

2017

36,1955

No. 12 of 1955.

In the Privy Council

UNIVERSITY OF LONDON
25 OCT 1956
INSTITUTION OF FINANCED
LEGAL STUDIES

ON APPEAL

FROM THE SUPREME COURT OF CANADA

BETWEEN

THE MINISTER OF NATIONAL REVENUE . *Appellant*

AND

ANACONDA AMERICAN BRASS LIMITED . *Respondent.*

44823

Case for the Appellant

10 1. This is an appeal by special leave from a judgment of the Supreme Court of Canada (Taschereau, Locke and Cartwright, JJ., Kerwin, C.J. and Estey, J. dissenting) pronounced on 1st November, 1954, dismissing the Minister's appeal from a judgment of the President of the Exchequer Court of Canada pronounced on 7th June, 1952. The latter judgment allowed an appeal of the Respondent Company from an assessment made for its 1947 tax year pursuant to the provisions of The Excess Profits Tax Act, 1940.

RECORD.
Vol. V, p. 1.
Vol. II, p. 405.

20 2. On the assessment of the income tax and excess profits tax of the Company for the year 1947, the Minister increased the amount of taxable income declared by the Company by the sum of \$1,611,756.43 as a result of reducing by that amount the cost attributed by the Company to the metals used by it during the year. The effect of increasing the taxable income was to increase the excess profits tax of the Company for 1947 by approximately \$241,000 and the income tax for 1947 by approximately \$483,000.

Vol. I, p. 38.

Only the excess profits tax is in issue on this appeal. The parties have agreed that on the income tax appeal they will regard themselves as bound by the outcome of this appeal.

Vol. I, p. 77, l. 29.

30 3. The Company also appealed from the assessment for income tax and excess profits tax for the year 1946, but the parties have agreed that that appeal should be dismissed without costs.

Vol. II, p. 406, l. 10.

4. The Excess Profits Tax Act, 1940, provides for payment of an excess profits tax by Section 3. That section reads as follows:—

“ 3. In addition to any other tax or duty payable under any Act, there shall be assessed, levied and paid a tax in accordance

with the rate set out in the Second Schedule to this Act upon the excess profits of every corporation or joint stock company residing or ordinarily resident in Canada or carrying on business in Canada . . . (1946, c. 47, s. 1)."

The rate set out in the Second Schedule is 15 per cent. of the excess profits in the case of corporations or joint stock companies.

"Profits" are defined by Section 2 (1) (f) of the Act as follows:—

"(f) 'profits' in the case of a corporation or joint stock company for any taxation period means the amount of net taxable income of the said corporation or joint stock company as determined under the provision of the *Income War Tax Act* in respect of the same taxation period, . . . (1940-41, c. 15, s. 1) . . ."

The net taxable income of corporations as determined under the *Income War Tax Act* is, generally speaking, income as defined by Section 3 (1) of that Act, which reads in part as follows:—

"3. (1) for the purposes of this Act 'income' means 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 as being 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 from any profession or calling, or from any trade, manufacture or business, as the case may be whether derived from sources within Canada or elsewhere; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source including . . ."

The effect of these provisions is that the amount of excess profits tax payable depends upon the amount of the "annual net profit or gain" of the Company for the year 1947.

5. The "annual net profit or gain" of the Company for 1947 consists, it is submitted, of the difference between the Company's receipts for the year and its expenditures laid out to earn those receipts. The largest expenditure laid out by the Company to earn its receipts for 1947 was the cost of the metals used by it in manufacturing its metal products.

The question raised by the Company's appeal from the Minister's assessment was as to the correct amount of this expenditure.

6. The Company carries on the business of purchasing metals, manufacturing them into sheets, rods and tubes and selling the manufactured metals. It purchases its metals from refineries on the terms quoted to it

by the refineries. About 98 per cent. of the metals purchased by the Company consist of copper (over 80 per cent.) and zinc (about 15 per cent.). The other principal metals are lead, tin and nickel.

p. 104, l. 6 ;
p. 134, l. 1

The prices which the Company charges for its products are closely related to the prices paid by it to replace the metals used in manufacturing its products. When market prices of metals purchased by the Company are increased, the prices charged by it for its products are immediately increased to a corresponding extent.

