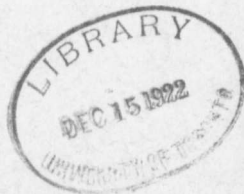


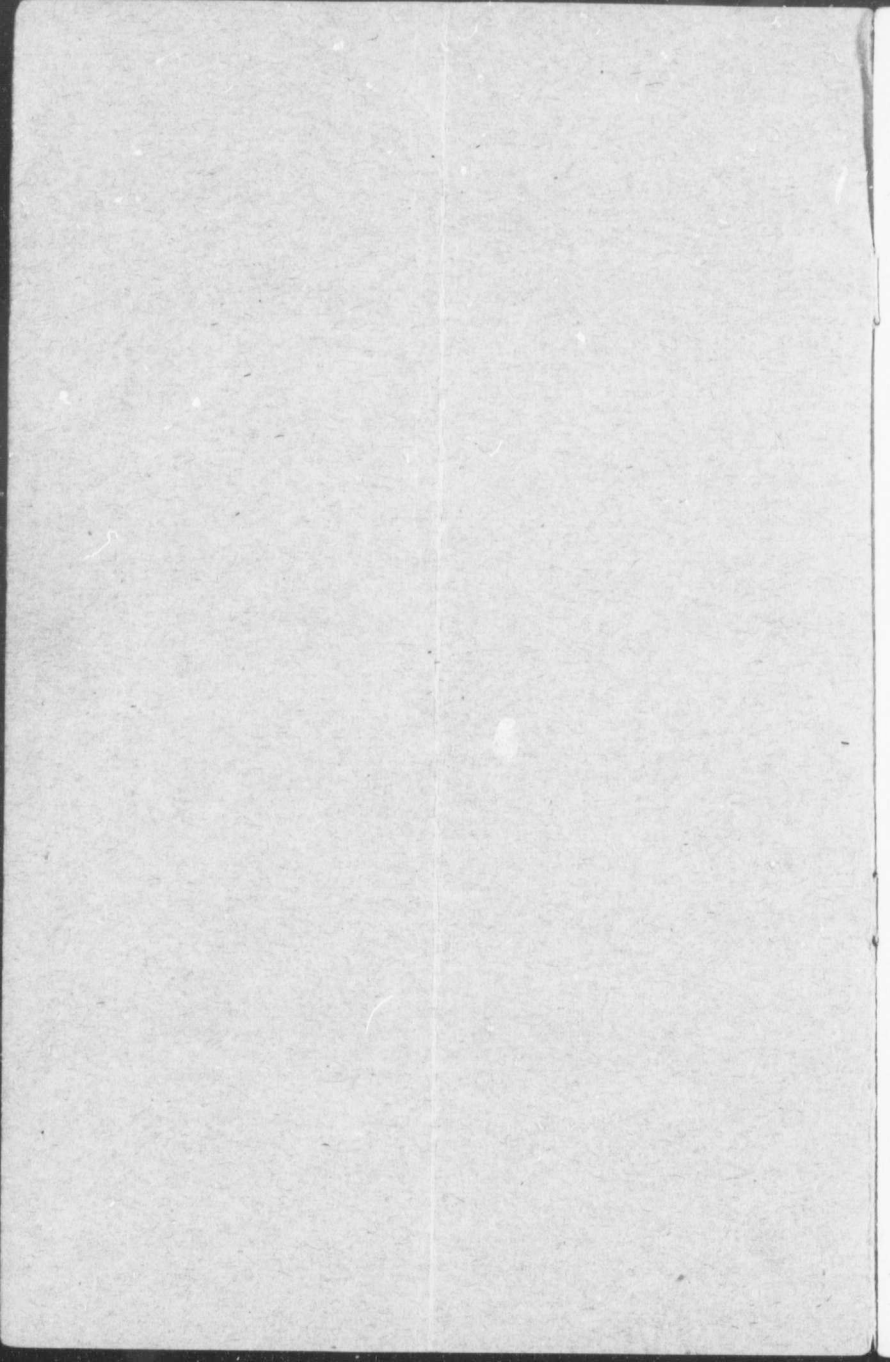
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The
Business Profits War
Tax Act
and
The Income War Tax Act

R. W. BREADNER
Commissioner of Taxation



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THE BUSINESS PROFITS AND INCOME WAR TAX ACTS.*

By R. W. Breadner, Commissioner of Taxation, Ottawa.

WHEN our mutual friend Mr. Hutchison asked me to address you, I at first hesitated, but on considering his request I thought it was due to you gentlemen, with whom the Department is so closely associated, especially in the administration of the Business Profits War Tax Act of 1916 and the Income War Tax Act, 1917, to comply, if I could be of any assistance to you.

I will speak first concerning the provisions of the Business Profits War Tax Act. I do not intend to enter upon any discourse as to the reasons why such an Act was placed on the statute books, but to deal with the administrative features of it. The Act became law on the 18th day of May, 1916, but it relates to any accounting period ending after December 31, 1914. A good many persons, especially tax-payers, have the idea that the Act applies only to profits made after that date; now the Act does not say that, it specifies that it shall apply to each and every accounting period which ended after the date stated, and that it would apply to a period of not less than 36 months. In other words, if the accounting period of a company was the calendar year, the profits made between the 1st of January, 1915, and the 31st of December, 1917, were to be taxable. At the last session of Parliament the Act was extended for another year. If the accounting period ended 31st January the Act would apply to profits made between February 1st, 1914, and 31st of January, 1917, and since extended to 31st of January, 1918. In other words, each company that was in existence prior to 1st of January, 1915, and has not changed its accounting period since that time, will be liable for taxation for 48 months, irrespective of the date when the accounting period starts.

