roselawn Dairy Division resulting in the purchase of that business as a going concern, and considering the whole of the evidence and the applicable law, the whole sum of $344,000 was paid for purchased goodwill and was an outlay of capital.

2. That goodwill cannot be purchased as a separate item of a business. It is intimately connected with and inseparable from the other assets and liabilities of a business which is purchased as a going concern.

3. That the expression "goodwill" when applied to a business, has a wide meaning and has been defined in its many aspects in judicial decisions and in accounting treatises which the Court adopted and followed.

4. That when a purchaser of a business as a going concern purchases the goodwill of such a business, he does not do so on any precise scientific basis.

5. That in any event, over a period of time, such purchased goodwill and the goodwill generated or kept by the purchaser in such business will become indistinguishable.

6. That the appeal be dismissed with costs.

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APPEAL under the *Income Tax Act.*

John G. McDonald, Q.C. and *H. L. Beck* for appellant.

M. A. Mogan and *John E. Sheppard* for respondent.

GIBSON J.:—This appeal is concerned with the 1962 income tax year of the appellant. The appellant seeks to deduct in computing its income for 1962 the sum of $209,-600 being the sum allocated by the appellant of the purchase price paid by the appellant for the Roselawn Dairy Division of E. T. Stephens Investments Ltd. pursuant to a contract dated May 23, 1962 between the appellant and E. T. Stephens Investments Ltd., which purchase was closed on July 4, 1962. The sum of $209,600 is part of the sum of $344,000 which is referred to in para. 1 (*d*) of the said contract which reads as follows:

> (*d*) Lists of customers, records, information and data relating to customers as set forth in route books, drivers' record books and the like and goodwill—Price $344,000.

In other words the appellant seeks to charge $209,600 as an expense for the year 1962, and the balance of $134,400 only of the said sum of $344,000 as goodwill, which it concedes is a capital cost.

Pursuant to the said contract, the appellant completely bought out the Roselawn Dairy Division of the vendor and obtained a restrictive covenant from the vendor and certain of its officers not to go into the same business for a certain length of time in a certain area, as is more particularly set out hereunder.

The other assets of the business purchased at the same time were categorized in the contract under three other headings namely,

(*a*) *Plant Equipment, Cans, Cases and Bottles* (the contract describes the same in detail)

Price $100,000;

(*b*) *Automotive Equipment* (the contract describes the same in detail)

Price $100,000; and

(*c*) *Store and Merchandising Equipment* (the contract describes the same in detail)

Price $25,000.

The said restrictive covenant is contained in para. 9 of the contract and reads as follows:

9. The Vendor and the Executives and Roselawn Farms Limited each expressly covenant and agree with the Purchaser that for a period of three years from the time of closing each of them will not (without the consent in writing of the Purchaser in the case of the Vendor, and in the case of the Executives or either of them other than as an executive or employee of the Purchaser or a subsidiary company of the Purchaser) directly or indirectly, engage in or be interested in any milk, cream or dairy products business or business similar to that comprising the Roselawn Dairy Division in the Municipality of Metropolitan Toronto, or within 50 miles of the boundaries thereof, and will not during such period and within such area authorize the use of the name "Roselawn" in connection with any business of the type aforementioned. The Vendor and the Executives and Roselawn Farms Limited hereby, as from the time of closing the transaction herein contemplated, assign, transfer and set over unto the Purchaser all such rights and interests as they may have in and to the name "Roselawn" for use in connection with, or as part of, the name of the business purchased hereunder by the Purchaser.

