Date: 19971118

Docket: A-69-94

CORAM: **STRAYER J.A.**
LINDEN J.A.
ROBERTSON J.A.

BETWEEN:

GSW APPLIANCES LIMITED

Appellant

- and -

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario on Wednesday, October 8, 1997.

Judgment delivered at Ottawa on Tuesday, November 18, 1997.

REASONS FOR JUDGMENT BY: LINDEN J.A.

CONCURRED IN BY: STRAYER J.A.
ROBERTSON J.A.

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REASONS FOR JUDGMENT

LINDEN J.A.

[1] The central question in this appeal is whether or not the appellant held inventory which could be the subject of an inventory allowance deduction. Paragraph 20(1)(gg) of the *Income Tax Act*[1] allows a taxpayer to deduct a portion of the value of inventory. Both versions of that section read:

[1] R.S.C. 1952, c. 148, as amended.

20.(1)...(gg) an amount in respect of any business carried on by the taxpayer in the year, equal to that portion of 3% of the cost amount to the taxpayer, at the commencement of the year, of the tangible property (other than real property or an interest therein) that was (i) described in the taxpayer's inventory in respect of the business, and (ii) held by him for sale or for the purposes of being processed, fabricated, manufactured, incorporated into, attached to, or otherwise converted into or used in the packaging of, property for sale in the ordinary course of the business...	20.(l)...(gg) une somme au titre de toute entreprise explitée par le contribuable pendant l'année, égale au produit de 3% du coût indiqué, pour le contribuable, au début de l'année, des biens corporels (autres que des biens immeubles ou des intérèts dans deux-ci) qui étaient (i) décrits dans l'inventaire du contribuable au titre de l'entreprise exploitée par ce dernier, et (ii) détenus par lui en vue d'étre vendus ou encore d'étre tranformés, fabriqueés, manufacturés ou annexés à des biens destinés à étre vendus dans le cours normal de l'exploitation de l'enterprise, ou autrement convertis en ce genre de biens ou utilisés dans l'emballage de ce genre de biens...

The purpose of paragraph 20(1)(gg) is set out in *Bastion Management v. The Queen*[i] where this Court states:

> ...properly construed, the paragraph 20(1)(gg) deduction was meant to give some tax relief from the effects of inflation to those taxpayers whose business involved carrying inventory. [ii]

Without the deduction, taxpayers carrying inventory would "realize" false profits through the operation of inflation.

[2] In order to qualify for the deduction, it is agreed that three conditions have to be met. First, the taxpayer must have property in the goods which it can sell. Second, the goods must be described in the

taxpayer's inventory in respect of a business carried on in the year. Third, the goods must be held for sale in the ordinary course of the business, subject to the distinction between finished and unfinished goods. Failure to satisfy any of these conditions will disentitle the taxpayer to the benefit of the deduction. The question, then, is whether the taxpayer satisfies these conditions.

Facts

[3] The facts are not in dispute. The appellant, GSW Ltd., was a wholly owned subsidiary of GSW. GSW Ltd. was in the business of manufacturing and selling household appliances. On September 27, 1976 GSW entered into a "Foundation Agreement" with Canadian General Electric Ltd. (CGE) for the purposes of integrating their respective major appliance businesses. To this end they caused a new company, Canadian Appliance Manufacturing Company Limited-Limitée (CAMCO), to be incorporated. CAMCO was to acquire all the assets of the subsidiaries of CGE and GSW (including the assets of the appellant). GSW entered into an Asset Transfer Agreement with CAMCO on December 28, 1976. Under the agreement GSW agreed to cause its subsidiaries to convey and transfer to CAMCO the assets used in carrying on the business of manufacture, sale and servicing of major appliances. The agreement further provided:

> ...the closing (the 'Closing') of the transactions contemplated hereby shall take place at the offices of...at 2:00p.m. on the 4th day of January, 1977 or at such other place and time as shall be fixed by agreement of the parties (the 'Closing Date') but with effect as of the commencement of January 1, 1977 (the 'Effective Date'). (Appeal Book, vol. II, p. 166)

The closing did take place on January 4, 1977. The appellant then sought to claim the deduction on the value of its inventory authorized by paragraph 20(1)(gg) of the Act for 1977 (and carried back to 1976). The deduction was disallowed.