Another question is as to the interpretation of "each and every accounting period." Many institutions prepare monthly statements, or quarterly, pay quarterly dividends, etc., but their accounting periods are not in my opinion monthly or quarterly. The ruling given on that point is that accounting periods may be considered as annual where the custom has been to submit

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only annual statements to the shareholders. Under part 1, sec. 3 of the Act (sub-sec. a) the amount of tax paid under part 1, "The Special War Revenue Act, 1915," may be deducted from the tax that would otherwise be payable under the Business Profits War Tax Act. That clause has caused a good deal of misunderstanding, as the words "part 1" as set forth in the Act have evidently been overlooked. The Special War Revenue Act has several parts, tax on railway tickets, on patent medicines, and several other different methods of taxation, and claims have been submitted that all these taxes, including the additional postage tax, should be deducted. Part 1 of the Special War Revenue Act has reference only to tax paid on bank note circulation, the income of trust and loan companies, and the premiums of certain insurance companies; and last year, in order to leave no doubt as to the meaning of that section, the words were inserted that the tax paid under the said Act must not be charged as an expense. The reason of that amendment was this: if the tax paid under the Special War Revenue Act were allowed to be treated as an expense of the company, by a trust and loan company, say, and in addition treated as a deduction from the tax payable under this Act, where the rate is, say 25%, the company would be getting \$1.25 for every dollar it paid, and I may say the argument was put forth that under the section as originally enacted a company was entitled to claim \$1.25; of course I may add that no one secured that rate. So that accounts for the amendment of last year, and also the words "Income Tax," were added.

Now the next sub-section (b) applies to dividends: "Dividends received from the stock of any incorporated company which has paid a tax upon its profits under the provisions of this Act shall not be included when the profits of any business are being determined."

That applies to dividends received by an incorporated company, and has special reference to dividends received by a holding company from a subsidiary, the profits of which have been taxed, the idea being that it would not be right or proper to have double taxation in Canada.

The next sub-section (c) refers to taxes paid in the United Kingdom, India, or any Dominion, Colony, or Dependency of His Majesty or any Allied country, under legislation for raising revenue for the war. It was thought proper at the time that if a tax was paid by a company in Great Britain, say, in respect to its Canadian business, it would be generous on the part of Canada to give credit to the extent of that amount on the tax payable here. Last session it was deemed advisable in view of conditions that had arisen regarding the administration, to repeal that provision. But I may say that sub-sec. c will still apply to account-

ing periods ending in 1915, 1916 and 1917, its repeal only affects the 1918 accounting period.

The next section defines an accounting period: "For the purposes of this Act an accounting period shall be taken to be the period for which the accounts of the business have been made up, but where the accounts of any business have not been made up for any definite period, or for the period for which they have been usually made up, or if a year or more has elapsed without the accounts being made up, the accounting period shall be taken to be such period and ending on such date as the Minister may determine."

It is almost needless for me to tell you that prior to the enactment of this Act many firms and companies, some quite large ones, did not have a regular accounting period, and their systems of bookkeeping were very poor. "Accounting period" is meant to be the regular and usual period for which the accounts and books of any business are kept, closed and determined for the purpose of showing the financial results of the operations for such period. You gentlemen will fully understand that, although all the business community apparently do not seem to so understand, they seem to think they can change their accounting periods as they see fit. In no case have they been relieved of payment of the tax for the full three years by so doing, and in some cases, unfortunately for themselves (for over that the Department has no control), they have made themselves liable for a longer period.

Sec. 5 sets forth the trades and businesses to which the Act shall apply. As originally passed it only applied to trades and businesses having a capital of \$50,000 and over; last session the Act was amended to include companies, firms and individuals engaged in trade or business with \$25,000 capital or over. Foreign companies shipping goods into Canada, on consignment of which the value at any time during the accounting period amounts to the sum of the capital set forth in the Act, will be considered as coming within the provisions of the Act; that is to prevent foreign companies coming into Canada and selling goods through agents, keeping a stock here or selling on consignment and escaping the tax. If this ruling had not been made it would mean that Canadian companies who have established a warehouse in this country would have this undue competition.

company incorporated in Canada whose business is carried on ~~on~~ assets situated entirely outside of Canada, is not subject to the provisions of the Act. The same provision was added to the Income War Tax Act during last session of Parliament; the idea being that no harm can come, but in fact good results to Canada by the incorporation of companies, and if the company is not doing business in Canada, but only has its head office here,

it should not be liable to taxation under this Act, being taxable in other countries.

The next section deals with something about which you gentlemen have doubtless had some experience, that is, Depreciation. If I mistake not, prior to the coming of this Act the Chartered Accountants of this Dominion were chiefly concerned in urging upon their clients the necessity of making adequate provisions under this head. I understand you have not had any trouble on that point since. More recently in the administration of the Act the question of appreciation and depreciation of securities has been raised; the Department holds that appreciation or depreciation based on stock exchange quotations of securities cannot be taken into consideration in determining profits for the purposes of this Act. The same principle applies to land. Many persons claim depreciation on lands, especially western lands. The Department takes the position that so-called profits or losses of this nature cannot be taken into consideration until the investments have been disposed of.