Vol. I—
p. 83, l. 1.
p. 107, l. 1.

10 The Company is constantly purchasing metals to replace the metals being used. Its practice is to make an estimate at the beginning of each month of the quantity of metals which will be used during the next month and to order from its suppliers the same quantity to replace such metals. The Company maintains an inventory of metals at all times amounting to approximately one-third to one-quarter of its annual requirements so that the Company turns over its inventory approximately three or four times a year. About two-thirds of the copper and zinc inventory is continuously in process in the plant, indicating that the average time in process is about eight weeks.

Vol. I, p. 110, l. 20.

Vol. I, p. 134, l. 22.

Vol. I—p. 131, l. 13 ;
p. 134, l. 11 ; p. 139,
l. 19.

20 7. The Company did not maintain records from which the actual metals used during the year could be identified and from which the amounts paid for those metals could be determined. The Company did, however, keep records of the quantities of metals in its inventory at the first of the year, the quantities of metals purchased during the year and the quantities of metals in its inventory at the end of the year. It also kept records of the prices paid for the metals purchased from time to time.

Vol. I, p. 127, l. 25.

From the Company's records the quantities of metals used during the year could be readily determined and there is no dispute as to the number of pounds of each metal used. The dispute is as to the cost of the metals used during the year.

30 8. There is no difference between the Company and the Minister as to the procedure to be followed in determining the cost of the metals used during the year. To the cost of the metals in the inventory at the first of the year is to be added the amount paid for the metals purchased during the year. From this total is to be deducted the cost of the metals in the inventory at the end of the year and the difference will be the cost of the metals used during the year.

40 9. It is apparent that there is a direct relationship between the cost attributed to the closing inventory of metals and the amount that will be arrived at as the cost of the metals used. If the cost attributed by the Company to the closing inventory is too low, as the Minister contends it was in this case, the amount arrived at as the cost of the metals used will be too high by the same amount. Since the cost of metals is deductible as an expense from the Company's receipts, the result of the cost of the metals being too high is that the profits will be too low.

10. On the assessment of the Company for 1947 the Minister increased the cost attributed by the Company to its closing inventory thereby decreasing the amount attributed by the Company to the cost of the metals used by it during the year and increasing its taxable profits for the year.

On its appeal from the assessment the Company contended that the cost attributed by the Minister to the closing inventory of metals and therefore to the metals used was incorrect.

11. In the absence of records from which the metals in the Company's inventory and therefore the metals used during the year could be identified, the Minister could not ascertain the precise cost to the Company of the metals used during 1947. What he did was to assume that the metals used during the year were those which had been longest in the inventory and he determined the cost of those metals from the Company's records. 10

The Minister's assumption that the first metals to come into the inventory would be the first metals used by the Company is known as the first-in-first-out or FIFO assumption.

12. When the true profits of a company cannot be determined precisely and no method of calculation is prescribed by statute or regulations, an estimate must be made and the method of estimate which should be used is, it is submitted, that method which will give results approximating most nearly the true profits : *Sun Insurance Office v. Clark* [1912] A.C. 443. 20

13. This principle, it is submitted, applies to the determination of the cost of metals used by the Company because the true cost cannot be determined precisely and no method of calculation is prescribed by the Act or by regulations.

It follows that in order to succeed on its appeal from the Minister's assessment it was for the Company to establish that it had adopted a method of estimate which gave results approximating more nearly the true cost of metals used than the method adopted by the Minister. 30

14. The Company arrived at the cost of the metals used during 1947 by attributing to the metals used during the year the metal costs most recently incurred by the Company. The Company contended that in computing its profits for a fiscal year the amount to be deducted as the cost of metals is not the cost of the actual metals used during the year, but an amount to be determined by a method which the Company recognised was not designed in any sense to approximate the cost of the actual metals used during the year. Its contention was that the last metal costs incurred should be the first metal costs charged against its operations. 40

This method whereby the last costs incurred are the first costs charged has come to be known as the last-in-first-out or LIFO method.

