Ikea Ltd. *v.* Canada, [1998] 1 S.C.R. 196

Ikea Limited *Appellant*

v.

Her Majesty The Queen *Respondent*

Indexed as: Ikea Ltd. *v.* Canada

File No.: 25674.

1997: December 2; 1998: February 12.

Present: Gonthier, Cory, Iacobucci, Major and Bastarache JJ.

on appeal from the federal court of appeal

Income tax -- Calculation of income -- Receipt of tenant inducement payment ("TIP") -- Whether TIP to be treated as revenue or as a capital receipt -- If revenue, whether to be included in income entirely in the year received or amortized over the period of the lease -- Income Tax Act, S.C. 1970-71-72, c. 63, s. 9(1) -- Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), s. 12(1)(x).

In an agreement dated six days after the original lease, Ikea became entitled to receive a tenant inducement payment ("TIP") from its landlord. The agreement clearly and unequivocally stipulated that this payment was to induce Ikea to lease the premises and that no obligation was placed upon Ikea to use the money for any particular purpose.

The payment was to be made to Ikea within seven days of its taking possession of and commencing business operations in the premises.

Ikea did not include the entire TIP in its income for the 1986 year for the purposes of its financial statements and instead amortized it over the period of the lease. It also offset a portion of the TIP against the cost of fixtures for the leased premises which were reflected as capital assets and which would have been depreciated over approximately the same time period used to amortize the balance of the TIP. In filing its tax return for 1986, however, Ikea neither reduced the cost of fixtures by the offset portion of the TIP nor included any portion of the TIP in its income, owing to its belief that, for tax purposes, the payment constituted a capital receipt rather than taxable revenue. In reassessing Ikea, the Minister required that the TIP be included in income entirely in the 1986 taxation year. On appeal by Ikea, the Tax Court of Canada agreed with the Minister that the TIP represented income and not a capital receipt, and also that the amount was required to be included in income wholly in the year of receipt. This decision was affirmed by a unanimous judgment of the Federal Court of Appeal. Two issues arose on this appeal: whether the TIP was to be treated for tax purposes as revenue or as a capital receipt, and if revenue, whether it should have been included in income entirely in the year received or amortized over the period of the lease of which it was the catalyst.

Held: The appeal should be dismissed.

A payment made as a reimbursement for the cost of capital property is to be treated as a capital receipt for tax purposes and one made as a reimbursement for an expense or reimbursement of a loss on revenue account is to be treated as income. Thus, had the payment been made by Ikea for the purpose of acquiring the lease, a capital asset, it would have been a capital payment. However, two simultaneous acquisitions by the same party (the lease and the cash payment) need not be characterized in the same way for tax purposes simply because they are related to the same transaction. Indeed, the desirability of an accurate picture of income inherently outweighs the possible inconvenience of an asymmetrical result in the occasional case.

The receipt of a TIP is an "integral element" of the day-to-day costs of business operations and can be properly viewed as another favourable condition, an additional benefit received as an incident of the lease negotiated. Here, the TIP was on revenue account and should have been included in income for tax purposes. The payment was clearly received as part of ordinary business operations and was, in fact, inextricably linked to such operations. No question of linkage to a capital purpose could seriously be entertained. Whether the TIP represented a reduction in rent or a payment in consideration of Ikea's assumption of its various obligations under the lease, it could clearly not be treated as a capital receipt and should have been included in income.

The TIP was taxable in the year received. The "realization principle", which holds that an amount may have the quality of income even though it is not actually received by the taxpayer but only "realized" in accordance with the accrual method of accounting, is well established in the jurisprudence. Amounts received or realized free of conditions or restrictions upon their use are therefore taxable in the year realized, subject to any contrary provision of the Act or other rule of law. Here, the taxpayer's right to the TIP accrued immediately upon the assumption of its contractual obligations, and thus could not properly be said to relate to future expenditures. In such a case, unless otherwise specified by the inducement agreement and in the absence of statutory or case law authority to the contrary, the realization approach gives a more accurate picture of the taxpayer's income.

