BETWEEN:

DONALD HART LIMITED ..... APPELLANT;

AND

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

1959
Mar. 16
May 15

Revenue—Taxation—Income tax—Damages for infringement of trade mark—Capital or income—The Income Tax Act, R.S.C. 1952, c. 148, ss. 3 and 4.

The appellant, a manufacturer of women's apparel, in an action for infringement of trade mark and other relief, recovered judgment in the sum of $20,000 and credited the net proceeds of the judgment, namely $15,000, to its surplus account. In reassessing the appellant, the Minister ruled that that sum constituted income and added it to the appellant's declared income. An appeal to the Income Tax Appeal Board was dismissed. In a further appeal to this Court, the appellant contended that the sum in question was not "income" within the meaning of ss. 3 and 4 of the *Income Tax Act* because (1) the amount recovered was damages for infringement of the appellant's trade mark, said to be a capital asset; (2) the amount awarded was for diminution

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of the appellant's good will, also said to be a capital asset; (3) the award was for punitive damages, and such damages are in the nature of a punishment for the benefit of the community and as a restraint against the defendant as a transgressor. In support of its contention, the appellant relied entirely on the admissions made by the respondent in his reply to the notice of appeal and on certified copies of the amended statement of claim in the proceedings brought in the Manitoba Court of Queen's Bench, in which court the damages were recovered, and also upon the formal judgment of that Court, the reasons of Maybank J., the trial judge, and the reasons of the Court of Appeal, affirming the judgment of Maybank J.

Held: That there was nothing in the formal judgment of the trial court, nor in the reasons of the trial judge, nor in the reasons of the Court of Appeal, from which it could be concluded that any part of the award was in the nature of punitive damages.

2. That the appellant failed to establish that the award was based on a loss or diminution in value of capital assets, such as it's trade mark or good will, and the sum paid in the name of damages must be treated as a payment in place of loss of trading profits.

Lightning Fastener Co. Ltd. v. Colonial Fastener Co. Ltd. [1936] Ex. C.R. 1; *A. G. Spalding & Bros. v. A. W. Gamage Ltd.*, 35 R.P.C. 101 at 117; *Burmah Steam Co. Ltd. v. C.I.R.*, 16 T.C. 67, referred to.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Cameron at Winnipeg.

H. Buchwald for appellant.

A. L. DeWolf and *G. W. Ainslie* for respondent.

CAMERON J. now (May 15, 1959) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board dated May 23, 1958[1], dismissing the appellant's appeal from a re-assessment dated October 25, 1956, and made upon it for its taxation year ending May 31, 1955. In re-assessing the appellant, the Minister added to its declared income the sum of $15,000, said to be "Proceeds re Court Award credited to surplus and deemed to be income", and the sole question for consideration is whether that amount is taxable income of the appellant.

In an appeal such as this, the onus is on the taxpayer to establish the existence of facts or law showing an error in relation to the taxation imposed upon him (*Johnston v.*

[1] 19 Tax A.B.C. 373; 58 D.T.C. 385.

M. N. R.[1]). In support of the appeal, counsel for the appellant relied entirely on the admissions made by the respondent in his Reply to the Notice of Appeal and on copies of four documents, the admissibility of all of which was disputed by counsel for the Minister.

The admissions made in the Reply established the following: the appellant was at all material times a body corporate with its head office at Winnipeg; that it was engaged in the manufacture and sale of women's apparel; that it owned the trade mark "a Kilroy Original" used in connection with its products; that in September, 1951, it took proceedings against Frank Kilroy Ltd. for infringement of the said trade mark and for passing off, claiming (1) an injunction in respect of the use of the said trade mark and of the word "Kilroy"; (2) destruction of offending labels, wrappers, etc.; (3) an account of profits earned by the defendant by such improper use of the plaintiff's trade mark and by passing off; and (4) damages of $50,000. Further, it was admitted that that case came on for trial before Maybank J. in March 1953 and that by his judgment, dated January 19, 1954 an injunction was granted and the appellant was awarded damages in the sum of $20,000, the reasons of the learned Trial Judge being reported in [2]; and that the said judgment was affirmed on appeal by the Manitoba Court of Appeal, whose reasons for judgment appeared in [3]. It also appears from the pleadings that in re-assessing the appellant, the respondent added to its declared income, not the full amount of the award, but $15,000, an amount said to represent the net receipts therefrom. This evidence may be conveniently referred to as "the Admissions".

Counsel for the appellant tendered in evidence the following:

Ex. 1 A certified copy of the amended Statement of Claim in the proceedings above referred to.

Ex. 2 A certified copy of the formal judgment therein dated January 19, 1954.

Ex. 3 The Reasons for Judgment of Maybank J. as reported in [1954] 11 W.W.R. (N.S.) 350.

Ex. 4 The Reasons for Judgment in the Court of Appeal as reported in [1955] 14 W.W.R. (N.S.) 70.