Vol. I, p. 96, l. 11 ;
p. 107, l. 1 ; p. 125,
l. 1 ; p. 259, l. 14 ;
p. 292, l. 24 ; p. 283,
l. 31.

15. The LIFO method as adopted by the Company, unlike the FIFO method as adopted by the Minister, is not a method of estimating what the Company in fact paid for the metals used during the year.

16. If the cost of metals which the Company is entitled to deduct as an expense in determining its net profit or gain for 1947 is what the Company paid for the actual metals used during the year, then the cost as determined by the Minister on the FIFO assumption is a closer approximation of the true cost than the figure arrived at by the Company by the LIFO method. This is quite clear from the evidence and has not been
10 challenged by the Company.

17. The effect of the LIFO method, as applied by the Company, is that a figure is taken for the cost of the metals used during any period which reflects substantially the prices at which purchases were made by the Company during the same period. In other words, the effect of the LIFO method is that quantity for quantity the figure taken as the cost of the metals used reflects the replacement cost of such metals.

Vol. II, p. 419, l. 22.

18. If the amount which the Company is entitled to deduct as its cost of metals is in effect the cost of replacing the metals used, then the Minister would concede that the cost in that sense is more accurately
20 determined by the LIFO method than by the FIFO assumption. It is submitted, however, that the amount which may be charged against the receipts of the Company as its cost of metals in determining its profits for tax purposes is what the Company paid for the metals used and not what it paid for the metals purchased to replace the metals used.

19. For the taxation years preceding 1946 the Company had always adopted the FIFO assumption in determining the cost of its inventory of metals for tax purposes. Starting with the year 1936, however, it had adopted the LIFO method of determining the cost of its inventory of copper and zinc for corporate purposes. During the years 1936 to
30 1945 the prices of metals remained relatively constant and, accordingly, the difference in the amount of the Company's taxable income resulting from the application of the FIFO assumption or the LIFO method in determining the cost of its inventory would be relatively small.

Vol. I, p. 157, l. 18.

Vol. III, Ex. 7.

20. Before the Company's tax return for the year 1946 was filed under date of 16th June, 1947, very considerable increases in the prices of copper and zinc had occurred as a result of the relaxation and later of the removal of the wartime price controls. In the case of copper, the price increased on 22nd January, 1947, from 11.5 cents per pound to 16.625 cents per pound and on 10th June, 1947, to 21.5 cents per pound.
40 In the case of zinc, the price increased on 22nd January, 1947, from 5.75 cents per pound to 10.25 cents per pound and on 10th June to 11 cents per pound.

Vol. I, p. 122, l. 1.

Vol. I, p. 102, l. 22.

Vol. III, Ex. 1.

21. It was apparent to the Company that the effect of these price increases would be to cause a substantial difference between its taxable income as computed on the FIFO assumption and as computed by the LIFO method. Accordingly, the Company adopted the LIFO method of

Vol. I, p. 88, l. 23;
p. 89, l. 24; p. 121,
l. 1.

Vol. I, p. 157, l. 23.

determining the cost of its inventories of copper and zinc for tax purposes starting with the year 1946, and in determining also the cost of its inventories of lead and tin starting with the year 1947.

Vol. I, p. 87, l. 6;
p. 123, l. 7.

The Company knew that the LIFO method of determining the cost of its inventories was not acceptable to the Minister as a means of arriving at its income for tax purposes.

Vol. I, p. 165, l. 12.

22. During 1946 the prices of metals did not change. For that year, therefore, the amount of the Company's taxable income arrived at by determining the cost of its inventories of copper and zinc by the LIFO method was the same as that arrived at on the FIFO assumption. 10

23. During 1947, however, due to the increases in the prices of metals, the amount of the Company's taxable income arrived at by determining the cost of its inventories of copper, zinc, lead and tin by the LIFO method was very much less than that arrived at by determining its cost of such inventories on the FIFO assumption.