Cases Cited

Considered: *The Queen v. Foothills Pipe Lines (Yukon) Ltd.*, 90 D.T.C. 6607; *St. John Dry Dock & Shipbuilding Co. v. M.N.R.*, [1944] Ex. C.R. 186; *IBM Canada Ltd. v. M.N.R.*, 93 D.T.C. 1266; *French Shoes Ltd. v. The Queen*, 86 D.T.C. 6359; **referred to:** *Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147; *Toronto College Park Ltd. v. Canada*, [1998] 1 S.C.R. 183; *Neonex International Ltd. v. The Queen*, 78 D.T.C. 6339; *Oxford Shopping Centres Ltd. v. The Queen*, 79 D.T.C. 5458; *Associated Investors of Canada Ltd. v. M.N.R.*, 67 D.T.C. 5096; *Symes v. Canada*, [1993] 4 S.C.R. 695; *Corporation of Birmingham v. Barnes*, [1935] A.C. 292; *The Queen v. Canadian Pacific Ltd.*, 77 D.T.C. 5383; *Consumers' Gas Co. v. The Queen*, 82 D.T.C. 6300; *London and Thames Haven Oil Wharves, Ltd. v. Attwooll*, [1967] 2 All E.R. 124; *Woodward Stores Ltd. v. The Queen*, 91 D.T.C. 5090; *Suzy Creamcheese (Canada) Ltd. v. The Queen*, 92 D.T.C. 6291; *Kenneth B. S. Robertson Ltd. v. M.N.R.* (1944), 2 D.T.C. 655; *Westfair Foods Ltd. v. Canada*, [1991] 1 C.T.C. 146; *Charles Brown & Co. v. Commissioners of Inland Revenue* (1930), 12 T.C. 1256; *Lincolnshire Sugar Co. v. Smart*, [1937] A.C. 697; *Schwartz v. Canada*, [1996] 1 S.C.R. 254; *Nesbitt Thomson Inc. v. M.N.R.*, 91 D.T.C. 1113; *M.N.R. v. Benaby Realties Ltd.*, [1968] S.C.R. 12.

Statutes and Regulations Cited

Income Tax Act, R.S.C., 1985, c. 1 (5th Supp.), s. 12(1)(*x*).
Income Tax Act, S.C. 1970-71-72, c. 63, s. 9(1).

APPEAL from a judgment of the Federal Court of Appeal, 96 D.T.C. 6526, [1996] 3 C.T.C. 307, [1996] F.C.J. No. 1243 (QL), dismissing an appeal from a judgment of Bowman J.T.C.C., 94 D.T.C. 1112, [1994] 1 C.T.C. 2140, [1993] T.C.J. No. 874 (QL). Appeal dismissed.

Warren J. A. Mitchell, *Q.C.*, and *Karen Sharlow*, for the appellant.

Roger Taylor and *Sandra Phillips*, for the respondent.

The judgment of the Court was delivered by

1 IACOBUCCI J. -- This appeal was heard along with *Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147, and *Toronto College Park Ltd. v. Canada*, [1998] 1 S.C.R. 183, reasons for which are being released simultaneously herewith, but raises in essence the opposite question of that raised in those cases. Whereas in *Canderel* and *Toronto College Park* this Court was called upon to determine the appropriate manner in which a taxpayer may deduct a tenant inducement payment ("TIP") from business income, the instant case requires a determination of how (prior to the enactment of s. 12(1)(*x*) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.)) the same type of payment was to be treated in the hands of the recipient. Was the TIP to be dealt with as revenue or as a capital receipt, and if revenue, was it to be included in income entirely in the year received or could it properly be amortized over the period of the lease to which it related?

I. <u>Facts</u>

2 The appellant, Ikea Limited ("Ikea"), is a furniture retailer which carries on its business through retail outlets which it owns or leases throughout Canada. In 1985, Ikea entered into a 10-year lease of premises at the West Edmonton Mall (the "Mall"),

with an option to extend the lease for a further 10 years. The lease provided for a base rent, payable in monthly instalments, plus a percentage rent based on sales. In an agreement dated six days after the original lease, Ikea became entitled to receive a TIP of $2,650,000 from the Mall. The agreement was clear and unequivocal in stipulating that the purpose of this payment was to induce Ikea to lease the premises, and no obligation was placed upon Ikea to use the money for any particular purpose, such as, for example, applying it against the cost of inventory or fixtures. The payment was to be made to Ikea within seven days of its taking possession of and commencing business operations in the premises.

3 Ikea tendered expert accounting evidence stating that it was proper treatment, in accordance with generally accepted accounting principles ("GAAP"), not to include the entire TIP in its income for the 1986 year and instead to amortize it over the period of the lease. Further, this evidence indicated that it was also in accordance with GAAP for Ikea to offset a portion of the TIP, an amount totalling $825,189, against the cost of fixtures for the leased premises, provided only that, had the cost of the fixtures been reflected as capital assets, they would have been depreciated over approximately the same time period used to amortize the balance of the TIP. In fact, this was precisely the accounting treatment accorded to the payment by Ikea for the purposes of its financial statements. This evidence was uncontradicted by the Minister of National Revenue (the "Minister"), who simply took the position that the appropriate accounting treatment was irrelevant to the issue of the computation of income for tax purposes.

4 Philip Boname, an expert called on behalf of the Minister, expressed the opinion, based on his general knowledge of the commercial real estate market in Edmonton at the time of the lease, that the TIP received by Ikea resulted in an increase in the amount of rent that it agreed to pay to the Mall. His experience suggested to him

that there was a direct correlation between the use of TIPs and the ability of a landlord to realize higher rents.