Mr. F. L. Hart, President and General Manager of the appellant company negotiated the purchase of this business and gave evidence on this appeal. He said that he was only interested in the customers' lists and route cards and the right to hire the salesmen drivers of Roselawn Dairy Division to carry on with his company after the purchase. He said the appellant company had heretofore computed that it cost it $10 to have their own salesmen canvass and obtain a retail customer of milk, and $30 for a wholesale customer. He submitted that since these costs were permitted for the purposes of the *Income Tax Act* as an expense of doing business, that it was reasonable for the appellant to apply this $10 and $30 formula to the contract of acquisition of customers of Roselawn Dairy Division, and in doing so the said sum of $209,600 was computed, which sum, as stated, the appellant submits should be allowed as an expense for 1962. Mr. Hart says that the relationship of the milkman with the customer is the only goodwill he considered the appellant bought. He says in essence that what the appellant paid $209,600 for was an opportunity to do business in the locations and with the people that Roselawn Dairy Division had been doing business and to have the right to the contractual relationship with the former milk drivers of Roselawn Dairy.

Mr. Hart also stated that the appellant had heretofore purchased other dairy businesses on the same basis, and

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was in the stage of negotiating other similar purchases of businesses which may be completed in the future.

Mr. W. D. Bruce, Secretary Treasurer of the appellant company, gave evidence of how the sum $344,000 was dealt with in the accounts of the appellant company. He said the whole of the $344,000 on the closing of the transaction in July 1962 was debited to the goodwill capital account. Then, after the auditors of the appellant had examined the appellant's books in preparation of the year-end statement for the year 1962, there was an adjusting and amending entry made in the journal on March 3, 1963, as a result of which there was written-off to expense for the year 1962 the said sum of $209,600. The wording of this journal entry in part reads:

To write off the cost of customer lists acquired from Roselawn Dairy Division .... $209,600.

Mr. Bruce said that the formula of $10 per retail stop and $30 per wholesale stop, above referred to in discussing the evidence of Mr. Hart, was the formula used in arriving at the figure of write off of $209,600. Mr. Bruce said the sum of $134,400 was left as a capital asset account, representing goodwill.

He said in his opinion he would add one other advantage obtained by the appellant from Roselawn Dairy Division as constituting part of the goodwill acquired, and that was the obtaining of the said above recited restrictive covenant of the vendor and certain of its officers not to engage in this business as referred to in the said recited covenant.

Mr. Bruce also conceded that a fifty-fifty division of the sum of $344,000 between the capital item goodwill and the write off as expense for the reasons given, might have been more reasonable.

On cross-examination it was determined from these witnesses that the sum of $344,000 was a negotiated figure and was the figure obtained by multiplying $261 by 1319. The 1319 figure represented daily cans of milk. Daily cans of milk times a dollar figure apparently is a formula used in this industry in negotiating the purchase of a business in this industry.

It was the submission of the appellant that it paid the said sum of $209,600 as a recurring expense and not as a once and for all payment; that it purchased transitory assets, that is assets which were not of an enduring nature

and therefore not capital assets. (In this connection the appellant submitted in evidence that it had lost by the end of 1964 about 42% of the number of customers named on the customers' lists obtained from Roselawn Dairy Division). In brief, the appellant submitted that in essence these customers' lists, the route cards and the contractual right to obtain the driver milkman's services who had contact with the customers of Roselawn Dairy Division, constituted a purchase of an outlet for the appellant's product or an opportunity to do business, a purchase of a kind that the appellant had done before and proposes to do again in the future and as such the sum expended for such purchase was a proper deduction from income within the principles enunciated in *B.P. Australia Limited v. Commissioner of Taxation.*[1]

The respondent on the other hand says that the contract of purchase of Roselawn Dairy Division was the purchase of a business as a going concern; that the fact that the appellant has bought out other businesses as going concerns and proposes to do so in the future does not turn these payments into income payments but instead they were all capital payments and the payments for any similar purchases in the future will also be capital payments.

The respondent says that what the purchaser paid $344,000 for was goodwill and the formula that the appellant used in arriving at that figure was by multiplying $261 by 1319 daily cans of milk; and that the formula worked out by the appellant of $10 per retail stop and $30 per wholesale stop sometime after this purchase of the business is of no validity and is merely an *ex post facto* rationalization of what the appellant says it did in purchasing this business.

