
BETWEEN:

ANGLO-CANADIAN OIL COMPANY LIMITED, ... } APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE, ... } RESPONDENT.

1946
Oct. 7
1947
Jan. 7

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, ss. 6 (1) (a), 6 (1) (b) and 90—Deduction from income of money expended in drilling oil well allowed—Travelling and legal expenses incurred in preparation of a brief for submission to the Minister of National Revenue in respect of allocation of proceeds of oil well to capital and income respectively not allowed as deductions from income—"Disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income."

The appeal is from the disallowance of part of a claim under s. 90 of the Income War Tax Act for capital expenditures, made by the appellant in the development of two oil wells. These expenditures consist of (1) amounts laid out to dig the well into which casing was later placed, including the cost of all necessary steps to get the drilling equipment set up, to provide power, supplies and labour therefor, the maintenance and operation thereof, and the cost of removing such plant and equipment after the well was completed; (2) the purchase of the casing and the cost of actually putting it in the well which were admitted by the respondent to be capital expenditures within the meaning of s. 90 of the act. The appellant did not claim allowance for the cost of rental of a drilling rig.

Appellant also appealed from a refusal to allow a claim for deduction from its income of certain costs for travelling expenses and legal expenses incurred in the preparation of a brief for submission to the

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Minister of National Revenue on the matter of determining what proportions of the proceeds of production were properly applicable to capital and income respectively.

Held: That the well or hole in the ground is part of the equipment of an oil well and the costs of constructing it as claimed by the appellant are all capital costs within the meaning of s. 90 of the act.

2. That the travelling and legal expenses were incurred in the process of conserving and retaining the profits which had been earned by the appellant and not in the process of profit earning and were "disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within s. 6 (1) (a) of the act, and, since they had to do with the preservation or protection of a capital asset, the outlay was a capital outlay and properly disallowed under s. 6 (1) (b) of the act. *Montreal Coke and Manufacturing Company* v. *Minister of National Revenue* (1944) A.C. 126; *Minister of National Revenue* v. *Dominion Natural Gas Company Limited* (1941) S.C.R. 19 and *Mahaffy* v. *Minister of National Revenue* (1946) S.C.R. 450 followed and applied.

APPEAL under the provisions of the Income War Tax Act.

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

G. H. Steer, K.C. and *W. G. Egbert, K.C.* for appellant;

H. W. Riley, E. S. MacLatchy and *N. D. McDermid* for respondent.

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

CAMERON J. now (January 7, 1947) delivered the following judgment:

This is an Income Tax Appeal in respect of the year 1941. Notice of assessment was forwarded to the appellant on May 11, 1945, and on June 6, 1945, it gave notice of appeal. On September 25, 1945, the Minister gave his decision, varying the assessment in some details and on October 18 gave a supplementary decision. On October 22, 1945, the appellant gave notice of Dissatisfaction, and on March 12, 1946, the Minister made his reply affirming his decisions. By Order of this Court pleadings were directed. The matter came on for trial at Calgary on October 7, 1946, and judgment was reserved.

By its Statement of Claim the appellant claimed relief in respect of three items, but at the trial it abandoned one

of them—a claim for allowance for exhaustion with respect to its income from management fees and special services revenue—and therefore it is not necessary to refer further to that item.

The first item of the appeal is in respect of disallowance of part of capital expenditures in the period beginning May 1, 1939, and ending April 30, 1940. The sum of $279,275.25 was claimed as capital expenditures under section 90 of the Income War Tax Act, but of this amount $96,647.10 was disallowed. The relevant parts of section 90 are as follows:

1. A taxpayer shall be entitled to deduct from the taxes otherwise payable under this Act an amount up to ten per centum of the capital cost hereinafter in this section mentioned in the manner provided.

One-third of the said ten per centum must be taken in each of the first three taxable fiscal periods occurring within the first six fiscal periods of twelve months each ending on or after the 30th April, 1940, provided however that should the said one-third exceed the tax otherwise payable in any one taxable period, the excess may be offset against taxes otherwise payable in the remaining period or periods of the said taxable periods.

Further provided, in any event, that no deductions shall be allowed against any tax payable for periods ending after 29th April, 1946.

