SINNOTT NEWS COMPANY LIMITED ..APPELLANT;

AND

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

1955 *Dec. 1

1956 *Mar. 28

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Wholesale news distributor—Whether reserve for loss on returns of periodicals deductible—Income War Tax Act, s. 6(1)(d).

*PRESENT: Kerwin C.J., Kellock, Locke, Cartwright and Fauteux JJ.

(1) [1952] 1 S.C.R. 170.

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The appellant, a wholesaler, distributed magazines, periodicals and books to retailers of the same on the basis that the latter were entitled to full credit for the return of unsold goods within a specified time. On its books, it treated the deliveries as outright sales. For income tax purposes, it set up a "reserve" for loss on returns which represented the profit element in the sale value of goods delivered during the year which it estimated would be returned to it during the three months following the end of its fiscal year. The Minister disallowed the deduction of this "reserve" as prohibited under s. 6(1)(*d*) of the *Income War Tax Act*. It was allowed by the Income Tax Appeal Board and this decision was reversed by the Exchequer Court.

Held (Kerwin C.J. dissenting): That the appeal should be allowed.

Per Kellock J.: The deliveries made by the appellant were not "on consignment" nor were they on the basis of "sale or return". The property passed to the retailers upon delivery. But since there was a right of return, the sales were therefore subject to a condition subsequent with the result that the property would re-vest in the appellant. Accordingly, the appellant was not entitled to set up any reserve of profits, but should be entitled to deduct the estimated sales value itself, subject, when the actual figure is ascertained, to adjustment when the returns are actually made.

Per Locke, Cartwright and Fauteux JJ.: The transactions were not outright sales or deliveries "on consignment" but were deliveries on a "sale or return basis". The property in the goods did not pass to the retailers nor were they liable for the amounts covering the deliveries other than for the goods sold or not returned within the agreed period. The claim for deduction has been established although the true nature of the transactions was not shown by the appellant's books. In computing the appellant's income, there should be excluded from the total of the sales any amount in respect of goods delivered and in the hands of retailers at the end of the fiscal year, for the purchase price of which the retailers were not then liable and, from the total of purchases, any amounts as the purchase price of such goods and the amounts set up in the accounts of the appellant for the year as a reserve for loss on returns should be deleted.

Per Kerwin C.J. (dissenting): The appeal should be dismissed for the reasons given by Cameron J.

APPEAL from the judgment of the Exchequer Court of Canada, Cameron J. (1), reversing the decision of the Income Tax Appeal Board.

Mannie Brown for the appellant.

J. Singer, Q.C. and *J. D. C. Boland* for the respondent.

THE CHIEF JUSTICE (dissenting):—These are two appeals from judgments of the Exchequer Court. For the reasons given by Mr. Justice Cameron in disposing of these matters, both appeals should be dismissed with costs.

(1) [1952] Ex. C.R. 508.

KELLOCK J.:—In these appeals the appellant claims to deduct, for the purpose of computing its taxable income for the fiscal years ending January 31, 1945 and 1946, respectively, a "reserve" for loss on returns representing the profit element in the sale price, as distinct from the sale price itself, of periodicals in the hands of dealers on the above dates unsold and expected to be returned to the appellant. In its profit and loss accounts for each of the years in question, the appellant has arrived at gross profit by taking the amount of the sale price of all periodicals delivered to dealers during the fiscal year, less the amount of the "reserve" above referred to, and deducting therefrom its own cost. It is the contention of the Minister that the deduction of this reserve is prohibited by the terms of s. 6(1)(*d*) of *The Income Tax Act*.

The appellant has throughout rested its claim for the deduction of this reserve exclusively upon the footing that all of its deliveries to dealers were "on consignment". This was specifically pleaded below in connection with the 1946 assessment. There were no pleadings with respect to the year 1945. In his opening to the Income Tax Appeal Board, counsel for the appellant stated that "it is made clear to each dealer before he commences business with the wholesaler that he obtains his merchandise on consignment and subject to the right of the Sinnott News to repossess the magazines whenever it pleases." This is again the position exclusively taken in the appellant's factum in this court.

I find myself in agreement with the learned trial judge that, in fact, the conduct of the appellant's business was not in accord with the position thus taken by the appellant. The only thing that was in accord was that the statements which accompanied shipments of magazines to dealers bore the words "on consignment", although even these words were missing in the case of repeat orders.

