1962
Jun. 20
1963
Apr. 19

BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

PENINSULAR INVESTMENTS LIMITED ..... RESPONDENT.

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 11(1)(c) (ca), and 70(1)(4)—Non-resident-owned investment corporation—Deductibility of interest paid on bank loan—Whether interest paid on "other indebtedness"—Ejusdem generis rule—Appeal allowed.

Section 70(1) of the *Income Tax Act* provides that in computing its income a non-resident-owned investment company shall not make any deduction in respect of interest on its bonds, debentures, securities or other indebtedness. Respondent in computing its income for 1959 deducted $22,402.12 representing interest on a bank overdraft paid to the Bank of Nova Scotia in New York. This was disallowed by the Minister. An appeal to the Tax Appeal Board was allowed and the Minister appealed to this Court.

Held: That the appeal be allowed.

2. That a distinction exists between interest expense incurred in temporary financing which is an integral part of a business being carried on and interest incurred in respect of capital invested in the business.

3. That the only limitation here imposed by the *ejusdem generis* rule is that the "other indebtedness" should relate to the acquisition of capital assets or the raising of capital to be employed in the business, rather than to indebtedness of the kind incident to and incurred in the day-to-day transactions of the business.

4. That the material before the Court fails to disclose that the respondent was engaged in a business in which the financing of its transactions was itself an integral part and in fact does not establish that the respondent was engaged in a business at all, and fails to show that the indebtedness in question falls outside the meaning of "other indebtedness".

5. That whether the source of respondent's income was the holding of investments or the business of trading in investments, its indebtedness to the bank was indebtedness of a capital nature and the interest in question was interest on such indebtedness and its deduction from income prohibited by s. 70(1) of the Act.

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Thurlow at Halifax.

T. E. Jackson and *E. E. Campbell* for appellant.

H. B. Rhude and *G. A. Caines* for respondent.

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

THURLOW J. now (April 19, 1963) delivered the following judgment:

This is an appeal by the Minister from a judgment of the Tax Appeal Board[1] allowing the respondent's appeal and vacating an assessment of income tax for the year 1959. The appeal raises a question on the interpretation of s. 70(1) of the *Income Tax Act,* R.S.C. 1952, c. 148, the issue being whether the respondent, a non-resident-owned investment corporation as defined in s. 70(4), is entitled in computing its income to deduct an amount of $22,402.12 which it paid to its bank in the year for interest on the debit balance from time to time outstanding on its current account.

Section 70 of the Act which deals with the taxation of non-resident-owned investment corporations occurs in Division H entitled "Exceptional Cases and Special Rules". By it provision is made for a special tax rate of 15% on the taxable income of a corporation which can qualify under its definition and elects to do so but while this rate of tax is lower than would otherwise be applicable, the section prescribes certain modifications in the computation of the income and the taxable income of the corporation which may result in it being disadvantageous for the corporation to be taxed under it rather than under the other provisions of Part 1 of the Act. As applicable to the year 1959 s-s. (1) of s. 70 read as follows:

> 70(1) In computing the taxable income of a non-resident-owned investment corporation for a taxation year, notwithstanding Division C, no deduction may be made from its income for the year, except
>
> (*a*) dividends and interest received in the year from other non-resident-owned investment corporations, and
>
> (*b*) taxes paid to the government of a country other than Canada in respect of any part of the income of the corporation for the year derived from sources therein,
>
> and in computing its income no deduction shall be made in respect of interest on its bonds, debentures, securities or other indebtedness.

The appeal turns on whether the interest in question was interest on the respondent's "bonds, debentures, securities or other indebtedness" within the meaning of this provision.

[1] 28 Tax A.B.C. 161.

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By s-s. (4) of s. 70 as applicable to the year 1959 a non-resident-owned investment corporation was defined as meaning

a corporation incorporated in Canada that during the whole of the taxation year in respect of which the expression is being applied complied with the following conditions:

(*a*) at least 95% of the aggregate value of its issued shares and all of its bonds, debentures and other funded indebtedness were

(i) beneficially owned by non-resident persons,

(ii) owned by trustees for the benefit of non-resident persons or their unborn issue, or

(iii) owned by a corporation, whether incorporated in Canada or elsewhere, at least 95% of the aggregate value of the issued shares of which and all of the bonds, debentures and other funded indebtedness of which were beneficially owned by non-resident persons or owned by trustees for the benefit of non-resident persons or their unborn issue or by several such corporations;

(*b*) its income was derived from

(i) ownership of or trading or dealing in bonds, shares, debentures, mortgages, hypothecs, bills, notes or other similar property or any interest therein,

(ii) lending money with or without security,

(iii) rents, hire of chattels, charterparty fees or remunerations, annuities, royalties, interest or dividends, or

(iv) estates or trusts;

(*ba*) not more than 10% of its gross revenues was derived from rents;

(*c*) its principal business was not

(i) the making of loans, or

(ii) trading or dealing in mortgages, hypothecs, bills, notes or other similar property or any interest therein;

(*d*) it has, not later than 90 days after the commencement of the taxation year, elected in prescribed manner to be taxed under this section; and

(*e*) it has not, before the taxation year, revoked in a prescribed manner the elections so made by it.

