Olympia Floor & Wall Tile (Quebec) Ltd (*Appellant*) *v.* **Minister of National Revenue** (*Respondent*)

Jackett P.—Montreal, February 9, 11, 1970.

Income Tax—Charities—Contributions to charitable organizations—Business profit, computation of—Charitable contributions made to obtain sales—Whether business expense—Whether "reasonable."—Whether limited to 10% of income—Income Tax Act, s. 12(2), 27(1)(a).

In 1962 and 1963 appellant company made contributions to charitable organizations headed by business men who in return caused their businesses to make large purchases of appellant's goods. It was necessary for appellant to make the contributions to the charities in order to obtain those sales. Appellant's contributions were over $8,000 in 1962 and over $10,000 in 1963, to obtain sales of over $250,000 in each year.

Held, the contributions made by appellant to obtain sales were expenses incurred in appellant's income-earning process and so deductible in computing appellant's business profit. Although in the form of gifts the contributions were not "gifts" within the meaning of s. 27 (1)(*a*) of the *Income Tax Act* so as to be limited to 10% of appellant's income. *Riedle Brewery Ltd v. M.N.R.* [1939] S.C.R. 253, *Montreal Trust Co. (Crosbie Est.)* v. *M.N.R.* [1961] I Ex.C.R. 297, applied; *O'Reilly & Belanger Ltd* v. *M.N.R.* [1928] Ex.C.R. 61, distinguished.

The disbursement was "reasonable" within the meaning of s. 12(2). A business man's bona fide decision to make a disbursement for a business reason raises a presumption that it is reasonable to do so.

The portion of the contributions made not to obtain sales but to avoid criticism for refusing deserving causes was however not an expense incurred in the income-earning process. *Hutchinson & Co. (Publishers) Ltd v. Turner,* 31 T.C. 495, referred to.

INCOME tax appeal.

M. Klein for appellant.

A. Garon and *G. Rip* for respondent.

JACKETT P.—This is an appeal from a decision of the Tax Appeal Board dismissing the appellant's appeal from its assessments under Part I of the *Income Tax Act* for the 1962 and 1963 taxation years. The appeal raises a question as to the deductibility, in computing the appellant's "income" for each of those years for the purposes of Part I, of certain payments that would otherwise be deductible (to the extent of the 10 per cent ceiling) as "gifts" to "charitable organizations" under section 27(1)(*a*) of the aforesaid Act.

In each of the two years in question, the appellant had sales, in the course of its business, of over one million dollars. In the view of the appellant's sales manager, between 25 per cent and 30 per cent of these sales were attributable to gifts that, while they qualified as "gifts" to "charitable organizations" within the meaning of those words in section 27(1)(*a*) of the *Income Tax Act*,[1] were made to charitable organizations that were headed up by men who, in their ordinary business lives, were in a position to cause purchases to be made of the appellant's goods and who, as a consequence of the appellant's gifts to their charitable organizations, did, in the ordinary course of events as things were done in the particular part of the Montreal community that was involved, cause substantial purchases to be made of the appellant's goods that would not otherwise have been made. This view was not seriously challenged on cross-examination of the appellant's sales manager and was supported by other evidence including the evidence of a person who swore that he obtained contributions to a school in which he was interested, from such business people as a plumber and an electrician, as well as from the appellant, by promising that he would use his business position to cause business to go to them and that, when he obtained contributions for that "charitable organization" in that way, he carried out his promise in a substantial way. I accept this evidence and I find that contributions to charitable organizations so made were expenditures laid out by the appellant in the years in question largely, if not entirely, for the purpose of increasing its sales and only subsidiarly, if at all, for charitable or benevolent reasons.

The total of the contributions made to "charitable organizations" by the appellant in 1962 was over $8,000 and the total of those made in 1963 was over $10,000. Of these contributions, however, it is only those that were over $100 that were made for the purpose of increasing the appellant's sales in the manner that I have described. The remainder were made to avoid criticism that would arise if gifts were refused for some deserving

[1] 27. (1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted from the income for the year such of the following amounts as are applicable:

(*a*) the aggregate of gifts made by the taxpayer in the year (and in the immediately preceding year, to the extent of the amount thereof that was not deductible under this Act in computing the taxable income of the taxpayer for that immediately preceding year) to charitable organizations in Canada exempt from tax under this Part by paragraph (*e*) of subsection (1) of section 62, corporations or trusts resident in Canada and exempt from tax under this Part by paragraph (*f*) or (*g*) of subsection (1) of section 62, housing corporations resident in Canada and exempt from tax under this Part by paragraph (*ga*) of subsection (1) of section 62, Her Majesty in right of the provinces and Canadian municipalities, not exceeding 10% of the income of the taxpayer for the year, if payment of the amounts given is proven by filing receipts with the Minister;

causes when they were being made for others, and I do not understand that counsel for the appellant seriously argued that such contributions should be treated as business expenditures.[2]

