Date: 19980910
Docket:**C20665**



# COURT OF APPEAL FOR ONTARIO

## MORDEN A.C.J.O., MOLDAVER and BORINS JJ.A.

| | | |
|---|---|---|
| **B E T W E E N :** | ) | |
| | ) | |
| **CANADIAN PACIFIC LIMITED** | ) | **John L. Bowles and** |
| | ) | **Stephen S. Ruby for the** |
| **Appellant** | ) | **appellant** |
| | ) | |
| | ) | |
| **-and-** | ) | **Walter Myrka for the** |
| | ) | **respondent** |
| **THE MINISTER OF REVENUE now** | ) | |
| **THE MINISTER OF FINANCE** | ) | |
| | ) | |
| **Respondent** | ) | |
| | ) | **Heard: January 22 and 23, 1998** |

## BORINS J.A.:

[1] This is an appeal by Canadian Pacific Limited ("CP") from a judgment of Blenus Wright J. dismissing CP's appeal from re-assessments made by the Minister of Revenue (the "Minister") for the taxation years 1981, 1982, 1983 and 1984. The re-assessments related to deductions from income made by CP in each year with respect to awards it was required to pay to permanently disabled workers under the provisions of the *Workmen's Compensation Act*, R.S.O. 1980, c. 539.

## FACTS

[2] The basic facts are not in dispute. CP was a Schedule 2 employer under the Act. As such, it was individually liable to reimburse the Workmen's Compensation Board (the "Board") for benefits payable to its workers, or their dependants, as a consequence of injuries, or death, sustained by workers arising out of, and in the

course of, their employment. Under the Act, CP's workers, depending on the nature and extent of their injuries, were entitled, in addition to health care costs, to compensation by way of periodic payments, or by way of a lump sum, for permanent partial disability or survivor benefits. Upon the claim of an injured worker, the Board would make an appropriate award. This appeal is concerned with permanently disabled workers who were the recipients of permanent disability awards by the Board during the relevant taxation years.

[3] In the typical situation, the Board made a permanent disability award and forwarded it to the worker and CP. The award contained its effective date, the amount of the monthly payment and the degree of the worker's permanent disability, and informed the worker that the monthly payment would continue for the duration of his or her disability. However, under the Act the Board was given the power to review periodic payments to a worker and to increase, decrease, suspend or cancel them. For example, the amount of a periodic payment could be varied upon the re-evaluation of the degree of a worker's disability. As well, the amount could be varied if the Act were to be amended to increase the stipulated minimum amount of compensation.

[4] To satisfy its liability to the Board, on the advice of its accountants CP established and maintained an account identified as "Deferred Liabilities — Workmen's Compensation" (the "account"). Upon receipt of a notice of an award, CP calculated the amount of the award on the basis of the life expectancy of the worker (obtained from actuarial tables), added that amount to the account, charged the amount as an expense against income for the year in which it was paid into the account and credited its liability account for the like amount. The account was reduced as payments were made to reimburse the Board for payments it made to disabled workers, and was increased as CP received notice of awards from the Board. In addition, from time to time, the Board advised CP of a cost of living increase in respect to outstanding awards. When this occurred, using the same method of calculation, CP added the appropriate amount to the account. Further, if an injured worker died before his or her life expectancy, so that no further periodic payments were required, the balance allocated to that worker in the account was deducted from it and also deducted from CP's operating expenses for that year.

[5] For example, suppose the Board awarded a permanently disabled worker, whose life expectancy was 25 years, permanent disability of $500 per month effective January 1, 1981. CP would calculate that it would be liable to the Board for $150,000 over the life expectancy of the worker, add this amount to the account and charge it as an expense against income for 1981. When invoiced by the Board on a monthly

basis for the payments it made to the worker, CP would reimburse the Board. In this example, CP would have reimbursed the Board for $6,000 in 1981.

[6] CP charged the following amounts as expenses, and, thus, as deductions from income, in the years in which they were paid to the account:

| | | |
|---|---|---|
| 1981 | - | $4,350,422 |
| 1982 | - | $5,628,310 |
| 1983 | - | $2,553,083 |
| 1984 | - | $2,271,833 |

In respect to each year, the amount was the total sum of all awards made by the Board for each disabled worker which CP calculated each worker would receive during his or her estimated life expectancy.

[7] Before Wright J., the uncontradicted testimony of CP's accounting expert, Mr. Hawkins, was that the liabilities recognized by CP in its financial statements for the relevant taxation years in respect of awards made by the Board in each of these years to permanently disabled employees, in accordance with generally accepted accounting principles ("GAAP"), constituted current liabilities, and not contingent liabilities. He also testified that the amounts reflected as liabilities did not constitute reserves for accounting purposes. It was Mr. Hawkins' opinion, based on the accrual basis of accounting which prevails in Canada, that, because the Board's awards did not generate any revenues for CP in the future, the charges reflected by the awards as added to the account had to be deducted from income in the year in which they were added. Mr. Hawkins opined that for CP to deduct the amount of the periodic payments made to a worker in the year in which they were actually paid, would be to apply the unacceptable cash basis of accounting. Lastly, it was Mr. Hawkins' opinion that CP's method of determining the amount of its liability to the Board, based its calculation of the injured worker's life expectancy, was reasonable.

