
Fortier (*Appellant*) v. **Minister of National Revenue** (*Respondent*)

Walsh J.—Ottawa, February 19, 27, 1970.

Income tax—Capital cost allowances—Recapture—Cost of property including non-depreciable subsidy—Sale for more than undepreciated capital cost—whether recapture—Income Tax Act, s. 20(6)(g).

Appellant constructed a cheese factory, receiving a statutory subsidy which under s. 20(6)(*h*) of the *Income Tax Act* was excluded in computing the property's capital cost. Appellant claimed capital cost allowances on the property, which was then sold for an amount in excess of its undepreciated capital cost. Appellant was assessed to income tax on the recaptured capital cost allowances and appealed, contending that the price in excess of the undepreciated capital cost represented the subsidy and could not "reasonably be regarded as being.... consideration for disposition of depreciable property".... but was "for something else" within the meaning of s. 26(6)(*g*).

Held, the assessment must stand. Although only part of the capital cost of the property was subject to capital cost allowances it was still depreciable property within the meaning of s. 20.

INCOME tax appeal.

J. G. Guertin for appellant.

J. C. Sarrazin for respondent.

WALSH J.—The facts in this case are not in dispute and are set out in the agreement on facts filed in the record. Appellant and his partner received a grant of $60,000 under the provisions of the *Cheese and Cheese Factory Improvement Act,* R.S.C. 1952, c. 47, in 1961 towards the construction of a building and equipment for same for the production of cheese. This grant was broken down to an amount of $22,000 towards the cost of the building and $38,000 towards the cost of the equipment. This building eventually cost $57,784.82 and the equipment $109,473.74. Additions to the equipment were later made in the amount of $10,301.16, making a total cost of the equipment in the amount of $119,774.90. Deducting the grants given the capital cost of the building for the appellant and his partner was $35,784.82 and the equipment $81,774.90.

In 1962 and 1963 they claimed capital cost allowance totalling $2,400 on the building and $12,410 on the equipment. A further amount of $1,500 was claimed as capital cost allowance on the building and $12,200 on the equipment in the year 1964, but these items were disallowed by the respondent when the building was sold on January 31, 1964 as the fiscal year of the company did not end until March of that year. Appellant does not dispute that these 1964 deductions were properly disallowed and this is not in issue. Deducting only the amounts allowed for 1962 and 1963 therefore the undepreciated capital cost to the vendors at the date of the sale was $33,384.82 for the building and $69,364.90 for the equipment.

In November 1963 appellant and his associate incorporated the Nation View Cheese Factory Limited, becoming the two principal shareholders of same and on January 31, 1964 they sold the cheese factory to this company, the portion of the sale price attributed to these two items being $53,884.82 for the building and $95,164.90 for the equipment. The question of whether or not this was an arm's length transaction so as to cause section 20(4) of the Act to be applied is not in issue as the figures have been accepted by the Minister and it is common ground that the transaction did not involve the conferring of a benefit upon either party.

The respondent did, however, in a new assessment dated March 19, 1968 claim recaptured capital cost allowance for the years 1962 and 1963 in the amount of $2,400 on the building and $12,410 on the equipment on the ground that the sale prices of these two items exceeded their undepreciated capital cost to the vendors at the time of the sale, applying section 20(1) of the Act[1]. This assessment was confirmed by judgment of the Tax Appeal Board dated January 13, 1969 from which the present appeal is taken.

The entire issue rests on the interpretation of section 20(6)(*g*) and (*h*) of the *Income Tax Act* which reads as follows:

> 20. (6) For the purpose of this section and regulations made under paragraph (*a*) of subsection (1) of section 11, the following rules apply:
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> (*g*) where an amount can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of

[1] 20. (1) Where depreciable property of a taxpayer of a prescribed class has, in a taxation year, been disposed of and the proceeds of disposition exceed the undepreciated capital cost to him of depreciable property of that class immediately before the disposition, the lesser of

(*a*) the amount of the excess, or

(*b*) the amount that the excess would be if the property had been disposed of for the capital cost thereof to the taxpayer,

shall be included in computing his income for the year.