Thereafter, however, the appellant treated the deliveries as actual sales. The deliveries were made three times a week and on the following Wednesday of each week, a statement of account was sent to each dealer particularizing the deliveries of the preceding week and notifying the dealers that such amounts were "now due". Again, all deliveries were immediately charged in the books of the

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appellant to each dealer and included in the appellant's accounts receivable. Moreover, when magazines were returned, a credit note was issued by the appellant to the dealers. Apart from the undoubted right on the part of the dealers to return the magazines, with which I shall subsequently deal, there was really nothing in the method of carrying on the appellant's business which supports the position they now take, apart from the use of the word "consignment" on the invoices to which I have referred. I am accordingly of opinion that there was ample evidence for the finding of the learned trial judge and that the appellant cannot succeed on this ground.

While the learned trial judge in the course of his judgment states that it was understood between the appellant and its dealers that the goods were delivered on the basis of "fully on sale or return", this statement is amplified in the following sentence of his judgment, which states that "the retailer is notified by the respondent as to the date by which unsold goods are to be returned, and upon their return by that date full credit is given to the retailer for the amount he has paid or been charged." It would be inconsistent with the conclusion to which the learned judge ultimately came that the goods were sold by the appellant to its dealers on delivery that he should be taken in his reference to the understanding that the goods were "delivered on the basis of fully on sale or return" to be making a finding that the parties were dealing on the basis of "sale or return" as that phrase is understood in law. The learned judge appears rather, in using this language, to have had in mind the evidence given by the witness Sinnott before the Income Tax Appeal Board namely:

> We sell everything to the retailer on the sale or return. Our invoices that we deliver with the goods are marked "on consignment".

This witness drew no distinction between deliveries on consignment and deliveries "on the sale or return". It is in this sense he was understood by the learned trial judge, who, on this footing, puts the issue as follows:

> . . . the sole question to be determined is whether or not there was a sale of the goods by the company to the retailers.

This is followed almost immediately by the statement that:

> Now, the only suggestion that the goods were delivered "on consignment" is the use of those words on the delivery slips.

It was not argued on behalf of the appellant that the deliveries here in question were on "sale or return". His contention, as already mentioned, was that all deliveries were on consignment.

I would, in any event, be of opinion that the same considerations which negative a consignment basis, equally negative "sale or return". S. 19 of *The Sale of Goods Act*, R.S.O., 1950, c. 345, rule 4, which deals with the passing of the property in the case of goods delivered on sale or return, is prefaced by the words "unless a different intention appears." For the reasons already given, I think it clearly appears that the property passed to the dealers upon delivery of the magazines.

This, however, does not end the matter, as the parties were at one that there was a right on the part of the dealers to return the magazines at any time. The witness Parke, called on behalf of the Minister, testified:

Q. In any event, you exercise the right to return anything and everything you desire?

A. That is right.

The witness made it clear that this right was exercisable at any time and the evidence on behalf of the appellant is to the same effect. This being so, while the transactions between the appellant and its dealers were sales and not deliveries on consignment, they were nevertheless sales subject to a condition subsequent, the result being that, in the case of magazines actually returned, the property re-vested in the appellant; *Head* v. *Tattersall* (1), per Cleasby B.; *May* v. *Conn* (2); *Benjamin*, 8th ed. 415. The situation would be otherwise where there is a sale but the vendor has bound himself to repurchase in certain events, such as was considered to be the situation in *The Vesta* (3).

Accordingly, the appellant is not entitled to set up, as it has done, any reserve of profits. The reserve sought to be set up is made up of the profit element in the sale value of goods delivered to dealers during each of the years in question which the appellant estimated would be returned to it during the three months following. This estimate, to quote the appellant's factum, "was practical, reasonably accurate,

(1) 7 Ex. D. 7 at 14. (2) 23 O.L.R. 102.
(3) [1921] 1 A.C. 774 at 782-3.

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and arrived at on the basis of the *actual experience* of the company with each magazine for a reasonable time prior to the end of the year."