[8] In summary, the apellant's uncontradicted expert evidence was that its methodology of computing its income for tax purposes was consistent with well-accepted accounting principles. From an accounting perspective, the awards were current liabilities in the years in which they were communicated to CP by the Board. Since these awards, which represented liabilities of CP to the Board, could not be linked to any future revenues, GAAP required them to be fully deducted in, or charged to, the year in which they first arose, and that it would not be in accordance

with GAAP to spread the deduction of such amounts over the lifetime of the injured worker. Indeed, it is common ground in this appeal that CP's practice conformed with GAAP.

[9] The Minister reassessed, or varied, the returns submitted by CP pursuant to the *Corporations Tax Act*, R.S.O. 1980, c. 97, on the basis that, for any given award, the only amounts that could be deducted in a taxation year were actual payments made to a worker during the year. It would appear that the Minister considered that the deductions were additions to reserves in each of the taxation years and acted on the assumption that the amounts added to the account were in the nature of a reserve, or a contingent, account. Wright J. held that the Minister's assessments were correctly made.

## THE RELEVANT LEGISLATION

[10] As the assessments were made in respect to the taxation years 1981-1984, the legislation which determined the appellant's tax liability was s. 12(1) of the *Corporations Tax Act*, R.S.O. 1980, c. 97, which incorporated for provincial tax purposes the provisions of s. 18(1)(e) of the federal *Income Tax Act*, S.C. 1970-71-72, c. 63. This legislation, respectively, stated:

> **12.** (1) Except as hereinafter provided, the income or loss of a corporation for a taxation year from a business or property shall for the purposes of this Act be determined in accordance with the subdivisions a and b of Division B of Part I of the Income Tax Act (Canada) and the said subdivisions a and b are applicable to this Act in so far as the said subdivisions apply to corporations.
>
> ...
>
> **18.** (1) In computing the income of a taxpayer from a business or property, no deductions shall be made in respect of
>
> ...

> (e) an amount transferred or credited to a reserve, contingent account or sinking fund except as expressly permitted by this Part.

**THE ISSUE**

[11] The issue before Wright J., which remains the issue before this court, was whether CP was entitled to deduct as an expense from its annual income monies which it transferred to its Deferred Liabilities — Workmen's Compensation account for the purpose of reimbursing the Board for the total payments to be made to CP's injured workers, pursuant to permanent disability awards made to the workers, calculated on the estimated life expectancy of each worker. To resolve this issue, it was necessary for the appeal judge to determine whether these capitalized amounts "were transferred or credited to a ... contingent account" within the meaning of s. 18(1)(e) of the *Income Tax Act* and, therefore, not deductible from income. If the amounts transferred to the account came within s. 18(1)(e), CP was limited to deducting as an expense from income, in each of the four taxation years, the amount which it in fact paid each year to reimburse the Board for the compensation which it paid to CP's disabled workers.

**REASONS OF THE APPEAL JUDGE**

[12] Before Wright J., and this court, the Minister took the position that, although CP's addition of the capitalized amounts of the payments to its Deferred Liabilities — Workmen's Compensation account was appropriate for the computation of its annual profit for accounting purposes, it was not appropriate for taxation purposes. The Minister submitted that the payments were non-deductible for tax purposes because the payments were subject to uncertainties which rendered the account a contingent account within the meaning of s. 18(1)(e) of the *Income Tax Act*.

[13] It was, and remains, the appellant's position that the account was not a contingent account within the meaning of s. 18(1)(e). It submitted that GAAP should normally be applied for taxation purposes because it presents a truer picture of the profit and loss of a corporation for any given taxation year and, in the circumstances of this appeal, more accurately portrayed CP's income and best matched revenues and

expenses. In this regard, CP submitted that its accrual accounting practices, which required expenses to be matched against income in the same period, were appropriate for determining the expenses that it incurred for taxation purposes in any given year. CP submitted further that s. 18(1)(e) is to be interpreted by reference to GAAP proper to the business which it conducted. It relied on the decision of the Supreme Court of Canada in *Time Motors Ltd. v. M.N.R.*, [1969] S.C.R. 501 for the proposition that the language of s. 18(1)(e) refers to accounting practice and, therefore, is to be interpreted by reference to GAAP in a business of the kind it conducted.



[14] Wright J. characterized the issue before him as follows:

> This is the question to be decided: Is the CP calculated amount of an award which is placed in the Deferred Liabilities — Workmen's Compensation account an amount transferred or credited to a reserve or contingent account as stated in Section 18(1)(e) of the *Income Tax Act*?