It may be noted at this point that a corporation of the kind defined may derive its income from the simple holding of investments or from the carrying on of a business or businesses of the kind contemplated by clauses (*b*), (*ba*) and (*c*) of the definition.

I turn now to the facts. On the hearing of the appeal no evidence was offered by either party but a written agreement as to facts was filed and it was agreed by counsel that this together with the respondent's income tax return for the year including the financial statements attached thereto, the notice of assessment, the respondent's notice of objec-

tion, the Minister's notification in reply and the admitted fact that the respondent was incorporated under the laws of Nova Scotia would constitute the material upon which the appeal should be determined.

The agreement as to facts is short and rather than attempt to paraphrase it, I shall quote it in full.

1. At all times during the taxation year 1959 the Taxpayer was a non-resident-owned investment corporation as defined in Section 70(4) of the Income Tax Act.
2. The 1959 taxation year of the Company ended April 30, 1959.
3. The financial statements of the Taxpayer for the year ended April 30, 1959, disclose no bonds, debentures or securities issued by the Taxpayer.
4. During the taxation year 1959 the Taxpayer borrowed money from the Agent of The Bank of Nova Scotia at 37 Wall Street, New York, U S A., for the purpose of purchasing investments.
5. On April 30th, 1959, the Company owed the Bank on current account the sum of $445,832 21 (U S) which had been used by it to purchase investments. During the 1959 taxation year the Company paid interest to the Bank on the debit balance from time to time outstanding in its current account in the amount of $22,402.12.
6. The investments purchased by the Company with the money borrowed from the Bank on current account were lodged with the Bank under the terms of two agreements, copies of which are attached hereto.
7. By Notice of Assessment dated February 11, 1960, the Minister of National Revenue assessed the Taxpayer for tax in the sum of $11,352 80 and in so doing treated the interest payment of $22,402 12 as a charge not properly deductible in the computation of income.
8. On or about the 6th day of May, 1960, the Taxpayer filed with the Minister of National Revenue a Notice of Objection against its assessment dated the 11th day of February, 1960, in respect of income for the taxation year 1959. By Notice dated September 1, 1960, the Minister of National Revenue confirmed the said assessment.
9. On or about the 29th day of September, 1960, the Taxpayer filed a Notice of Appeal to the Tax Appeal Board against the confirmation of the said assessment by the Minister of National Revenue. This appeal was subsequently heard and was allowed by the Tax Appeal Board on a Judgment dated November 20, 1961.

To this were attached copies of two agreements between the respondent and the Bank of Nova Scotia hypothecating certain securities to the bank as security for any indebtedness of the respondent to the bank. The earlier of these agreements was dated October 24, 1957 that is, prior to the commencement of the taxation year, and the later December 11, 1958.

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The balance sheet which accompanied the respondent's income tax return for the year in question indicates that on April 30, 1959 the respondent had assets totalling $754,046.88 of which $752,560.43 was represented by investments in stocks and bonds. The shareholders' equity in the company at that date consisted of $10,000 in paid up share capital and $68,292.83 in earned surplus. Liabilities totalled $675,754.05 and included what was referred to as a deferred liability of $198,317.36, the respondent's overdraft at the Bank of Nova Scotia in New York of $445,314.71 and a number of other smaller liabilities. Included with the statements accompanying the return was one entitled "Statement of Investment Income and Expenditures" which showed under *Revenue*

Dividends	$ 5,852.00
Bond Interest	57,368.75
Premium on Exchanges	11,698.64
Profit on Sale of Investments	1,376.34
Sundry Interest	3.70
	$ 76,299.43

and under *Expenditures* the following:

Interest Bond charges and Brokerage fees	$ 22,700.15
Miscellaneous expenses	174.34
	$ 22,874.49