As deposed to by the witness Sinnott, at the end of the three month period, the appellant would "know exactly" the value of goods actually returned. Accordingly, instead of deducting the above mentioned reserve from the sales figure in respect of each of the years in question, the appellant should be entitled, in its income tax returns, to deduct the estimated sales value itself, subject, however, when the actual figure is ascertained at the end of the three months' period, to adjustment in the year in which such returns are actually made.

Although the appellant fails with respect to the basis upon which it contested this litigation, the practical result is the same. I would therefore allow the appeals with costs here and below.

The judgment of Locke, Cartwright and Fauteux JJ. was delivered by:—

LOCKE J.:—This appeal concerns the appellant's liability for income and excess profits taxes in respect of its fiscal years terminating on January 31, 1945 and 1946. The facts which affect the question are the same in each of these years and the matter may be conveniently dealt with by considering the relevant evidence as to the former only.

The appellant distributes magazines and other periodicals to some 2,500 retail dealers in Toronto and elsewhere in the Province of Ontario. It receives its supplies of these publications either from the publishers or from the distributors representing them, accounting for them under agreements a typical specimen of which is in evidence, being an agreement between the Curtis Publishing Company and the appellant dated August 1, 1942. Under that agreement, deliveries of the publications of that company are made to the appellant on consignment for the purpose of enabling their distribution to retailers, the price received from these dealers, less specified deductions, being remitted to the publisher and the cover pages of unsold copies returned. The status of the appellant under this and other

similar agreements with publishers or wholesale distributors appears to be that of a mercantile agent to which the *Factors Act* (c. 125, R.S.O. 1950) would apply.

The arrangements made between the appellant and the retailers to whom it delivers the publications for sale have been found by the learned trial judge to constitute deliveries on sale or return and, accordingly, Rule 4 of s. 19 of the *Sale of Goods Act* (R.S.O. 1950, c. 345) applies.

S. 19, Rule 4, of the *Sale of Goods Act of Ontario* was taken verbatim from Rule 4 of s. 18 of the *Sale of Goods Act 1893 (Imp.)*. The expression delivery "on sale or return" had a well known meaning under the law merchant prior to being incorporated in that statute. That meaning was stated by Sir George Jessel M.R. in *Ex parte Wingfield* (1), as follows:—

> Let us consider, then, what is the position of a man who has goods sent to him on sale or return. He receives the goods from the true owner with an option of becoming the owner, which can be exercised in one of three ways—by buying the goods at the price named by the vendor; by selling the goods to some one else, which is taken to be a declaration of his option; or by keeping them so long that it would be unreasonable that he should return them.

This definition was adopted by the Court of Appeal four years after the passing of the statute in *Kirkham* v. *Attenborough* (2).

For the fiscal year ending January 31, 1944 and for at least some years previously, the appellant, in preparing its annual balance sheet and profit and loss account for income tax purposes, included as accounts receivable the amounts which would become owing by the retail dealers in respect of publications delivered to them on sale or return in the same manner as would have been done had the goods been sold outright. In preparing the profit and loss account, the price payable, if they were sold or retained, for the goods in the hands of the dealers on these terms was included in the total of the sales. In this manner, the company was assessed to income tax for amounts which included the profit upon goods delivered on sale or return, in respect of which the dealers might or might not exercise their right to purchase or which they might otherwise elect not to return.

(1) (1879) L.R. 10 Ch. D. 591 at 593.
(2) (1897) 1 Q.B.D. 201.

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Up to and including January 31, 1944, the appellant claimed as a business expense for the year following the termination of its fiscal year the amounts refunded by it for publications delivered during the previous year and, during the war years when paper supplies were short and the numbers of the various publications consequently limited, the returns from retail dealers in respect of which it was necessary to give credits were comparatively small in number and the appellant was apparently content to be taxed on this footing.

During the fiscal year ending January 31, 1945, there were larger supplies of available paper, with the result that most of the publishers increased considerably the number of their publications printed and more ample supplies were available for the retail dealers. Apparently as a result of this, much greater numbers of publications were returned by the retailers for which they became entitled to credit, these returns running as high as 30 to 35% of the goods delivered. In spite of the fact that the practice of delivering the publications on sale or return had continued throughout the year, the appellant continued to show the amounts which might become payable by the retailers if they elected to purchase the publications or retain them beyond the time limited for their return as if they were sales outright. At the end of this fiscal year, the balance sheet showed accounts receivable of $64,256.83, representing the amounts which would become payable by the retailers if all merchandise then in their hands on sale or return was retained. Similarly, in the profit and loss account the gross figure for sales included this merchandise and the net profit was computed as if all of the deliveries had been sales. Since this would, as it had in previous years, result in the company being taxed upon an amount for income which would, of necessity, be excessive if any such proportion of the publications so delivered were returned, the accountants for the company set up a reserve for loss on returns of $11,574.69. This was the taxpayer's estimate of the credits which, in the ordinary course of business, it would be necessary to give to the retailers for publications returned after January 31, 1945, which had been in their hands on sale or return on that date.