[15] After reviewing the stated facts, the appeal judge concluded that the appeal must fail for two reasons. The first reason, which was neither advanced before him nor this court by the Minister, was that the amounts added to the account were not deductible under s. 18(1)(a) of the Act, which precluded the deduction of expenses that were not incurred by a taxpayer for the purpose of producing income from its business. The second reason was that they were not deductible under s. 18(1)(e) on the basis of the following analysis:

> Secondly, it is my view that the amounts added to the Deferred Liabilities — Workmen's Compensation account are amounts credited to a reserve or contingent account within the meaning of Section 18(1)(e) of the *Income Tax Act* and therefore cannot be deducted in computing CP's business income. WCB payments to injured workers which are reimbursed by CP in a taxation year are proper operating expenses but not the total estimated amounts as calculated by CP which in fact may never be paid.

[16] Wright J. reviewed the discussion of s. 12(1)(e) of the *Income Tax Act*, which later became s. 18(1)(e), in *Day and Ross Ltd. v. The Queen* (1977), 76 D.T.C. 6433 (Fed. Ct. T.D.), and distinguished that case on the facts. He went on to conclude:

> In CP's case, the only thing that is certain is WCB awards for specific amounts of monthly payments for each injured worker who is given a permanent disability award. It is uncertain as to what the succeeding month's payment might be because the amount could change by reason of a cost of living increase, by an increase or decrease in the percentage of disability of the worker, or the worker may die without survivors on which no further payments would be made.
>
> In my view, the Deferred Liabilities — Workmen's Compensation account is a contingent account *because the liability to pay the amounts credited to the account is contingent*. As stated, in *Samuel F. Investments Limited v. The Minister of National Revenue*, [88 *DTC* 1106] at 1108:
>
>> "... a liability to make a payment is contingent if the terms of its creation include uncertainty in respect of any of these three things: (1) whether the payment will be made; (2) the amount payable; or (3) the time by which payment shall be made."
>
> When CP calculates an estimated award amount over the life expectancy of an injured worker and credits that amount to the deferred liabilities account, it is uncertain whether that amount will actually be paid, whether that amount is the correct amount which will be paid or over what period of time payments will actually be made. (Emphasis added.)

[17] Wright J. did not consider *Time Motors*, *supra*, on which the appellant placed significant reliance. As well, it does not appear that he took into consideration the evidence of Mr. Hawkins, who presented expert testimony on behalf of the appellant.

**DISCUSSION**

[18] In my view, Wright J. erred in the interpretation of "contingent account" in s. 18(1)(e) of the *Income Tax Act* and his finding that CP's Deferred Liabilities — Workmen's Compensation account was "a contingent account because the liability to pay the amounts credited to it [was] contingent." In doing so, he applied the test stated by Christie A.C.J.T.C. in *Samuel F. Investments Limited v. The Minister of National Revenue* (1988), 88 D.T.C. 1106 at 1108 (T.C.C.) relating to when the liability to make a payment is a contingent liability.

[19] Three distinct accounts are specified in s. 18(1)(e) and "contingent account" is the description of one of them: *Dominion Telegraph Securities Limited v. The Minister of National Revenue*, [1947] S.C.R. 45 *per* Kerwin and Rand JJ. at 49. The other accounts are a reserve account and a sinking fund.

[20] The starting point, in my view, is to determine the purpose of CP's Deferred Liabilities — Workmen's Compensation account. As the evidence disclosed, the purpose of the account was to establish a fund to be used by CP to enable it to fulfill its obligation under the *Workmen's Compensation Act*, in particular ss. 3 and 5, to compensate its disabled workers. On the day CP transferred a given amount to the account in respect of a disabled worker to fulfill this obligation, CP was aware of its statutory obligation, the monthly payment awarded by the Board to the disabled worker and that the worker was entitled to receive the monthly payment for the duration of his or her disability. Because the worker was permanently disabled, CP capitalized the amount of the award based on the worker's life expectancy. As I will explain, on the basis of the evidence and the definitions and authorities to which I will refer, the Deferred Liabilities — Workmen's Compensation account was not a contingent account within the meaning of s. 18(1)(e) of the *Income Tax Act*.

[21] Section 18(1)(e) lists three different types of account which a taxpayer may create, and prohibits the taxpayer from subtracting the amount paid into each account from its gross income in arriving at its taxable income for the taxation year in which the amount was paid. Generally speaking, determining which expenses a taxpayer can

deduct is a matter of matching them to the deduction-granting provisions of the governing tax legislation. This issue does not arise in this appeal as it is implicit in the position of the Minister that, but for the application of s. 18(1)(e), the annual sums which CP transferred to its account to meet its statutory liability were deductible from its annual income as a business expense. This follows from the accepted purpose of an income tax, which is to impose a tax only on annual accretions in wealth. Thus, as I have stated, the narrow issue is whether the amounts transferred annually by CP to its account were non-deductible from income because the account was a "contingent account" within the meaning of s. 18(1)(e).