In my opinion it is beyond peradventure that what the appellant purchased by this contract above referred to was the business of Roselawn Dairy Division as a going concern; and in doing so, it purchased goodwill as an asset in this case.

It is therefore necessary to consider the purchased goodwill in this transaction.

It must be assumed that the appellant-purchaser acted on the premise that X percent would be a satisfactory

[1] [1965] 3 All. E.R. 209.

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return on the investment it was going to make in purchasing this business.

Having started with such a premise, then the appellant-purchaser must have made a judgment on how much it could afford to pay the vendors of this business as it then existed and still earn the said X percent on its investment.

Exhibit A-4 introduced in evidence by the appellant shows some of the basis of its assumptions and business judgment in purchasing this business.

This is an inter-office communication between the said Mr. F. L. Hart, President and General Manager of the appellant, Dominion Dairies Limited, addressed to a Dr. C. R. Roberts at the New York office of the holding company of the appellant.

The relevant excerpts from this letter are as follows:

Roselawn Farms Dairy is owned by the E. T. Stephens Investment Company. The family own large acreage in the north end of the City of Toronto in fact they are almost surrounded by a housing development and they operate 21 routes from a branch *on the farm*. They use two trailers to haul merchandise up to the branch at 3 o'clock in the morning, and from which they load their retail routes. These north routes average 2,700 pts (5 days).

I have suggested to John Stephens, the son, who operates the dairy, that I thought the Company would be willing to negotiate on a basis, such as 1,400 cans of milk per day at $350 per can which would total $490,000. The garage property at Geary Avenue for $75,000, the equipment and machinery in the processing plant for $50,000 (some of which would be used by us and some of which we would sell to the junk man) and $87,000 for the motor equipment. There are about 87 pieces automotive including the tractors and trailers.

The Stephens family to keep the Dufferin Street processing plant and after we gut it of everything salvageable in the way of equipment they can sell it or demolish it.

What I am suggesting comes to $702,000, John originally wanted $1,000,000 for the entire operation. He has $100,000 in a cash bond which would revert to the family, being no further need for it, and if the building is worth $82,000, the difference between my price and his is about $116,000.

It appears that on the basis of the conservative figures worked out by Quinn and Murray, we can make about $175,000 a year after taxes by this consolidation. In other words it would pay off in four years. I have an idea that because of the fact that we are buying assets rather than shares, this would be a pretty good deal. It would serve to strengthen our hold on the retail business in the western end of the City, and we would acquire 21 routes up at Richmond Hill, in a territory for which we have no license It puts us into a Loblaw store at Richmond Hill with Sani Seal milk which we cannot service at present. We figure we can place all of his wholesale on our present Sani Seal routes if we spread over all, or at the

worst we might need two or three trucks with a realignment of routes. On the retail it looks as if we might be able to consolidate so that we would eliminate 10 or 12 routes.

...

There is only one figure that I am less than sure of, and that is the $87,000 for the trucks, I want Verne Quinn to take a look at them and we may revise our figure downwards by up to 20%. As far as the garage property at Geary Street is concerned, I believe this property could be sold in the neighbourhood of the $75,000 figure, but I would like to think in terms of using it as an equipment depot, a machine shop for the repair of equipment and the main service garage for the Toronto area. Keeping only a service crew here at Walmer to handle batteries, tire changes and minor repairs. The Geary building has high ceilings and our boys think we can do a real job at this location. This garage bit, of course, is subject to a great deal of further discussion.

...

Subsequent to the preparation and sending of this memorandum, after negotiation with the vendor, Mr. Hart was able to purchase this business on the basis of the formula above referred to, namely, $261 x 1319 daily cans which works out to $344,000, instead of $350 per can, as referred to in the above quoted memorandum.

This sum of $344,000 as above noted, was, after the close of this purchase and sale in July 1962, entered in the books of the appellant company as a capital cost of the asset goodwill.