5 In contrast to the treatment accorded the TIPs in its financial statements, in filing its tax return for 1986, Ikea did not reduce the cost of fixtures by the $825,189 portion of the TIP, nor did it include any portion of the TIP in its income. This treatment reflected its opinion that, for tax purposes, the payment constituted a capital receipt rather than taxable revenue. In reassessing Ikea, the Minister required that the TIP be included in income entirely in the 1986 taxation year. On appeal by Ikea, the Tax Court of Canada agreed with the Minister that the TIP represented income and not a capital receipt, and also that the amount was required to be included in income wholly in the year of receipt. This decision was affirmed by a unanimous judgment of the Federal Court of Appeal.

II. Relevant Statutory Provisions

6 *Income Tax Act*, S.C. 1970-71-72, c. 63 (now R.S.C., 1985, c. 1 (5th Supp.))

> **9.** (1) Subject to this Part, a taxpayer's income for a taxation year from a business or property is his profit therefrom for the year.

III. Judicial History

1. *Tax Court of Canada (Bowman J.),* 94 D.T.C. 1112

7 Bowman J. began by stating at p. 1115 that the "accounting treatment does not affect the determination whether the receipt was on revenue or capital account. That

determination is one of law based upon a consideration of all of the facts". After commenting briefly on the differences between income tax and financial accounting, he observed that the rationale for the accounting treatment of the $825,189 might have been that since it represented the cost of fixtures, it was not inappropriate to offset it against that cost, "thereby achieving an effective amortization over the term of the lease by reducing the basis against which annual depreciation would be deducted". However, he found no legal or factual basis for such treatment for income tax purposes.

8 Moreover, Bowman J. could find no basis whatsoever for the amortization of the balance of the TIP over the term of the lease. Beginning with the proposition that, even for accounting purposes, expenditures are to be attributed to the period that they benefit and revenues are either to be allocated to the period in which they are earned or applied as a reduction of expenses for the period to which they relate, he observed that the tenant inducement agreement specified that the purpose of the TIP was strictly to induce Ikea to enter into the lease and carry on business in the premises. The question, then, was when the payment was actually earned. One possibility was that it was earned when the consideration flowed from Ikea to the Mall, that is, when Ikea commenced business at the Mall. In fact, the agreement stipulated that the right to the TIP became absolute seven days after this event. If it was completely earned in this way, however, then in the view of Bowman J., this analysis did not support the amortization of the payment over the term of the lease. Such treatment could only be rationalized either by deeming the consideration flowing from Ikea to consist not only of the signing of the lease and the fulfilment thereof, but also of its continuing obligation to carry on its business in the premises during the term of the lease, or by regarding the TIP as a reduction of the rent payable over the term of the lease. However, neither of these hypotheses supported Ikea's treatment of the TIP as capital. Both supported its treatment as revenue.

9 Bowman J. considered in some detail the role of accountants and GAAP in the court's determination of income tax matters. He viewed such evidence as potentially useful in indicating the underlying commercial and economic reality that the transaction represents, free of tax considerations, but viewed accounting evidence as only of "marginal assistance" in tax cases. He relied on several cases, including *Neonex International Ltd. v. The Queen*, 78 D.T.C. 6339 (F.C.A.), *Oxford Shopping Centres Ltd. v. The Queen*, 79 D.T.C. 5458 (F.C.T.D.), and *Associated Investors of Canada Ltd. v. M.N.R.*, 67 D.T.C. 5096 (Ex. Ct.), in support of the proposition that the accounting treatment of revenues and expenses is not determinative and that the true question is one of law, having regard to "ordinary commercial principles". Relying on the decision of this Court in *Symes v. Canada*, [1993] 4 S.C.R. 695, he found at p. 1117 that "GAAP is not relevant in determining whether a receipt or expense is on revenue or capital account . . . [or] whether an item of revenue is to be recognized in the year of receipt or in a later year", and concluded at p. 1118 that while GAAP may have "an extremely circumscribed subordinate function" within ordinary commercial principles, "[i]t cannot supersede those principles".

10 Turning to the first substantive question, whether the TIP was on revenue account or on capital account, Bowman J. first noted a number of relevant facts. Ikea was not in the business of entering leases, and although the leasing of property was obviously an essential part of its business, the leases were nonetheless capital assets in its hands. The leasing of premises by Ikea was not of such frequency that lease negotiations could be regarded as a "recurrent or ordinary phenomenon" in its business. Ikea had requested the TIP as part of the overall economic package surrounding the lease, and had acknowledged at trial that the terms and conditions of its leases affected its profits on an ongoing basis. However, the base rent agreed to was suggested early in

the lease negotiations and never changed. On this basis, Bowman J. concluded that the TIP resulted in an increase in the aggregate value of the rent which Ikea agreed to pay, based on the direct correlation between the use of such payments and the ability of a landlord to realize higher rents. In his view, this conformed to "obvious commercial common sense". Bowman J. was also of the opinion that the other evidence, including that given by an officer of Ikea, confirmed that the TIP was "inextricably bound up with the rent that was to be paid and the economic return that the parties expected from the commercial relationship between them".

