Ottawa 1965
Apr. 5, 6
Apr. 23

BETWEEN:

THE CONSUMERS' GAS COMPANY. ..... APPELLANT;

AND

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

Income tax—Computation of income—Deductions—Stock issue—Underwriting expenses—Income Tax Act, R.S.C. 1952, s. 11(1)(cb).

In computing its income for 1960 and 1961 Consumers' Gas Co. claimed a deduction of certain sums paid to underwriting firms in connection with a stock issue. Under the underwriting agreement the underwriting firms were paid the following sums:

(*a*) $24,150 in 1960 and $121,980 in 1961 for managing an underwriting group;

(*b*) $108,315 in 1960 and $136,653 in 1961, commission as dealers in securities;

(*c*) $46,739.89 in 1960 and $121,980 in 1961 for administrative and clerical work in processing the stock issue.

The company sought to deduct one-half of the amounts described in (*a*) and all of the amounts described in (*c*), but conceded that the amounts described in (*b*) were not deductible.

Section 11(1)(*cb*) of the *Income Tax Act* permits deduction of:

an expense incurred in the year,

(i) in the course of issuing or selling shares of the capital stock of the taxpayer. . .

but not including any amount in respect of

(iii) a commission or bonus paid or payable to a person to whom the shares were issued or sold or from whom the money was borrowed, or for or on account of services rendered by a person as a salesman, agent or dealer in securities in the

course of issuing or selling the shares or borrowing the money. . .

The underwriting agreement did not disclose the basis for calculating the amounts described in (*a*), but the amounts described in (*c*) were calculated at a bonus or commission rate of 17½ cents per share.

Held, all of the expenses claimed were barred from deduction by s. 11(1) (*cb*) (iii) of the *Income Tax Act,* R.S.C. 1952, c. 148, (am. 1955, c. 54, s. 1(1)).

APPEAL from income tax assessments for 1960 and 1961.

John G. McDonald, Q.C., W. H. Zimmerman, Q.C. and *M. L. O'Brien* for appellant.

M. A. Mogan and *M. Barkin* for respondent.

DUMOULIN J.:—The instant appeal is directed against the re-assessment dated May 1, 1963, and assessment dated May 6, 1963, in respect of income for taxation years 1960 and 1961.

Appellant company filed Notice of Objection to the re-assessment for 1960 and the assessment for 1961 on July 25, 1963, and such re-assessment and assessment were confirmed by respondent by a Notification of July 29, 1964.

Consumers' Gas is a company "incorporated by Special Act of the former Province of Canada and continued under the Corporations Act, 1953, of Ontario, and is engaged in the business of distributing natural gas to consumers in the Provinces of Ontario and Quebec, and in the State of New York".

As related at trial by the appellant's Vice-President, Treasurer and Assistant Secretary, Mr. Warren Hurst, this company has maintained an oft-repeated policy of soliciting additional working capital from the investing public at large. Since 1954, recourse was had to 17 such financings, an 8 months' periodicity, in the form of bonds, debentures, preferred and common shares. Two of the latest issues were those of December 3, 1959, and June 8, 1961.

Paragraph 3 of the Notice of Appeal sets forth that:

Pursuant to terms of a Prospectus filed on December 3, 1959, (ex. A-3) the Appellant issued and sold 309,472 of its common shares without par value upon the exercise by holders of the Appellant's common shares of subscription warrants evidencing the right to subscribe for one additional common share without par value of the capital stock of the Appellant for each six common shares without par value then issued and outstanding. In the course of issuing and selling such shares the Appellant incurred, inter alia, the expenses described in paragraph 5 of this Notice of Appeal

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It could go without saying that the sole and only moot question is that of the deductibility of those disbursements, re-occurring also, for different amounts, in connection with the 1961 issue of 1,093,230 common shares, evidenced by the June 8, 1961, prospectus (ex. A-6).

Each prospectus resulted from agreements dated, respectively, November 23, 1959 (ex. A-4) and June 7, 1961 (ex. A-7), between Consumers' Gas and Dominion Securities Corporation, Ltd., and A. E. Ames and Co. Ltd., hereinafter called the "Underwriters".

