The Role of Accounting in Tax Law

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An interesting effect of the development of Canadian income tax legislation is the mutual respect and cooperation which has been generated between the accounting and law professions over the years. Relationships between lawyers and accountants have become increasingly more harmonious and each profession has recognized the vital role played by the other in the income tax field. The old adage that "Necessity is the Mother of Invention" can perhaps be properly applied to an analysis of the interrelationships which have developed between these two professions - the "necessity" being the need to provide the utmost of competent service to clients and the "invention" being the combining of skills of the two professions to provide such services.

The spirit of cooperation between lawyers and accountants is not one of just peaceful co-existence, nor is it by any means a mere acknowledgement by each profession that the other has some rights to practice in the tax field. Quite the contrary is the case. For example, there has been an active participation and collaboration of outstanding practitioners from both professions in carrying on the work of the Canadian Tax Foundation. The Foundation may be described as an independent tax research organization whose purpose is to provide the tax-paying public and the governments of Canada with the benefit of expert and impartial research into problems of taxation and government finance. Its Governors are nominated jointly each year by the Canadian Bar Association and the Canadian Institute of Chartered Accountants. Thus the Foundation provides a clear illustration of the united efforts of lawyers and accountants to furnish the general public with the benefit of many years of specialized training and practical experience.

The friendly association between the two professions is further enhanced by the implied understanding between them that each will stay within the field in which it is competent to practice. As is so often the case in dealing with clients on tax matters, the affairs of the client will require both legal and accounting advice. Practising accountants readily refer their clients to solicitors when the clients'

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problems touch on legal matters on which the accountant is not competent to advise, and it has also been the experience that lawyers likewise will direct their clients to seek accounting advice when the circumstances warrant it.

Another good example of joint effort by accountant and lawyer is the filing of Notices of Objection to the Minister of National Revenue and the filing of Notices of Appeal to the Tax Appeal Board or the Exchequer Court. In dealing with a Notice of Objection, for instance, the accountant will frequently prepare a synopsis of facts which he feels should be presented in the appeal. Since he is familiar with the financial affairs of his client, the accountant is usually the person in the best position to furnish all the relevant data which are vital to a successful appeal. However, having ascertained the salient facts for such an appeal, the accountant will then suggest to his client that this Notice of Objection be reviewed by a solicitor. Being a legal document the Notice of Objection should under no circumstances be prepared solely by an accountant.

When an appeal is being heard by the courts, it is best to remember that accountants are not competent to plead cases for their clients; this is an act which is wisely the exclusive prerogative of the taxpayer's legal counsel. In certain provinces, cases before the Tax Appeal Board may be pleaded by accountants or the appellant may act on his own behalf; while such permission may be granted to accountants it is preferable that they should not make use of this privilege. The Exchequer Court, on the other hand, permits only lawyers to defend taxpayers' cases heard before it. The accountant can, however, and often does, function as counsel to the lawyer. Here again, the accountant, being readily conversant with his client's financial affairs, can supply the lawyer with information which often means the difference between winning and losing a case.

Accountants may also be called upon to serve as witnesses in tax cases. They may merely supply or authenticate information without any explicit expression of an opinion or they may testify as expert witnesses where they are asked to express opinions based on their professional judgment and their appraisal of given information.

Given the broad context of the mutual relationship between practising lawyers and accountants in matters of income tax law, a careful analysis of the role played by each profession is necessary before we can fully comprehend the need for the existence of each profession in this field. A description of the role played by lawyers is of course better left to be done by lawyers themselves since only they are competent to make such an analysis. On the other hand, the role of accountants can perhaps be best understood by a focus on four different aspects of their income tax practice: first, the rules governing the accountants' practice in this field; secondly, the role of accounting in defining the income concept under our tax legislation; thirdly, an outline of some of the anomalies which presently exist in our tax law; and, finally, a comment on the accountants' suggestions to remedy the existing anomalies.