Reasons of the Trial Judge

[4] McKeown J. determined that, in order to qualify for the deduction, contrary to this Court's decision in Bastion, the inventory had to be owned by the taxpayer and held for sale (if finished goods) or held for sale in the ordinary course of the business (if unfinished goods). Nevertheless, he found that, because the appellant had already struck the Asset Transfer Agreement before the commencement of 1977, the appellant did not have tangible property held for sale. He states:

> In the case before me the taxpayer had already committed the inventory to be sold pursuant to the agreements made in 1976. In fact these agreements were completed and the inventory was sold as part of the overall sale. The December 28th and September 27th agreements amount to equitable transfers. (Reasons, p. 11, Appeal Book, vol. II, p. 259)

The Trial Judge dealt with other arguments raised by the appellant, but ultimately decided the case on the basis of ownership of the property.

Submissions of the Parties

[5] For the appellant, Mr. Arnold Englander, in his usually thorough and creative way, concedes that the distribution of its assets during the course of its winding-up is not in the ordinary course of the business. It was for this reason that the appellant did not originally seek an inventory allowance on the non-finished goods portion of its inventory. However, the appellant submits that the words "in the ordinary course of the business" in subparagraph 20(1)(gg)(ii) are not meant to modify "held for sale." It is the appellant's position that this Court erred in deciding Bastion. In that case, he contends that this Court failed to take into account the French text, which uses the words *"ou encore"* where the english text uses only "or". According to the appellant this must indicate that the clauses of the subparagraph

are distinct. Therefore, there is no necessity that the finished inventory be held for sale in the ordinary course of the business; this is only required for unfinished materials.

[6] The appellant finds support for this argument in the subsequent enactment of subsections 20(17) and (18)[iii]. Subsection 20(17) has the effect of reducing the inventory deduction in certain circumstances. Those circumstances are described in subsection 20(18):

> 20. ...
> (18) Definitions. For the purposes of this subsection and subsection (17),
> (a) "Qualifying Inventory" - "qualifying inventory" means tangible property (other than real property or an interest therein or property of a taxpayer that becomes property of a new corporation by virtue of an amalgamation or merger) described in subparagraphs (1)(gg)(i) and (ii); and
> (b) "Specified transaction".-"specified transaction" means
> (i) a distribution by a corporation of qualifying inventory on or in the course of its winding-up.

[7] These provisions limit the applicability of the inventory deduction in the case of specified transactions. "Qualifying inventory" is defined as inventory which qualifies for a deduction under paragraph 20(1)(gg) and a "specified transaction" includes the winding-up of a subsidiary with the distribution of assets to the parent. If finished inventory had to be held for sale in the ordinary course of the business, then, it is said, that paragraph 20(18)(a) would never be applicable because the winding-up of a subsidiary does not occur in the ordinary course of business. Mr. Englander, also presented some very imaginative arguments in support of the position that GSW Ltd. was carrying on a business in the year.

[8] Mr. Harry Erlichman for the respondent relies in large part on the reasoning of McKeown J. In addition, he submits that, on both the English and French versions of the section, the inventory must be

held for sale in the ordinary course of the business in order to qualify for the deduction. The winding up of the company is not something which occurs in the "ordinary course of the business."

Analysis

[9] As indicated above, three conditions must be satisfied in order for the taxpayer to claim the deduction. In deciding this case, however, because of the view taken by this Court and because of the concession of Mr. Englander, it is necessary to deal only with the requirement that the taxpayer hold the inventory for sale in the ordinary course of the business. In doing so, we reject the appellant's arguments with respect to this Court's decision in *Bastion*. In that case, the taxpayer was a futures trader. Ordinarily, the business did not stock inventory. In an effort to take advantage of paragraph 20(1)(gg) the taxpayer purchased large quantities of gold and silver bullion just prior to its year end, at the same time issuing offsetting futures contracts for the sale of the bullion just after its year end at the same price. The Minister disallowed the deduction and ultimately this Court upheld the Minister's reassessment. The central question was whether or not the provision required the taxpayer to hold the goods for sale "in the ordinary course of the business." This Court found that the provision made sense only if it required that all inventory be held for sale in the ordinary course of the business. This Court stated:

> Despite the awkwardness and complexity [of the subparagraph], however, in my view Mr. Spiro's interpretation is the one that is most in accord with the purpose of the provision, its context, its language and common sense. Its aim was to provide relief against the effects of inflation to those taxpayers "whose business required them to invest in and carry an inventory of tangible goods" (see Mattabi Mines, supra).[iv]

[10] The appellant in this case asks us to reconsider the decision in *Bastion* in light of the French version of the text, which was not brought to the attention of the Court in *Bastion*.

[11] In the appellant's view the use of the word "encore" in conjunction with "ou" in paragraph 20(l)(gg), where the English uses only the word "or" indicates that the entire clause which follows is separate from the preceding clause. Therefore, the words "vendus dans le cours normal de l'exploitation de l'enterprise" do not modify "détenus par lui en vue d'être vendus". We do not agree with this interpretation. The word "encore" seems to be more accurately interpreted as a linguistic flourish which allows the drafters to join the two clauses together more smoothly. It is a matter of esthetics not one affecting the meaning of the provision. Further, the words "dans le cours normal de l'exploitation de l'enterprise" in the French version appear in the middle of the subparagraph, which makes it even clearer than it is in the English version, that they are meant to modify both uses of the word "vendus".

[12] Another consideration is the placement of the words "annexés à des biens destinés à être vendus dans le cours normal de l'exploitation de l'enterprise". This must be interpreted as applying to materials (finished or unfinished) that are to be attached to goods that are held for sale in the ordinary course of the business. It would defy logic if goods that are to be attached to goods destined to be sold in the ordinary course of the business qualified for the deduction only if those goods to which they are destined to be attached are unfinished. Furthermore, if we read it to mean both finished and unfinished goods, then consistency demands that the expression "dans le cours normal de l'exploitation de l'enterprise" apply identically to both categories of goods. In other words "dans le cours normal de l'exploitation de l'enterprise" cannot mean one thing with respect to goods attached to other goods and another thing with respect to those other goods themselves.

[13] The *Bastion* interpretation is further supported when we examine the status of packaging. The distinction advanced by the appellant would force us to say that packaging used for unfinished goods

would qualify for the deduction (as long as those goods were held for sale in the ordinary course of the business), but if used for finished goods would not qualify for the deduction. If the two clauses are distinct then the reference to packaging would not apply to finished goods. In the English version "the packaging of" precedes "property for sale in the ordinary course of the business." But in the French text this clause follows that phrase and refers to "l'emballage de ce genre de biens." If we read "ce genre de biens" as referring only to unfinished goods then the result is unavoidable; the phrase cannot refer to unfinished goods *and* finished goods as two distinct categories because the words are in the singular. Therefore, "ce genre de biens" must refer to goods in general, whether finished or unfinished, that are "destinés à être vendus dans le cours normal de l'exploitation de l'enterprise."

[14] The appellant urges us to accept the argument that the subsequent enactment of subsections 20(17) and (18) only makes sense if "held for sale" is not modified by "in the ordinary course of the business." The appellant argues that the definition of "qualifying inventory" as tangible property described in subparagraphs 20(1)(gg)(i) and (ii) requires that at the time of the specified transaction, the inventory be held for sale or for the other purposes mentioned in subparagraph 20(1)(gg)(ii). Because winding-up is included under the definition of "specified transaction" it is clear that "in the ordinary course of the business" cannot modify "held for sale," because the distribution of assets on the winding-up of a company is not in the ordinary course of the business. Therefore, it would be impossible for the taxpayer to fulfil the condition of having "qualifying inventory" for the purposes of subparagraph 20(1)(gg)(ii). If this Court were to find that "held for sale" is modified by "in the ordinary course of the business" then, in order to reconcile the decision in *Bastion* with the enactment of these provisions, the appellant's counsel asks us to read in a "but for" test. In other words, he suggests that the goods would have been held for sale in the ordinary course of the business *but for* the specified transaction. According to counsel for the appellant, this would make sense of the qualifying inventory criteria.