2. The capital costs on which the ten per centum shall be calculated are those costs incurred and paid by the taxpayer in the period beginning the first day of May, 1939, and ending the thirtieth day of April, 1940, in respect of work actually done in Canada during the said period, on the construction, manufacture, installation, betterment, replacement, or extension of buildings, machinery or equipment in the said period from the first day of May, 1939, to the thirtieth day of April, 1940, provided such buildings, machinery or equipment are to be used in the earning of the income of the taxpayer. The machinery or equipment referred to herein shall mean only such machinery or equipment as is required to be affixed for a permanency to the business premises of the taxpayer.

For the period in question the appellant expended the sum of $279,275.25 in the development of two of its oil wells, namely "Anglo 8" and "Anglo-Phillips Petroleum 1." All of these expenditures were allowed as capital expenditures under section 90, except for the sum of $46,760.39 in respect of "Anglo 8" and $49,886.71 in respect of "Anglo-Phillips Petroleum 1", particulars of the items disallowed being set out in detail in para. 6 of the Statement of Claim. There is no dispute that the total amounts now claimed as capital expenditures were in fact expended. The respondent contends, however, that the casing was the only item of machinery or equipment required to be affixed for a permanency to the business premises of the taxpayer and

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that while the costs of purchasing and placing the casing itself in the ground are allowable as capital expenditures, the costs preliminary thereto, and as later referred to in greater detail, should not be so allowed.

The appellant company did not itself do the drilling or installing of the casing. It entered into a contract with another company (a subsidiary of the appellant) to perform this work and on completion paid it the amounts now claimed as deductible as well as certain other items not now in dispute. The breakdown of costs, as shown in Ex. 7, is that of the drilling company but the figures are accepted as correct by the appellant. In the case of each well it shows thirty-six items of costs. In my view, however, it is not necessary to deal individually with each item. It is sufficient I think to state that, while all have to do with costs necessarily incurred to bring the well into production, they may, for the purpose of my decision, be divided into two main categories.

(*a*) Amounts laid out to dig the hole or well into which the casing was later placed, including the cost of all necessary steps to get the drilling equipment set up, to provide power, supplies and labour therefor, the maintenance and operation thereof, and the cost of removing such plant and equipment after the well was completed.

(b) The purchase of the casing and the cost of actually placing it in the well.

The respondent admits the latter group to be capital expenditures within the meaning of section 90, but denies that those in the former group are within the section. He did, however, *ex gratia,* allow the actual labour and supervision costs of digging the well on the ground that it would have been difficult to divide these items correctly between categories (*a*) and (*b*).

The procedure followed at each well was briefly as follows:

A road necessary for getting drilling materials to the site was constructed and protected by fences and signs. A cellar, sump, and foundations, all for the use of the derrick, were constructed on the site. Later a derrick was rented, brought in and installed and it is from this derrick that the drilling rig is operated. To supply power for drilling, derrick lighting, etc., a boiler-house was constructed

and necessary wiring installed. A drilling rig was rented (cost of said rental is not here claimed) and transportation costs were incurred in moving it to the site as well as expenses for installing the rig.

The costs of drilling included wages, supervision salary and charges, workmen's compensation, power, oil, water and mud used in drilling, repairs and replacements to rig and pumps, drill pipes, tools and bits. Insurance was carried during the drilling operations and to comply with regulations a hole survey was maintained as drilling progressed to ensure that the maximum permitted deviation was not exceeded. A small expense was incurred for a temporary watchman when the drilling program was temporarily interrupted. Certain drilling materials were bought in the United States and exchange paid thereon. In the preliminary stages of drilling a small length of surface casing was installed to cement off the surface water.

When the drilled hole—or well—reached the surface of the limestone formation where oil was secured, a 7-inch casing was placed in the 9-inch well, extending from the derrick floor to the top of the limestone, a distance in the case of "Anglo 8" well of 7,000 feet. In addition, to prevent the intrusion of water, the casing was cemented in the well from the top of the limestone upward to within 2,000 feet of the derrick floor. This casing, of course, remained permanently in the ground. It was bought in the United States and foreign exchange thereon was allowed as a capital expenditure but disallowed on other items purchased there.

When the drilling and installation of casing were completed, the derrick, rig, boiler-house and other structures used in drilling were removed from the property so that the operator of the well was left with the well and the casing installed therein. The oil itself is later brought to the surface through a pipeline installed within the casing.

The problem for consideration, therefore, is whether the costs of and incidental to the drilling of the well are costs of installing the casing itself. By his allowance of the costs of installing the casing and of the casing itself, the respondent has, I think, admitted that the casing is equipment used in the earning of the appellant's income and that it is affixed for a permanency to the business premises of the

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appellant. It is obvious that the casing could not be installed without the drilling of the well having been first completed.