I. Rules Governing Accountants in Income Tax Practice.

First, it may be useful to understand the "terms of reference" within which Chartered Accountants conduct their public practice. In the province of Quebec, practising Chartered Accountants are governed by the Quebec Institute whose main object is to maintain the status of its members; promote the efficiency and usefulness of its members; and regulate their discipline and professional conduct. In this connection it has embodied certain restrictions in its Rules of Professional Conduct which provide, in part, as follows:

> "1. Professional competence.
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> While the attached rules contain no specific provisions relating to the maintenance of adequate standards of competence by members of the Institute, members are reminded that under the general heading "Spirit of the Profession" they are required at all times to maintain the standards of competence which the Institute and its members have established. If a member signs or in any way associates himself with any statement, exhibit, schedule or any form of accountancy report, whether for publication or not, which is prepared in a manner which might tend to be misleading or in any way to disgnise the actual situation, or if a member expresses an opinion on financial statements examined by him when he has failed to obtain sufficient information to warrant such expression of opinion, he may expose himself to a civil claim based on negligence, incompetence or misrepresentation. The determination of guilt in such cases is obviously the responsibility of the courts. Nevertheless, where such gnilt is established, or where, in the opinion of Council, the actions of the member have tended to bring the profession to disrepute, the member may be subject to the disciplinary procedures of the Institute".

It is interesting to note that the *Quebec Bar Act* [1] grants to accountants the right to give tax advice to clients and to prepare certain types of documentation. This permission is clearly set out in Article 6 and provides as follows:

> "6. 1. Nothing in the foregoing article forbids accountants referred to in Chapters 47 and 89 of 10 George VI, 1946, and amendments thereto, within the limits of said laws and amendments, to give advices and consultations on all questions of a financial, administrative or fiscal nature, to prepare and submit to whom it might concern plans of financial or fiscal administration, organization and reorganization, to prepare and submit sur-

[1] 2-3 Eliz. II, S.Q. 1953-54, ch. 59.

veys, statements and declarations of the same nature, including tax statements of all kinds, to discuss with all persons having authority in the matter all and every kind of tax assessments and also to prepare and give Notices of Appeal to the Minister of Finance of Canada and to discuss with him or the officers of his department of the merits of the assessments imposed upon their clients with respect to income tax."

Given the general rules which govern practising accountants, we readily come to the conclusion that accountants have been given certain rights in the income tax field. Why ? Have they usurped these rights by default or is accounting itself vital to tax law ? This question can be best answered by an analysis of the very heart of our income tax legislation - the concept of income.

II. Role of Accounting in Defining the Concept of Income

A study of the income concept must emphasize the function of accounting in the determination of income. The measurement of income is the foundation stone upon which all of our tax legislation is built. While there are many sections of the *Income Tax Act* [2] dealing with the computation of income, an analysis of only several of these sections will provide a basic understanding of the meaning of "income". These sections are the following:

"Sec. 4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

Sec. 12(1)(a). In computing income, no deduction shall be made in respect of an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.

Sec. 12(1)(b). In computing income, no deduction shall be made in respect of an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part."

Undoubtedly, a layman not conversant with the provisions of our income taxing statute would consider the wording and meaning of Section 4 to be perfectly clear and unequivocal. He would appear to be justified in doing so since the key word, "profit", would be assumed to have the same meaning to everyone. Unfortunately, such is not the case. There is no unanimity of opinion on the determination of a profit and consequently we must have a closer look at the principles which govern its calculation.

Since the *Income Tax Act* does not provide a definition of a "profit" one must refer to the courts and prior jurisprudence to find some guidelines. In this respect the courts have held that ordinary generally

[2] R.S.C. 1952, ch. 148.

accepted principles of commercial trading and accounting practice will govern in determining income unless there is specific provision in the Act to the contrary. To avoid confusion, it should be noted that the words "profit" and "income" are synonymous from an accounting viewpoint. However, having determined "income" as defined by accountants it is then necessary to make certain adjustments to that income to arrive at "income" as defined by the *Income Tax Act.* Hence, in accordance with Section 4, the accountant's version of income after being ajusted in accordance with certain specific provisions of the Act, becomes the income for tax purposes.

In *Publishers Guild of Canada Limited* v. *M.N.R.*[3] Thorson, J., puts accounting principles and expert accounting evidence into their proper perspective and emphasizes the important role they play in income tax law.