[22] The common feature of each of the three accounts is that the purpose of the account is to make provision for some event that *may* occur in the future. This is apparent from the words used to describe each account.

[23] In *Black's Law Dictionary* (abridged 6th ed., West Publishing Co., 1991), at p. 906 "reserve" is defined as follows:

> Funds set aside to cover future expenses, losses, claims, or liabilities.

And at p. 222 "contingency reserve (or fund)" is defined as follows:

> In accounting, a reserve set up to cover possible or potential losses; *e.g.* possible judgment against company.
> A fund created in anticipation of incidental or unforeseen expenditures.

At p. 965 "sinking fund" is given several meanings:

> **Sinking fund**. Assets and their earnings earmarked for the retirement of bonds or other long-term obligations. An obligation sometimes imposed pursuant to the issuance of debt securities or preferred shares by which the issuer is required each year to set aside a certain amount to enable the issuer to retire the securities when they mature. A sinking fund may be allowed to accumulate or may be

> used each year to redeem a portion of the outstanding securities.
>
> A fund (usually invested), which will be used to replace improvements as needed. Most commonly set aside from the income of income producing property.
>
> A fund arising from particular taxes, imposts or duties, which is appropriated toward the payment of the interest due on a public loan, and for the payment of the principal.
>
> In general accounting, segregated assets that are being accumulated for a specific purpose. In governmental accounting, a fund established to accumulate resources for the retirement of bonds but not for the payment of interest, which is handled through the general fund or a special revenue fund.

[24] Although "contingent account" is not defined in *Black's Law Dictionary*, the terms "contingent," "contingent debt" and "contingent liability" are defined, as well as "contingency reserve (or fund)." At p. 222 "contingent" is defined as follows:

> Possible, but not assured; doubtful or uncertain; conditioned upon the occurrence of some future event which is itself uncertain, or questionable. Synonymous with provisional. This term, when applied to a use, remainder, devise, bequest, or other legal right or interest, implies that no present interest exists, and that whether such interest or right ever will exist depends upon a future uncertain event.

At p. 223 "contingent debt" is defined, in part, as follows:

> One which is not presently fixed, but may become so in the future with the occurrence of some uncertain event.

And "contingent liability" is given this meaning at p. 223:

> One which is not now fixed and absolute, but which will become so in case of the occurrence of some future and uncertain event. A potential liability: *e.g*. pending lawsuit, disputed claim, judgment being appealed, possible tax deficiency.

[25] On the basis of this analysis of the three different types of accounts referred to in s. 18(1)(e) and the meaning of "contingent" and related terms, it is my opinion that a contingent account is an account set up by a taxpayer to be used to pay debts, or other obligations, neither fixed nor absolute when the fund is set up but which may become so with the occurrence of some future and uncertain event. This description conforms with the few cases which have considered the meaning of "contingent account" in s. 18(1)(e). As pointed out in P.W. Hogg and J.E. Magee, *Principles of Canadian Income Tax Law*, (2nd ed., 1997, Carswell) at 239:

> A liability of any kind is deductible only if the liability is a legal obligation at the end of the taxation year. The *Income Tax Act* generally prohibits the deduction of liabilities that are merely contingent, or of "reserves" to provide for expected future liabilities.

[26] In *Harlequin Enterprises Limited v. The Queen*, [1977] 2 F.C. 579 (C.A.), the taxpayer was a book publisher which had an agreement with its distributors to provide them with a full credit for any books which were returned to it unsold. For the purpose of making provision for giving credits for the unsold books, the taxpayer deducted $335,000 in computing its income for the 1969 taxation year. The Minister disallowed the deduction on the basis that it constituted a contingent account within the meaning of s. 18(1)(e). The taxpayer contended, *inter alia*, that the deduction was a current liability. The taxpayer's appeal before Mahoney J. of the Federal Court Trial Division failed, as did its appeal to the Federal Court of Appeal. In dismissing the appeal, Urie J. quoted from the reasons of Mahoney J., and then went on to say at pp. 583-84:

> An account set up to provide for those contingent liabilities whether by way of a provision for returns and allowances on its balance sheet or a deduction from earnings in the calculation of its taxable income was a contingent account within the meaning of section 12(1)(e).
>
> I agree with this conclusion and the reasoning of the learned Trial Judge in reaching it. No useful purpose would be served, in my view, in reviewing and restating that reasoning particularly since the appellant did not quarrel with the findings of fact of the Trial Judge but only with the application of the law to those findings. Specifically, I agree with him that, on the evidence of the expert witness called by the appellant, the appellant's practice of making provision for book returns was in conformity with generally accepted accounting principles. However, the fact of its acceptability in accounting practice does not of itself make it a proper deduction from income for tax purposes. Whether or not it is must be found in some provision of the Act. I agree that the provision for returns is contingent, because in any fiscal period, although it was known from experience that there would be returns, the number and actual value thereof could not be fully known until all returns on sales made within that fiscal period had actually been received which might not be until some considerable period of time had elapsed after the end of the fiscal period. Therefore, the provision falls within the prohibition contained in section 12(1)(e).