Paragraph 5 and its subparagraphs (*a*), (*b*) and (*c*), next quoted, would sum up the purport of these agreements so far as they may interest this suit:

> 5. Pursuant to the terms of an agreement evidenced by letter dated November 23, 1959, the Appellant agreed to pay to Dominion Securities Corpn. Limited and A. E. Ames & Co. Limited (hereinafter called the "Underwriters") the following amounts in consideration of the services rendered by the Underwriters as hereinafter described:
>
> (*a*) $24,150 for services rendered by the Underwriters in forming and managing an Underwriting Group and Soliciting Dealers Group to facilitate subscriptions for the new common shares of the Appellant, and in consideration of the agreement by the Underwriters to use their best efforts to maintain an orderly market in the rights evidenced by the subscription warrants;
>
> (*b*) $108,315 representing commission payable to the Underwriters in consideration for their services as dealers in securities; and
>
> (*c*) $46,738.89 in consideration for the services of the Underwriters for the performance of all administrative and clerical work involved in processing warrants tendered by shareholders in the course of exercising their right to subscribe for and purchase the new common shares of the Appellant. Such charges were required by the Underwriters in accordance with the provisions of Regulations issued by the Investment Dealers Association of Canada, the Toronto Stock Exchange and the Montreal Stock Exchange to reimburse the Underwriting Group for the cost of such administrative and clerical work.
>
> Such particular services rendered by the Underwriters were not rendered by them as agents or dealers in securities in the course of issuing and selling the Appellant's new common shares.
>
> All of the expenses described in this paragraph 5 were incurred by the Appellant during the 1960 taxation year.

Paragraph 6 is identically worded, save that it concerns the 1961 taxation year and the amounts in its subparagraphs are: (*a*) $121,654; (*b*) $136,653; (*c*) $121,980, and substitutes "Facilitating Group" for "Soliciting Dealers Group" in (*a*) of paragraph 5.

The Notice of Appeal next proceeds to explain, in paragraphs 7 and 9, that for the 1960 and 1961 taxation years, appellant deducted, in computing its income returns according to s. 11 (1) (*cb*) of the *Income Tax Act*:

7. . . . $12,075 (representing one-half of the expenses described in paragraph 5(*a*) of this Notice of Appeal) and the whole sum of $46,738.89 described in paragraph 5(*c*) . . . The Appellant did not deduct the sum of $108,315 described in paragraph 5(*b*) . . ., such sum being regarded by the Appellant as a non-deductible commission payable to the Underwriters in consideration for their services as dealers in securities.

Similar averments for larger figures appear for 1961 in paragraph 8 of the Notice of Appeal, which urges the following reasons and statutory provisions in paragraph 10, Part B:

10. The Appellant submits that none of the expenses described in paragraphs 5(*a*) and (*c*) and 6(*a*) and (*c*) . . . constituted "commission or bonus paid or payable . . . for or on account of services rendered by a person *as* (emphasis in text) a salesman, agent or dealer in securities in the course of issuing or selling the shares" of the Appellant, within the meaning of section 11(1) (*cb*) (iii) of the *Income Tax Act*. The Appellant says that such expenses were on account of services rendered by the Underwriters acting in a clerical capacity and not as dealers in securities. . . .

The company therefore submits that the expenses above mentioned, for the material taxation years 1960 and 1961, are deductible in accordance with the provisions of section 11(1)(*cb*)(i) enacting 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

(*cb*) an expense incurred in the year

(i) in the course of issuing or selling shares of the capital stock of the taxpayer.

The Minister replies negatively on the assumption that all sums referred to in subparagraphs (*a*) and (*c*) of paragraphs 5 and 6 of the Notice of Appeal "were payments on account of capital and properly disallowed as deductions . . . under the provisions of paragraph (*b*) of subsection (1) of section 12" . . . and/or "were commissions paid to persons on account of services rendered as salesmen, agents or dealers in securities in the course of issuing or selling the Appellant's shares within the meaning of subparagraph (iii) of paragraph (*cb*) of subsection (1) of section 11 of the *Income Tax Act*".

These two sections read thus:

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

(*b*) an outlay, loss or replacement of capital, a payment on account of capital . . .

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11. (1) (*supra*)

(*cb*) (*supra*) Deductions allowed are exclusive of

(iii) a commission or bonus paid or payable to a person to whom the shares were issued or sold or from whom the money was borrowed, or for or on account of services rendered by a person as a salesman, agent or dealer in securities in the course of issuing or selling the shares or borrowing the money.