He says, at pages 16-17:

> "At this stage it would, I think, be appropriate to make some remarks of a general nature regarding the role of accountancy experts in income tax cases. The accounting profession is not a static one and the system of accounting which accountants should apply to the accounts of the business in which they are called upon to act are not immutable. A system of accounting that would be appropriate to one kind of business is not necessarily appropriate to a different kind. Only an arbitrary minded person would contend that there is only one system of universal applicability. No reasonable person would do so. But while accountants devise changes in systems of accounting to meet the changing conditions in the business world and new ways of conducting business, their guiding principle must always be the same. Accounting is really the recording in figures, instead of words, of the financial implications of the transactions of the business to which it is applied. The accountant is thus the narrator of the transactions, his narrative being in the form of figures instead of words. His narrative should be such as to disclose to persons understanding his language of figures the true position of his client's business at any given time or for any given period. The accountant cannot fulfil the duty thus required of him unless he has carefully considered the manner in which his client carries on his business and has applied to it the system of accounting that is appropriate to it and most nearly accurately reflects its financial position including its income position, at the time or for the period required.
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> But the court must not abdicate to accountants the function of determining the income tax liability of a taxpayer. That must be decided by the court in conformity with the government income tax law. If the law does not prohibit the use of a particular system of accounting, then the opinion of accountancy experts that it is an accepted system and is appropriato to the taxpayer's business and most clearly reflects his income position should prevail with the court if the reasons for the opinion commend themselves to it."

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[3] [1957] C.T.C. 1.

If accountants are charged with the responsibility of determining profit, what, then, is their definition of the term ?

Such a definition is found in *Accounting Terminology* published by the Canadian Institute of Chartered Accountants. It reads as follows :

> "Profit. - This term is used in several different senses. Usually it refers to the gain resulting from business operations and indicates the excess of revenue over expense. From the accountant's viewpoint, the measurement of profit calls for the maintenance of "money" capital. From the economist's viewpoint, profit arises only after "real" capital has been maintained and consequently represents a measure of the increase in value. 'Income' is sometimes used as a synonym."

Inasmuch as the above definition can be condensed to state that profit is simply the excess of revenue over expenses, it is necessary to explore further afield for the definitions of revenue and expenses. The *Accounting Terminology* we find, gives us the following definitions :

> "Revenue - The gross proceeds of sale of goods and services including the gross yield of investments, generally after deducting returns, allowances and discounts. The revenue from disposition of assets other than stock-in-trade is generally considered to be the proceeds in excess of costs or book value rather than gross proceeds."
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> "Expense - 1. A general term applied to the costs of carrying on a business.
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> 2. A cost incurred in the process of earning the revenue attributed to a period, including those costs not assignable to any particular revenue but incurred during the period in the course of ordinary operations and not assignable to the operations of a future period or periods."

While the definition of a profit has a wide coverage, it is well established that for income tax purposes it does not include gains realised on the disposal of capital assets. To the extent that the meaning of revenue has a fairly uniform interpretation for accounting as well as for income tax purposes, the conflicts which arise between the taxpayer and the taxing authorities in this area are less numerous than those arising in the area of expense deductibility.

It is in the broad area of expense deductibility where we run into limitations as to the nature of the items which may be deducted in computing income for tax purposes. The *Income Tax Act* enumerates to a small degree those items which must be included in income and those expenses which are deductible in arriving at income, but nevertheless, one may be awestruck by the realization that there are countless thousands of items which are not specifically provided for in the Act. Accordingly, one would have to look at the general provisions of the Act relating to the computation of income in order to determine the rules governing the deductibility of these unspecified items.

Such a review of the general limitations of the Act brings us face to face with Sections 12(1)(a) and 12(1)(b) and forces us to look once again to court judgments for an interpretation of their meaning. Translated into accounting terminology the remarks made in court cases dealing with these specific interpretations have been summarized by A. W. Gilmour [4] into the following set of rules :

1. The net income of the business should first be computed in accordance with ordinary principles of commercial trading or well accepted principles of business and accounting practice.