Section 90 of the Income War Tax Act (called Part XIV) was first enacted by section 17, chap. 46, Statutes of 1939. By chap. 55, section 16, Statutes of 1946, it was entirely repealed. It was manifestly incentive taxation legislation to encourage capital expenditures as a means of helping the general economic condition of the country. It was a clear departure from the general scheme of the act that capital expenditures are not allowed as deductions from income or from tax. It is limited in its operation to costs incurred in the specified twelve months and by subsection 4 certain capital costs are excluded from permissible deductions. From the general tenor of the whole section it seems to have been designed to encourage the outlay of capital to create productive work of one sort and another. The section should, therefore, be interpreted if possible in such a way as to give effect to the intention of Parliament.

The capital costs referred to in sec. 90 (2) are "the capital costs incurred and paid in respect of work actually done in Canada on the construction, manufacture, installation . . . of machinery or equipment to be used in the earning of the income of the taxpayer and required to be affixed for a permanency to the business premises of the taxpayer."

The words costs, installation and equipment are not defined in the act, but in the Shorter Oxford English dictionary there are the following definitions:

Cost: That which must be given in order to acquire, produce or effect something. The price paid for a thing.

Installation: The action of setting up or fixing in position for service or use (machinery, apparatus, etc.) Spec. used to include all the necessary plant, materials and work required to equip. e.g. a room with electric light.

Equipment: Anything used in equipping. To provide with what is requisite for action, as arms, instruments or apparatus.

The cost of installation of equipment would therefore appear to be "that which must be given in order to produce the necessary plant, materials and work required to provide what is needed for action." Here it is sought to limit the meaning of "costs of installation" to those costs incurred in the purchase and actual placing of the steel core or casing in the well, but I cannot find anything in the section which requires such a limitation. Bringing into production

of new oil wells was doubtless in the minds of the legislators for by subsection 4 (*ii*) the cost of leases and licences to work oil wells is excluded from the allowances. The drilling for oil wells is doubtless a major expense in the bringing in of new oil wells, and had it been the intention of Parliament to exclude the costs nothing would have been easier than to have so indicated.

The cost of installing equipment is in my view wide enough to include the cost of preparing the place in which the equipment is to be installed—in this case, the well. The casing could not have been effectively used and oil could not have been produced without the preliminary and essential stage of drilling the well.

In the view of the appellant all the capital costs shown on ex. 7 (with the exception of item 32 for each well) are within the provisions of section 90 inasmuch as they are either costs of construction of equipment—the equipment being the well—or, alternatively, that they are costs of installation of equipment—the equipment being either the well, casing or pipeline.

Section 90, so far as I am aware, has not been the subject of judicial interpretation. Counsel for the appellant referred me to the case of *National Petroleum Corporation Limited* v. *Minister of National Revenue* (1). This case had nothing to do with section 90 of the act but related to questions of deductions for depreciation, development costs and depletion. In the course of his judgment the late President of this Court referred to the reply of the Minister, quoting therefrom as follows:

> That the costs of drilling the oil well and the necessary buildings, roads, etc., were expenses incurred in the creation of capital assets or expenses of putting the taxpayer in a position to earn income and not expenses wholly, exclusively and necessarily incurred in the earning of income within the meaning of Section 6 (*a*) of the said Act.

Counsel for the appellant urges upon me that the above is a finding and statement by the Minister that the costs of drilling the oil well, necessary buildings, roads, etc., were capital costs and that therefore they should be considered as capital costs within the meaning of section 90. But, as I have pointed out, the question in that case was quite different from the one now before me. The problem there was as to whether such costs were capital costs or

(1) (1942) Ex. C.R. 102.

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whether they were expenses wholly, exclusively and necessarily incurred in the earning of income within the meaning of section 6 (*a*). In the instant case there seems to be no doubt that all the expenses incurred were capital costs but it is not all capital costs that are taken into consideration in allowing the deductions under section 90, but only those specifically defined in the section.

Later in his judgment in the same case the late President stated:

> The Income War Tax Act provides no rules, in the case of mining and gas or oil producing properties, for ascertaining allowances for depreciation, depletion, or development, and no doubt it was because of a realization of the inevitable difficulties surrounding such matters that this duty was left to the discretion of the Minister. There is no mention of "development costs" in the Act and I assume that in theory and in the strict and proper sense a coal mine shaft, or the shaft of a metalliferous mine, or the hole in the ground through which oil is recovered, is plant and equipment, but it has been found by experience that such development costs had to be treated as a branch or division of the matter of depreciation of plant and equipment, because the problem there cannot be disposed of on the same basis, or with the same approximation to accuracy, as in the case of fixed assets, such as buildings, machinery, etc. . . .