S. 6(1)(*d*) of the *Income War Tax Act* (R.S.C. 1927, c. 97 as amended) provided that, in computing the amount of the profits or gains to be assessed, no deduction shall be allowed for amounts credited as a reserve, except such an amount for bad debts as the Minister may allow and except as otherwise provided in the Act. The Minister disallowed the amount so set up as a reserve and assessed the appellant as if the deliveries included in the accounts receivable for the year in question had all been sales.

No question of credibility arises in considering the evidence of the witnesses, there being no conflict on any material point. It is true that the witness Sinnott, the President of the appellant company, said that they "sold" on consignment, meaning presumably that the goods were delivered on consignment, but his description of the arrangements and that of the accountant Willcock and of the witness Parke show clearly that this was inaccurate and that the deliveries were on sale or return, as found by the learned trial judge.

Under the verbal agreements made between the appellant and the various retailers, the publications were delivered thrice weekly. With each delivery an account, which showed the amount which would be payable if all the goods then and theretofore delivered were retained by the dealer, accompanied the goods. The retailer was required to pay a stipulated price for each of the publications sold by him or retained beyond dates specified from time to time by the appellant. The amounts payable, which would rarely be the amount of the balance shown on the account, were to be paid either weekly or, in the case of some large dealers such as the United Cigar Stores, monthly. For publications returned within the required times, credit was given in the running account kept by the appellant and payments made since the delivery of the last account were shown as credits. The retailer might return at any time publications which, for any reason, he did not wish to retain further other than those in respect of which he had become liable and, on its part, the appellant might require the return of any of them at its option.

Keeping the accounts in this manner, it is true, did not show the true nature of the transactions since the property in the goods did not pass to the retailer, nor was he liable

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for the amounts shown except to the extent that he had sold the goods or failed to return them within the agreed period, or otherwise exercised what Jessel M.R. in *Wingfield's case* referred to as his option to become the owner of them. Keeping an inventory of the goods remaining in the dealers' hands from time to time which were the property of the appellant and charging the dealer only with the price of those in respect of which the property had passed to him and for which he had become liable would, no doubt, have been a more accurate way of recording the transactions. But as to this, the appellant contends that the cost of maintaining a staff sufficient to keep such a running inventory on its behalf would be prohibitive and impractical.

While the learned trial judge found as a fact that the deliveries made to the retailers were on sale or return, he concluded that they were thereafter treated by the parties as outright sales and that, accordingly, the amounts which would become payable by the dealers if the goods in their hands were all sold or retained should be treated as accounts payable.

At the hearing it was contended on behalf of the appellant that the publications in the hands of the dealers were delivered on consignment and the learned trial judge rejected this contention, properly in my opinion. There is a clear distinction to be made between goods held on consignment which a mercantile agent may sell on behalf of his principal *qua* agent, to which the provisions of the *Factors Act* apply, and deliveries made on sale or return, to which the *Sale of Goods Act* applies. In the latter case, the person in possession of the goods exercising his option to purchase them sells them *qua* principal.

I am unable, with respect, to agree with the finding that in the present matter these transactions became outright sales. In coming to this conclusion, the learned trial judge emphasized the fact that in the case of the United Cigar Stores, the accounts of which concern with the appellant were paid monthly, they admittedly paid the amount shown by the appellant's accounts for publications delivered to its stores, less the amounts credited for publications returned during the month in question. When the transaction is examined, however, it does not support the conclusion. The