[27] Mahoney J. interpreted "contingent account" in his reasons for judgment, reported in [1974] 2 F.C. 877 at 892:

> The adjective "contingent" means "liable to happen or not; of uncertain occurrence or incidence" (The Oxford English Dictionary). The term "contingent account" [in the *Income Tax Act*, R.S.C. 1952, c. 148, s. 18(1)(e)] taken literally would appear to be nonsense. An account, once set up is itself not contingent; it has, so to speak, happened and is not uncertain. It exists. The term must be taken to mean "account for a contingency". In other words, it is not the account that must be found to be contingent but rather the thing in respect of which it was set up: in this case the liability to pay or give credit for the refunds and rebates.

[28] Mahoney J. examined the purpose of the account and concluded that it was a contingent account in the following passage at p. 894:

> Certain as it was that the plaintiff would, in due course, be obliged to give rebates on royalties or on returns of books, the fact is the plaintiff's liability to do so, under the terms of the agreements which were, in practice, observed, did not arise until the plaintiff was presented with a demand for the credit. The plaintiff's obligation to the distributors in respect of credits for returns was a contingent liability. So was its obligation to rebate royalties to Simon & Shuster. An account set up to provide for those contingent liabilities whether by way of a provision for returns and allowances on its balance sheet or a deduction from earnings in the calculation of its taxable income was a contingent account within the meaning of section 12(1)(e). No deduction in respect of that account, even to the extent that generally accepted accounting principles required it to be made, is permitted in the calculation of the plaintiff's taxable income.

[29] Mahoney J. then distinguished the case before him from *Time Motors* where, he stated, the uncertainty did not pertain to the coming into existence of the liability, which came into existence when the credit note was issued, but rather pertained to whether the creditors would do what was necessary to enforce the *existing* liability. Similarly, Urie J., on behalf of the Federal Court of Appeal, stated at p. 587:

> I agree, too, with the learned Trial Judge that the decisions of the Supreme Court in *M.N.R. v. Atlantic Engine Rebuilders Limited* and *Time Motors Limited v. M.N.R.* are also distinguishable on their facts. In each of those cases there were existing, ascertained current liabilities in contra-distinction to the case at bar where no such ascertained liability existed unless and until the retailers exercised their right to return unsold books. (Emphasis in original.)

[30] This brings me to a consideration of *Time Motors*. In this case, Pigeon J., on behalf of the Supreme Court of Canada, also focused on the purpose of the account set up by the taxpayer which the Minister of National Revenue contended did not consist of existing liabilities and should be disallowed for tax purposes as being contingent.

[31] The taxpayer, a used car dealer, gave credit notes in partial payment for cars acquired for resale. A credit note could be applied by the holder within a stipulated time against the purchase price of another car of stated minimum value. In the taxpayer's accounts, credit notes outstanding were treated as current liabilities. If they were not redeemed before their expiration, the amount of the note was removed from accounts payable and treated as a profit. The Tax Appeal Board allowed the taxpayer's appeal, but was reversed by the Exchequer Court. The Supreme Court of Canada allowed a further appeal by the taxpayer and restored the judgment of the Board.

[32] At p. 504, Pigeon J. recognized the need to consider the reason the taxpayer treated the credit notes as current liabilities:

> ... The credit note should not be considered apart from the transaction out of which it arises. It is part of the

> consideration for an executed contract, the purchase of a used car. Under that contract, appellant became obliged to pay a stated sum of money, a part only of that sum was paid in cash, the balance remaining due was stipulated payable in merchandise of a stated kind. While the contract is spelled out in two separate documents, the bill of sale and the credit note, the latter cannot be considered otherwise than as evidence of the conditions of the obligation to pay the balance of the purchase price. That obligation must be considered as subsisting until satisfied or expired. No special reason was advanced, no authority was cited to support the contention that the credit note should be considered otherwise.

[33] At pp. 505-06, Pigeon J. discussed the Minister's contention that the credit notes constituted a contingent account:

> Respondent's second contention is that because appellant's obligation was conditional it should not, until the condition was realized, be treated for purposes of income tax as a current liability but as an amount properly to be entered in a contingent account. As a result, the deduction would be prohibited by s. 12(1)(*e*) [which became s. 18(1)(e)] of the *Income Tax Act*:
>
> > 12 (1) In computing income, no deduction shall be made in respect of
> >
> > ...
> >
> > (*e*) an amount transferred or credited to a reserve, contingent account or sinking fund except as expressly permitted by this Part.
>
> The wording of that provision clearly refers to accounting practice. The only expression applicable to the present case is not "contingent liability" but "contingent account". This means that the provision is to be construed by

reference to proper accounting practice in a business of the kind with which one is concerned. In the present case, the only evidence of accounting practice is that of appellant's auditor, a chartered accountant. His testimony shows that in appellant's accounts credit notes are treated according to standard practice as current liabilities until they are redeemed or expired. They are not classed as contingent liabilities. When asked why he considered the obligation under a credit note as current liability and the obligation under a warranty as contingent, he said:

> ... the credit note, while it is a liability, is also an existing obligation today. A warranty may be a liability in the future. It may be determinable in the future but isn't an existing obligation until the future. At least, this is my interpretation of the difference.