2. In computing income, any expense incurred is inherently deductible as long as the expenditure was made in accordance with the ordinary principles of commercial trading or well accepted principles of business practice. If the expense does not meet this general test, it is not deductible in computing income in accordance with ordinary principles of commercial trading.

3. Finally, expenses which can be shown to have been incurred in accordance with ordinary principles of commercial trading, should be examined to ascertain if they conflict with any of the specific prohibitions contained in Section 12 of the Act.

It should be emphasized that in order to qualify as a deduction under Section 12(1)(a), an expense must have been incurred for the purpose of gaining or producing income. It is not necessary that income be produced but only that the expense was *for the purpose of gaining or producing income.* In *Imperial Oil Limited* v. *M.N.R.* [5] Thorson J., states at page 371:

> "The view that an item of expenditure is not deductible unless it can be shown that it earned some income is quite erroneous. It is never necessary to show a causal connection between an expenditure and a receipt."

At issue in the *Imperial Oil* case was the conflict between the Minister's interpretation of the deduction provisions of the *Income War Tax Act* [6] and the broader business and accounting concepts of expenses which were necessary to earn income. The court held that the deductibility of disbursements or expenses is to be determined according to the ordinary principles of commercial trading or well accepted principles of business and accounting practice *unless* their deductibility is prohibited by reason of their coming within the express terms of the excluding provisions of the Act.

The basic principle recognized in the *Imperial Oil* case echoed the findings of earlier cases. In one of these, *Dominion Natural Gas* v. *M.N.R.* [7] Maclean, J., states at pages 147 and 148:

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[4] A. W. Gilmour, *Income Tax Handbook*, 1964-65, p. 161 et seq.

[5] [1947] C.T.C. 353.

[6] R.S.C. 1927, ch. 97.

[7] [1940-41] C.T.C. 144.

"The generally recognized rule as regards trade expenses is that a deduction is permissible when it is justifiable on business and accountancy principles, but this principle is subject to certain specific statutory provisions which prohibit the allowance of certain expenses as deductions in computing the net profit or gain to be assessed. To the extent that ordinary business and accounting principles are not invaded by the Statute they prevail."

While the previous cases were heard under the *Income War Tax Act*, subsequent rulings by the Income Tax Appeal Board and the Exchequer Court of Canada have upheld that this principle is also applicable under the *Income Tax Act*. On this topic perhaps the leading case under the present Act is *The Royal Trust Company* v. *M.N.R.*,[8]. The judgment in this case sets out in clear terms the conditions under which an expense is deductible under the Act and is summed up on page 44:

The essential limitation in the exception expressed in Section 12(1)(a) is that the outlay or expense should have been made by the taxpayer "for the purpose" of gaining or producing income "from the business". It is the purpose of the outlay or expense that is emphasized but the purpose must be that of gaining or producing income "from the business" in which the taxpayer is engaged. If these conditions are met the fact that there may be no resulting income does not prevent the deductibility of the amount of the outlay or expense. Thus, in a case under the Income Tax Act if an outlay or expense is made or incurred by a taxpayer in accordance with the principles of commercial trading or accepted business practice and it is made or incurred for the purpose of gaining or producing income from his business its amount is deductible for income tax purposes."

It is interesting to note a remark made in the *Royal Trust* case by the learned President of the Exchequer Court in referring to his earlier judgment in the *Imperial Oil* case:

". . . My only present observation is that I should have omitted the reference to accounting practice which I made in that case."

Accordingly, he has in effect ruled that the prime test of an expense deductibility is determined according to the sound principles of commercial trading and business practice for the particular business under review.

The learned President's remark regarding the omission of the reference to accounting practice should not be construed as restricting the importance of accounting practice in determining business profits. Indeed, it is superfluous to state that the expense must have been made in accordance with good accounting practice. Accounting is but a tool of business. It is the process of recording, classifying, summarizing and interpreting in a significant manner, transactions and events of a financial nature. It records such transactions and events "after the fact". Thus, it follows the route taken by the business

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[8] [1957] C.T.C. 32.

which it is recording. If the business carries on its trading operations in accordance with sound commercial practices, it is the responsibility of accountants to effect proper accounting for the business operations. It is a well recognised accounting principle that costs must match revenues and inherent in this principle is the taxing concept that a cost must be incurred for the purpose of earning income in order to be deductible in arriving at income.