11 Bowman J. observed that prior to the enactment of s. 12(1)(*x*) of the Act, there was a common assumption that TIPs were not taxable as either income, capital gains, or reductions of the capital cost of property. He found that this proposition had its roots in *Corporation of Birmingham v. Barnes*, [1935] A.C. 292 (H.L.), *The Queen v. Canadian Pacific Ltd.*, 77 D.T.C. 5383 (F.C.A.), and *Consumers' Gas Co. v. The Queen*, 82 D.T.C. 6300 (F.C.T.D.), in each of which, third-party contributions to the construction of various works were not required to be taken into account in determining the "actual cost" of the works for the purposes of determining their capital cost for depreciation.

12 In the view of Bowman J., relying on *London and Thames Haven Oil Wharves, Ltd. v. Attwooll*, [1967] 2 All E.R. 124 (C.A.), the crucial matter to be determined, as a general rule and irrespective of whether the receipt reimbursed a "loss" or an "expenditure", is the nature of the expense that the payment is designed to reimburse. If the reimbursement is of a capital loss or a capital expenditure, then the receipt will be on capital account: *Woodward Stores Ltd. v. The Queen*, 91 D.T.C. 5090 (F.C.T.D.), and *Suzy Creamcheese (Canada) Ltd. v. The Queen*, 92 D.T.C. 6291 (F.C.T.D.). From the cited case law, he concluded that while in the absence of a

statutory provision to the contrary, a payment made to a taxpayer to reimburse the taxpayer for the cost of capital property does not reduce the capital cost of the property for tax purposes, such a payment is nonetheless a capital receipt and is not to be included in income under the Act. On the other hand, a payment made as a reimbursement to the taxpayer for an expense that is on revenue account, or as a reduction of such an expense, is an income receipt and must therefore be included in income.

13 In applying the law to the facts of this case, Bowman J. observed that under the tenant inducement agreement, Ikea was not obliged to apply the TIP to any expense in particular. Aside from the accounting treatment of the expense, which was seen as irrelevant, nothing in the evidence could support the conclusion that the payment was made to reimburse a capital expenditure or capital loss. Indeed, there was no other linkage whatsoever between the payment and any capital outlay. Bowman J. held that there was no reason to extend the principle in *Birmingham v. Barnes*, *supra*, to allow the accounting treatment of a receipt to affect its characterization as revenue or capital. He concluded that it would have been arbitrary to treat the payment as capital for tax purposes merely because it may not have been inappropriate for accounting purposes to attribute a portion of it to the cost of fixed assets. This, he found at p. 1124, would have constituted "an abdication to the professional judgment of accountants of the court's obligation to determine what is essentially a question of law".

14 The question remained whether the inability of the TIP to be connected with any capital purpose automatically made it income. Bowman J. observed, at p. 1125, that the payment was not fortuitous and was neither a gift nor a windfall, but rather "arose out of the negotiation of an obligation whose incidents . . . were to the appellant of a purely revenue nature". In his view at p. 1125, the receipt, although not arising out of the sale of goods in which Ikea dealt, was "directly and inextricably bound up with the

economics of the operation", because of its obvious effect upon the costs which the business had to satisfy. The payment was an integral element of the day-to-day costs of running the business. Bowman J. accordingly found that the TIP was income to Ikea, either as a reduction of rent, which he saw as making more economic sense in light of the evidence, or as consideration for moving into the premises, paying rent, and carrying on business therein.

15 Turning to the second question, the timing of recognition of the receipt, Bowman J. again found that the accounting treatment of the TIP was not determinative. He could find no basis in the Act for a reserve in respect of this type of income, and observed at p. 1125 that, as a rule, "amounts become taxable as income in the year of receipt provided the amounts received exhibit the nature and quality of income at that time": *The Queen v. Foothills Pipe Lines (Yukon) Ltd.*, 90 D.T.C. 6607 (F.C.A.), at p. 6612. Put another way, the question was whether Ikea's right to the receipt became absolute, with no restriction as to its disposition, use or enjoyment, in the year in question: *Kenneth B. S. Robertson Ltd. v. M.N.R.* (1944), 2 D.T.C. 655 (Ex. Ct.). In the view of Bowman J., this condition was clearly satisfied, and thus, the income was taxable in 1986. Accordingly, he dismissed Ikea's appeal of the reassessment on both counts.

