

not an expense in the year of purchase. It was a capital expenditure and was subject to depreciation. Likewise machinery sold was not brought into revenue account.

The second system was, as stated, the accrual or inventory basis. This requires the maintenance of proper accounts and records, taking into consideration not only the cash receipts and the cash outlays but maintaining an accurate record as to inventory of live stock, grain and other revenue producing assets on hand at the beginning and end of each year, so that the cost thereof could be carried forward and offset against the sales in the year of sale. Likewise it required the maintenance of a record of accounts receivable and accounts payable. The number of farmers using this accrual basis is in fact very small. Generally speaking it is not their practice. They are not accustomed to it. They are not skilled in it and, generally speaking, they find it difficult and confusing. The practical application of the income tax law was therefore on a cash basis.

There were practically no objections raised to farmers reporting on a cash basis until the advent of war and the resultant increase in their sales, particularly of live stock at substantially increased prices. Herds had been built up by farmers. The cost of raising or purchasing, maintaining, attending and feeding the cattle had been allowed as an expense in years prior to their sale. Thus all expenses over successive years were taken during the successive years as an expense against whatever income there might be in those years from all sources. The herd, by natural increase or by purchase, continued to grow—that is, expenses continued successively over the years—but no substantial sale of cattle took place. Then a sale of a substantial portion of the stock did take place. The sale price as usual was income in the year of sale. The farmer perhaps felt aggrieved that in the year of the substantial sale of cattle he should be called upon to declare his income on the cash basis, even though that was the usual basis.

Now it is quite clear that he has laid the foundation over the years in respect of which his assessment should be levied, but the high rates of tax, together with the high income, with the resultant heavy tax, creates in him a sense of dissatisfaction. His tax will be much higher than that which he has normally been paying over the past years. Not having felt the weight of such a heavy tax he feels that there is something wrong in asking him to pay a heavy tax in the year of substantial

sale on the mere basis of relativity when compared with the prior years of small tax liability.

The taxation division, appreciating the difficulties and the concern of such farmers, under date of February 24, 1944, instructed the inspectors of income tax across Canada that any farmer or rancher who had previously filed his return on a cash basis but who desired to change to an accrual basis would be permitted to do so, and outlined the procedure to be followed in such cases. Briefly the procedure was as follows: First, ascertain the inventory of cattle, grain, et cetera, on hand at December 31, 1935; second, tax that inventory as income of 1935 along with the income of 1935 previously reported; and third, adjust subsequent returns in accordance with the inventory at the end of each year.

The instructions also indicated that where actual inventories could not be accurately determined, a reasonable estimate of such inventories would be accepted, provided that in future the farmer or rancher took actual annual inventories. The inventory values were to be taken having regard to the appropriate stock market and grain market reports in the locality of the taxpayer at the various dates. The effect of this ruling was to spread the income arising from a substantial sale over a number of back years, including the year of sale, instead of considering the total receipts as income of the year of sale. This resulted in relief from an excessive tax burden to the farmer by ascribing his income to the years during which the inventory grew in value.

This method is dependent entirely upon the farmer being prepared to go in future on an accrual basis and keep accurate records henceforth of cattle, grain, et cetera, inventories, accounts receivable, accounts payable, et cetera—in other words to maintain a proper accounting system, if he continues in business. There are no statistics of the number of farmers or ranchers who have changed from a cash basis to an accrual basis, although on general knowledge they are believed to be comparatively few.

Another problem arose in connection with farmers who were giving up business and selling their entire herd and inventories in a bulk sale. The claim was made that it was unfair to tax in one year the proceeds of the sale of stock which had been acquired over a number of years. Again it had to be pointed out that the cost of raising or purchasing that stock had been allowed as an expense of previous years, and having returned their income on a cash basis the cash received on