[15] The appellant's counsel is mistaken when he suggests that the definition of qualifying inventory requires that at the time of the transaction it be held for sale in the ordinary course of the business. There is a difference between being held for sale in the ordinary course of the business and being sold in the ordinary course of the business. Paragraph 20(1)(gg) does not require that the inventory actually be sold in the ordinary course of the business in order to qualify for the deduction, only that it be held for that purpose. If the company were wound-up and the assets distributed to the parent, the taxpayer might still qualify for the deduction. If the taxpayer were to hold the property for sale in the ordinary course of the business, but subsequently exchange them in a barter transaction, the deduction might not be disallowed on that basis. Furthermore, the question arises as to why the legislature would have wanted to distinguish between finished and unfinished goods. If we accept the appellants reading of subsections 20(17) and (18) and its interpretation of subparagraph 20(1)(gg)(ii) then the conclusion is that finished goods would be affected but not unfinished goods. Unfinished goods, by virtue of the requirement that they be held for sale in the ordinary course of the business, could never be qualifying inventory for the purposes of paragraph 20(18)(a).

[16] When interpreting the *Income Tax Act*, as with any statute, it is crucial to remember the purpose behind its provisions. In this case we are dealing with a government subsidy delivered through the tax system designed to help those businesses that are forced to carry inventory during inflationary periods. While, for purposes of this appeal, I do not find it necessary to deal with the issue of whether or not the appellant had property in the goods on January 1, 1977, it is instructive to consider this point for purposes of statutory interpretation. With regard to ownership it is important to look at the whole situation and understand the relationship between the taxpayer and the goods. In *Pardee Equipment Ltd. v. The Queen*[v] , Reed J. states:

> While the Federal Court of Appeal in Dresden stated that in order to be inventory, goods have to be owned by the

> taxpayer, there was no analysis in that case of the type of ownership interest that was required. There was no analysis of the situation in which the indicia of ownership are divided with someone other than the taxpayer holding the legal title until the point of sale. In addition, in this case the evidence establishes that treating the machines as inventory in the plaintiff's hands is consistent with ordinary commercial accounting and business practices because the risks and rewards associated with ownership rest with the plaintiff not Deere Canada.(emphasis added). [vi]

[17] Reed J. finds a qualification to the ownership criterion set down in *The Queen v. Dresden Farm Equipment Ltd.*[vii], but does so on a principled basis. That is, by establishing that, if the "risks and rewards" are to be the responsibility of the taxpayer, and therewith the risk of inflation, the taxpayer may be able to come within the scope of the deduction.

[18] Even if McKeown J. is mistaken in saying that GSW Ltd. did not own the goods on January 1, 1977, it certainly was not responsible for the "risks and rewards associated with ownership." If the bottom dropped out of the major appliance market on January 1, GSW would not have suffered. Furthermore, if inflation had run rampant, their profits would not have been skewed, because the price had already been established by the agreements signed in 1976. The rationale underlying the provision has no application to the appellant's situation. Further, that rationale is unrelated to the appellant's proposed interpretation of the Act.

[19] I, therefore, conclude that finished goods must also be held for sale in the ordinary course of the business. At all times during the taxation year 1977 the appellant held the goods for the purposes of transferring them to CAMCO. They were not held for sale in the ordinary course of the business to qualify for the deduction in paragraph 20(l)(gg). Consequently, the appeal will be dismissed with costs.

"A.M. Linden"

J.A.

"I agree
B.L. Strayer J.A."

"I agree
J.T. Robertson J.A."

i. 95 D.T.C. 5238 (F.C.A.).

ii. *Ibid*., at 5241.

iii. S.C. 1980-81, c. 48, ss. 10(7).

iv. *Ibid*., at 5241, see also *The Queen v. Mattabi Mines Ltd*., 89 D.T.C. 5357 (F.C.T.D.).

v. 97 D.T.C. 5279 (F.C.T.D.).

vi. *Ibid*., at 5283.

vii. 89 D.T.C. 5019 (F.C.A.).