2. *Federal Court of Appeal (Reasons of Robertson J.A., for the court),* 96 D.T.C. 6526

16 In oral reasons delivered from the bench, the Federal Court of Appeal dismissed Ikea's appeal. Robertson J.A. explained that the court had not been persuaded that there was any basis, either in fact or in law, for interfering with the Tax Court's decision, nor that anything in its own decision in *Canderel*, *supra,* had any meaningful effect on the timing issue, despite the apparent asymmetry between the two cases. He

stated, at p. 6527, that "[w]hile the matching principle will be of relevance in cases involving 'non-running expenses', it has never been suggested that it should be applied to the exclusion of the line of authorities beginning with *Kenneth B. Robertson* [*sic*] *v. M.N.R.*"

IV. Issues

17 Two issues are raised on this appeal. The first is whether the TIP received by Ikea was to be treated for tax purposes as revenue or as a capital receipt. If it was properly to be considered revenue, the next task is to determine when it was to be included in income: entirely in the year received or amortized over the period of the lease of which it was the catalyst.

V. Analysis

18 By way of preliminary comment, I should like to acknowledge the great assistance provided by the lucid and comprehensive reasons of Bowman J. As shall become clear, I agree substantially with his reasons on both of the issues raised in this appeal. However, because this appeal was heard together with those in *Canderel* and *Toronto College Park*, and particularly because of the importance of the issue of timing to the outcome of those appeals, I feel obliged to make some brief observations of my own.

1. *Legislative change since 1986*

19 At the outset, I would note that since the dispute which precipitated this case arose, the *Income Tax Act* has been amended to include a specific provision dealing with

the issues raised on this appeal. The relevant portions of R.S.C., 1985, c. 1 (5th Supp.), s. 12(1)(*x*) read:

> **12.** (1) There shall be included in computing the income of a taxpayer for a taxation year as income from a business or property such of the following amounts as are applicable:
>
> . . .
>
> (*x*) any amount (other than a prescribed amount) received by the taxpayer in the year, in the course of earning income from a business or property, from
>
> (i) a person who pays the amount (in this paragraph referred to as "the payer") in the course of earning income from a business or property or in order to achieve a benefit or advantage for the payer. . . .
>
> . . .
>
> where the amount can reasonably be considered to have been received
>
> (iii) as an inducement, whether as a grant, subsidy, forgivable loan, deduction from tax, allowance or any other form of inducement, or
>
> (iv) as a reimbursement, contribution or allowance or as assistance . . . in respect of the cost of property or in respect of an outlay or expense
>
> to the extent that the amount
>
> (v) was not otherwise included in computing the taxpayer's income, or deducted in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts, for the year or a preceding taxation year. . . .

20 It is evident that the TIP paid to Ikea in the instant case would fall squarely within this section, which would render the payment income to Ikea and taxable entirely in the year received. However, because the section was not in force in 1986, when the payment in question was received, the matter remains to be determined for the purposes of this appeal in accordance with the law as it existed then. The new provision, obviously, has no effect on the outcome of the instant case.

2. *Capital or income*?

21 Ikea argued that the TIP was a capital receipt and not income, and therefore should not have been included in income at all. This argument was premised primarily on an attempted analogy between this receipt and an amount received upon the acquisition or disposition of a capital asset, which is clearly a capital receipt: *Woodward Stores*, *supra*; *Westfair Foods Ltd. v. Canada*, [1991] 1 C.T.C. 146 (F.C.T.D.). As the argument goes, the character of the receipt is properly to be determined by the character of the asset to which it relates, and because the lease that gave rise to the TIP in this case was characterized by the trial judge as a capital asset in Ikea's hands, the TIP itself must therefore be considered a capital receipt. However, no specific authority was advanced in support of this interpretation, and for my part, I am unable to see any legal basis for the analogy.

22 Certainly, the notion of categorizing ambiguous receipts by reference to the income "holes" which they fill is far from novel in Canadian law. In *St. John Dry Dock & Shipbuilding Co. v. M.N.R.*, [1944] Ex. C.R. 186, the Exchequer Court of Canada considered the tax treatment to be given to a subsidy received by the taxpayer from the federal government, pursuant to a statute, for the construction of a dry dock. The taxpayer argued successfully that this constituted a capital receipt, which was at the time non-taxable, rather than taxable income. After a review of the relevant case law, including *Charles Brown & Co. v. Commissioners of Inland Revenue* (1930), 12 T.C. 1256 (C.A.), and *Lincolnshire Sugar Co. v. Smart*, [1937] A.C. 697 (H.L.), Thorson J. concluded, at pp. 200-201, that

> <u>[income] subsidies come into the hands of the recipient in the course of trade or business operations or because of them and, being operational revenues, may properly be described as income subsidies subject to tax</u>. The situation in the present case is quite different. The appellant was not entitled to receive nor did it receive the subsidy in the course of its trade or business operations or because of them. The subsidy was not a trade or business receipt or revenue or an item of trade or business profit or gain. There was no guarantee of trade or business profits or earnings nor was the subsidy given to supplement or increase the operational revenues of the appellant. Indeed, the subsidy payments had nothing to do with the trade or business operations of the appellant at all. [Emphasis added.]