In the administration of these Taxation Acts the desire and endeavor of the Department has been to look at questions from the standpoint of the tax-payer as well as of the collection of revenue, and if there is a doubt the policy has been, as laid down in the Customs Act, that the benefit of the doubt must be given to the tax-payer. Therefore when the question came up as to how the tax paid under this Act should be treated, the Department after careful consideration decided that the tax paid under the Business Profits War Tax Act should be considered an expense of the accounting period following that during which it accrued. Now, whether it appears in the accounts of the tax-payer or not, in the preparation of the assessment at Ottawa the tax paid is always so treated.

Donations to patriotic funds, etc., may be considered as an expense, and not a deduction from the tax payable. Many letters were received by the Department contending that contributions to the Patriotic Fund, Red Cross, etc., etc., should be allowed as deductions from the tax payable. If that were allowed, you gentlemen will readily see what the result would have been—there would have been no tax collected at all.

Another point in respect to profits came up; and in some cases I have no hesitation in saying that it results in what seems a hardship; that is, that losses incurred in one period cannot be allowed as a reduction against profits of a succeeding period; the Act sets forth clearly that "such tax shall be levied against and paid by the person owning such business for each and every accounting period ending after 31st December, 1914." The powers of the Department are administrative only, and where

specific provisions are set forth the Department has no power to change them.

Another question of vital importance to those engaged in business at the present time is that of inventories. Owing to the very high prices now prevailing, and the practical certainty of a drop when normal conditions return, the Department has ruled that inventories of merchandise shall be taken at cost, or at market values if less than cost. It is no business of the Department if a company sets aside a reserve against the contingency of a future fall in prices. But whether any part or the whole of that reserve will be allowed as an expense can only be determined after scrutiny of the returns for assessment purposes, and consideration of the conditions that have arisen after the setting aside of that reserve; the Department cannot settle that question in advance.

Now as to the collection of the tax, there seems to be some misunderstanding among the business community and the newspaper fraternity. Take the 1917 period; many persons say, "Well, you have not collected for 1917 yet." True—and why? Under the Act 1917 returns do not have to be submitted until July 1, 1918, and the Act as originally passed provided that no assessment for 1917 should be made until 1st September, 1918. In making the assessment the Department must be a year to a year and a half behind.

Another question which affects corporations largely is the treatment of life insurance premiums paid. The Department has held that corporation life insurance can not be regarded as an expense, it is rather an asset; and on the same principle the proceeds that will be realized from such policies will not be treated as profits. We consider that that is a fair ruling. Otherwise, if the persons insured die, under the present rate of taxation, if the profits of the company amounted to 20%, it would mean that the Government would be taking practically 75% of that insurance instead of the company.

Question—In the case of term insurance, a policy taken for five years, say, where there is no surrender value; the premiums paid are absolutely gone; does that make any difference?

Answer—In my opinion it is much better for the company to have the payment treated not as an expense, for the premium paid would be small, while if it were treated as an expense the proceeds received in case of death would have to be treated as a profit and taxed accordingly. Treat the payments as capital, and you get credit as capital if the policy is paid.

Q.—But in the event of no death it is a straight expense?

A.—It would be in that case, but in respect to an endowment policy or tontine or any policy where there is a surrender

value, the Department will treat it as an asset from the first payment all the way through.

Q.—The full amount?

A.—Yes.

Q.—Not the surrender value?

A.—No.

Q.—On all life insurance policies for the first three years there is no surrender value. Would you not consider the first three years' premiums as an expense and only the surrender value as an asset?

A.—No, because if you did that the amount received in case of death would have to be treated as a profit, as I said.

Q.—Might I suggest that an equitable method of treatment would be, that the premiums be charged to expense, and where any return is received, that at that time the amount of premiums paid be reversed from expense, and the excess over that amount treated as capital?

A.—That might work if the Business Profits War Tax Act is to be considered as a permanent measure. But indications so far lead to the conclusion that it is considered as a temporary measure, for war time only. Therefore the matter has to be closed up each year.

Q.—If the War Tax is not continued some other will be?

A.—The Income Tax is another matter.

Q.—Furthermore, if this tax is only of brief duration, isn't it the more likely that there will be no off-setting profit? Therefore this expense could only be considered as lost.

A.—That might be so if we had any certainty in life, but the Department has already had to deal with several cases in which the insured has passed away, and it would have been a serious hardship to the companies concerned if that insurance had been treated as a profit, or as revenue.

Q.—The majority of cases where this insurance is carried are small companies who are not financially strong and they have to carry it for the protection of the bank, and it seems to me the position you take works a hardship. I know of cases where the premiums run into two or three thousand dollars a year for straight term insurance, no surrender value. I might add that I think I have seen a ruling in the United States where these premiums have been allowed as expense.

A.—I wish you would show it to me.

Another point that came up and was pressed very forcibly until the Act was amended, is that profits made during an accounting period should for that period be classed as capital. In the case of one company it would have made a difference of some \$10,000; their accounting period was the calendar year,

and they claimed that half the profits should be treated as capital from July 1st. It was submitted to this company's solicitors that if that principle were followed the company would have a right to go farther, and claim a daily balance. You can see what the result would be. (A member—The Accountant would get the money instead of the Government.) So the Department ruled that profits made during the accounting period cannot be classed as capital.