[1] [1948] S.C.R. 486. [2] (1954) 11 W.W.R. (N.S.) 337.
[3] (1955) 14 W.W.R. (N.S.) 49.

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No objection was taken as to the form in which this documentary evidence was tendered, but counsel for the Minister took the position that as these documents had to do with an action *in personam* in which the respondent herein was neither a party nor privy, they were therefore inadmissible on the ground that they were *res inter alios acta*. He relied on *Dokuchia v. St. Paul Fire & Marine Insurance Co.*[1] (a decision of the Court of Appeal of Ontario); *Hollington v. F. Hewthorn & Co. Ltd.*[2] (a decision of the Court of Appeal in England); and Halsbury's *Laws of England*, 3rd Ed., Vol. 15, p. 396, where it is stated:

> 708. A judgment *in personam* or *inter partes* operates as an estoppel or conclusive evidence against parties and privies of the truth of the facts upon which such judgment is based; but except to prove its existence, date and consequences, it is inadmissible in evidence for or against strangers.

Counsel for the appellant intimated at the hearing that whether or not the documentary evidence was admitted, he intended to lead no further evidence. Accordingly, I stated that I would reserve my finding on what I considered to be a difficult point and, if necessary, would dispose of it in my judgment.

The appeal of the taxpayer is substantially based on the fact that the award resulting in the receipt of $15,000 is one for "damages" and counsel concedes that if it had been an award for loss of profit resulting from infringement of trade mark and passing off, the amount received would have been taxable income. It seems to me that if the documents tendered as Exhibits 1 to 4 are rejected as inadmissible, the appellant could not succeed in the appeal since the only evidence of importance in the "Admissions" as to the nature of the award is that it was an award of "damages". In income tax matters, the receipt of compensation by way of "damages" is neutral, without further evidence as to the nature and quality of the award. It is trite law to say that the receipt of an award of "damages" may or may not result in the receipt being taxable income.

In an ordinary case I would, of course, have followed the principles which I have referred to and would have rejected the documentary evidence as inadmissible as being *res inter alios acta*. In such a case as the instant one—a tax case in

[1] [1947] O.R. 417. [2] [1943] 2 All E.R. 35.

which the amount in question was added to the declared income of the appellant as being "Proceeds re Court Award" —there is much to be said for permitting the tendered documents to be put in evidence on the ground that the Minister has adopted the "Court Award" as the basis of the re-assessment and may possibly, therefore, be considered as having become privy to the original action, as well as on the further ground that an appellant who has received an award for "damages" would in some cases find it difficult, if not impossible, to show the real nature and quality of the amount received without recourse to the best evidence available, namely, the Court records. The point is an interesting and difficult one, but in the present case I do not find it necessary to reach a concluded opinion thereon inasmuch as the appellant, in my view, must fail even if the documents are admitted. I shall therefore dispose of the matter on the basis that the documents have been admitted in evidence.

For the Minister it is submitted that the sum of $15,000 was received as damages for loss of profits suffered by the appellant in carrying on its business; that therefore it is profit from a business and is income by virtue of ss. 3 and 4 of *The Income Tax Act,* which are as follows:

> 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all
>
> (*a*) businesses,
>
> (*b*) property, and
>
> (*c*) offices and employments.
>
> 4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

For the appellant it is submitted that the sum in question is not "income" within the meaning of ss. 3 and 4 because (1) the amount recovered was damages for infringement of the appellant's trade mark said to be a capital asset; (2) that the amount awarded was for diminution of the appellant's goodwill, also said to be a capital asset; and (3) that the award was for punitive damages, that such damages are in the nature of a punishment for the benefit of the community and as a restraint against the defendant as a transgressor.

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The third ground mentioned may be disposed of at once. A careful reading of Exhibits 2, 3 and 4 satisfies me that there is nothing therein which enables me to come to the conclusion that any part of the award was in the nature of punitive damages and therefore I do not need to explore the question as to whether or not such damages constitute taxable income.

The first and second grounds may be considered together. At p. 349 of his reasons for judgment (Exhibit 3), Maybank J. stated:

> I consider that the plaintiff should succeed against the defendant company in its claim for trade-mark infringement and its passing off claim.

Then, after considering and rejecting a further claim of the appellant in respect of an alleged infringement of its patent, he granted the injunction asked for in respect of infringement of trade mark and passing off and continued at pp. 350-351:

> The plaintiff is entitled to an accounting of profits from the defendant company or to damages, and may choose which. Plaintiff's counsel has indicated that the plaintiff would prefer to have compensation by way of damages and I proceed to assess them.
>
> It seems to me that some of the loss suffered by the plaintiff is due not to the infringement and passing-off activities of the defendant company but is due merely to the fact that Shuckett and Kilroy separated from each other. Immediately they formed their association the plaintiff company successfully forged ahead in its business enterprises. Both, it seems to me, were capable, aggressive business managers and Kilroy certainly contributed to the building-up of the business. Hence his withdrawal would be injurious to the business. But, of course, he had a right to withdraw. It was also brought out in evidence that carrying on business in 1951 was made difficult by reason of certain bank restrictions effected by Canadian government regulations or regulations of the Bank of Canada. Not all of the difference between a $300,000 gross, with a $4,000 profit and a $200,000 gross with a $10,000 loss can be attributed to the improper competitive actions of the defendant company. I consider that damages in the amount of $20,000 would meet the requirements of the case and judgment will go for that amount against the defendant company, with costs and fiat for discovery.