I am of opinion that the amounts in question (after eliminating those that were not over $100), if one puts aside the fact that they were gifts to charitable organizations, fall clearly within the authority of *Riedle Brewery Ltd. v. M.N.R.*[3] where amounts were held to be deductible when they were spent by breweries in following a practice of "treating" potential customers because it was found that, if the practice was followed consistently, their sales would either be maintained or increased "whereas when the practice was discontinued, their sales would materially decrease". See per Kerwin, J. (as he then was) delivering the judgment of himself and Crockett, J., with which Duff, C.J.C. agreed, at page 263:

> Now upon the evidence, it appears to me that the appellant company disbursed the sum in question for the purpose of earning income and not as a capital expenditure. As to the words "wholly" and "exclusively," it is not suggested that the appellant desired to give away its funds, or any part of them, nor is it contended that there was any fraud or bad faith, or that any part of the expenditures was fictitious. The learned President of the Exchequer Court held that the expenditure was not necessary but, with respect, I find it impossible to agree. As already mentioned, the practice followed by appellant is one adopted by the other brewers in Manitoba, and followed by all as something considered by them, not merely as advisable, but as obligatory, to increase, or at least sustain, the volume of their sales. Being considered thus in a commercial sense, I think it should be similarly held for the purposes of the Act.

Certainly, if on facts that, in my view, are not more favourable to the taxpayer, the deductions were permissible in the *Riedle Brewery* case notwithstanding section 6(1)(*a*) of the *Income War Tax Act,* which prohibited the deduction of disbursements "not wholly, exclusively and necessarily laid out... for the purpose of earning the income," the deductions here are not prohibited by section 12(1)(*a*) which only prohibits an outlay or expense "except to the extent that it was made or incurred... for the purpose of gaining or producing income..."

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[2] In so far as the amounts that were not over $100 are concerned, I regard the reasoning of Vaisey, J. in *Hutchinson & Co. (Publishers) Ltd. v. Turner,* 31 T.C. 495, at page 503, as applicable. He said there:

> The alternative claim on this part of the case may be thus stated: The payment of the £31,469 to the corporation is alleged to have been a necessary outgoing of Hutchinson's business because had it not been made Hutchinson would, or at least might, have been so ruined in reputation as to affect to a serious degree their financial position and standing. This is to my mind a plausible plea but I have come to the conclusion that it is open to the same kind of objection as the other. Take the case of a successful tradesman in a country town who has a relative living in poverty near him whom, as his customers and neighbours all know, he has promised to maintain with an annual payment. If such a man were to withhold that payment it is all too likely that he would lose his custom as well as his reputation. But could the payment for that reason be held to be a proper outgoing of and deduction from the profits of his business? I think not.

[3] [1939] S.C.R. 253.

The decision of this Court in *O'Reilly & Bélanger, Ltd. v. M.N.R.*[4] is distinguishable from this case in that there was no evidence there, as there is here, with reference to the amounts over $100, of an immediate expectation of business as a result of making the payments. I recognize, however, that there are passages in the reasons for judgment in that case that would be applicable to the problem before me but as, in my view, such passages are inconsistent with the reasoning of the majority of the Supreme Court of Canada in the *Riedle Brewery* case, I have concluded that I must not adopt them as applicable here.

So far as section 12(1)(*b*)[5] is concerned I have difficulty in appreciating the submission that it operated to prohibit the deduction of the amounts in dispute. From this point of view, I cannot distinguish such amounts from advertising expenses. Compare *Algoma Central Ry. v. M.N.R.*[6]

So far as the objection based on section 12(2)[7] is concerned, I cannot see how it can be contended that a disbursement of a substantial part of $8,000 in one year and of $10,000 in another year to attract or maintain sales of over $250,000 was not, in the absence of additional facts, "reasonable". The fact that the business man makes a *bona fide* decision to make disbursements for business reasons raises a presumption in my mind that it was "reasonable" to make such disbursements unless fact are proved that establish that it was not "reasonable".

In this case, moreover, we have the unchallenged evidence that the contributions were necessary to keep some 25 per cent to 30 per cent of the appellant's sales. That being so, it was a "necessary" expense within the test applied by the majority of the Supreme Court of Canada in the passage that I have just quoted from the *Riedle Brewery* case. If an expense was "necessary", I do not think it can be said that it was not "reasonable".