Another ruling is that insurance taken as a sinking fund for payment of a mortgage is not considered as an expense.

It was surprising the number of firms in Canada, especially in respect to close corporations and private firms, where very small or no salaries were paid to the partners or members who conducted the business of the concerns. In some cases the Department was called upon to determine what was a proper allowance to make to these individuals. Now that could not be done by correspondence, it practically had to be done by personal interview, chiefly by the officials in the different districts where the tax-payers reside. The Department has ruled that a reasonable reduction should be made for salaries where no allowance has been made.

The next section has certainly been a bone of contention, that is, the question of capital—what is capital? The first subsection sets forth—capital shall be the amount paid up on its capital stock. Bonds or borrowed money cannot be classed as capital, but the interest paid thereon is considered as an expense of the business. "For the purposes of this Act the amount paid up on the capital stock of a company shall be the amount paid up in cash. Where stock was issued since January 1, 1915, for any consideration other than cash, the fair value of the stock at the date of issue shall be deemed to be the amount paid up on such stock. In estimating the value of stock issued for any consideration other than cash, regard shall be had to the value of the assets, real and personal, movable and immovable, and to the liabilities of the company at the date as of which such value is to be determined."

The Department holds that where a trade or business has been converted into a company and the shares in the company are wholly or mainly held by the person or persons who were the owners of the trade or business, no value shall be attached to such shares so far as they are represented by "goodwill" or otherwise than by material assets of the company unless special circumstances warrant consideration. But patents and secret processes shall be deemed to be material assets. I may say the ruling I have just quoted is in conformity with the ruling in Great Britain. Another point that has arisen on which the view of the

Department will perhaps not agree with that of the accountants is that impairment of capital does not constitute a reduction of the amount paid up on the capital stock of an incorporated company. The Act says "the amount paid up on its capital stock," and there is no provision in the Act for any reduction of that amount.

Q.—There would be no object in claiming an impairment, would there—you would lose the 7%?

A.—But in some cases it would reduce the capital of the business below the \$50,000.

The next sub-section (4) says: "For the purposes of this Act the actual unimpaired reserve, rest or accumulated profits of an incorporated company shall be included as part of its capital."

Owing to a good deal of controversy during the first year, to remove any doubt that section was amended to provide that the actual unimpaired reserve, rest or accumulated profits held at the commencement of an accounting period by an incorporated company shall be included.

The amendment was made to agree with the ruling of the Department. (Laughter.) Some companies might feel that they were not being treated fairly, and in the administration of an Act of this kind, over a territory extending from ocean to ocean, the Department must exercise the greatest care that the treatment of all is on a basis of equality, and therefore where it makes a ruling, unless it is found to be absolutely wrong, it is not advisable that the principle so laid down should be changed.

Q.—Is the merchandise reserve that you spoke of part of the capital of the business?

A.—If when the returns are scrutinized it is considered that the allowance should be made, it is treated, not as capital, but a liability of the company, and the balance treated as capital.

Another amendment provides that dividends paid during an accounting period shall be considered as a reduction of unimpaired surplus, rest, or accumulated profits. If any other principle was followed it would mean that the Department would have to employ an army of officials throughout this whole country to investigate each case and ascertain from the tax-payers' books whether the profits were actually made at the time the dividends were paid, that is, during the period in question, or whether made in a prior period; therefore this course was taken to save expense, and it is not a hardship, considering that the tax paid is allowed by the Department to be treated as an expense in the following accounting period; so these amendments were made for administrative purposes.

Q.—I know clients who have made their returns regularly yet have not received their assessment from the Department. If they are entitled to deduct the tax paid as an expense, and have not received the assessment, how are they to deal with it?

A.—The instructions given to the accountants who are handling the returns in the Department are as follows: "Your duty is to check these accounts, and be fair to and protect the tax-payer as well as the revenue." Now, if in any case the tax is found to be payable but has not been assessed, we will credit against the profits made during the following accounting period the tax found to be payable. And, by the way, I would be very glad if the gentleman will give me the name of the company (he can do it in private, of course); I want to see about it. I have heard that stated before, but in almost every case it turns out on investigation either that no tax is payable, or in other cases that the assessment has been made and the tax paid for a year or two years, and yet that complaint comes to the ears of the Department.

Q.—You credit it whether paid or not?

A.—Yes, we treat it as an expense of the following period.

Q.—With respect to the capital of a non-Canadian company, can you give us a simple illustration of that?

A.—Yes, the Act is very specific; take the total assets of the company and divide that amount by the amount of the assets in Canada, and apply the percentage so obtained to the total capital and you have the capital in Canada. Of course the "capital" includes the unimpaired rest and accumulated profits, etc.

"For the purposes of this Act the capital employed in the business of a non-Canadian company shall be such portion of the amount paid up on its capital stock as shall bear the same proportion to the amount paid up on its entire capital stock as the value of its assets in Canada bears to the value of its total assets.

Q.—In the case of a foreign company selling on consignment in Canada, whose duty is it to make the returns as to profits?

A.—It is the duty of the owner of the goods, the company, without any notice or demand from the Department.

Q.—If the company is in Europe I do not see how the Department has any jurisdiction.

A.—They have to have an agent or someone to do their business—the company is responsible, no matter where it is, for the business done by it in Canada.