While the President was considering a different section of the act, he did, in fact, give consideration to the problem as to whether development costs included costs of the well and found that the hole in the ground through which oil is recovered was plant and equipment.

The Shorter Oxford English Dictionary has several definitions of the word "construction" including: "The manner in which a thing is constructed or formed". It defines, for example, a construction railway as a "temporary railway for use in the construction of a permanent railway, canal or the like."

Certain regulations were made under section 90, part of them being as follows:

> 10. "Costs incurred" means those legal obligations for costs within the meaning of Section 90, entered into within the said period of twelve months (Regulation No. 3) which are binding when made between strangers, requiring the one party to perform certain capital works and the other to make payment therefor, and also includes those capital costs incurred by persons using their own employees in the construction of capital properties, provided always that the capital properties are used or intended to be used in the earning of income of the taxpayer.
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> 13. The term "machinery or equipment" includes machinery or equipment purchased within or without Canada but requiring work to be actually done in Canada on their installation in any business activities or enterprises in Canada. The term, however, does not include any machinery or equipment purchased either within or without Canada

which is complete in itself and requires no work to be actually done in Canada on installation in a scheme of equipping a business activity or enterprise in Canada. In particular the term does not include automobiles, trucks, motorcycles, bicycles, aeroplanes and other moveable equipment which is complete in itself and does not become affixed to the premises of the business enterprise and does not require any actual work to be done upon it within the meaning of the statute.

Taking into consideration the nature of section 90 and the purpose for which it was intended, I am of the opinion that the interpretation placed thereon by the respondent is too narrow. In my view the well or hole in the ground is part of the equipment of the oil well and a very essential part of the equipment. It was necessary to provide (or equip) the property with a well before any productive operations could be commenced. The late President of the Court was of the opinion that an oil well was equipment and I respectfully agree with that finding. And it follows, that if the well is equipment, that the costs of constructing it would include all items in ex. 7 (except items 32) for there is no dispute that they were all essential to the digging of the hole. If one can speak of the "construction" of a canal (as done in the Shorter Oxford English Dictionary to which I have referred) one can also, I think, speak correctly of the "construction" of an oil well. Both are excavations in the ground, one horizontal and the other vertical.

The section also requires that the equipment shall be such as is affixed for a permanency to the business premises of the taxpayer. The oil lands are undoubtedly part of the business premises of the appellant. The emphasis, I think, must be placed on the words "for a permanency" rather than on "affixed". The word "buildings" which is used in the first portion of subsection 2, is omitted from the last sentence because by the very nature of buildings it is assumed that they are affixed for a permanency and if permanency of equipment is the essential requirement, I think the shaft or well is undoubtedly a permanent part of the necessary equipment, being a part of the land itself.

And I think also that the costs of excavating the hole, including all items in ex. 7 (excepting Items 32) are costs of installing the casing and pipeline which are admittedly "equipment". If equipment is to be installed there must be a suitable place in which to install it. In the case of an oil producing company the pipeline and casing must be placed

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in a well and the well must first be dug. In the case of machinery it would no doubt be placed in a factory and the cost of such building and of the permanently affixed machinery installed are within the section. I see no reason for excluding the necessary work of excavation from the benefit of the provisions of section 90.

On this point therefore the appellant must succeed. I find that all the capital costs mentioned in ex. 7 (excepting item 32 for each well—rental of drilling rig—and which were abandoned by the appellant) were capital costs within the meaning of section 90 and should have been allowed by the respondent as deductions from tax to the extent and in the manner mentioned in the section.

The remaining question has to do with an item of $1,095.25 for travelling expenses and $4,374 legal expenses paid by the appellant in 1939 and disallowed by the respondent under section 6 (1) (*a*) of the act which is as follows:

> In computing the amount of profits or gains to be assessed deductions shall not be allowed in respect of (*a*) Expenses not laid out to earn income; disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income.