Also included with the statements were schedules entitled "Schedule of Share Investments and Income Thereon" and "Schedule of Bond Investments and Income Thereon". The first of these showed investments held at the beginning of the year totalling $188,575 in shares of 18 companies, purchases of shares in two other companies during the year amounting to $14,835 and no disposals during the year, leaving investments held at the end of the year totalling $203,410 in shares of 20 companies. The schedule of bond investments listed 15 investments on hand at the beginning of the year totalling $703,574, 14 additions during the year totalling $325,626.42 and six disposals during the year totalling $481,426.33, leaving investments on hand at the end of the year totalling $549,150.43. Five of the six disposal transactions related to investments which were on

hand at the beginning of the year and three of these resulted in gains totalling $4,319.22 while the other two resulted in losses totalling $4,224.14 leaving a net gain of $95.08. The other disposal was of an investment acquired during the year and it resulted in a gain of $1,281.26 making with the $95.08 the amount of $1,376.34 which as previously mentioned appeared in the Statement of Investment Income and Expenditures. The one investment which was acquired and disposed of during the year amounted to $48,781.24 and 10 of the investments held at the beginning of the year totalling $272,305.25 were still on hand at the end of the year. There is no other indication of how long any of the bond investments were held but combining the figures for shares and bonds it becomes apparent that the respondent continued to hold at the end of the year investments in shares of 18 companies and in 10 issues of bonds totalling $460,880.25 all of which had been on hand at the beginning of the year and which exceeded by a considerable amount the shareholders' equity in the company and the deferred loan. It would seem to follow as a matter of inference that a substantial portion at least of the overdraft in question was outstanding at the beginning of and throughout the year. There was no explanation of the revenue item of $11,698.64 entitled "Premium on Exchanges". In the return itself on the line provided on p. 1 for a statement by the taxpayer of the nature of its business the answer given is "non-resident-owned investment corporation". There appears to be nothing further in the return or the financial statements which accompanied it or in the other material before the Court to indicate that the respondent was actually engaged in any business and the material as a whole leaves me unsatisfied that the respondent was engaged in a business as opposed to merely holding investments and changing them from time to time as occasion to do so arose. Moreover even if the respondent should be regarded as having been engaged in a business of trading in investments during the year the material does not indicate the manner in which the transactions were carried out or what the ordinary course of the business involved.

The Minister's case for disallowing the deduction of the interest in question is that the amount in question is interest on the respondent's "securities or other indebtedness" within

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the meaning of the prohibition of s. 70(1). His argument in support of this contention was that the scheme of the Act was such as to indicate an intention to tax the non-resident-owned investment corporation on the same basis as non-residents are taxed by s. 106 on dividends, interest, rents, royalties, etc., and that in any case the only genus suggested by the words bonds, debentures and securities in s. 70(1) was that of secured indebtedness which was exhausted by the three words themselves leaving the words "other indebtedness" to be given their broadest meaning which would include the overdraft in question. The respondent on the other hand submitted that the overdraft was obviously not indebtedness on bonds or debentures, that though the bank held security for the overdraft it was not indebtedness on "securities" within the ordinary meaning of the word in the context in which it is found, and that the amount was not interest on "other indebtedness" within the meaning of s. 70(1) because the scope of that expression was as a matter of interpretation limited by the *ejusdem generis* rule to other indebtedness like that upon bonds, debentures and securities and the overdraft was not an indebtedness of that kind. In support of his contention counsel argued that if the legislative intention was to prohibit the deduction of interest paid on all indebtedness it would have been easy to say so in a word or two and there would have been no occasion first to single out bonds, debentures and securities and then to follow this enumeration with the expression "or other indebtedness" and he went on to submit that the overdraft in question did not have the attributes of bonds, debentures or securities, that it was merely a current liability on an open account, an overdraft and part of the circulating capital of the company, that its amount was not formalized by an instrument, and that the time for repayment was not fixed, all of which distinguished it from indebtedness like that on bonds, debentures and securities.

In approaching the question of the interpretation to be put upon the words of s. 70(1) it is, I think, important to bear in mind several things which are part of the setting in which the subsection is found. The first of these is that the *Income Tax Act* is a statute which imposes a tax on income and that in applying it the distinction between receipts and disbursements of an income nature and receipts

and disbursements of a capital nature is one of general importance. The second is that by s. 4 of the Act income from a business or property is declared, subject to the other provisions of Part 1 of the Act, to be the profit therefrom for the year. The third is that while express provisions with respect to the deduction of interest payments in computing the income of a taxpayer for the purposes of Part 1 of the Act are contained in paragraphs (*c*) and (*ca*) of s-s. (1) of s. 11, such payments would not ordinarily enter into a computation of the profit either from a property or from a business except in cases falling within the principle of *Farmer v. Scottish North American Trust Ltd.*[1] where the incurring of the liability to pay the interest is itself an ordinary incident of the business. In *Bennett & White Construction Co. Ltd. v. M.N.R.*[2], a case which arose under the *Income War Tax Act* Rand J. put the matter thus at p. 292:

> The acquisition of capital may be by various methods including stock subscriptions, permanent borrowings through issues of securities, or term loans; and ordinarily it should make no difference in taxation whether a company carried on financially by one means or another. In the absence of statute, it seems to be settled that to bring interest paid on temporary financing within deductible expenses requires that the financing be an integral part of the business carried on. That is exemplified where the transactions are those of daily buying and selling of securities: *Farmer v. Scottish North American Trust* [1912] A.C. 118; or conversely lending money as part of a brewery business: *Reid's Brewery v. Mail* [1891] 2 Q.B. 1.
>
> Now the Crown has allowed the deduction of interest paid to the bank, and it must have been either on the footing that the day-to-day use of the funds was embraced within the business that produced the profit, or that the interest was within section 5, paragraph (*b*).