Now as to the meaning of the word "unimpaired," the Department has ruled that reserves for bad and doubtful debts, or depreciation of plant and machinery or any form of wasting

assets, are reserves against impairment of assets and therefore cannot be classed as capital.

The next section we have practically dealt with. Now I come to a very important section. When the Act was passed we had a great many applications from those who wished to be members of the Boards of Referees. I want to say that owing to the patriotic spirit displayed by the tax-payers the Government has not been called upon yet to appoint a Board of Referees. (Applause.)

I also desire to give you some information as to the amount of taxes paid under this Act, and the cost of collection.

BUSINESS PROFITS WAR TAX ACT, 1916.

Revenue and Cost of Collection.

Amount Collected.	Cost of Collection.	Cost per \$100 Collected.
1st Year, \$12,508,549.96	\$58,174.81	46½c
2nd Year, \$21,271,083.57	\$80,634.02	Fraction less than 38c
Total Collections to date (Sept. 18).....		\$43,330,494.12
Estimated Amount to be Collected, Accounting		
Periods 1915 and 1916		2,500,000.00
Accounting Period 1917.....		18,000,000.00
Total.....		\$63,830,494.12

Estimate when Bill was submitted to Parliament "Probably as much as twenty-five or thirty million dollars."

The Department expects the tax payable during the three years the Act was originally intended to cover will be collected before the close of the fiscal year.

There is an impression in certain circles that the amount of tax unpaid in respect of the 1915 and 1916 periods amounts to an enormous sum. The best estimate I can make is that the amount unpaid is about \$2,500,000. There are many reasons for that remaining unpaid; one reason is that assessments in some cases have not been made, or have been delayed, owing to the necessity of a personal interview with the tax-payer. In respect to the 1917 accounting period the Department expects to receive about \$18,000,000—or a total for the three years of nearly \$64,000,000, as against a maximum estimate of \$30,000,000.

Q.—In the case of those delinquent companies is any attempt made to equalize the position by charging interest?

A.—The Act provides that the tax shall be payable within one month of the date of mailing the notice of assessment, and in default of payment interest at 7% per annum shall be paid. If the assessment is not made the responsibility is not on the

company, but on the Department. And as to that, I consider that it is far better for the Department to be sure and to get the full amount of tax that is rightfully payable rather than hastily fix an arbitrary amount which may be much below what it should be, or on the other hand, to have to deal with an appeal case; by that course the administration will be ahead much more than the small amount of interest lost; besides which we have also the good-will of the tax-payers, which is very essential, where we are covering, from a centre at Ottawa, the whole Dominion. The assessment of a municipality is an entirely different matter. There the Assessor can come in contact with the taxpayer at once. The maximum staff employed throughout the whole Dominion during any one year, including the staff at Ottawa, in the administration of the Business Profits War Tax Act, was forty, half of whom were stenographers and typists. Often it was much less. The principle we followed was that this was a temporary Act. The Department could have put on a large staff, run up a heavy expenditure and completed the work in four or five months, and for the rest of the year the staff would have been idle, or else we would have had to release them and hire a new staff for the next year, resulting in lack of uniformity. It was considered more advisable to have a permanent organization for the three years and preserve uniformity of administration. The Department expects that the tax payable during the three years the Act was originally intended to cover will be collected by the close of the fiscal year.

Q.—I would like to ask a further expression as to the attitude you propose to take with respect to inventory reserves. I understand your position is that the taxpayer may set up whatever reserve he deems advisable, but you reserve the right to disallow that or deal with it as you think fair. Suppose an inventory so taken, the goods have since been sold at a profit, will you say that is a taxable profit even though the taxpayer had to turn around immediately and invest a still larger amount in goods at prices still further enhanced and so has still in prospect a future loss?

A.—If there has been no loss incurred at the time the returns are scrutinized, why should any allowance be considered? It is a question that must be left largely to the judgment of the officials dealing with the matter, we cannot lay down any set rule. We had a case not long ago of a company handling a line of goods in which there was a material drop in prices. At the date of the returns the stock was set forth as being worth a certain amount. In determining the assessment six months afterwards those factors were taken into consideration. I cannot impress upon you too strongly, gentlemen, that in the adminis-

tration of this Act the Department desires to deal fairly with the taxpayer.

Q.—I am convinced of that; I think, however, the solution depends on whether or not this tax is to be a continuing measure; if it is only for a three year period, and if at the end of that time the dealer is still carrying a stock at prices much above normal and so facing a future loss that is not provided for in assessing his tax.

A.—That statement is correct; all I can say is that the taxpayer must trust to the fairness of the Department when it makes his assessment for the next year. No rule can be made in advance setting forth any exact rate that would be allowable, it would depend on many factors, the Department must be the judge; subject, of course, to the taxpayer's right of appeal if he sees fit.

Q.—It may be of interest to point out that the English authorities have passed legislation allowing two years after the cessation of hostilities within which loss on stocks carried over may be adjusted and deducted from the tax.

A.—There is no such provision here.

Q.—No. The point is you do not regard this as a continuing tax.

Q.—You have given a number of important rulings. Is it possible to get these in a shape to be available?

The President—That is dealt with in the President's address.

Q.—In regard to inventories and goods that have gone out of fashion or become shopworn, is it expected that the merchant (I speak with special reference to the small trader) shall take these goods at cost price and a deduction made at the foot of the inventory and that deduction set out on his return? Generally a merchant in taking stock prices such goods at what he considers them worth to him, and in fixing his selling price he bases it on the last current inventory price, so unless he used two columns of prices he would not know just what he had taken off. Would he be accused of an evasion of the Act by taking them at the price he considers them worth?