With respect, Gibson J. was in error in holding that whether or not appellant's financial statements were drawn up according to generally accepted accounting principles could be disregarded. On the contrary, the wording of the relevant provision of the *Income Tax Act* implies that this is the essential question.

[34] Following the reasoning of Pigeon J. in *Time Motors*, the annual amounts which CP added to its account should not be considered apart from its statutory liability under the *Workmen's Compensation Act*. Under that Act, CP was obligated to reimburse the Workmen's Compensation Board for awards made by the Board to its disabled workers. At the time CP added the capitalized amount to the account, in respect to a disabled worker, it did so pursuant to a statutory obligation. Thus, as in *Time Motors*, each time an amount was added to the account, it was on the basis of an existing liability, or obligation. That liability was not contingent, in the sense that, at the relevant time, it was a liability that was not fixed and absolute, but one which *may* become so in the future with the occurrence of some uncertain event. Rather, at the time of transfer to the account, there was an existing, ascertained liability; and not a liability which would arise only upon the happening of a future event. At the time a payment was made to the account, the following facts were ascertained: CP's

statutory liability to pay the award made to its disabled worker; the monthly amount of the award; the effective date of the award; and that monthly payments would be paid to the worker for the duration of his or her disability.

[35] Wright J. found that the only fact that was certain was the amount of monthly payments for each injured worker who had received a permanent disability award. However, after taking into consideration the Board's powers under the *Workmen's Compensation Act* to vary the amount in the circumstances provided by the Act, and the circumstances which render the *liability* to make a payment contingent, stated by Christie A.C.J.T.C. in *Samuel F. Investments*, he found that CP's account was "a contingent account because the liability to pay the amount credited to the account [was] contingent."

[36] In my view, Wright J. erred in reaching this conclusion for a number of reasons. As I have indicated, the determination whether an account is a contingent account within the meaning of s. 18(1)(e) is to be made at the time payment is added to the account based on the purpose for which the taxpayer established the account. Although it was true that the amount to which a disabled worker might ultimately be entitled was subject to variation in accordance with the *Workmen's Compensation Act*, this did not affect CP's statutory liability to make good the award. It affected only the amount of the award which, as I have said, was fixed when CP added the capitalized amount to the account. Thus, at that moment, CP's statutory obligation was to be considered as subsisting until satisfied, or an event occurred which resulted in its termination.

[37] In my view, Wright J.'s concerns were of an accounting nature. He confused CP's statutory liability to pay an award with events that might occur that could affect the amount of the liability. However, the liability remained throughout the lifetime of the disabled worker, subject only to the possible variation of its amount, or the unlikely event of the worker's condition improving. As the evidence disclosed, when there was a variation affecting the quantum of a worker's disability payments, CP made the necessary accounting adjustment. For example, on the death of a worker before he or she achieved life expectancy, the excess in the account was removed and allocated to income. Similarly, in *Time Motors*, if a credit note was not redeemed before its expiration, the amount of the note was removed from accounts payable and treated as a profit.

[38] In my view, the appeal judge also erred in the way he applied the definition of contingent liability in *Samuel F. Investments* stated by Christie A.C.J.T.C. at p. 1108

where he said that "a liability to make a payment is contingent *if the terms of its creation include uncertainty*" in respect of any of the three factors he discussed. As I have pointed out, there was nothing in the terms of the creation of CP's statutory liability to pay awards to its disabled workers that contained any uncertainty. As well, Wright J. ignored the interpretation placed on s. 18(1)(e) by Pigeon J. in *Time Motors* where he stated at p. 506: "The wording of that provision clearly refers to accounting practice. The only expression applicable ... is not 'contingent liability' but 'contingent account.'"

[39] As I stated earlier, the only evidence of the accounting practice followed by CP was given by Mr. Hawkins, who provided expert testimony on its behalf. He was not cross-examined by counsel for the Minister, nor did the Minister provide any testimony to refute Mr. Hawkins' opinion. Wright J. made no reference to Mr. Hawkins' testimony in his reasons for judgment.

[40] It is helpful to summarize Mr. Hawkins' testimony. He stated that because CP was obligated to make future payments with respect to a disabled worker, but would not have the services of the worker, the capitalized amount added to the account was a liability in the year it was added. Consequently, he testified, CP "should book a liability and take the charge as soon as it's known." Another reason for taking the charge as soon as the liability is known was based on principles of accounting which match revenues and expenses. Because the worker was disabled, the amount added to the account, based on the expected future life of the worker, was not going to generate any future income. Although Mr. Hawkins agreed that the amount added in respect to a disabled worker was an estimate, he said that estimates are common in many areas of financial statements, particularly when it is necessary to book a liability. He opined that it was reasonable for CP to estimate the amount of its liability on the basis of the expected future life of the disabled worker as determined by actuarial tables. He gave as a further reason for booking the payment when it was transferred to the account "the high degree of probability" that it would be paid.