In 1939 the oil producing companies of Alberta retained the services of a solicitor to prepare and submit a brief to the Income Tax authorities and the Minister of National Revenue at Ottawa. In its reasons for appeal in regard to this item the appellant stated:

> The said sums represent monies paid to the Company's Counsel and Auditor for services in obtaining from the Income Tax Branch of the Department of National Revenue rulings on allowances to be made with respect to the drilling of oil wells. The method of calculation of the amount of allowances of this character, which should have been made in about the year 1940, was uncertain since the decline factor of production for Turner Valley wells was unknown. There was no one in Western Canada with authority to deal with the question which made representations to the Income Tax authorities at Ottawa necessary. The fees and expenses incurred were incurred on behalf of all operators of wells in Turner Valley for the purpose of assembling data to enable the Income Tax authorities and operators of oil wells to determine what proportion of the proceeds of production was properly applicable to capital and income respectively. The determination of such proportions was obviously necessary to ascertain the income of the Appellant and other operators of oil wells. Following the assembly and presentation of the said data the concessions requested by the Operators were granted by the Income Tax Branch and operators were then in a position to and did set up their accounts accordingly so that company officials and shareholders could know the exact position of

their undertaking. The said sums should be allowed to be deducted for the purpose of ascertaining the annual net profit or gain of the Appellant under the provisions of Sections 3 (1).

From a perusal of the brief and the evidence at the trial, I am satisfied that the reasons for appeal, above stated, satisfactorily set out the nature of the work done and what was accomplished thereby, except that at the trial it was pointed out these expenses were confined to legal expenses for fees and travelling and did not include any amount for auditor's services. It is to be noted that the appellant not only produced oil on its own account but managed a number of subsidiary and associated companies. The Turner Valley area in Alberta was a new field of operations and drilling for crude oil was commenced about 1937. Little information was available as to the decline factor for the area. The appellant first got into production in 1939. On their own behalf and as managers of their subsidiary and allied companies, after production had started, they filed tentative income tax returns claiming the same allowances for recovery of capital costs, depreciation and depletion, as requested in the brief; and later when a ruling was obtained following the presentation of the brief the records and income tax forms were adjusted in accordance with the ruling received on or about July 10, 1939 (see ex. 3). Very substantial savings in taxes were made as a result of this ruling which applied to the taxation year 1939 and subsequent years for all crude oil producing wells in Alberta.

In order to ascertain more fully the nature of the representations made in the brief I put certain questions to counsel for the appellant as follows:

THE COURT: Now would it have been possible to have ascertained the profits for the year in question on the basis of the legislation existing and the rules existing before your brief was submitted?

MR. STEER: Not adequately, in my submission.

THE COURT: Was the brief primarily for the purpose of securing further tax relief? I am now asking. I have not seen the brief, so I do not know.

MR. STEER: No, it was not primarily for that, My Lord, so much as it was for the purpose of getting a logical set of rules to be applied by the Minister in his discretion, for the purpose of allocating the receipts of the company as between return of capital and what is properly income.

THE COURT: But there were in existence, prior to the submission of your brief, certain regulations?

MR. STEER: That is right, My Lord.

THE COURT: Which were not satisfactory in the view of your client?

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MR. STEER: That is right, My Lord.

THE COURT: You wanted them changed?

MR. STEER: That is right, My Lord. The rules that were in force, My Lord, are discussed in this National Petroleum Corporation case against the Minister of National Revenue. That is in 1942, 3 D.L.R. 109. Now, those rules had no particular application to this Turner Valley situation which was a new situation which had not been specifically dealt with by the Minister and there was this very important problem of getting the development costs written off during the life of the pool of oil that was being produced from.

THE COURT: I take it in the preparation of this submission you had to get certain evidence as to the probable length of life of that area.

MR. STEER: Yes, My Lord.

THE COURT: And on that basis find out what was the proper method of taxation, spread over the whole life.

MR. STEER: That is right, My Lord.

THE COURT: And that is what you call the declination factor?

For the appellant it is contended that the expense here incurred was a proper one made for the purpose of ascertaining its net profit or gain as provided under section 3 (1) and that it is not barred by either section 6 (*a*) or (*b*). For the respondent it is argued that these expenses were not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income within the meaning of section 6 (1) (*a*) of the act.

Section 6 (1) (*a*) has been frequently the subject of judicial interpretation. Many of the leading cases are referred to in the Dominion of Canada Taxation Service.