To characterize this purchased goodwill, a consideration of some of the legal principles concerning the same, is helpful.

It should be noted, for example, that goodwill cannot be purchased as a separate item of a business. It is intimately connected with and inseparable from the other assets and liabilities of a business which is purchased as a going concern. It modifies or adjusts such assets and liabilities. (See Lord Macnaghten in *Inland Revenue Commissioners v. Muller & Co.'s Margarine, Limited*[1] where he said:

I now come to the second point It was argued that if goodwill be property, it is property having no local situation. It is very difficult, as it seems to me, to say that goodwill is not property. Goodwill is bought and sold every day It may be acquired, I think, in any of the different ways in which property is usually acquired. When a man has got it he may keep it as his own He may vindicate his exclusive right to it if necessary by process of law. He may dispose of it if he will—of course under the conditions attaching to property of that nature.

Then comes the question, Can it be said that goodwill has a local situation within the meaning of the Act? I am disposed to agree with an

[1] [1901] A.C. 217 at p. 223 et foll.

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observation thrown out in the course of the argument, that it is not easy to form a conception of property having no local situation. What is goodwill? It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates. Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different businesses in the same trade. One element may preponderate here and another element there. To analyze goodwill and split it up into its component parts, to pare it down as the Commissioners desire to do until nothing is left but a dry residuum ingrained in the actual place where the business is carried on while everything else is in the air, seems to me to be as useful for practical purposes as it would be to resolve the human body into the various substances of which it is said to be composed. The goodwill of a business is one whole, and in a case like this it must be dealt with as such.

And see also Lord Davey in the same case at page 227 where he said:

The position taken up by the Attorney-General was a singular one, and somewhat embarrassing to persons who have to stamp their contracts. He admitted that, so far as the goodwill was attached to the business premises and thereby enhanced their value, he did not claim that an ad valorem stamp should be affixed in respect of that value. But I am not aware that you can split up goodwill into its elements in that way, and I see great difficulty in doing so. The term goodwill is nothing more than a summary of the rights accruing to the respondents from their purchase of the business and property employed in it . . .

It also does not affect the characterization or allocation of the capital cost of purchased goodwill because in any particular case the purchaser did not get all the benefit from the goodwill he thought he was going to get, or that the purchaser subsequently lost some of the benefit of goodwill by losing customers (as happened to the appellant in this case). (See Thurlow J. in *Schacter v. Minister of National Revenue*[1] where he said:

Nor in my view is the matter affected by the fact that goodwill in the case of an accountant and particularly one who practices alone is largely personal to the particular practitioner and scarcely capable of being sold with any assurance that the purchaser will obtain any benefit from it. No doubt one who pays for so tenuous an advantage takes a risk but there is nothing uncommon about professional men acquiring the undertakings of established practitioners with whatever goodwill can be retained in the transfer and I know of no reason why if they see fit, as appears to have occurred in this case, they cannot in such a transaction agree upon a consideration for such goodwill. The fact that in the result no goodwill

[1] [1962] Ex. C.R. 417 at p. 424 et foll.

may be acquired or that the benefits of the purchase may soon disappear appears to me to be irrelevant for the present purpose for in the test referred to in the cases cited what matters is the nature of the advantage sought rather than the benefit actually obtained.

The reason that it is desirable for the purchaser to obtain a restrictive covenant from the vendor of a business not to engage in the same business for such and such a length of time in such and such an area, (as the appellant did in this case) is that such a purchaser, when he pays substantial monies to such a vendor for the goodwill asset of the business, wishes to make sure he gets the full benefit of the goodwill he paid for, since he may not if he has not obtained such a restrictive covenant. (See Cotton L. J. in *Leggott v. Barrett*[1] where he said:

> ...Goodwill, possibly, in some of the later cases, has been a little extended, but undoubtedly the cases have established that the sale of goodwill does prevent a man from representing that he is carrying on the old business or that he is the successor of it, and in that way trying to get the customers of the partnership. But in *Churton v. Douglas* [Joh. 174] the judgment of the Vice-Chancellor quite concurs, I think, with the previous decisions, in assuming that the Defendant might, if he thought fit, have carried on business with the customers of the old firm, provided that he did not represent to them that his was the old business, or that he was the successor in business of the old firm. Therefore, to say that the Defendant should not be at liberty to deal with any customer whom he did not solicit to deal with him, is to give a forced interpretation to the words used. In my opinion that is not the fair meaning of a sale of goodwill.

