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BETWEEN:

MARINE INDUSTRIES LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Revenue—Income tax—The Income Tax Act, 11-12, Geo. VI, c. 52, ss. 3, 4 and 127(1)(e)—Payment made to reduce deficits incurred in performance of a contract—Donation or trading debt—Money received in consequence of regular business operations—Appeal from Income Tax Appeal Board dismissed.

Appellant contracted with another company to perform certain work for a determined price. Later appellant received payment of an additional sum to cover operating deficits incurred in the performance of the contract. Appellant was assessed income tax on such additional sum and now contends that such money was received as a minimization of capital loss and not as income.

Held: That the payment under consideration was made as an acknowledgement of a contractual and trading debt and not as a donation.

2. That the payment was received by appellant in consequence of previous and regular business operations and was rightly assessed for income tax.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

Lazarus Phillips, Q.C. and *Neil F. Phillips* for appellant.

Léon Lalande, Q.C. and *F. J. Dubrule* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

DUMOULIN J. now (February 14, 1957) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board, dated the 27th of January 1955 (1), dismissing an appeal by the taxpayer from an assessment levied for the taxation year 1950.

The facts are undisputed. Appellant company, incorporated under Letters Patent issued by Canada, is engaged mainly in the shipbuilding and dredging business at Sorel, a river port in the Province of Quebec. On March 31, 1939, appellant entered into a principal contract (amended and extended by a subsequent agreement dated March 6, 1943), with Beauharnois Light, Heat & Power Co. (hereinafter referred to as Beauharnois), a company then owned by private shareholders, the said contract having for its main object certain dredging work in the construction of the Beauharnois Canal (Exhibit A-1).

From and after April 15, 1944, all the shares of the capital stock of Beauharnois Light, Heat & Power Co. became the property of the Quebec Hydro-Electric Commission, a Crown corporation (Chapter 22, Statutes of Quebec, 8 George VI, 1944, s. 14). Simultaneously an amendment to the Hydro-Electric Commission Act (9 George VI, c. 30) was enacted, adding in section 33 thereof:

18*a*—From and after the 15th of April 1944, Beauharnois Light, Heat & Power Co. has always been and still is an agent of the Crown in the right of the Province, and its property as well as the profits which it realized have belonged and belong to the Province.

From March 31, 1939, to April 15, 1944, appellant was under contract with a private company, but from this latter date on to December 20, 1944, when the undertaking reached completion, it worked for an agent of the Crown in the right of the province.

The principal contract and its amendments provided for the excavation of "between 5,000,000 and 6,000,000 cubic yards of unclassified boulder clay and its disposition outside of the limits of the canal."

Unforeseen technical difficulties, such as a far greater amount of rock than was expected; various complications brought about by the wartime restrictions then obtaining; a shortage of labour with the obviating necessity of an

(1) 12 Tax A.B.C. 161.

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onerous raise in wages, culminated in the overall loss of $1,487,124.35, based "on the difference between the total cost of the contract to the appellant and the total amount received from Beauharnois". Understandably reluctant to shoulder this burden without at least seeking some indemnification, appellant, on February 16, 1945, presented to Beauharnois a demand for compensation of those operating deficits set out at length in an itemized memorandum of costs (Exhibit A-2).

This official request (Ex. A-2, p. 11), signed by appellant's comptroller, Mr. P. A. Lavallée, in its concluding paragraph and in bold type reads:

> Cette réclamation est présentée sur une base d'équité et tous les faits mentionnés dans ce factum justifient la "Compagnie" de payer au "Contracteur" la somme réclamée. Nous sommes convaincus que la compagnie nous accordera cette part de justice qui nous revient. Le tout sans préjudice.

What occurred during the four years following remains untold and would be of no import. Suffice it to say that, on June 17, 1949, Beauharnois Light, Heat & Power Co. paid to Marine Industries Ltd. a sum of $750,000 by cheque to which was attached a stub containing this legend:

> In settlement of your claims against this company, under contract dated March 31, 1939, and amendment thereto dated March 6, 1943. (Ex. A-4).