A.—Where the market value of merchandise is less than its cost, owing to being out of fashion or for other reasons, a merchant in my opinion would be justified in taking it in at what he thinks its fair value at the time the inventory is taken. That is subject to the approval of the Department as to the price being reasonable.

One other point in respect to the Business Profits War Tax Act. Many taxpayers, and by that I mean taxpayers as defined by the Act, sec. 2, are inclined to decide for themselves as to whether or not they are taxable, and so neglect to file returns.

Now the Act places the responsibility for filing returns on the taxpayer. In addition to that the Department has during the last three years forwarded forms for returns by registered mail to those who are deemed liable to taxation under this Act. The receipt of those forms requires the making of the returns called for; whether the tax is payable or not, the Department will be the judge. But every person who receives the forms should file returns; and they will be followed up and will have to do so.

The Income War Tax Act, 1917.

This, in my opinion, will be a permanent Act as long as we are alive, although I am also of the opinion that the revenue derived therefrom may not reach the amount that some of our newspaper friends estimate, based on the wealth of the country.

In furnishing returns under this Act gross income must be shown in all cases, and particulars furnished of deductions claimed. Subject to the taxpayer's right of appeal the officers administering the Act are the judges of what are proper deductions from gross income and the taxpayer will not be excused from liability for omission; it is absolutely necessary that the taxpayer should take the Department into his confidence, place his cards on the table and let the Department decide, and I think the reputation the Department has in connection with the Business Profits War Tax Act will be maintained in the administration of the Income War Tax Act. In a taxpayer's gross income should be reported every item of income derived from any source whatever, actually received or accrued due in the calendar year for which the return is made, whether received in cash or the equivalent of cash, including:—

(a) The annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments; or

(b) Profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment or profession or calling or any trade, manufacture or business, as the case may be.

(c) Interest, dividends, or profits directly or indirectly received from money at interest on any security or without security, or from stocks, or any other investment, and whether such gains or profits are divided or distributed or not, including items of foreign income as well as income from domestic sources.

(d) Income from, but not the value of property acquired by gift, bequest, devise, or descent, received directly or through trustees, executors, administrators or financial agents;

(e) The income from but not the proceeds of life insurance policies paid on the death of the person insured, royalties from mines, oil, and gas wells.

And last, "the annual profit or gain from any other source."

All corporations and individuals carrying on business, singly or as a partnership, will require to value their accounts receivable at the end of the period for the purpose of the returns, and in case of a partnership each partner will require to show his part as gross income. Allowance will be made for amounts received during the year but actually earned prior to 1st January, 1917. That will not apply to any year in the future, but the Act has to have some starting point, therefore the Department holds that the income taxable is that which properly accrued since Dec. 31st, 1916.

Question—Not for the fiscal year?

A.—No, we had to make a dividing line to start from, therefore the Department ruled that companies that had their accounting period between the 1st January, 1917, and the 30th June, 1917, need not file returns for 1917, and that companies having accounting periods ending after 30th June would file returns for 1917 period.

Bonuses paid to employees are income of the calendar year in which they are received, without regard to any fiscal year or other period in respect of which they may have been earned or paid. All persons in receipt of free rent, or board, or similar perquisites shall add to the amount of their income for taxable purposes the reasonable value thereof, because the Act provides that personal and living expenses shall not be taken as a deduction.

The farmer is required to add to his net income the value of the goods that he and his family have consumed. And I want to say here that there have been hundreds of assessments made against farmers. The other day an assessment of nearly \$5,000 was made in respect of 1917 income against a farmer.

Preferred dividends are not a proper deduction from the income of a corporation. Stock dividends stand in the same position as cash dividends for the purpose of the tax.

The income received from Canadian industrial bonds, even though expressed to be issued tax free, will be considered income subject to taxation. Royalties paid to a proprietor by those allowed to develop or use property is to be accounted for as income. No deduction can be allowed from the income of the Canadian branch of a foreign company in respect to tax paid thereon to the foreign government. Taxes paid by persons resident in Canada to foreign governments in respect of income arising within the jurisdiction of the foreign government may be

deducted in determining taxable income. Except where the buying and selling of securities is the main occupation of the taxpayer profits or losses on stock transactions must not be taken into consideration in determining taxable income, neither should losses sustained through endorsing notes. Profits or losses of real estate corporations on sales prior to the commencement of the 1917 accounting period will not be taken into account for income tax purposes. Contingent reserves set aside to provide against possible future losses are not a proper deduction from income. Money advanced by a mortgagee for protection of his security is a proper deduction from mortgage interest income, and when repaid will be taxable income for the year in which it is repaid, in addition to the interest received on the mortgage. Annual life insurance premiums paid by a corporation for insurance on the life of its officers cannot be deducted as a business expense.

Depreciation consists of a reasonable allowance for the wear and tear of property arising out of its use or employment, the amount allowed will be the amount of the loss occurring during the year to which the returns relate, estimated on the cost and the estimated lifetime of the property with respect to which such deduction is claimed.

There are many other points, but I think it well if I close my remarks here and allow you gentlemen to ask questions concerning points which have not been made clear.