It may also be well to note at this stage that what may be deducted under s. 11(1)(*c*) in computing the income of a taxpayer for the purposes of Part 1 of the Act is interest on

> (i) borrowed money used for the purpose of earning income from a business or property; or
>
> (ii) an amount payable for property acquired for the purpose of gaining or producing income therefrom or for the purpose of gaining or producing income from a business;

and that what is deductible under s. 11(1)(*ca*) is interest on an amount that would be deductible under para. (*c*). These provisions are no doubt broad enough to authorize the

[1] [1912] A.C. 118. [2] [1949] S.C.R. 287.

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deduction in computing the income of a taxpayer of both interest which would be deductible under the principle of *Farmer v. Scottish North American Trust*[1] in computing the profit from a business and other interest, such as interest in respect of capital invested in the business, as well but the distinction between interest of the former kind which is a business expense and the latter which is a capital expense nevertheless exists.

Turning then to s. 70(1) it appears to me that the words "bonds", "debentures" and "securities" suggest a class of obligation which while generally arising from borrowings may arise from other types of transactions as well—which may account for the reference to "other indebtedness" in the words which follow "bonds, debentures, securities" rather than to the more restricted connotation of "other borrowings", and that indebtedness represented by the bonds, debentures and securities of a corporation ordinarily at least is indebtedness arising from the acquisition of capital assets or the raising of capital to be employed in its business rather than indebtedness of the kind incident to and incurred in the day-to-day transactions of the business. In my opinion this is the only limitation which the application of the *ejusdem generis* rule would impose on the broad ordinary meaning of the words "other indebtedness" for I am unable to discern in the context any sufficient reason for thinking that the fact that ordinarily obligations arising on bonds, debentures and securities are secured in some manner and are evidenced by formal documents which state the amount of the indebtedness and prescribe a fixed time for payment and a fixed rate of interest should be held to limit the meaning of the words "other indebtedness" in s. 70(1) to obligations so secured or evidenced.

In the present case, the material before the Court, in my opinion, does not show that the indebtedness in respect of which the interest in question was paid falls outside the meaning of "other indebtedness" in s. 70(1) as so interpreted. It could fall outside such meaning only if the respondent was in fact engaged in a business in which the financing of its transactions was itself an integral part and as previously mentioned it does not clearly appear from the material that the respondent was engaged in a business at

[1] [1912] A.C. 118.

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all and even less does it appear that it was engaged in a business in which the financing of the transactions was an integral part. For this purpose the submission that the moneys in respect of which the indebtedness arose were used as circulating capital if correct in my opinion disposes of the matter in favor of the Minister since money used as circulating capital is nevertheless capital (*vide European Investment Trust Co. Ltd. v. Jackson*[1]) and may itself be raised through the issue of bonds, debentures and securities as well as in other ways including other types of borrowing. In the view I take of the facts while the overdraft may have been of uncertain and in that sense temporary duration because no time for repayment had been set, the material is just as consistent with the view that the respondent was simply engaged in holding investments paid for largely with capital borrowed from the bank and changing them from time to time as occasion arose as with the view that it was engaged in trading in investments. It is thus in my view not established that the respondent was engaged in a business at all. But even if contrary to this view the respondent's purchases, holding and sales of investments indicate the carrying on of a business of trading in such investments, having regard to the size of the amounts, other than those borrowed on overdraft, which were available to the respondent as capital for the carrying on of such a business on the scale indicated and having regard also to the absence of evidence that the investments were being actively traded by the respondent rather than held for lengthy periods it appears to me that the proper inference to draw is that the moneys borrowed on the overdraft were obtained and employed not as mere temporary accommodations incidental to the carrying on of a business of which the obtaining of such accommodations was an integral part but were in truth moneys obtained and employed as additional circulating capital in the business. Thus whether the source of the respondent's income is regarded as the holding of investments or as a business of trading in investments the amount in question was interest on indebtedness of a capital nature the deduction of which in computing its income was prohibited by s. 70(1) if the respondent was to be taxed as

[1] (1932) 18 T.C. 1.

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a non-resident-owned investment corporation. I am accordingly of the opinion that no error in the assessment has been established.

The appeal will therefore be allowed and the assessment restored. The appellant is entitled to his costs of appeal.

Judgment accordingly.