On receiving this amount, appellant's auditors marked it to income "and immediately deducted therefrom the sum of $650,000 as 'Amounts set up for special contract expense by charge to special revenue'." As a result of the foregoing, appellant included in income on its books the $750,000 received from Beauharnois, claimed as a deduction the contingent reserve (for reconversion of a dredge from electric power to steampower) of $650,000 and continued to include in income on its books the $100,000 difference between the two sums aforesaid." The Minister added the $750,000 to appellant's reported income for the 1950 taxation year. At that time, however, Marine Industries Ltd., reversing its initial interpretation of the deal, had taken the stand that it was not a trading receipt but a minimization of capital loss, outside the scope of regular business affairs.

Consequently, in paragraph 17 of its Notice of Appeal, Marine Industries Ltd. claims it "is not bound by the erroneous entries made in its books of account with respect to the receipt of the $750,000 from Beauharnois." I agree that a real error is not binding: "erreur n'est pas cause"; although one might be interested to know where, in appellant's view, the error lies. Would it be in the so-called reserve fund outlined without any perceptible deprecation in paragraph 13 *supra?*

The fact remains that, upon receiving payment, appellant listed it in its income column, the subsequent change of "name" from income to capital arising as an afterthought. This of course, by itself, is not conclusive, yet, in a limited degree, it could be indicative.

What is the true nature of this payment? Such is the question at stake.

Appellant claims:

(a) That the said sum of $750,000 does not constitute income under ss. 3 and 4 of The Income Tax Act, 1948 (11-12 George VI, c. 52). (N. of A. para. 18).

(b) This sum represents a receipt on capital account. (N. of A. para. 20).

(c) It is not a trading receipt or an ordinary payment, but a gratuitous or extraordinary payment received outside the ordinary course of business. (N. of A. para. 21).

(d) That such gratuitous benefit conferred after the close of a contract, which did not result in a profit but only in the minimization of a loss, does not constitute taxable income. (N. of A. para. 23).

The respondent, relying upon ss. 3, 4 and 139(1)(*e*) of the Act (s. 127(1)(*e*) (1948) R.S. 11-12 Geo. VI, c. 52, would be more appropriate), briefly replies in law that:

(a) The assessment for the taxation year 1950 is correct and made in accordance with the provisions of the Income Tax Act.

(b) The amount of $750,000 received by the appellant in the taxation year 1950 is income.

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I will at once dispose of the so-called "act of grace" or purely benevolent character of the payment made by Beauharnois to appellant.

Ages ago, shrewd observers of human nature, the Romans, had inscribed in the pertinent law a caution which holds good to this day: *Nemo praesumitur donare*—"Gifts are not presumed but proven".

I am at a loss to understand how or why the regular process of the taxing statute could be diverted from its ordinary course, merely because a trade obligation, implemented through payment, happened to be a moral one and not strictly enforceable at law.

In my opinion, there is no doubt but that Beauharnois paid for value received, acknowledging its real, if not strictly legal, obligations. In the English case of *Herbert v. McQuade* (1), it was said:

> . . . the test is whether, from the standpoint of the person who receives it (i.e. the voluntary payment), it accrues to him in virtue of his office; . . . and the liability to income tax is not negatived merely by reason of the fact that there was no legal obligation on the part of the persons who contributed the money to pay it.

In a similar vein, we read in *Cooper v. Blakiston* (2) that:

> The question is not what was the motive of the payment, but what was the character in which the recipient received it. Was it received by him by reason of his office?

Regarding the motive of the "payer", I have stated my conviction; concerning the "character" of the recipient or "payee", it received payment of its contractual enterprise. This also disposes of the time factor which fails to alter the nature of the payment.

Furthermore, should the transaction at issue be anything but a regular acquittance of debt, in the ordinary, though tardy, course of business, the alternative then necessarily points to a gift or donation, something outside the scope of trade between a privately owned concern, and a Crown company.