And see also Lord Herschell in *Trego v. Hunt*[2] where he said:

> The question whether a person who had sold the goodwill of his business was entitled afterwards to canvass the customers of that business came first before the Courts for decision in the case of *Labouchere v. Dawson* [L.R. 13 Eq. 322]. Lord Romilly M.R. answered in the negative. He was of opinion that the principles of equity must prevail, and that persons are not at liberty to depreciate the thing which they have sold. He considered that the defendant was not entitled personally, or by letter, or by his agent or traveller, to go to any one who was a customer of the firm and to solicit him not to continue business with the old firm but to transfer it to him; that this was not a fair and reasonable thing to do after he had sold the goodwill. He accordingly granted an injunction to restrain the defendant, his partners, servants, or agents from applying to any person who was a customer of the old firm prior to the date of the sale, privately, by letter, personally, or by a traveller, asking such customers to continue to deal with the defendant or not to deal with the plaintiffs.

[1] (1880) 15 C A. 306 at p. 315. [2] [1896] A.C. 7 at p 11 et foll.

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And see also Teetzel J. in *Foster v. Mitchell*[1] where he said:

As stated in Lindley on Partnership, at p. 476, the expression "goodwill", when applied to a business, "is generally used to denote the benefit arising from connection and reputation, and its value is what can be got for the chance of being able to keep that connection and improve it". Or, as put by Lord Macnaghten in Inland Revenue Commissioners v. Muller, [1901] A.C. 217, at pp. 223-4: "It is the benefit and advantage of the good name, reputation, and connection of the business; it is the attractive force which brings in custom; it is the one thing which distinguishes an old-established business from a new business as its first start." See also Trego v. Hunt, [1896] A.C. 7; and Hill v. Fearis [1905] 1 Ch. 466.

The proposition that the terms of the partnership agreement in this case were sufficiently comprehensive to include the taking over of the defendant's goodwill without that item of his business being specifically mentioned, is abundantly supported by Jennings v. Jennings, [1898] 1 Ch. 378, where, in a compromise agreement settling a partnership action, A. was to retain the "assets", and it was held that, though not specifically mentioned, the goodwill of the business was included; and by In re Leas Hotel Co., Salter v. Leas, [1902] 1 Ch. 332, where it was held that the word "property" was sufficient to include goodwill in the business though not specifically mentioned. See also In re David and Matthews, [1899] 1 Ch. 378.

It is a fact also that when a purchaser of a business as a going concern purchases the goodwill of such a business as one of the assets, he does not do so on any precise scientific basis. There are accounting and merchandising rules and guides he may employ so as to enable him to exercise the best business judgment possible. Such a purchaser hopes to obtain the custom of the business he is purchasing and in every other way obtain all the economic advantages that such a business had. In this he may estimate correctly, in which event the cost of such purchased goodwill if he puts it on the balance sheet of his business will accurately set out its value at that time. But more often than not, some figure greater or lesser will probably be the correct figure.

In any event, over a period of time such purchased goodwill and the goodwill generated or kept by the purchaser will become indistinguishable.

The businessman's approach in purchasing goodwill as an asset of a business has been admirably characterized by certain author accountants. (See for example, Professional Accounting by John Parker and David Bonham, published by Sir Isaac Pitman (Canada) Limited, 1965 at page 110 et foll. which reads as follows:

[1] (1911-12) 3 O.W.N. 425 at p. 428 et foll.