It was laid down by the Privy Council in the case of *Montreal Coke and Manufacturing Co.* v. *Minister of National Revenue* (1) that expenditures to be deductible must be directly related to the *earning* of income from the trade or business conducted. The section was further considered by the Supreme Court of Canada in the case of the *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (2) where Duff, C.J. held that in order to fall within the category: "disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning income", expenses must be working expenses —that is to say incurred in the process of earning income.

The above case was referred to and followed in the case of *Mahaffy* v. *Minister of National Revenue* (3).

In the *Montreal Coke and Manufacturing* case (*supra*) Lord McMillan (page 134) said:

(1) (1944) A.C. 126.
(2) (1941) S.C.R. 19.
(3) (1946) S.C.R. 450.

In the history of both companies the financial readjustment of their borrowed capital was an isolated episode unconnected with the day to day conduct of their business, and the benefit they derived was not "earned" by them in their business.

In order to apply the principles and tests set out in the above case, it is necessary to look at the true nature of the expenditure now claimed as deductible and to ascertain whether it is a part of the company's working expense and whether it is expenditure laid out as part of the process of profit earning.

I am of the opinion that it is neither. The business of the company is the production and sale of oil. Depreciation and depletion could have been ascertained under the existing legislation and regulations but what the appellant and its associates wanted to secure was an improvement in their tax position and one that would endure throughout the life of the project. It was for that purpose that they stressed the necessity of ascertaining the special declination factor throughout the area. The expense was not incurred in the process of profit earning, but in the process of conserving and retaining the profits which had been earned and was an expense incurred once for all.

If it be the case, as suggested by counsel for the appellant, that the appellant and others who joined in the brief wanted to ascertain what portion of the sales of the product of the wells could be considered as capital return—as is evidenced by the fact that what was asked for therein was the preservation of capital disbursements and increased depreciation and depletion allowances—then it follows, I think, that the outlay had to do with the preservation or protection of a capital asset, and it would therefore, as a capital outlay, be disallowed under section 6 (1) (*b*).

Counsel for the appellant referred at length to a recent decision of the English Courts: *Rushden Heel Co. Ltd.* v. *Keene* (1). Following a decision of the Assessing Commissioners fixing the standard profits at £1,500.0.0 an appeal was taken to the Special Commissioners and in the result the standard profits were increased to £4,500.0.0. The company therefore, benefited to the extent of £3,000.0.0 less what salaries they would have been allowed as an expense and the fund available for and subject to income tax was similarly increased. The legal and auditing

(1) (1946) 2 A E.R. 141.

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expenses of this successful appeal were later disallowed as proper deductions and the matter then came before the court. It was held by Atkinson J.:

Held: (1) an expense properly and reasonably incurred in the final ascertainment of profits might properly be considered as an outlay in order to earn profits and not an outlay of profits, certainly not of ascertained profits, as the profits were at all times subject to that outstanding expense.

(ii) in this case none of the profits whether profits divisible among the shareholders, profits subject to excess profits tax or profits available for income tax, was ascertainable for a certainty until the appeal had been heard and the final decision given.

(iii) all the expense in dispute was incurred before the final determination of what the profits, in any of those senses, amounted to; consequently the expense was allowable as a deduction for income tax and for excess profits tax purposes.

As stated in the 'Editorial Note' the successive steps in the reasoning upon which the decision was based were as follows:

(1) an admissible deduction must represent an outlay in order to earn profits, as distinct from a disbursement of profits earned; (2) an expense incurred in ascertaining the profits may be said to be an outlay in order to earn profits; (3) in the circumstances under consideration the profits were not ascertained until the appeal to the Special Commissioners had been heard and finally decided; (4) the legal and accoutancy expenses of the appeal were, therefore, deductible for both taxes.

The judgment is a lengthy and interesting one and I have been advised that it is now under appeal. I do not propose to take it as a precedent which I should follow. The English Act under which the decision was made is, in several respects, different from the Income War Tax Act. The decisions in the Supreme Court of Canada and the Privy Council to which I have referred must be my guide in reaching a conclusion. I am of the opinion that the principles laid down in those judgments indicate quite clearly that the legal and travelling expenses here in question come within the provisions of section 6 (1) (*a*) and were therefore properly disallowed; and that they would also be barred under section 6 (1) (*b*). For these reasons, the appeal as to these items must fail.

In the result, therefore, I would allow the appeal as to the claims made under section 90 of the act and disallow the appeal as to the claims for legal and travelling expenses. The appellant is entitled to costs, such costs, in my view, not having been materially increased by reason of the claim in which the appellant is unsuccessful.

Judgment accordingly.