How could a Crown agent, such as Beauharnois Light, Heat & Power Co. "donate" $750,000 to Marine Industries Ltd. without proper authority so to do, namely a vote of

(1) [1902] 2 K.B. 631 at 649, in fine. (2) [1907] 2 K.B. 688 at 703.

the Legislature as in the *Geo. T. Davie* case (*infra*). And would a "donation" be properly acknowledged by means of a company resolution, such as Exhibit R-1, dated June 17, 1949, recording, *inter alia*, para. 4:

> Que la compagnie donne *une quittance complète, totale et finale* à Beauharnois Light, Heat & Power Company en considération *du paiement* de ladite somme de $750,000, de toute réclamation quelconque au sujet dudit contrat et de toutes choses qui en ont découlé.

If this does not qualify conclusively, and in appellant's own terms, the nature of the act "un payement" and the "character" according to which it was received that of a vendor of services and material, warranting a release or quittance "de toute réclamation quelconque au sujet dudit contrat", I renounce all possibility of showing it in a more revealing light.

A few precedents were referred to during the argument and with special emphasis those of *British Mexican Petroleum Co. Ltd. v. Jackson* (1) and *Geo T. Davie and Sons Ltd. v. Minister of National Revenue* (2).

In the former affair, the pertinent matter was that:

> Under the terms of an agreement dated the 25th November, 1921, the Appellant Company (British Mexican Petroleum) paid to the producing company (The Huasteca Company) the sum of £325,000 and was released by the producing company from its liability to pay the balance remaining due, viz., £945,232. The amount so released was carried direct to the Appellant Company's balance sheet and was shown as a separate item under the head "Reserve" at the 31st December, 1922.
>
> The question in this appeal (wrote Lord Thankerton at page 590) is whether this sum of £945,232 falls to be brought into account for the purpose of computing the profits and gains of the Respondents under Schedule D of the *Income Tax Act*, 1918, either by reducing by that amount the debit item in the trading account to 30th June, 1921, or by crediting it as a trading receipt in the trading account to 31st December, 1922.

Due account taken that respondents never disputed the sum of their contractual liability to the Huasteca Company (p. 592), Lord Thankerton continued thus:

> I am unable to see how the *release* from a liability, which liability has been finally dealt with in the preceding account, can form a *trading receipt* in the account for the year in which it was granted.

That case seems readily distinguishable from ours, in which I perceive no "release" from a liability but the "acquittance" of one.

(1) 16 Tax Cases, 570 ff. (2) [1954] Ex. C.R. 280 ff.

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Marine Industries who, alone, could have forgiven Beauharnois its, let us say, moral and equitable (*lato sensu*) obligations, insisted on obtaining payment.

Admittedly, the receipt by appellant of $750,000 served to abate an eventual loss. But so do all payments when envisaged from that viewpoint.

The distinction alluded to above assumes the proportion of a neat difference as another glance may reveal. At page 593, third paragraph, Lord Macmillan held that:

> If then, the accounts for the year to 30th June, 1921, cannot now be gone back upon, still less in my opinion can the Appellant Company (B.M. Petroleum Co.) be required to enter as a credit item in its accounts for the eighteen months to 31st December, 1922, the sum of £945,232, being the extent to which the Huasteca Company *agreed to release the Appellant Company's debt to it.* I say so for the short and simple reason that the Appellant Company *did not,* in those eighteen months, either *receive payment of that sum* or acquire any right to receive payment of it. I cannot see how the extent to which *a debt is forgiven* can become a credit item in the trading account for the period within which the concession is made.

The essential expressions are, of course, those indicating a "release" of debt and a debt "forgiven".

As already stated, in the case at issue, none, save Marine Industries Ltd. enjoyed the right of "releasing" or "forgiving" any liability owing by Beauharnois. Far from releasing or forgiving any fraction of the latter's indebtedness, appellant, four years pending, strove to obtain $1,487,124.35, of which it was finally *paid* $750,000 on a pro and con settlement basis.

The agreement, in *British Mexican Petroleum v. Huasteca Co.* (*supra*), was to *release* and *forgive* a debt of £945,232; whilst here, in complete contrast, we find an *acknowledgement* of a debt, a contractual and trading one, fully instanced on June 23, 1949, through actual payment. Hence appellant's apparent confusion of a debt *forgiven* with a debt *admitted* and *acquitted.*

Let us now advert to the question raised in the matter of *Geo. T. Davie and Sons Ltd. v. The Minister of National Revenue* (*supra*).