Q.—Re Sec. 3, Business Profits War Tax Act, 1916, as amended to include companies with capital exceeding \$25,000 and not \$50,000, with the exemption of 10% and the tax of 25%, is it the intention of the Department to apply the graded tax to this class of companies, passing an Order-in-Council as a further amendment to Sec. 3?

A.—The Governor-in-Council has under certain legislation power to modify certain taxes, but Parliament reserves to itself the right to impose taxation. Parliament in this case has imposed a certain rate of taxation, and I doubt very much if the Governor-in-Council has any power to alter it.

Q.—Re Par. a, Sec. 3, the original was repealed and a new paragraph substituted which concludes with the following words: "but in computing the profits of his business no taxpayer shall include any tax paid under the said Acts in the expenses of his business."

A.—"The said Acts" include part 1, Special War Revenue Act, 1915, and the Income War Tax Act, 1917. If the taxes paid under these Acts were treated as an expense the taxpayer would be getting the amount both as an expense and also getting the benefit of the full amount as a reduction of the tax under the Business Profits War Tax Act.

Q.—The reason I ask that is that it was rumored that the principle which you say has been adopted by the Department, would be changed.

A.—I may say that the principle of treating the tax paid as an expense of the following period could not very well be departed from at this time without doing an injustice to thousands of taxpayers. I do not think there is any probability of it being changed while the Act is in force.

Q.—Is it the intention of the Department to regard the tax as a distribution of profits rather than an item of business expense, and if so will this apply to tax paid under the Business Profits War Tax Act accretion of capital during the fiscal year, and reduction of capital by dividends paid? Is it the practice of the Department to regard the profits of a business as being made only at the close of the fiscal year, and payment of dividends as being a reduction of capital at the time the dividend is paid?

A.—For the purpose of capital it is the accumulated profits at the commencement of the period. The Act states that the dividends paid during the accounting period shall be considered as a reduction of unimpaired reserve, rest, or accumulated profits, not of the capital itself.

Q.—It amounts to the same thing?

A.—No, it does not.

Q.—In calculating the amount of the capital exemption?

A.—Yes, but in cases where the dividend paid has been more than the accumulated profits on hand at the commencement of the period the capital stock is not impaired in any way.

Q.—But in this case the dividend may be paid for the current year and paid quarterly, but the exemption is allowed of the amount of the fully paid up capital.

A.—Plus the amount of the accumulated profits that remain in the business; that is, if it is paid quarterly deduct the first three months, all accumulated profits left are treated as capital, then we deduct the amount of the dividend from that profit and continue the balance for the next three months.

Q.—You presume there has been no profit for the first three months?

A.—We do not presume anything; the Act decides.

Q.—If the profit and loss account of a company determines the profits quarterly, can these quarterly profits be added to capital for the purpose of claiming an exemption as an offset to the reduction caused by the payment of the dividend?

A.—No, that would be contrary to the provisions of the Act.

Q.—Is a stock dividend declared and paid out of surplus (created out of profits of years previous to the Income Tax legislation) subject to individual income tax? That is, will the individual have to pay income tax on this stock dividend?

A.—No.

Q.—How should a company with a capital of \$40,000 at the beginning of 1918 be taxed?

A.—Be taxed on its profits in excess of 10% of its capital employed to the extent of 25% of those profits. There is a question here covering several pages relating to the income tax. I will put it in my pocket and send a written answer.

Q.—With reference to the ruling that in the computation of capital goodwill is not allowed except in so far as it can be proved to be represented by actual cash expenditure, and in view of the fact that the principal asset of a trade paper publishing company is its goodwill, it is represented that to strike out goodwill would be unfair. Where the property has always been in the hands of one company it might be fair to take the loss which such companies invariably make in the early years as actual expenditure on goodwill, but where the property has changed hands several times, as often happens, it may be impossible to ascertain the exact aggregate of such expenditure.

A.—The viewpoint of the Department is that goodwill cannot be treated as an asset. If it were so treated, every company would have a right to it. Therefore unless special circumstances warrant a departure from that rule, goodwill cannot be regarded as an asset. There may be cases where goodwill is represented by actual cash expenditure for which there is no asset; in such cases it would be fair to consider what proportion of the asset claimed to be goodwill is represented by that cash expenditure. Each such case would have to be treated on its merits, but the general rule is that goodwill cannot be treated as an asset, because it is nothing more than watered stock, and I do not think there is anyone who considers that any value should be placed on watered stock.

Q.—We understand the principle, but this is a general class of business which it is submitted is an exception, and that it would be a distinct hardship if goodwill was not allowed as an asset in their case. Such publications could not be acquired in the market at anything like the value of their physical assets only.

A.—That is true in regard to publications owned by a company, but the same treatment would have to be accorded to those owned by a private party or partnership; the mere fact of being incorporated as a company should not allow that company to set up one or two hundred thousand dollars for goodwill, and the partnership nothing.

Q.—An industrial company holds real estate, and sells for cash a part of its land not required for its business. Many companies in B.C. are like this. The company declares a dividend out of this special profit in real estate. This dividend I claim is not subject to tax, but how does it affect the shareholders liable to the supertax?

A.—The receipt of that dividend by a shareholder would be a return of capital largely; it is only actual income that would be taxable. The Act provides that there shall be an allowance made for depletion of mines, etc. The same principle has to be extended to timber limits, and the depletion of real estate, etc. It is a question of fact what proportion of that is income and what proportion return of capital.