As a result of the Company changing to the LIFO method for 1947, it reported its taxable income for 1947 at an amount which was very much less than that determined by the Minister following his usual practice of applying the FIFO assumption.

24. The reason why the Company, by adopting the LIFO method in 20 determining the cost of its inventory, arrived at a much smaller amount than that arrived at by the Minister on the FIFO assumption, can be shown by comparing the results of applying LIFO and FIFO to determining the cost of copper in the closing inventory for 1947.

Vol. III, Ex. 7.

25. There were 14,291,007 pounds of copper in the Company's inventory as at 31st December, 1947.

Vol. III, Ex. 7.

The method adopted by the Company in determining the cost of this copper applying LIFO (which in the case of copper had first been adopted for corporate purposes in 1936) was as follows :—

(A) 6,500,000 pounds were regarded as having a cost of 30
7.5 cents per pound (the average cost of the copper in the inventory when LIFO was adopted in 1936) amounting to \$487,500 ;

(B) 802,697 pounds were regarded as having a cost of 9.466
cents per pound (the average price paid in 1936) amounting to \$75,983.30 ;

(C) 17,577 pounds were regarded as having a cost of 11.191
cents per pound (the average price paid in 1937) amounting to \$1,967.04 ;

(D) 639,807 pounds were regarded as having a cost of 10.443
cents per pound (the average price paid in 1938) amounting to 40
\$66,847.04 ;

(E) 973,477 pounds were regarded as having a cost of 11.036 cents per pound (the average price paid in 1939) amounting to \$107,432.92 ;

(F) 3,151,684 pounds were regarded as having a cost of 11.5 cents per pound (the price paid in 1945) amounting to \$362,443.66 ;

(G) 2,205,765 pounds were regarded as having a cost of 11.5 cents per pound (the price paid in 1946) amounting to \$253,662.97.

The total cost of the 14,291,007 pounds of copper in the Company's closing inventory was, therefore, determined by the Company by the
10 LIFO method to be \$1,355,836.93.

26. The method adopted by the Minister in determining the cost of this copper applying FIFO was to assume that the copper most recently purchased in 1947 would be the copper on hand at the close of the year. Accordingly he assumed that the 14,291,007 pounds of copper left in the inventory at the close of the year was the last copper to have been purchased by the Company during that year and he calculated the cost of this copper on the basis of the price paid for the last 14,291,007 pounds purchased. Vol. II, p. 350, l. 6.

During the year 1947 the Company purchased 63,268,555 pounds of copper. From 10th June, 1947, to the end of that year, the price paid
20 for copper was 21.5 cents per pound and more than 14,291,007 pounds (the quantity in the closing inventory) had been purchased at that price in the last three months of the year. The Minister determined the cost of the copper in the closing inventory, therefore, at the price of 21.5 cents per pound which would amount to \$3,072,566.50. Vol. III, Ex. 7.
Vol. II, p. 231, l. 26.

27. It will thus be seen that the cost attributed by the Minister on the FIFO assumption to the Company's closing inventory for 1947 was based upon the increased prices paid for the metals last purchased since it was assumed that the metals purchased had not been used, but were still in the inventory. In the case of copper, the price of the metals last
30 purchased was the current price of 21.5 cents per pound.

On the other hand, the cost attributed by the Company by the LIFO method to its closing inventory for 1947 was based upon prices paid for metals prior to the 1947 price increases. Indeed, in the case of copper the price attributed by the Company to almost half its inventory was 7.5 cents per pound, a price which was less than any price prevailing since 1935.

28. As a result of the different methods adopted, the cost attributed by the Minister to the Company's closing inventory was greater by \$1,611,756.43 than the cost attributed by the Company to its closing
40 inventory ; the cost attributed by the Minister to the metals used during 1947 was less by \$1,611,756.43 ; and, finally, the taxable profits of the Company as determined by the Minister were greater by \$1,611,756.43 than as determined by the Company. Vol. I, p. 38.