In my view, this passage is most instructive in setting out useful criteria for the classification of "unusual" receipts as income or capital.

23 The case law cited by Bowman J., beginning with *Birmingham v. Barnes*, *supra*, and continuing through *IBM Canada Ltd. v. M.N.R.*, 93 D.T.C. 1266 (T.C.C.), reaffirms this proposition. Where a payment is made to a taxpayer as a reimbursement for the cost of capital property, it is to be treated as a capital receipt for tax purposes. On the other hand, a payment that is made as a reimbursement for an expense on revenue account is to be treated as income. In fact, even the case law cited by Ikea in support of its contention that the TIP was a capital receipt in the end commends the opposite conclusion, given the above analysis. In *Woodward Stores*, *supra*, at p. 5091, the payment in question, while clearly a TIP, was earmarked specifically as a "fixturing allowance". It was advanced for the express purpose of reimbursing a capital expense, and therefore constituted a capital receipt. Similarly, in *Westfair Foods*, *supra*, the payments made to the taxpayer were characterized by the court as capital receipts only because they were compensation for the premature termination of leases and therefore related to the disposition of a capital asset. These cases are both entirely consistent with the law as stated by Bowman J. and provide no specific assistance to Ikea's argument.

24 That the lease of the premises here in question was to Ikea a capital asset was not disputed, and I believe this proposition is correct in law. It follows that if the payment in question had been made by Ikea for the purpose of acquiring the lease, it would have been a capital payment, and this too is undisputed. To my mind, however, there is a significant difference between a payment made by the lessee for the purpose of acquiring a lease and one received by the lessee as an inducement to lease. Whereas a capital asset is surely paid for by a capital expenditure, and disposed of in consideration of a capital receipt, I see no reason why two simultaneous acquisitions by the same party, that is, the lease and the cash payment, must be characterized in the same way for tax purposes simply because they are related to the same transaction. Obviously, the TIP was not paid as consideration for the disposition of a capital asset; quite the opposite, in fact. The symmetry contended for by Ikea, though perhaps convenient, is not necessarily the rule in tax law.

25 The question which must be asked in this case is whether, on the facts, the TIP was received by Ikea as reimbursement of an expenditure, or replacement of a loss, which was on capital or on income account. Bowman J. found that the payment could not be linked to any capital expenditure or purpose. Instead, in his words at p. 1125:

> The negotiation of the lease and the payment of rent are, however, necessary incidents of the conduct of the appellant's business, and in determining the cost to the appellant of carrying on its business in the West Edmonton Mall it is impossible to imagine how such a payment could be ignored. . . . It is true, as Reed, J. observed in *Westfair Foods Limited*, that not every receipt that is *related* to a business is necessarily income *from* that business. She was, however, dealing with a receipt that, albeit related to the business, was nonetheless one that arose from a disposition of a capital asset of that business. Here we are concerned with a receipt that, although it does not arise from the sale of the goods or services in which the company deals, is directly and inextricably bound up with the economics of the operation. It impinges immediately upon the costs that must be satisfied out of the appellant's trading operations. [Italics in original; underlining added.]

He also found that the payment was an “integral element” of the day-to-day costs of Ikea’s business operations, and therefore concluded that the receipt was on income account because, in essence, it constituted reimbursement for expenses which were also on income account: either the payment of rent, or the assumption of other obligations incident to carrying on business in the premises, or both.

26 I can find no fault with this reasoning or this conclusion. In *French Shoes Ltd. v. The Queen*, 86 D.T.C. 6359 (F.C.T.D.), Teitelbaum J. observed that where a taxpayer leases premises for its business operations, business efficacy generally dictates the need to do so under the best possible conditions: the least expensive rent, the lowest possible start-up costs, etc. The receipt of a TIP, he noted, can properly be viewed as another such favourable condition, an additional benefit received as an incident of the lease negotiated. The receipt of the benefit assists the taxpayer in earning profit from its business, and is therefore part of the taxpayer’s revenue that is derived because of, and comprises part of, its business activity, notwithstanding that on first glance, the receipt might not appear to be of a revenue character because of the irregular circumstances under which it is obtained. In my view, this analysis is eminently sensible and is apposite, notwithstanding that in *French Shoes*, the tenant inducement agreement included a clear stipulation that the TIP was to be applied against inventory.