Counsel for the appellant stressed the fact that at the trial the appellant had elected to ask for an award for "damages" rather than an accounting of profits from the defendant company therein. He submits, therefore, that this constituted an abandonment of the appellant's claim to loss of profits and that since the learned trial judge assessed the appellant's damages for infringement of trade

mark and for passing off, such damages must have been for diminution in value of the appellant's trade mark and of its goodwill, both of which it is said, are here capital assets. I must reject the first part of this submission, based as I think it is on a misunderstanding of what occurred when the appellant abandoned its claim to "an accounting of profits". The amended Statement of Claim (Exhibit 1) shows that the appellant claimed either (*a*) an account of the *profits made by the defendant company* by the use of the appellant's trade mark or by passing off; or, (*b*) damages—and in doing so it was following the usual practice in such cases. But in a large number of infringement cases the measure of the defendant's profit by no means represents the loss of the plaintiff. Such a profit is often difficult to establish and in a great number of cases the plaintiff, as here, elects to take an award of damages more truly representing its loss rather than the defendant's gain. As stated in *Lightning Fastener Co. Ltd. v. Colonial Fastener Co. Ltd. et al.*[1], the quantum of damages to be awarded is the actual loss suffered by the plaintiff which is the natural and direct result of the unlawful acts of the defendant. Then, as stated in *A. G. Spalding & Bros. v. A. W. Gamage Ltd.*[2], the damages will include any loss of trade actually suffered by the plaintiff, either directly from the acts complained of, or any damage properly attributable to injury to the plaintiff's reputation, business, goodwill, and trade and business connections caused by the acts complained of.

It is clear, therefore, that an award of damages in such a case may include damages for loss of trade suffered by the plaintiff. An examination of the reasons for judgment of Maybank J. indicates that the only evidence which he referred to as a basis for awarding damages was that relating to the appellant's loss of profits. I have already set out the only passage of the judgment in which the amount of the award is considered and it appears that the only loss for which damages were awarded was the loss of profits, nothing whatever being said in the judgment as to any part of the award being attributable to diminution in value of the trade mark or of the appellant's goodwill. Indeed, the only other evidence referred to in the entire judgment

[1] [1936] Ex. C.R. 1.
[2] (1918) 35 R.P.C. 101 at 117.

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which relates to the appellant's loss is the paragraph on p. 341 which compares the difference in profits of the appellant company in the first year in which infringement and passing off occurred with that of the preceding year.

In my opinion, therefore, the appellant has failed to establish that the award was based on a loss or diminution in value of capital assets such as its trade mark or goodwill. Indeed, the only reasonable inference is that it was based solely on the loss of profits due to infringement and passing off.

Interpreting the judgment as best I can to ascertain the true nature and quality of the award for the purposes of income tax, I have reached the conclusion that it was made for the purpose of filling the hole in the appellant's profit which it could normally have expected to make, but which had been lost to it by reason of the tortious acts of the defendant therein. Such acts constitute an injury to the appellant's trading. A case in point, although one arising out of a breach of contract, is *Burmah Steamship Co. Ltd. v. C. I. R.*[1], a decision of the First Division of the Court of Sessions, in which the Lord President (Clyde) said at p. 71:

> Suppose some one who chartered one of the Appellant's vessels breached the charter and exposed himself to a claim of damages at the Appellant's instance, there could, I imagine, be no doubt that the damages recovered would properly enter the Appellant's profit and loss account for the year. The reason would be that the breach of the charter was an injury inflicted on the Appellant's trading, making (so to speak) a hole in the Appellant's profits, and the damages recovered could not therefore be reasonably or appropriately put by the Appellant—in accordance with the principles of sound commercial accounting—to any other purpose than to fill that hole. Suppose, on the other hand, that one of the Appellant's vessels was negligently run down and sunk by a vessel belonging to some other shipowner, and the Appellant recovered as damages the value of the sunken vessel, I imagine that there could be no doubt that the damages so recovered could not enter the Appellant's profit and loss account because the destruction of the vessel would be an injury inflicted, not on the Appellant's trading, but on the capital assets of the Appellant's trade, making (so to speak) a hole in *them*, and the damages could therefore on the same principles as before—only be used to fill *that* hole.

[1] [1931] S.C. 156; 16 T.C. 67.

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My conclusion, therefore, is that the sum of $15,000 paid in the name of damages must be treated as a payment in place of loss of trading profits and not a payment for any loss in value of any capital assets. Accordingly, the appeal fails and will be dismissed with costs to be taxed.

Judgment accordingly.