29. The important difference in principle between the parties on this appeal has arisen in the form of a competition between two methods of determining cost of inventories of metals and cost of metals used, namely, the FIFO method adopted by the Minister and the LIFO method adopted by the Company.

The question as to which of these two competing methods is the proper method depends, it is submitted, upon whether in determining the "annual net profit or gain" of the Company for purposes of The Excess Profits Tax Act the cost which may be charged against the Company's receipts is what the Company paid for the metals actually used in the year or what the Company paid for the metals last purchased by it. 10

30. The Company's position has been that it is entitled to charge against its receipts as its cost of metals for a fiscal year, what it paid for the metals last purchased regardless of whether such metals were in fact used in the year.

The argument which has been advanced by the Company in support of its position is, briefly, as follows: since the Act does not make any provision as to the method by which a taxpayer is to determine its costs of metals, such cost is to be determined in accordance with commonly accepted commercial and accounting principles, the LIFO method of determining the cost of metals is an acceptable accounting method and in the circumstances of this case is the method which, according to accepted commercial and accounting principles, most accurately reflects the income of the Company. 20

31. The Company did not attempt to establish that it had adopted a method of estimating the cost of the metals actually used by the Company which would more nearly approximate what the Company had paid for those metals than the method adopted by the Minister.

What the Company attempted to establish was that its method of arriving at a figure for the cost of metals was an acceptable accounting method and the appropriate method in the circumstances. For this purpose the Company called a number of chartered accountants as witnesses. 30

32. The learned President of the Exchequer Court found that the weight of the accounting evidence was to the effect that the LIFO method is an acceptable and recognised inventory accounting method in the circumstances that are appropriate to it and that it was appropriate in the circumstances of the Company's business. The majority of the Supreme Court of Canada agreed with the learned President.

Vol. II, p. 429, l. 6.

Vol. V, p. 8, l. 5:
p. 15, l. 45;
p. 16, l. 2.

To the extent that the learned President's finding was a finding of fact, it is not challenged by the Minister. It is submitted with all respect, however, that the finding of fact is irrelevant to the real issue to be determined in the case. 40

33. Even though LIFO may be an acceptable accounting method for certain purposes and in certain circumstances, it is not, it is submitted, an acceptable method for tax purposes because profits as determined by the LIFO method are not the true "profits" of the Company within the meaning of the Act.

34. In order to determine its "profits" within the meaning of the Act, the Company should, it is submitted, have deducted as its cost of metals used an amount representing what it paid for the metals actually used as nearly as that could be determined. By the LIFO method it
10 deducted as its cost of metals used an amount representing what it paid for the metals purchased to replace the metals used.

35. The real issue is not, therefore, whether the LIFO method is an acceptable and appropriate accounting method for certain purposes and in certain circumstances. The real issue, it is submitted, is whether in determining the Company's profits for tax purposes the cost of metals which may be deducted as an expense is what the Company paid for the metals actually used by it as nearly as that can be determined, as the Minister contends, or what the Company paid for the metals purchased to replace the metals used, as the Company contends.

20 36. The evidence adduced by the Company indicated that the LIFO method has now been widely adopted in the United States by companies carrying on certain types of business, but that it was not permitted to be adopted for tax purposes in the United States until 1938. An amendment made in that year to the United States revenue laws permitted its adoption subject to certain conditions. This amendment was, however, found to be unworkable and in 1939 further amendments were made. Vol. II, p. 290, l. 4. Vol. II, p. 300, l. 32.

30 According to the evidence the main reason why companies in the United States have changed to LIFO since 1939 is the tax advantage to be gained as a result of the rising prices since that time. Vol. II, p. 337, l. 19 p. 340, l. 2; p. 343, l. 26.

37. It is apparent from the evidence that the LIFO method of determining costs reflects an evolution in accounting thinking that has originated in the United States in comparatively recent years. It has never been recognised by the revenue authorities in Canada as being an acceptable method for ascertaining profits for tax purposes.