VALUATION OF A BUSINESS

The valuation of a business entity involves in large measure both the value of its assets and its potential earning power. Particularly from the viewpoint of a prospective purchaser, the worth of a business is based primarily on earning power. But since earning power, to be meaningful, must be related to capital employed, asset values are essential to the process of business valuation. When the value of the entity is found to include intangibles, goodwill becomes an important part of the valuation process. Indeed, this aspect of the problem is largely analogous to valuing the enterprise itself. Because of the importance of goodwill, some general comments are in order before proceeding to the measurement of this asset.

GOODWILL

The true nature of goodwill has perhaps best been described in two leading English legal decisions:

> The goodwill which has been the subject of sale is nothing more than the probability that the old customers will resort to the old places (Lord Eldon)
>
> Goodwill regarded as property has no meaning except in connection with some trade, business, or calling In that connection I understand the word to include whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers and agreed absence from competition, or any of these things, and there may be others which do not occur to me. (Lord Lindley)

The goodwill shown in a financial statement usually arises on the purchase of a business through the acquisition of its net assets, or through the acquisition of a controlling interest in its shares. When consolidated financial statements are prepared, the excess of cost of the investment over the fair value of the subsidiary's net assets at date of acquisition is usually treated as goodwill.

In accounting theory, purchased goodwill is generally considered to be an asset that has a value at date of acquisition equivalent to its cost. Although goodwill may be built up by advertising, and through the general operational activities of a business, these costs are normally charged to expense when incurred. Except in the case of partnerships, the accounting recognition of goodwill is usually restricted to that acquired by purchase.

The subsequent accounting treatment of purchased goodwill permits showing this asset in the balance sheet with or without amortization. Goodwill can be viewed as the purchase of earning power in excess of a normal return on the investment. As long as operating results indicate the validity of this view, the alternative of amortizing or not amortizing is available. If goodwill is amortized, the charges to expense should be systematic, even though the period selected is often arbitrary. If a material distortion of net income is likely to result from amortization, a partial write-down of goodwill may be made by a charge to retained earnings When goodwill is not amortized on a systematic basis and when operating results begin to indicate a limitation in its usefulness, the cost of all or a portion of goodwill is usually written off to retained earnings This wide range of possible accounting treatments supports the commonly held view that goodwill is the most "intangible" of intangible assets.

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And at page 113:

The estimate of future earnings must disregard economies associated with any proposed merger, and any improvement in earnings expected to result from changes that might be introduced by the prospective owner. Since the goodwill belongs to the vendor, the main reason for measuring it is to determine an amount that the purchaser should be willing to pay for this asset. In theory, the purchaser should pay for goodwill whatever is necessary to ensure that the estimate of annual, future earnings will just equal a normal rate of return on the total investment. The emphasis, therefore, should be on future, maintainable profits reasonably attributable to the going concern which has been built up by the present owner.

In order to test for the presence of goodwill, it is necessary not only to estimate annual future earnings, but also to determine the fair value of capital employed. Since balance sheet valuations reflect asset costs adjusted according to the conventional rules of accounting, market values, instead of book values, should be used for determining capital employed. (Goodwill is sometimes recorded in the accounts as the difference between the book value of capital employed and the value indicated by the purchase consideration. This practice is obviously unsound, and its use can only result in a misstatement of goodwill).

See also An Income Approach to Accounting Theory (Readings and Questions) by Sidney Davidson, David Green Jr., Charles T. Horngren and George H. Sorter, published by Prentice-Hall Inc., Englewood, N.J., U.S.A., 1964 at page 367:

Before beginning the discussion of this particular point, however, it might be well to set forth the writer's general point of view with regard to goodwill. First of all, it should be noted that the general concept of goodwill has changed considerably over the past century. Whereas business goodwill was formerly considered to pertain almost exclusively to customer relations, the concept is now used in a much broader sense, in that it encompasses almost any intangible factor of economic value to an enterprise. In general, goodwill is looked upon as the economic advantage of friendly and harmonious relationships enjoyed by a business firm throughout the different phases of its operations. This advantage evidences itself in the form of earnings in an amount greater than that expected in a typical firm in the industry with a similar capital investment. The factors underlying goodwill may be considered to effect either greater total revenues or decreased unit costs. The former is commonly referred to as consumer or customer goodwill; the latter as industrial goodwill.