27 Ikea submitted that Bowman J. premised his conclusion on the improper assumption that simply because the receipt was not capital, it was therefore income. Certainly, it is possible that a given receipt might constitute neither capital nor income for the purposes of the Act; if it is not received from a “source” of income, as that term has been judicially defined, an amount may not be taxable at all: see, for example, *Schwartz v. Canada*, [1996] 1 S.C.R. 254. Each receipt must be considered individually

in order to ascertain its true character, and it would certainly be improper to classify a receipt as income automatically upon the determination that it is not capital.

28 Having said this, however, I do not believe that this was the treatment accorded to the receipt in the instant case. To begin with, I note that in *Nesbitt Thomson Inc. v. M.N.R.*, 91 D.T.C. 1113 (T.C.C.), at p. 1115, it was held that a TIP was neither fortuitous nor a windfall, but rather was income, given that it was expected, requested, and arose out of active negotiation. Such was certainly the case in the instant appeal. More importantly, though, the above-quoted passage from the reasons of Bowman J. makes clear that his conclusion was not automatic upon the finding that the payment was not a capital receipt. Rather, it was based upon a total analysis of the role of the TIP in the business operated by Ikea and of the purposes for which it was negotiated and obtained.

29 Ikea further submitted that the two possible justifications posited by Bowman J. for the treatment of the payment as income, that it was either a reduction of rent or consideration for the continued obligation to carry on business pursuant to the lease, do not in fact support such treatment. With respect, I cannot agree. In the first place, the payment of rent is most obviously an expense on revenue account, as it is incurred for the purpose of producing income and does not result in the acquisition of any capital asset. Therefore, the plain fact that the overall expense was reduced in this case by an initial lump-sum payment that, in Ikea's submission, provided an "enduring benefit over the term of the lease" does not support the treatment of the payment as capital. Regardless of the terms or mode of payment, the TIP was made to reimburse an expense on income account and thus was clearly itself income.

30 As for the second contention, Ikea argued that if the payment were to be characterized as consideration for its continued obligation to carry on business in the premises during the term of the lease, it should be considered a capital receipt because such a payment goes to the "structure of the business". With respect, however, I believe this submission misses the mark. An accurate characterization of the receipt requires an assessment of the nature of the specific obligations in question. In this case, as Bowman J. correctly found, Ikea's obligations under the lease essentially consisted of the payment of rent and the operation of its business in the leased premises. These were clearly expenses incurred in the day-to-day operation of the business and were therefore on revenue account.

31 In *IBM Canada*, *supra*, Mogan J. discussed the purpose of TIPs in the following terms (at p. 1274):

> Taken at face value, the underlying purpose for the payments was to induce the Appellant to sign the seven leases. But that face value purpose is too simplistic because each lease brings into existence both rights and obligations. In the circumstances of this case, I find that <u>the primary consideration granted by the Appellant for the lease inducement payments was the Appellant's acceptance of its obligations under the various leases to pay rent during the terms of those leases. Those obligations were on revenue account</u>. . . . I find that <u>the inducement payments flowing from the various landlords to the Appellant are just as much revenue payments as the periodic rental payments flowing from the Appellant to its landlords</u>. [Emphasis added.]

See also *French Shoes*, *supra*, as a further example of the characterization of this type of expense as being on revenue account.

32 I can see no basis at all on which to distinguish *IBM Canada* from the present case. Therefore, I am of the opinion that this argument must also fail.

33 In my view, Bowman J. was entirely correct in finding that the TIP received by Ikea was on revenue account and should have been included in income for tax purposes. The payment was clearly received as part of ordinary business operations and was, in fact, inextricably linked to such operations. On the evidence, no question of linkage to a capital purpose can seriously be entertained. Had Ikea wished, it could have requested that the TIP be advanced expressly for the specific purpose of fixturing, or to defray some other capital cost. It did not do so, however, and the payment was in fact made free of any conditions for or stipulations as to its use. Therefore, whether the TIP represented a reduction in rent or a payment in consideration of Ikea's assumption of its various obligations under the lease, it clearly cannot be treated as a capital receipt and should have been included in Ikea's income. The question that remains, however, is in which taxation year should this inclusion have taken place.

3. *Timing of recognition*

34 To my mind, the timing analysis in the present case is considerably less complicated than in either *Canderel* or *Toronto College Park*, which involved the deduction of TIPs from the income of the payer, not their inclusion in the income of the recipient. In the present case, the jurisprudence clearly points to the conclusion that the TIP was taxable in the hands of Ikea in the year in which it was received. In *M.N.R. v. Benaby Realties Ltd.*, [1968] S.C.R. 12, Judson J. considered the timing of recognition of certain proceeds of expropriation. He concluded, at p. 16, that the Act "requires that profits be taken into account or assessed in the year in which the amount is ascertained".