Q.—A large company holds a big line of war bonds and declares a stock dividend out of the interest received thereon by buying and distributing further war bonds. It is presumed that this dividend is not subject to income tax.

A.—If the bonds have been issued by the Dominion Government tax free, the Department cannot tax the income derived from them, whether paid in cash, or stock dividend, or however paid.

Q.—In case of a concern selling their product on long deferred payments, such as a retail piano business, is it your ruling that the taxable profits consist of the surplus added as a result of the sales during the accounting period, or of the realized profits actually received, whether the sales were made during that period or in earlier years?

A.—It is the profit made during the accounting period that is taxable. A merchant engaged in that business should set aside a reasonable reserve for bad debts, and it is net profits that are taxable.

Q.—I happen to know that your ruling is different from that of the U. S. Government.

A.—We are not guided by that.

Q.—Is that a ruling of the Department, or have I only got that ruling from the local office?

A.—If the local officer gave a ruling such as I have now stated, he will be sustained.

(Oral questions.)

Q.—That matter about provision for future losses. Now, the case of the piano dealer who has the sale notes on his books, and who wisely makes provision for the losses he may sustain on the notes taken that year. Is that a provision for future losses?

A.—That is a current loss; it is the amount applying to that period. The Income Tax Act came into force January 1st, 1917.

All accounts receivable on the books of the taxpayer at that date are capital. Now we only want to tax the income that has properly accrued for the 1917 accounting period, the net profits for that period are what is taxable, and against the sales of that period they should set aside sufficient reserve to meet the bad debts of that period.

Q.—Certain legislation was enacted by which certain industries were practically ruled out of business, the distilleries, the breweries; how would you propose to deal with the depreciation down to the vanishing point of the investment in those industries?

A.—I wish to say that conditions that prevail, say in B.C., are entirely different from conditions in Quebec, the breweries are still doing business in Quebec. The Act provides that the profits made during each and every accounting period shall be taxable. Each accounting period must be taken by itself. But I can understand a brewer, or even a merchant engaged in the wine and spirit business, having a great many accounts on his books which would have been perfectly good if the business had continued, but which as a result of the prohibition legislation have become worthless. In the adjustment of the assessment those worthless accounts must be considered.

Q.—But as to land, buildings and plant?

A.—The plant has to be depreciated by a reasonable amount, there is a certain residual value. That is a question of fact in each case, you cannot make a general rule.

Q.—Have you in mind in that connection the depreciation allowed persons who created works for the manufacture of munitions of war, where the Government allowed such a price for the product as would enable them to write off the whole plant, besides a reasonable profit?

A.—Well, that arrangement was by the Imperial Munitions Board, not the Dominion Government. According to rumor they had two classes of contracts. One was at a certain price which included the cost of installing the machinery; the other did not.

Q.—Referring to the business profits tax, a partnership is subject to the normal and super-tax?

A.—No, that is under the Income Tax Act.

Q.—Yes, a partnership is subject to both normal and super-tax; a company is not; and in the discussion before the House it was stated that you propose to equalize that by taxing the man who receives the dividend. How do you propose to overcome the possibility whereby under that state of things the company can undersell a partnership to the extent of the difference?

A.—The question you raise is one with respect to legislation; I am only dealing with the administration of the Act. But

I would point out that to a certain extent that has been remedied; that in respect to the accounting periods of 1918 and thereafter the tax paid by the corporation will be 6% instead of 4%. 4% is the normal tax, and the shareholder will only receive credit to that extent, not for the 6%, so there is a difference of 2%.

Q.—As to the publication of the rulings of the Department and also whether anything has been done with respect to the issue of a primer on the income tax, such as that issued by the Treasury Department of the United States?

A.—Both of these matters have been considered by the Department; the rulings have been collaborated, and an Income Tax Primer has been prepared, but it was considered advisable, as the Income War Tax Act is a new Act, not to issue a primer or book of rulings until the Act had been in operation for a period. I expect both will be issued at an early date, and after that the rulings under the Income War Tax Act will be published monthly, and I shall see that the Secretary of the Chartered Accountants' Association receives a copy.

Q.—A lumber concern with a large plant, whose share capital is, say \$100,000, with a bond liability of \$75,000, secured by a mortgage on all their property except lumber and stock in trade, and with a large loan liability unsecured, a few years ago bought a portable mill for \$50,000, used in the course of their business, and it of course came under this mortgage. They have since sold this mill for, say \$150,000, which amount was appropriated to the liquidation of the unsecured loan. No depreciation has been charged against profit and loss for any of the years on fixed plant and machinery, and no dividends ever paid. Would this apparent profit of \$100,000 be taxable?

A.—If the total assets were sold outright that is a sale of capital, it is not profits from operation. It is the sale of a capital asset.

Q.—Suppose the sale of capital assets produces a large profit, is that taxable?

A.—The profits taxable are profits earned in the operation of the business.

Q.—Suppose someone bought a boat for \$50,000 and sold it for \$200,000, is that profit taxable?

A.—Unless the business of the person is buying and selling boats, no. And that is in accordance with the decision of the Privy Council in Great Britain. Take the Hudson's Bay Co., they have a large area of land, they are selling it, the decision of the Privy Council is that they are a trading company and the profits made in respect of that land is not income for income tax purposes in Great Britain; it is the return of capital.