40 38. In his judgment, the President of the Exchequer Court pointed out that LIFO had been formulated by accountants to reflect the opinions of practical business men who considered that when a business was carried on in such a way that sales prices closely reflect replacement costs the correct profit or loss of a business cannot be determined by the FIFO method. He stated that the LIFO method was a radical change in accounting practice and had been criticised on the grounds that it did not reflect physical realities, that it excluded inventory profits from the computation of income and that it resulted in a valuation of the closing inventory that was meaningless from the point of view of the balance sheet. With respect to this last criticism, he stated that the accounting Vol. II, p. 425, l. 10. Vol. II, p. 425, l. 22. Vol. II, p. 426, l. 16.

profession had agreed that when there is a conflict between the method which would lead to a more correct determination of income and one that might be preferable from the balance sheet point of view, the balance sheet must give way to the income account.

Vol. II, p. 427, l. 24. The learned President was of the view that the problem in the case was the ascertainment of the Company's materials cost which may properly be chargeable against its gross income for 1947. He considered that what costs are properly chargeable against gross income must depend upon accepted business and accounting principles. The question for decision, in his view, was whether the LIFO method properly ascertained 10 the Company's materials cost and this, he thought, depended upon whether that method is an acceptable accounting method and whether it is appropriate in the circumstances of the Company's business.

Vol. II, p. 429, l. 6. On the basis of the evidence before him, he found that the LIFO method is an acceptable and recognised inventory accounting method in the circumstances that are appropriate to it. He also found that the LIFO method is appropriate in the circumstances of the Company's 10 business and that the FIFO method is not a proper one. He, therefore, allowed the Company's appeal from the assessment.

Vol. II, p. 430, l. 9.

39. It is respectfully submitted that the learned President of the 20 Exchequer Court erred in regarding the question for decision to be whether the LIFO method is an acceptable accounting method and whether it is appropriate in the circumstances of the Company's business.

The real question for decision is, it is submitted, whether in determining the "annual net profit or gain" of the Company for the purposes of the Excess Profits Tax Act, the Company is entitled to deduct as its cost of metals, the price paid for the last metals purchased or whether, as the Minister contends, it must deduct as its cost of metals the price paid for the metals actually used, as nearly as that can be determined.

40. The Supreme Court of Canada by a majority of three to two 30 dismissed the Minister's appeal from the judgment of the Exchequer Court.

Vol. V, p. 5, l. 36.

Vol. V, p. 6, l. 13.

41. Chief Justice Kerwin, who dissented, after referring to certain 40 authorities, reviewed the evidence. In the course of his review, he drew attention to the fact that in the case of copper, which accounts for more than 80 per cent. of the metal content of the Company's products, the Company using the LIFO assumption attributed to its closing inventory prices which had been paid by the Company as long ago as 1936. In his view what is required is the cost of the metals used so as to ascertain the profit for the year and not what the Company adopts as a wise plan to cover fluctuations over the years in the cost of its raw materials. He thought that an assumption (referring to the LIFO method) the result of which indicates that 6,500,000 pounds of copper has been in the premises since 1936, would be unwarranted.

The learned Chief Justice pointed out that in the United States FIFO had been in use for years and that it was only when legislation was passed which permitted the use of LIFO, subject to certain conditions, that the United States Company, which is the parent of the Respondent Company, made its tax returns on the LIFO basis. Even though the LIFO assumption is recognised as a proper accounting method for corporate purposes, he was of the opinion that the authorities show that that is not sufficient and, therefore, the view of the learned President of the Exchequer Court that the question to be determined was whether LIFO was an acceptable accounting method for the Company was incorrect. The learned Chief Justice further held that the LIFO method does not determine the Company's profits for 1947 more accurately than the FIFO method, but that the latter is more in accordance with the known facts. He would, therefore, have allowed the appeal.

Vol. V, p. 7, l. 21.

Vol. V, p. 7, l. 36.

42. Mr. Justice Estey, who also dissented, referred to passages from the evidence of the accountants called to give evidence on behalf of the Company which make it clear that the LIFO method is not intended to indicate physical flow of metals and that their acceptance of LIFO is based on the accounting view that the physical identification of metals used is not a factor governing the determination of income.