Accountants have for many years been following the principle which the courts have slowly acknowledged. The accountants have the responsibility of recording the millions of business transactions in this country in the day to day routine. With minor exceptions, they faithfully follow the long established accounting principle that costs must match revenues. If this were not so, disorder of an unlimited magnitude would result. No one, not the taxing authorities, not the taxpayer and not the judiciary, would ever hope to unscramble the chaos.

Turning now to Section 12(1)(b), we must first of all relate it to Section 12(1)(a) which, as already outlined, limits the deductibility of expenditures to only those which are made or incurred for the purpose of gaining or producing income. Section 12(1)(b) provides a restriction on this deductibility by stating that no deduction can be made for "capital" items unless they are "expressly permitted" by Part I of the Act.

As mentioned earlier, it is an established principle that gains realized on the disposal of capital assets are not included in the determination of "income" for income tax purposes and accordingly no tax is exigible on them. This principle is consistent with the one followed in Section 12(1)(b) in that no allowance is granted for capital losses or expenditures. Thus, capital gains and losses are ignored in computing income for income tax purposes. However, the Act does give recognition to the role played by capital assets in determining income by permitting the deduction of allowances on the capital cost of depreciable property, depletion allowances on the capital cost of natural resources and certain expenses of borrowing money and issuing shares. Nevertheless, the rule is basically that no deduction is permitted for capital expenses.

The distinction between "capital" receipts and expenditures and "current" receipts and expenditures is not an easy one. A large number of the tax cases heard by our judiciary deal with the conflict as to whether an item is of an income or of a capital nature. Through the years many attempts have been made by the courts to distinguish between capital and revenue expenditures. The problem is complicated by the fact that an expenditure may be considered a "current" item under normal business practice but may be considered a "capital" item for income tax purposes.

A capital expenditure can perhaps be most simply defined as one which brings into existence an asset or one that protects an asset already in existence. A detailed distinction has been made between capital expenditure and revenue expenditure by Robert R. Thompson, a chartered accountant and a former professor at McGill University, in his modestly titled book *120 Graduated Exercises in Bookkeeping* [9].

"Capital expenditure is that -

(1) Which is incurred for the purpose of creating or acquiring the Fixed Assets by means of which the business is to be carried on; and

(2) That expenditure on Fixed Assets, which is incurred for the purpose of increasing the earning capacity of the business.

Examples: (1) Purchase of a Factory.
(2) Expenditure on Improvements to the Factory.

Revenue Expenditure is that which is incurred for the purpose of:

(1) Carrying on the business; and

(2) Maintaining the Fixed Assets in a state of working efficiency.

Examples: (1) Office salaries, rent, depreciation.
(2) Repairs and renewals to machinery.

In *British Columbia Electric Railway Company Limited* v. *M.N.R.*[10] the Supreme Court of Canada considered earlier attempts by the courts to define the nature of capital items. Two of these attempts are referred to on page 26:

"In *Vallambrosa Lumber Company* v. *Farmer* (1910), 5 T.C. 529, Lord Dunedin said in part (p. 536):

'I don't say that this consideration is absolutely final or determinative, but in a rough way I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year'.

In *Atherton* v. *British Insulated and Helsby Cables Ltd.* (1925), 10 T.C. 155, Lord Cave said (p. 192) that:

'when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is a very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such expenditure as properly attributable not to revenue but to capital.'."

III. Some Existing Anomalies in Income Tax Law.

One may ask "what are the traps in which an unsuspecting taxpayer may find himself if he is not knowledgeable about the above

[9] Robert R. Thompson, *120 Graduated Exercises in Bookkeeping*, 1936, p. 16.
[10] [1958] C.T.C. 21.

legislation and the courts' interpretation of that legislation? What are the anomalies which exist under our present legislation?

It could be concluded from what has been said thus far that an expenditure is either "current" and allowed as an immediate tax deduction or "capital" and subject to amortization against income of the current and future incomes. Unfortunately, however, this is not so. For there is a third category - an infinite abyss - a category of "nothings".