[41] In Mr. Hawkins' opinion, were CP to charge the payments only in the year in which they were actually paid to a disabled worker as contended by the Minister, would be to apply the cash method of accounting. He testified that to employ this method would be inappropriate as the *Canada Business Corporations Act* requires companies to keep their books of account in accordance with GAAP, which require that it follow the accrual method of accounting. Moreover, as I have stated, the decision in *Time Motors* holds that s. 18(1)(e) of the *Income Tax Act* is to be construed by reference to proper accounting practice in the business being conducted.

[42] From Mr. Hawkins' testimony, it is clear, according to proper accounting practice, that the fact that an estimate is involved will not, in itself, lead to a finding that an account is contingent within the meaning of s. 18(1)(e). In this respect, it is relevant to note that s. 3290.04 of the Canadian Institute of Chartered Accountants Handbook states the following, under the heading "Contingencies":

> In the preparation of the financial statements of an enterprise, estimates are required for many on-going and recurring activities. However, the mere fact that an estimate is involved does not of itself constitute the type of uncertainty which characterizes a contingency. For example, amounts owed for goods or services received but not billed are not contingencies, even though the amounts may be estimated. There is nothing uncertain about the fact that these obligations have been incurred; any uncertainty is related solely to the amounts thereof.

[43] To conclude this part of my reasons, where a taxpayer has incurred a liability in a taxation year, and has placed money into an account to enable it to fulfill the liability, uncertainties surrounding the amount which will ultimately be paid will not *per se* result in the liabilities being classed as contingent, nor the account being classed as a contingent account. In this appeal, I would hold that CP's Deferred Liabilities — Workmen's Compensation account was not a contingent account within the meaning of s. 18(1)(e), notwithstanding the lack of complete certainty as to the amount which CP would ultimately have to pay to disabled workers. In my view, although the amount of the award may vary due to the premature death of a worker, a cost of living increase, or an improvement in the condition of a disabled worker, there was reasonably sufficient certainty in respect to the amount of the award at the time of its inclusion in the account. Any change in the amount arising as a result of these factors, generally speaking, should be relatively inconsequential, and is easily and adequately accounted for by prompt and proper accounting entries at the relevant time.

[44] Subsequent to the argument of this appeal, the Supreme Court of Canada released a trilogy of decisions which considered, *inter alia*, the extent to which interpretive aids, such as GAAP, may assist in determining a taxpayer's income:

*Canderel Ltd. v. Canada* (1998), 155 D.L.R. (4th) 257; *Toronto College Park Ltd. v. Canada* (1998), 155 D.L.R. (4th) 285; *Ikea Ltd. v. Canada* (1998), 155 D.L.R. (4th) 295. Since the court thought these decisions might have application to the resolution of this appeal, the parties were asked to provide written submissions in this regard. The submissions were not completed until April 1998 which, in part, accounts for the delay in the preparation of these reasons.



[45] It is my view that these decisions, particularly the *Canderel* case, lend support to the conclusion which I have reached. In *Canderel*, Iacobucci J., on behalf of the Supreme Court of Canada, provided a detailed and helpful analysis of the principles which apply, and the factors which a court is permitted to consider in ascertaining the most accurate picture of a taxpayer's profit for income tax purposes. This analysis was conducted in the context of whether a taxpayer could deduct as a business expense, in the taxation year in which it was paid, the entire amount of tenant inducement payments to various prospective tenants to induce them to enter into leases of premises in a new office building, or whether, as the Minister of National Revenue contended, the matching principle required the taxpayer to deduct the inducement payments over the terms of the leases to which the payments related.

[46] Before conducting the analysis, Iacobucci J. discussed the concept of "profit" in s. 9(1) of the *Income Tax Act* at p. 269:

> It is appropriate to begin the consideration of profit with s. 9(1) of the Act, which defines a taxpayer's income for a taxation year from a business or property source as "his profit therefrom for the year". Significantly, "profit" is not defined in s. 9(1) or anywhere else in the Act. It seems to me that this approach was a deliberate legislative choice, particularly given that the Act contains exhaustive definitions of numerous other concepts and terms with which it deals. This choice reflects the reality that no single definition can adequately apply to the millions of different taxpayers bound by the Act. Under our self-assessment system, each taxpayer must be able to compute his or her income in such a way as to constitute an accurate picture of his or her income situation, subject, of course, to express provisions in the Act which require specific treatment of certain types of expenses or receipts.