In the opinion of Mr. Justice Estey, the issue raised is whether under the taxing statutes the Minister must accept returns computed upon any recognised accounting system which is deemed appropriate to its business by a company or whether the Minister may insist upon that accounting system which will the more closely arrive at the actual value of the inventory. He thought that the problem which must be decided for taxation purposes was which of the two methods, FIFO or LIFO, more nearly approaches the actual value or market value and that because a particular method has the greatest merit from a corporate point of view, it does not follow that it must be accepted for taxation purposes.

Vol. V, p. 10, l. 18.

Vol. V, p. 11, l. 20.

He referred to certain authorities and to the history of the development of the LIFO method in the United States and the conditions imposed on the use of the method by the United States revenue laws. He concluded that the Minister was justified in refusing to accept the LIFO method and in requiring the Company to compute its inventories upon a basis that more nearly approximated its current market value. He would, therefore, have allowed the appeal.

Vol. V, p. 14, l. 44.

43. Mr. Justice Locke stated that the point to be determined is as to what is the method of inventory accounting which will more accurately determine the income of the Company for 1947, as that term is defined in the Act. Since the Act does not define the manner in which manufacturing costs such as the cost of metals are to be calculated, they are to be determined, in his opinion, upon the ordinary principles of commercial trading. On his consideration of the evidence, it was his conclusion that in a business operation such as the one in question, the LIFO method determines the true income with greater accuracy than any other method which it was practical to apply. He agreed with the conclusion of the learned President.

Vol. V, p. 15, l. 22.

Vol. V, p. 15, l. 37.

Vol. V, p. 16, l. 12.

44. Mr. Justice Cartwright agreed with the reasons and conclusion of the learned President and added only a few observations. He considered that the question was as to which of two well-recognised systems of accounting will most nearly arrive at the true figure for the material cost of the Company's sales for the year and that that question was one of fact. In his opinion, the evidence supported the findings of fact made by the learned President.

Vol. V, p. 8, l. 5.

45. Mr. Justice Taschereau would dismiss the appeal for the reasons given by Mr. Justice Locke and Mr. Justice Cartwright.

46. It is respectfully submitted that the learned President and the majority of the Supreme Court of Canada erred in their view that the question in issue in the appeal is a question of fact, namely, whether LIFO is an acceptable and appropriate accounting method. 10

As has already been submitted, the question in issue in the appeal is whether, in determining the Company's "annual net profit or gain" for the purposes of The Excess Profits Tax Act, the amount which may be deducted as the cost of metals is what the Company paid for the metals actually used by it as nearly as that can be determined. This question, it is submitted, is a question of law, not a question of fact and is not dealt with in the judgment of the learned President or in the majority judgments in the Supreme Court. 20

It is submitted, with all respect, that Mr. Justice Locke in referring to "true income" and Mr. Justice Cartwright in referring to "the true figure for the materials cost" and the "true gain" begged this question. These learned judges did not deal in their judgment with the question as to what constitutes the cost of metals and therefore as to what is meant by "true income" and "true gain" and that was the substantial question raised by the Minister in his appeal to the Supreme Court.

47. If, as the Minister contends, the Company's cost of metals in determining its profits for tax purposes is what the Company paid for the metals actually used, no question of fact arises at all because the Company has not suggested that its cost of metals in that sense can be determined more accurately by the LIFO method than by the FIFO method. 30

If, on the other hand, the Company's cost of metals in determining its profits for tax purposes may be an amount which is arrived at in accordance with an acceptable and appropriate accounting method, again no question of fact arises. There is no doubt that the weight of expert evidence adduced on the appeal is that the LIFO method is an acceptable and appropriate accounting method.

48. The effect of the judgment of the majority of the Supreme Court is that what is meant by "profits" of a company in the Act is to be determined by currently acceptable accounting principles and that such principles are to be established by a preponderance of the evidence of accountants in a particular case. 40

Such evidence, however, may vary from case to case according to the particular accountants called to give evidence and may vary from time to time in accordance with changes in accounting principles. If the judgment of the majority of the Supreme Court were right, it would follow that the meaning attributed by the Court to the word "profits" in the Act may vary according to the evidence adduced in a particular case and according to changes in the opinion of accountants from time to time.