As already indicated, the above conclusions were reached putting aside for the moment the fact that the amounts in question were gifts to charitable organizations. I must now consider whether that fact, in itself, or by reason of section 27(1)(*a*), operates to bring about the result that the amounts in question are not deductible in computing "income" for the purpose of Part I of the *Income Tax Act.*

At this point, it is well to pause and recall to mind the basic scheme of Part I of the *Income Tax Act.* That Part imposes an income tax on an arbitrary amount called "taxable income" which, by definition, is "income" less certain deductions specially allowed, of which the section 27(1)(*a*) allowance for "gifts to charitable organizations" is one, "income", being,

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[4] [1928] Ex.C.R. 61.

[5] 12. (1) In computing income, no deduction shall be made in respect of . . .

(*b*) 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,

[6] [1967] 2 Ex.C.R. 88; [1968] S.C.R. 447.

[7] "In computing income, no deduction shall be made in respect of an outlay or expense otherwise deductible except to the extent that the outlay or expense was reasonable in the cirmumstances."

in the case of a business such as we have here, the "profit" from the business (section 4). Putting it in reverse, you start by computing the "profit" from the business, which involves setting off against the revenue of the business the "expenditure laid out as part of the process of profit earning".[8] Having determined the "profit" from the business, you have its "income" and you deduct from that its "gifts" to charitable organizations to the extent permitted by section 27(1)(*a*) to obtain its "taxable income" being the amount on which its tax is computed.

Having tentatively concluded that the disbursements here were deductible in computing the profit from the business because they were laid out as "part of the process of profit earning", I must now consider whether that conclusion can stand up when one considers that they were laid out as contributions to charitable organizations.

Ordinarily, one thinks of charity as a personal matter. One gives of what one would otherwise have for oneself for the relief of poverty in others or for education or other "good works". In its original concept, therefore, one would not deduct a charitable gift in computing one's profit or income because it is, by definition, a gift made out of the profit or income after it is earned. Quite clearly, I should have thought, in its inception, a gift to charity was a "personal" outlay, the deduction of which would have been prohibited by the forerunner of section 12(1)(*h*).[9] That, I should have thought, is why, originally, the special provision for deduction of charitable gifts was limited to gifts by individuals (who else could have been motivated to make such gifts?) and that is why the ceiling was expressed as a percentage of "income" (which fact presupposed that the amount of the "income" had been established before the individual made his "gifts" out of it).

Presumably, a time came in the evolution of income tax law when, the more sophisticated campaigns of charitable organizations having resulted in corporations being forced to make charitable contributions (not because they were as corporations capable of charitable motivation but because an atmosphere was created in which a failure to contribute would damage the corporate "image" so as to affect adversely the corporation's business operations), Parliament, for that reason, decided that corporations should have the same sort of tax treatment for such contributions as individuals. If that is the correct rationalization of the present state of section 27(1)(*a*) as far as gifts to charitable organizations are concerned, it follows that what is being permitted by that provision is a deduction of an amount that has been given out of the corporation's income after it has been earned and not a deduction of an amount that has been laid out as part of the income earning process; and this is indeed the form that the provision takes. Indeed, it might be said that, while Parliament could not have been oblivious to a certain cynicism underlying certain charitable giving on the part of both

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[8] See *Tata Hydro-Electric Agencies, Ltd, Bombay v. I.T.C.* [1937] A.C. 685 at 696.

[9] 12. (1) In computing income, no deduction shall be made in respect of

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(*h*) personal or living expenses of the taxpayer except travelling expenses (including the entire amount expended for meals and lodging) incurred by the taxpayer while away from home in the course of carrying on his business,

individuals and corporations, the legislature could not have foreseen, when section 27(1)(*a*) was enacted, the sort of commercialism that has produced the facts of the present appeal.

While hitherto unforeseen, however, I can find no inherent incompatibility between an "outlay ... for the purpose of ... producing income" and a gift to a charitable organization. If, on the facts of a particular case, such a gift is found to have been made *bona fide,* as an outlay for the purpose of producing income, I am of the view that, *prima facie,* it escapes the prohibition in section 12(1)(*a*).

There remains for consideration the question whether, when section 27(1)(*a*) is read with the other provisions of the Act, one must reach the conclusion that Parliament intended that gifts to charitable organizations were not to be deducted except in the manner and to the extent authorized by that provision. In other words, must one infer from the existence of section 27(1)(*a*) a prohibition against any deduction of charitable contributions in the computation of income?

It is trite law that all the provisions of a statute must be read together in deciding what any one of them means. It certainly is improbable that Parliament intended that some gifts to charitable organizations should be deducted in computing income and should also be deducted from income in computing taxable income. Before I reached such a conclusion, I should, I think, decide that Parliament was impliedly prohibiting the deduction of gifts to charitable organizations as outlays for the purpose of earning income regardless of the circumstances; and I do not think that I would be relieved of the obligation to reach that conclusion merely because the particular appellant says, as it does here, that it is not claiming both deductions for the same contributions.