[47] Subsequently, he stated the interpretive goal at p. 275:

> [T]he goal of the legal test of "profit" should be to determine which method of accounting best depicts the reality of the financial situation of the particular taxpayer.

[48] After a detailed analysis of the principles to be used in determining profit for income tax purposes, Iacobucci J. summarized them at pp. 278-89:

> (1) The determination of profit is a question of law.
> (2) The profit of a business for a taxation year is to be determined by setting against the revenues from the business for that year the expenses incurred in earning said income.
> (3) In seeking to ascertain profit, the goal is to obtain an accurate picture of the taxpayer's profit for the given year.
> (4) In ascertaining profit, the taxpayer is free to adopt any method which is not inconsistent with
> (a) the provisions of the *Income Tax Act*;
> (b) established case law principles or "rules of law"; and
> (c) well-accepted business principles.
> (5) Well-accepted business principles, which include but are not limited to the formal codification found in G.A.A.P., are not rules of law but interpretive aids. To the extent that they may influence the calculation of income, they will do so only on a case-by-case basis, depending on the facts of the taxpayer's financial situation.
> (6) On reassessment, once the taxpayer has shown that he has provided an accurate picture of income for the year, which is consistent with the Act, the case law, and well-accepted business principles, the onus shifts to the Minister to show either that the figure provided does not represent an accurate picture, or that another

> method of computation would provide a *more* accurate picture. (Emphasis in original.)

[49] In elaborating on the sixth principle, Iacobucci J. had earlier stated at p. 278:

> ... In so doing, however, I emphasize that the Minister is not entitled to rely on particular well-accepted business principles as being *inherently* preferable over others. If the method chosen by the taxpayer is otherwise acceptable by law and in accordance with such well-accepted principles, then it is no answer for the Minister to say that other principles should have been employed unless to do so would have yielded a more accurate picture of income. (Emphasis in original.)

[50] All three of the cases affirm that, whether the subject matter is an expense or an item of income, any dispute regarding the timing of its deduction, in the case of an expense, or its inclusion, in the case of an item of income, is to be resolved by a single overriding objective, namely, the treatment of the expense or item of income which gives the *more accurate picture* of the taxpayer's income.

[51] In my view, the quest for the more accurate picture of the appellant's income leads to the conclusion that the deduction of the totality of the payments made to its account in the year in which the award of the Workmen's Compensation Board was made provides that picture. To the appellant, who stood to receive no corresponding benefit from the payment in years subsequent to that in which the award was made, the liability imposed by the *Workmen's Compensation Act* represented a very real liability in its current financial statements. Moreover, deducting the expense at that point was consistent with the well-established principle that expenses should be recognized in the same period as the revenue to which they relate.

[52] In ascertaining its profit, the method adopted by CP was not inconsistent with the provisions of the *Income Tax Act* because, as I have found, its Deferred Liabilities — Workmen's Compensation account was not a "contingent account" within the meaning of s. 18(1)(e) of the Act. Nor was it inconsistent with established case law.

In *Time Motors*, Pigeon J., by distinguishing a "contingent liability" from a "contingent account," was clearly of the view that, for the purposes of s. 18(1)(e), if an amount was not contingent from an accounting perspective, its deduction was not precluded by s. 18(1)(e). Thus, for the taxation years 1981 through 1984, s. 18(1)(e) specifically precluded the deduction only of amounts that constituted contingent amounts for accounting purposes. In addition, as Mr. Hawkins testified, the method adopted by the appellant was not inconsistent with well-accepted business principles.

[53] Lastly, as stated by Iacobucci J. in the *Canderel* case, where the taxpayer has determined its profit for a particular year in accordance with the principles of profit determination described in that case, the onus shifts to the Minister to prove that, either the taxpayer's methodology of computing profit did not produce an accurate picture of the taxpayer's profit, or the Minister has an alternative method of computing the taxpayer's profit which produces a more accurate picture of profit than that adopted by the taxpayer. In this appeal, the Minister did not lead any evidence to prove that the method of computing profit adopted by the appellant did not produce an accurate picture of profit, nor did the Minister lead any evidence to establish that there is an alternative method of computing profit that would have produced a more accurate picture of profit than that used by the appellant. Where the Minister fails to satisfy this onus of proof, the appellant is entitled to succeed.

## CONCLUSION

[54] On the basis of the foregoing analysis, it is my opinion that s. 18(1)(e) did not preclude the appellant from deducting from income in the taxation years 1981, 1982, 1983, 1984 the capitalized amounts pursuant to the awards made in those years to its disabled workers by the Workmen's Compensation Board. It follows that the Minister's reassessments were incorrect.

[55] In the result, I would allow the appeal with costs, set aside the judgment of Wright J. and substitute an order that the appellant's computation of tax payable be varied as requested by the appellant and that refunds issue to the appellant in the following amounts: $169,915, $217,147, $103,187 and $92,824 in respect of the taxation years 1981, 1982, 1983 and 1984, respectively.

**Released: September 10, 1998.**