"Nothings" have been defined by tax practitioners as legitimate business expenditures for which there is no tax relief. There is no immediate deduction allowed. There is no deduction for amortizations against future income. Some of these "nothings" are obvious from a close study of our Act and the supporting regulations. Others, however, have been declared by the tax courts in cases heard by them since inception of our income tax legislation. Most of them have been found to be of a nature of "capital" cost for which a write-off is not allowed by statute.

A classified list of nothings, originally prepared in *Tax Review* [11], is reproduced below. (Some of these items, i.e. 1(c) and 8(e) have been permitted as deductions by subsequent changes to the Act.).

1. Legal expenses
   (a) To fight an eviction notice.
   (b) To fight competition.
   (c) To contest income tax assessments.
   (d) To obtain lower import duty.
   (e) To defend a franchise.
2. Contracts and Rights, sums expended.
   (a) To acquire a newsprint contract.
   (b) To obtain a permit to export natural gas from the United States.
   (c) To obtain transfer of a liquor licence and licence for public commercial vebicles.
   (d) To acquire a patent application.
   (e) To make a franchise payment in connection with a bus service.
   (f) To acquire a right to drill for oil.
   (g) To obtain admission to the Bar.
   (h) To acquire a sugar quota.
3. Damages, Cancellations, ete.
   (a) Charter cancellation.
   (b) Surrender of lease.
   (c) Brokerage transaction.
   (d) Compensation on leasehold.
   (e) Deposit on block of timber.
   (f) Non-competition agreement.

[11] Canadian Chartered Accountant, November, 1957, p. 461 et seq. and December, 1957, p. 559 et seq.

4. Losses on Loans, Advances, etc.
   (a) Accommodation loans to customers.
   (b) Loss under guarantee of advances.
   (c) Losses on logging advances.
   (d) Shares in lieu of debt.
   (e) Sales of notes.
   (f) Partner's income tax.
   (g) Loan to company.
   (h) Loss on oil company shares.
5. Financial Expenditures.
   (a) Bond discount.
   (b) Premium on redemption.
   (c) Bonus to obtain mortgage.
   (d) Premium to discharge mortgage.
   (e) Cost of guarantee of bank loans.
6. Acquisition of Business, etc.
   (a) Expense before incorporation.
   (b) Expenses before commencement of business.
   (c) Expenses to obtain agency.
   (d) Receivables of retired partner.
   (e) Debts of predecessor.
7. Sundry Assets.
   (a) Land for new building.
   (b) Expenses of golf course.
   (c) Breaking farm land.
   (d) Goodwill.
   (e) Trade mark registration.
   (f) Sulphur drilling costs.
8. Miscellaneous Expenses.
   (a) Terminal audit.
   (b) Expenses of subsidiary company.
   (c) Transfer fees - a stock exchange membership.
   (d) Misappropriation by manager.
   (e) Post graduate studies.
   (f) Political contributions.
   (g) Partners' life insurance.
   (h) Wife as partner.
   (i) Interest on income tax.
   (j) Fines and penalties.

This list gives some indication of the nature of these outcast items. One can gather from the updating summary prepared by Gwyneth McGregor [12] that the composition of subsequent additions to this list of "nothings" has continued in much the same pattern as before. To say that this situation is appalling is presenting the case very mildly, indeed !

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[12] *More Ado About Nothings*, Canadian Tax Journal, July-August, 1964, p. 268.

Many of the expenses which are disallowed under the Act are nevertheless recognized by accountants as bona fide deductions in arriving at an enterprise's profit. In most instances, practising accountants will report that profit and loss statements with deductions of this nature are drawn up in accordance with generally accepted accounting principles. Because accountants have been given wide latitude of freedom in developing principles, standards and procedures by which income is determined and because they have been painstakingly diligent in policing their development, should not the statutory concept of income parallel the concept of income which has been developed by sound commercial and accounting practices ?

IV. Some Suggested Remedies to Existing Anomalies.

This question - whether the *Income Tax Act* should give cognizance, in defining business income, to "generally accepted accounting principles" - has been under considerable study in the past. The problem, however, always seems to settle at the accounting profession's inability to agree with any unity as to what constitutes such principles.