. . .

With respect to the problem of evaluating the goodwill of an enterprise, the technique generally resorted to is some sort of capitalization of earnings. The more acceptable methods of making the calculation assume a more or less definite term of existence for the excess earning capacity of the business. Some effort is made to determine what a "normal" rate of return in the industry might be, and this is matched against the estimated future earning capacity of the particular enterprise. The difference supposedly represents goodwill earnings. In this connection, it should be noted that future earnings are estimated on the basis of a projection of past earnings, adjusted to reflect a typical profit trend. It is generally recognized, however, that the amount actually paid for goodwill

in practice is seldom arrived at by a theoretically sound calculation. But regardless of the actual procedure used in determining the purchase price of goodwill, the payment represents some sort of estimate of the present value of future "super-profits" to be earned by the business.

The problem of whether or not purchased goodwill should be written off must necessarily be considered with regard to the varying circumstances under which it may appear. For example, the treatment called for where the amount appearing as goodwill on the balance sheet represents nothing more than the cost of an unfortunate investment in super-profits which failed to materialize would not be the same as that which would be indicated where the goodwill is grossly undervalued on the books. Between the two extremes there can be many intermediate situations.

See also Accounting—An Analysis of its Problems (Volume One/Revised Edition) by Maurice Moonitz and Louis H. Jordan published by Hold, Rinehart and Winston Inc., 1963 at pages 505-06:

. . It is commonplace in business affairs that businesses are bought and sold at amounts widely divergent from book values, even where the records have been kept by excellent bookkeeping procedures and the financial statements examined by the most competent auditors available...

. . .

The net effect of these factors, in the case of the successful business, is to *understate* the actual value of its proprietorship; in the case of the unsuccessful business, the limitations within which the accountant works serves to result in *overstatement* of the value of the enterprise taken as a whole. Goodwill can therefore be described, to use Canning's excellent phrasing, as the "master valuation account," and may assume either a debit or a credit aspect, depending upon whether the concern has a successful career ahead of it, or a dismal future. [John B. Canning, The Economics of Accountancy (New York: The Ronald Press, 1929), page 42.]

As a master valuation account, goodwill then adjusts or modifies virtually all the recognized assets and liabilities. It is therefore inaccurate, properly speaking, to refer to it as an asset, in the sense that cash, receivables, inventories, and fixed assets are referred to as assets. This distinctive characteristic of goodwill is widely recognized in the prevalent conception that goodwill cannot ordinarily be sold separately, as can the true assets, apart from the business as a whole. Since the amount of goodwill represents an unallocated (and, perhaps, unallocable) adjustment of all assets and debts, it becomes patently impossible to "acquire" the goodwill without acquiring the items it modifies or adjusts. For the sake of simplicity in expression, however, we shall follow the usual practice of referring to goodwill as an asset.

These legal authorities and accounting treatises, when read in the light of the facts of this case, clearly explain not only what the appellant did in purchasing this business but also its motivation in purchasing.

In the result therefore, in this case, having regard to the negotiations that took place between the appellant and the

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owners of Roselawn Dairy Division resulting in the purchase of that business as a going concern, and considering the whole of the evidence and the applicable law, I am of opinion that what the appellant paid the whole of the sum of $344,000 was for purchased goodwill, a capital asset, and that it is not possible in law in this case to treat any part of this sum in the manner in which the appellant seeks to do as expense during the year 1962.

The ratio of the decision of *B. P. Australia Limited v. Commissioner of Taxation*, in my opinion, is not applicable to the facts of this case.)

The appeal is therefore dismissed with costs.