10 49. The Minister recognises that in addition to the tax advantage the Company would gain by having its cost of metals and therefore its profits determined by the LIFO method, there may be other advantages to the Company in the adoption of that method. It may, for example, be a matter of prudent management for the Company for its own corporate purposes to use the LIFO method in order to determine the profits which may safely be distributed as dividends.

It is respectfully submitted, however, that considerations of what is desirable as a matter of prudent management for a company's own corporate purposes have no bearing upon the determination of profits for tax purposes.

20 50. The LIFO method of valuing inventories and determining the cost of materials used by a taxpayer is, according to Company witnesses, a member of the same family of accounting principles as the "base stock method." In the United States, the base stock method was severely criticised by Mr. Justice Brandeis in delivering the judgment of the Supreme Court of United States in *Lucas v. Kansas City Structural Steel Company* [1930] 281 U.S. 264 ; 50 S. Ct. 263. Mr. Justice Brandeis was of the view that in years of rising prices it causes an understatement of income because it disregards the gains actually realised through the liquidation of low price stock on a high price market and was inconsistent
30 with the annual accounting required for tax purposes.

Vol. II, p. 278, l. 25.

51. In England, the Court of Appeal has also held in *Patrick v. Broadstone Mills Limited* [1954] 1 W.L.R. 158, that the base stock method is not a proper method of determining the cost of a company's inventory for tax purposes or the cost of materials used by a company. It was the unanimous view of the Court of Appeal that however well recognised the base stock method might be for company accounting purposes it was not a proper method of accounting for tax purposes.

40 52. It is submitted that the reasons given by Mr. Justice Brandeis in the Supreme Court of United States and by the Court of Appeal in England for rejecting the base stock method as a method of determining profits for tax purposes, support the views expressed by Chief Justice Kerwin and Mr. Justice Estey in dissenting from the decision of the three majority judges of the Supreme Court of Canada.

53. The Minister respectfully submits that this appeal should be allowed for the following among other

REASONS

- (1) BECAUSE the use of the LIFO method in respect of the year 1947 causes an understatement of the Respondent's profits for the purposes of the Excess Profits Tax Act, 1940.
- (2) BECAUSE the use of the LIFO method in respect of the year 1947 disregards the profits realised by the Respondent on the sale of low cost metals on a high 10 price market.
- (3) BECAUSE the cost of metals as determined by the LIFO method is the replacement cost of the metals used, whereas it is the cost of the metals used, not their replacement cost, which is properly deductible as an expense in determining profits for the purposes of the Excess Profits Tax Act, 1940.
- (4) BECAUSE the cost of metals as determined by the LIFO method does not approximate more nearly the true cost of the metals used than the cost as determined 20 on the FIFO assumption.
- (5) BECAUSE the LIFO method is not an attempt to arrive at the true cost of the metals used but determines an amount as "cost" by reference to an arbitrary standard.
- (6) BECAUSE the LIFO method is an indirect way of appropriating a part of the profits for a year as a reserve in respect of the enhanced cost of replacement of stock-in-trade.
- (7) BECAUSE profits as determined by the LIFO method 30 are not the profits of the Respondent for the purposes of the Excess Profits Tax Act, 1940.
- (8) BECAUSE the judgments of Kerwin, C.J., and Estey, J., are right.

C. F. H. CARSON.

W. R. JACKETT.

ALLAN FINDLAY.

F. N. BUCHER.

No. 12 of 1955.

In the Privy Council.

ON APPEAL

from the Supreme Court of Canada.

BETWEEN

THE MINISTER OF
NATIONAL REVENUE . *Appellant*

AND

ANACONDA AMERICAN
BRASS LIMITED . . *Respondent.*

Case for the Appellant.

CHARLES RUSSELL & CO.,
37 Norfolk Street,
Strand, W.C.2,
Solicitors for the Appellant.