The accounting profession in Canada and the United States has been undergoing some deep soul searching in attempting to identify generally accepted accounting principles. There are conflicts amongst accountants themselves, since accounting matters are largely interpretations, and in varying degrees are arbitrary and subjective. Even though practising accountants have committed themselves in their audit reports to the existence of generally accepted accounting principles, they have not been able to enumerate a definitive list of such principles. It may well be that the reference to generally accepted principles in the draft of the 1948 revision of the *Income Tax Act* was finally dropped because of the great uncertainty as to their precise definition.

The Accounting and Auditing Research Committee of the Canadian Institute of Chartered Accountants considered this problem and gave its majority conclusion in an appendix to the Institute's brief to the Royal Commission on Taxation. The committee came to the conclusion that it would be undesirable for our *Income Tax Act* to refer to "generally accepted accounting principles" since this would possibly restrict the development of accounting principles and practice. If tax legislation and jurisprudence did not develop in the same general direction as accounting theory, then it is reasonable to conclude that accounting practice would tend to follow the course set by our laws rather than develop free from their influence.

Of major concern to the Committee also was the effect that the reference to generally accepted accounting principles would have in the determination of income for income tax purposes. Because of the diversity in accounting principles and the even greater diversity in accounting practices, it was felt that reference to generally accepted accounting principles would create a considerable amount of uncertainty. It would then follow that in the absence of judicial decisions the income tax statutes would have to provide specific provisions to clarify the uncertainty.

While it has been concluded by accountants that the *Income Tax Act* should make no reference to generally accepted accounting principles it is nevertheless apparent to them, to lawyers and to businessmen that there are generally accepted practices in determining profit from a business but these are presently not recognised for tax purposes. Perhaps the main area where this is so is in the category of expense deductibility. Other areas where generally accepted business and accounting practices differ from the stand taken in the Income Tax Act include: the *LIFO* method of inventory evaluation; allowances for doubtful accounts; reserves and prepaid and deferred charges. It is hoped that the coming revision to our tax system résulting from the findings of the Royal Commission on Taxation will correct the obvious inequity resulting from the non-deductibility of legitimate business expenditures.

Certain quarters have suggested that the present anomaly in the Act with respect to non-deductible expenditures could be eliminated by providing that all capital expenditures incurred for the purpose of earning income could be deducted in arriving at taxable income. Such a remedy, while being startling, yet simple, is not to be recommended. It would result in such wide inequities in the taxing of business enterprises that there would immediately arise a great clamour for exempting and relieving provisions to cover the inequities. Thus, the patch-work, which is so typical of our present tax legislation, would start all over again.

There would appear to be one logical solution to the problem. Taxpayers could be given the tax relief they deserve by providing for the creation of a new capital cost class which would include capital expenditures incurred for the purpose of gaining or producing income, but which do not fall into an already existing capital cost class. An arbitrary class rate of say, 10%, could be used to provide for the systematic and orderly amortization of the cost against income. Some quarters suggest that if such a proposal were adopted, capital expenditures falling into the categories of land, goodwill and investments, should not be permitted as additions to the new capital cost class.

While such a recommendation is based on sound arguments, we might perhaps go one step further and provide for the systematic amortization of these three items as well. Any "recaptured depreciation" on the eventual disposition of these assets would of course be subject to the same rules of taxation as is presently the case.

Given the role which accounting plays in the development of our income tax legislation and in its interpretation, one might come to the conclusion that accountants could be justified if they adopted a prima-donna attitude to the effect that the tax field was theirs and theirs alone. Fortunately this is not the case, for even where they have many years of experience in tax work they have not assumed the responsibility for giving legal opinion.

Given the broad background of the role played by accountants in the area of tax law, we can readily conclude that they have an onerous responsibility to the taxpaying public and to government to provide the optimum level professional skills and services. With this aim in mind it should be concluded that accountants as well as lawyers, if they are to fulfill their function, must constantly strive for new knowledge in tax matters and be ever alert to the problems of their clients, their professions and the public.