United Cigar Stores operate a great many business places in Toronto and the vicinity which are supplied by the appellant. As publications are delivered to the individual stores, accounts are delivered showing the amount payable up to the date of the delivery if all the publications then and theretofore delivered were sold or retained. The witness Parke, the secretary-treasurer of the company, said that weekly statements of the publications delivered to the various stores were sent to his office and that, at the end of the month, a further statement, which was a recapitulation of the accounts of all of the stores showing the amounts which would be payable upon the above basis and giving credit for returns made during the period, was sent. The amount so shown was paid by the company on the 20th of the following month and, no doubt, would include payment for some publications on hand at the end of the previous month for which the company was not liable on the sale or return basis. Since no running inventory was kept of the publications in the individual stores, either by the appellant or by United Cigar Stores, the exact amount payable at the time of the delivery of the monthly statement was not ascertainable. There was no business risk to the company, however, in paying on this basis since, in the interval between the end of the month and the 20th of the month following, large quantities of publications would be sold in the company's stores for which it was liable to make payment.

The learned trial judge referred in particular to an account marked Exhibit B delivered by the appellant to United Cigar Store No. 31 on March 15, 1952, which included a charge for goods delivered on the day previous which, he considered, indicated that the transactions were treated as sales and not as if the goods were held on consignment. This, however, overlooks the evidence as to the reason why these running accounts were delivered with the merchandise, and also the evidence of the witness Parke who described the manner in which the accounts of that company with the appellant were handled. Exhibit B was on a printed form which contained a statement that the "last amount in this column is now due." But this was inaccurate and was disregarded not only by the United Cigar Stores but all other dealers in settling for goods for

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which they had become liable. It may also be pointed out that the real question was not whether the transactions were outright sales or sales of goods held on consignment, but rather as to whether they were outright sales or sales of goods held on sale or return.

Other circumstances considered by the learned judge to be relevant in determining the true nature of the transaction were that no running inventory was kept by the appellant of the goods held by the dealers, that the accounts were carried as accounts receivable and treated as such in the annual balance sheet, and the further fact that the appellant carried no insurance on the goods in the hands of the retailers. The reason that such inventories were not kept by the appellant was explained. The manner in which the amounts which would have been payable by the dealers at the end of the fiscal year, had they then elected to purchase all of the goods in their possession or otherwise had become liable for them, were included in the accounts receivable, is as above stated. The fact that no insurance was carried by the appellant on these stocks is, in my opinion, altogether insufficient to justify a finding that the deliveries made on sale or return had been, by the conduct of the parties, transformed into something completely different.

The accuracy of the conclusion reached at the trial may be tested, in my opinion, by considering whether, in view of the uncontradicted evidence as to the nature of the agreements made by the appellant with the retailers, the appellant could have brought actions against them on January 31, 1945, to recover the balances shown in their respective accounts in its books before they had elected to exercise or reject their option to purchase the merchandise or to return it within the time limited. Such an action would inevitably fail, in my opinion.

The argument that the goods were delivered on consignment failed. From an income tax standpoint, I think the position of a person holding goods on sale or return who has not exercised his option to purchase or otherwise become liable to the owner would be the same as if they were held on consignment. In the case of the bankruptcy of the

dealer, the property would not pass to the trustee in either case. (*Ex parte Wingfield* above referred to: *In Re Ford* (1): *Williams on Bankruptcy,* 16th Ed. 316).

While I think the manner in which the appellant conducted its business and carried its accounts and designated the amount estimated as that which would, in the ordinary course of business, be refunded to the dealers for goods returned out of the stocks in their hands as a reserve for loss on returns, really invited the assessment made by the Minister, this should not affect the proper determination of this matter. When the true nature of these transactions is determined, in my opinion, the claim of the appellant on this appeal is established.

I would allow both appeals and refer the matter back to the Minister with a direction that, in computing the income of the appellant for its fiscal years ending January 31, 1945 and January 31, 1946, there shall be excluded from the total of the sales any amount in respect of periodicals, books or other publications theretofore delivered and in the hands of retail dealers on the said dates respectively, for the purchase price of which such dealers were not then liable to the appellant and, from the total of purchases, any amounts as the purchase price of such goods and the amounts set up in the accounts of the appellant for the said years as a reserve for loss on returns shall be deleted. I would allow the appellant its costs in this Court and in the Exchequer Court.

Appeal allowed with costs.

Solicitor for the appellant: *Mannie Brown.*

Solicitor for the respondent: *A. A. McGrory.*

(1) (1929) 1 Ch. 134.