disposition of depreciable property of that class irrespective of the form or legal effect of the contract or agreement; and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount;

(*h*) where a taxpayer has received or is entitled to receive from a government, municipality or other public authority, in respect of or for the acquisition of property, a grant, subsidy or other assistance other than an amount authorized to be paid under an *Appropriation Act* and on terms and conditions approved by the Treasury Board for the purpose of advancing or sustaining the technological capability of Canadian manufacturing or other industry, the capital cost of the property shall be deemed to be the capital cost thereof to the taxpayer minus the amount of the grant, subsidy or other assistance;

Section 11(1)(*a*) reads as follows:

11. (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

(*a*) such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation;

It is common ground that the subsidy was one which fell within the provisions of section 20(6)(*h*) and that the amount of same must be deducted from the capital cost of the property in question to the taxpayer, to obtain the capital cost thereof for depreciation purposes. It is also common ground that the amounts deducted as capital cost allowance in 1962 and 1963 were properly deducted from the capital cost of the property as so determined and that the amounts were within the allowable limits for these deductions.

Appellant's counsel explained that the selling price of $53,884.82 for the building and $95,164.90 for the equipment was calculated as follows:

The capital cost of the depreciable property represented by the building as defined under section 20(5)(*a*) of the Act[2] amounted to $35,784.82. After deducting the $3,900 capital cost allowance (including $1,500 for 1964 which was later disallowed) the undepreciated capital cost amounted to $31,884.82 to which was then added the $22,000 subsidy which could not be depreciated, making a total of $53,884.82, for which the building was sold. Similarly the capital cost of the depreciable equipment, including that purchased subsequently, was $81,774.90 from which capital cost allowance in the amount of $24,610 (including $12,200 for the year 1964

[2] 20. (5) In this section and regulations made under paragraph (*a*) of subsection (1) of section 11,

. . .

(*a*) "depreciable property" of a taxpayer as of any time in a taaxtion year means property in respect of which the taxpayer has been allowed, or is entitled to, a deduction under regulations made under paragraph (*a*) of subsection (1) of section 11 in computing income for that or a previous taxation year;

which was disallowed) was deducted, leaving a balance of $57,164.90 to which was added $38,000 being the amount of the subsidy on the equipment which could not be depreciated to arrive at a selling price of $95,164.90. Since the 1964 capital cost allowance claim was disallowed the building would have had an undepreciated capital cost of $55,384.82 of which $33,384.82 would be subject to capital cost allowance and the equipment would have had an undepreciated capital cost of $107,364.90 of which $69,364.90 would be subject to capital cost allowance. On the basis of this calculation appellant contends that the building and equipment were properly sold for their respective capital cost less accumulated capital cost allowance (save for the fact that the 1964 depreciation: was later disallowed) and that there was no question of selling for an amount in excess of the undepreciated capital cost within the meaning of section 20(1).

While the calculation above explains how appellant arrived at the sale prices for which the building and equipment were sold to the company he makes a further calculation on a different basis in paragraphs 2 and 3 of his appeal which leads him to the same conclusion that the capital cost allowance claimed in 1962 and 1963 is not subject to recapture. His argument is based on the fact that the sale prices for the building and equipment respectively were based on the undepreciated capital cost of them at the time of the sale and that in each case these values consisted of a depreciable component and a non-depreciable component represented by the amount of the subsidy. Contending that section 20(6)(*g*) applies he argues that the consideration was in part for the disposition of the depreciable property and in part for "something else", being the undepreciable portion and that the sale price should be attributed on the same basis. Applying this to the figures in question he shows that the capital cost of the equipment was $119,774.90 before capital cost allowance of which $81,774.90 was depreciable and $38,000 being the amount of the subsidy was non-depreciable, the depreciable component being therefore 68.27% of the capital cost of the equipment. Similarly the capital cost of the building was $57,784.82 before capital cost allowance of which $35,784.82 was depreciable and $22,000 non-depreciable, the depreciable component representing 61.93% of the capital cost of the building. Applying the percentage of 68.27 to the sale price of $95,164.90 for the equipment he concludes that the portion of the sale price attributable to the depreciable component of same was $64,969 with $30,195.90 being attributable to the non-depreciable component, and similarly applying the percentage of 61.93 to the sale price of $53,884.82 for the building he concludes that $33,370.87 was attributable to the depreciable component and $20,513.95 to the non-depreciable component.