However, I am of opinion that the correct interpretation of the statute does not involve either extreme position. In my view, when a taxpayer makes an outlay for the purpose of producing income—*i.e.* as part of his profit making process—even though that outlay takes the form of a "gift" to a charitable organization, it is not a "gift" within the meaning of that word in section 27(1)(*a*) which, by reason of the place it holds in the process of computing taxable income, was obviously intended to confer a benefit on persons who made contributions *out of income* and was not intended to provide deductions for outlays made in the course of the income earning process.

In reaching the conclusion that the "gifts" to charitable organizations as part of the profit earning process are not "gifts" within the meaning of section 27(1)(*a*), I do so by following the same line of reasoning that I followed in *Montreal Trust Co.* (*Crosbie Estate*) *v. M.N.R.*[10] where I held that a bonus granted to an employee who happened to be a close relative of the principal shareholder of the employee's company was not a "gift" within the meaning of that word in the *Estate Tax Act.* The following portion of the reasons that I gave in that case indicates, I think, my approach to the problem that arises in this case:

> The question that has to be decided is whether a benefit conferred by a company controlled by the deceased, upon Andrew C. Crosbie as an employee of

[10] [1967] 1 Ex.C.R. 297.

the company "for legitimate business reasons" is to be dealt with for estate tax purposes as property passing on the death of the deceased by reason of the fact that Andrew C. Crosbie happened to be a blood relation of the deceased. There is no suggestion that the transaction was a mere subterfuge for conferring a benefit on Andrew C. Crosbie as a blood relation of the deceased and there is no suggestion that any part of the amount of the benefit is for anything other than the benefit that "legitimate business reasons" dictated that it was in the commercial interest of the company that it should confer on this employee. This aspect of the case is underlined by the otherwise irrelevant fact that a similar arrangement was made for a fellow employee on very similar terms at the same time.

One further point needs to be developed in considering the neat point that has to be decided on this appeal. In my view, what was done here falls into a not uncommon category of business transactions, namely, payments made in the ordinary course of business without legal liability. A business is operated to make a profit. No disbursement is a proper business disbursement unless it is made directly or indirectly to attain that end. Generally speaking, business payments are made pursuant to contracts whereby the business man receives a *quid pro quo* for that payment—e.g., contracts for services, purchase contracts, construction contracts, etc. Neverthless, good business can dictate, depending on the circumstances, disbursements over and above the amounts legally owing for what the business man has received or is to receive. A special payment to a good contractor in unforeseen difficulties so that he will be available for future work, is one example. Bonuses to employees over and above any requirement of the contracts of employment, so as to maintain their goodwill and keeep employees morale high is another. Still another is the very type of benefit conferred on senior executives that we find in this appeal. That it is a very common type of benefit conferred on senior executives is evidenced by the special provision made in section 85A of the *Income Tax Act* for their income tax treatment.

Two aspects of the facts call for special attention when it is claimed that the benefit should be treated as part of the deceased's estate for estate tax purposes, viz.:

(*a*) the benefit was conferred on Andrew C. Crosbie as an employee of the company and not as a blood relation of the deceased, and

(*b*) while the benefit was completely gratutitous in the sense that it was not conferred pursuant to a legal obligation as payment for something already received or pursuant to a contract for something to be received, it was nevertheless an ordinary business transaction and had none of the characteristics of what is commonly thought of as a gift *inter vivos*.

Counsel for the respondent submits that neither of these aspects of the matter is of any significance. He would say, I believe, that the statute necessarily contains arbitrary provisions designed to bring into the tax net transactions that might otherwise be employed to avoid the incidence of estate tax and that such provisions are to be applied quite literally to transactions that are not avoidance transactions—probably because of the difficulty involved in establishing that any particular transaction has a tax avoidance character.

I accept the proposition that provisions such as section 3(1)(c) and (g) and 3(6)(b), by their very nature, must be applied according to their terms, regardless of whether their application to particular circumstances may go further than, in the opinion of the Court, is required to carry out the scheme of the statute. I am of opinion, however, that in determining the effect of such a provision, as in the case of determining the effect of any other provision in a statute, it must be weighed having regard to the place it occupies in the scheme of the statute.

Applying that approach to this case, in my view, the outlays made by the appellant for the purpose of maintaining or expanding sales, even though

they took the form of contributions to charitable organizations, were not "gifts" within the meaning of that word in section 27(1)(*a*) of the *Income Tax Act*.

The appeal will be allowed with costs and the assessments under appeal will be referred back to the respondent for re-assesment on the assumption that all the contributions in question that were over $100 are deductible in computing the appellant's income for the appropriate year and that the remainder of such contributions are "gifts" within section 27(1)(*a*) of the *Income Tax Act*.