35 Similarly, in *Foothills Pipe Lines*, *supra*, at p. 6612, Urie J.A. provided the following concise summary of the law:

> A considerable body of jurisprudence has developed certain principles applicable in determining whether or not sums of money received by a taxpayer are to be considered as income in the tax period when received or are to be recorded as a liability or in some other way. . . .
>
> It is useful then to recall that, as a matter of law, amounts become taxable as income in the year of receipt provided the amounts received exhibit the nature and quality of income at that time. [Emphasis added.]

36 In using the term "quality of income", Urie J.A. referred at p. 6612 to *Kenneth B. S. Robertson Ltd.*, *supra*, at pp. 661, where Thorson J. enunciated the following test as to whether an amount received by a taxpayer has this quality:

> Is his right to it absolute and under no restriction, contractual or otherwise, as to its disposition, use or enjoyment?

37 The combined effect of these passages is to confirm what in the law of income tax has become known as the "realization principle", given that an amount may have the quality of income even though it is not actually received by the taxpayer, but only "realized" in accordance with the accrual method of accounting. The ultimate effect of this principle is clear: amounts received or realized by a taxpayer, free of conditions or restrictions upon their use, are taxable in the year realized, subject to any contrary provision of the Act or other rule of law. The TIP received by Ikea in the present case fits this description perfectly. The tenant inducement agreement made it clear that the sole condition precedent to receipt of the payment was the assumption of Ikea's obligations under the lease agreement, and further stipulated that the payment was to be made within seven days of Ikea's commencing business in the premises, pursuant to the lease. Thus, Ikea's right to the payment became absolute at that time. There were no further strings attached such as to postpone actual realization or receipt into a subsequent taxation year, and the payment was received in full by Ikea in 1986. Therefore, I conclude that the entire amount was taxable in that year.

38 I cannot accept Ikea's argument that the case law relied upon by the courts below is not relevant to this case. Ikea notes that *Robertson* was decided not under the present *Income Tax Act* but under its predecessor, the *Income War Tax Act*, R.S.C. 1927, c. 97. That statute made taxable all income received in a year and did not permit computation of profit on the accrual basis, which is now the only acceptable method in most cases. Therefore, it is argued, the "matching principle" of accounting, the application of which was held to be mandatory by the Federal Court of Appeal in both *Canderel* and *Toronto College Park*, was not then relevant and the computation of profit was a completely different matter.

39 As this Court has held today in both of the latter cases, however, the correct approach to the determination of profit for tax purposes is for the taxpayer to adopt a method of computation which is consistent with the Act, with established rules of law, and with well-accepted business principles, and which gives an accurate picture of the taxpayer's income for the taxation year in question. The "matching principle" is not an overriding rule of law, and there is no reason to apply it as paramount to or in lieu of the "realization principle", which is of key importance in the present circumstances. Indeed, I cannot see how the amortization of the TIP in this case could possibly yield a truer picture of income than its immediate inclusion. Ikea received a large sum of money with no conditions attached as to its use. It was free to dispose of the money whenever it chose and in whatever manner it saw fit. In my view, it would constitute a serious distortion of Ikea's taxation picture to ignore the fact that this entire amount was freely available to it as of the 1986 taxation year.

40 This situation is quite different from that canvassed in *Canderel*, where the issue was when a TIP is to be deducted from the income of the payer, rather than

included in the income of the payee. There, in a proper fact situation (though not in *Canderel* or *Toronto College Park*), it could well be argued that the payment relates directly to specific items of revenue to be realized in subsequent taxation years, and that a more accurate picture of income is thus to be obtained via matching. But I fail to see how a TIP to which the payee's right accrues immediately upon the assumption of its obligations under a contract can properly be said to relate to future expenditures. The consideration for the TIP is not the future payment of rent, but rather, the immediate assumption of the contractual obligations. In such a case, unless otherwise specified by the inducement agreement, then, and in the absence of statutory or case law authority to the contrary, the realization approach commends itself as that which will give a more accurate picture of the taxpayer's income.

41 Before concluding, one final matter bears mentioning. Even if this approach is prone to lead to asymmetry in some future case, where a TIP might be amortizable by the payer over the term of the lease but should properly be included in income immediately by the payee, such is perhaps an inevitable consequence of the attempt to obtain an accurate picture of each taxpayer's income. It should be of no real concern to the law, however. Each case must necessarily turn on its individual facts, and on the particular situation of each individual taxpayer. The desirability of an accurate picture of income, in my view, inherently outweighs the possible inconvenience of an asymmetrical result in the occasional case. In this regard, I am in agreement with Robertson J.A. in the court below.

VI. <u>Disposition</u>

42 For the foregoing reasons, I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Thorsteinssons, Vancouver.

Solicitor for the respondent: The Attorney General of Canada, Ottawa.