Geo. T. Davie (for short), a shipbuilding enterprise, at Lévis, P.Q., fell into financial difficulties while building five Yangtze River boats, under contract with a Chinese company, which derived its funds mainly from loans guaranteed by the Canadian Government. The Davie Co.

obtained, under a mortgage security covering all its immovables, advances from the Canadian Commercial Corporation, a Crown company, to which it was already indebted in the amount of $450,000 for previous loans. Upon completion of the contract, Geo. T. Davie's total indebtedness to C.C.C. amounted to $914,000.

On November 2, 1949, the Crown, ultimate if not proximate creditor, abated the shipbuilder's debts in respect of two amounts: the first of $248,813.83 "being the amount of a payment received by the Canadian Commercial Corporation from the Chinese company, representing the final increase in the price of the three large vessels"; the second of $450,000 "being a portion of the said advances made by the Canadian Commercial Corporation to the shipbuilder and representing the portion of the loss assumed by the Canadian Government . . . ." The payment of $248,813.83 from the Chinese company *was taken in appellant's accounts* for 1949 *as a trading receipt*, but the sum of $450,000, shown in its tax returns for the same year as an increase in capital surplus, was added by the Minister to appellant's declared revenue, whence the problem. It was held, *inter alia,* that (p. 281):

> (3) The mere cancellation or abatement of an undisputed trade debt does not give rise to taxable income in the hands of a taxpayer whose trade debt has been cancelled or abated. The abatement of a capital indebtedness cannot give rise to taxable income.

To this must be joined the following pronouncement:

> (4) The benefit conferred on Appellant by the abatement of its *capital liability* was not something received in the course of its normal trading operations. It was outside those operations entirely. *It did not* in 1949 *receive payment of the sum of $450,000* or acquire any right to receive it. The liability was diminished purely as an act of grace. The benefit received was not a profit from Appellant's business.

In the George T. Davie case, the Crown agent, Canadian Commercial Corporation, shows up merely in the guise of a mortgage creditor for moneys advanced and is, otherwise, alien to the shipbuilding contracts, while Marine Industries Ltd. and Beauharnois are linked together in a direct contractual relationship, comparable to that of vendor and purchaser in final analysis.

Another significant factor of the Davie case: the sum of $248,813.83 paid, in 1949, by the Chinese company to Canadian Commercial Corporation and credited to George

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T. Davie's account (an incident of close analogy to the $750,000 paid by Beauharnois to Marine Industries) "was taken into the appellant's accounts for the year 1949 as a trading receipt" and shown as an item of assessable revenue. As Cameron J. put it in the Davie case (p. 287):

> There is no evidence whatever that in paying the additional sum of $248,813.83, Ming Sung (the Chinese firm) *was contributing to the losses* of the Appellant. The letter of the Deputy Minister dated November 2, 1949, states that that sum "was received by the C.C.C. from Ming Sung *as the final increase of contract price* in respect of the three large vessels."

A wording, very similar, was resorted to in our Exhibit A-4 *supra* and *infra*. Lastly, the abatement of $450,000 consented to by the Canadian Government, in reduction of advances to George T. Davie, never took the form or shape of a *payment* but that of a mere *entry* in the lender's books. On the other hand, in sharp contrast, Beauharnois Light, Heat & Power, *by its cheque* of June 17, 1949, went through the positive act of paying $750,000 to appellant, "attaching to the above mentioned cheque a stub with the following legend (Exhibit A-4):

> In settlement of *your claim* against this company *under the contract* dated March 31, 1939, and amendment thereto dated March 6, 1943.

Finally, how could one trace the faintest outline of a *capital liability* throughout the entire unfolding of this transaction?

The inescapable result is to classify the $750,000 paid in the category of operational trading obligations as contemplated by ss. 3 and 4 and as further defined by s. 127(1)(*e*) of the Act. Appellant received, in 1949, this amount in consequence of previous and regular business operations.

The consequent assessment by the Minister was correct and made conformably to the relevant provisions of *The Income Tax Act*, 1948.

Therefore, appellant's appeal should be dismissed, with costs taxed in the usual way.

Judgment accordingly.