Since after deducting the capital cost allowance of $12,410.90 for the equipment in 1962 and 1963 the depreciable component of same had been reduced from $8,774.90 to $69,364.90 at the time of the sale and this was more than the figure of $64,969 which was received as a result of the sale there would be no recapture of capital cost allowance. Similarly with respect to the building since the depreciable component of same had been reduced from $35,784.82 to $33,384.82 by the time of the sale as the result of deducting $2,400 capital cost allowance for the years 1962 and 1963, and the sale price was $33,370.87 for this depreciable component which was again slightly less, he argues that there would be no recapture of capital cost allowance in this case either.

In order to decide this case it is necessary to determine whether section 20(6)(*g*) of the Act is intended or can be applied to the present circumstances. Both counsel conceded that there has been no jurisprudence applying this section to a situation where a non-depreciable subsidy forms part of the value of the property disposed of, nor have I been able to find any. All the cases deal with situations where the sale price is partially in payment of property which can be depreciated and partially in payment of non-depreciable property and the price is then broken down into the two components, such as for example the portion of the price attributable to buildings as opposed to land on which they are located, or the portion attributable to the sale of equipment as opposed to the portion attributable to goodwill. Counsel for respondent conceded that had the subsidy been applied *in toto*, for example, to the purchase of a specific piece of equipment there would then have been no objection to applying section 20(6)(*g*) attributing the sale price of all the equipment partly to the value of the other equipment which could be depreciated and partly to the value of this specific item of equipment which could not be depreciated. However he argued that the situation is different where there is just one item being sold, such as the equipment or the buildings in the present case, contending that the component portion of the equipment or buildings not represented by the subsidy cannot be given a value separate and apart from the subsidized and hence non-depreciable component, and that the prices therefore cannot be broken down into the portion paid for depreciable property and the portion paid for "something else".

Appellant's counsel for his part argued that although it was the property itself which was sold and not two separate items, namely, depreciable property and non-depreciable property, the entire consideration could not be considered as having been paid for the portion of the value of the property which was depreciable since the total value of the property also included the value of the undepreciable portion which did not simply disappear into thin air, and that a portion of the price must be attributable to this component as being "something else", as if, for example, it had been land on which the building had been built.

While appellant's argument as to the applicability of section 20(6)(*g*) to the present circumstances is an interesting one, which does not appear to have been raised before the Tax Appeal Board as no reference is made to it in the judgment, I have reached the conclusion that it must fail.

Neither in the case of the building nor the equipment are we dealing with items which can be broken down into separate components, one being depreciable and the other not. The building is itself by its nature "depreciable property of a taxpayer of a prescribed class", and so is the equipment. Section 20(6)(*h*) creates an artificial restriction on depreciating the full cost of either the building or the equipment as a result of the subsidies by stating that "the capital cost of the property shall be deemed to be the capital cost thereof to the taxpayer minus the amount of the grant, subsidy or other assistance". The fact that only a portion of the capital cost of the property is subject to capital cost allowance as a result of this section does not however change the nature of the property itself which remains depreciable property subject only to this restriction.

On this interpretation the consideration paid must be considered as having been for the purchase of depreciable property of the taxpayer, and since the prices paid of $53,884.82 for the building and $95,164.90 for the equipment exceed in each case the undepreciated capital cost to the taxpayer at the date of the sale of $33,384.82 and $69,364.90 respectively, determined by the application of the deeming provision of section 20(6)(*h*) the capital cost allowances claimed in each case for 1962 and 1963 are subject to recapture.

The appeal will therefore be dismissed with costs.