As the hearing of the case began, the appellant's counsel reminded the Court, as said in paragraphs 7 and 8, that the amounts of $24,150 in paragraph 5(*a*) and $121,654 in 6(*a*) were reduced by one-half each, and those of $108,315 in 5(*b*) and of $136,653 in 6(*b*) were completely withdrawn, these latter disbursements "being regarded by the Appellant as a non-deductible commission payable to the Underwriters in consideration of services as dealers in securities". The explanation offered for the 50% reduction of the claims in subparagraphs (*a*) of paragraphs 5 and 6 was their similarity with those of subsections (*c*) in paragraphs 5 and 6 of the Notice of Appeal, respectively.

These preliminary informations disposed of, there now remains for the Court's decision the real subject matter consisting in:

1. The legal connotation of the disbursements sought in subparagraphs 5(*a*) and 6(*a*): "for services rendered by the Underwriters in forming and managing an Underwriting Group and Soliciting Dealers Group" (5*a*); and/or "a Facilitating Group to facilitate subscriptions for the new common shares of the Appellant" (6*a*); and
2. Are the payments "in consideration for the services of the Underwriters for the performance of all administrative and clerical work involved in processing warrants tendered by shareholders" . . . alleged in subparagraphs 5(*c*) and 6(*c*) of the Appeal governed by the provisions of s. 11(1) (*cb*) (i) of the Act or, rather, of 11 (1)(*cb*)(iii)?, deductible in the former hypotheses, excluded in the latter.

I will attempt to answer these questions in their numerical sequence.

1. The duties and obligations assumed by the Underwriters, Dominion Securities Corp. Ltd., and A. E. Ames &

Co. are minutely detailed in the Letters of Agreement, exhibits A-4 and A-7, relating to the 1959 and 1961 issues of shares. Their wording is, substantially, along comparable lines except, *inter alia*, that in A-7, the noun "fee" has ousted that of "commission" used in the initial, 1959, covenant, ex. A-4, from which the texts hereunder are excerpted.

The two underwriters' opening offer is (ex. A-4, first page):

(*a*) to form a Soliciting Dealer Group (A Facilitating Group in ex. A-7) to facilitate subscriptions for the New Stock and to use our best efforts to maintain an orderly market in the rights evidenced by the Warrants;

(*b*) to form an Underwriting Group to be composed of substantially the same investment dealers and brokers who have recently participated in the primary distribution of other securities of the Company and such Underwriting Group will include and be managed by us;

(*c*) to invite all members of the Underwriting Group, The Investment Dealers' Association of Canada, The Toronto Stock Exchange, Montreal Stock Exchange and Canadian Stock Exchange to become members of a Soliciting Dealer Group.

If, peradventure, there could remain any stock dealers unreached by this global "call to action", it would require even better than the eagle's keen glance to ferret them out.

Adverting to ex. A-3, the company's prospectus dated December 3, 1959, conveying information about the new issue of 309,472 common shares, we see, on page 30, that:

The Company has entered into a letter agreement with Dominion and Ames dated November 23, 1959 (ex. A-4) whereby:

(i) Dominion and Ames agreed to form a Soliciting Dealer Group (changed into a Facilitating Group in ex. A-6, the 1961 prospectus) to facilitate subscriptions for the common shares currently being offered and an Underwriting Group and to use their best efforts to maintain an orderly market in the rights evidenced by the subscription warrants and the Company agreed to pay Dominion and Ames, for such services, an aggregate *commission* (italics throughout these notes added) of $24,150.

(ii) . . .

(iii) . . .

(iv) Dominion and Ames agreed: to purchase from the Company at the price of $32 50 per share all of the shares currently being offered and not subscribed for pursuant to the subscription warrants at the expiry of the subscription period . . .

The 1961 prospectus (A-6) does not materially differ, except, as already noted, that the expression "aggregate

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commission" of $24,150 in the 1959 one now becomes an aggregate "fee" of $121,654.

I do not attach paramount importance to this varied expression, holding "commission" to be much truer to the facts and quite in accordance with the definition of the word found in Black's Law Dictionary 1951, Fourth ed., V° Commission, p. 339:

> The recompense or reward of an agent, factor, broker or bailee, when the same is calculated as a percentage on the amount of his transactions or on the profit to the principal.

Though the percentage ratio or margin of profit remained undivulged, the two sums of $24,150 and $121,654 not in round figures suggest clearly enough a basis of computation. A stronger reason derives from the services attributed to the Underwriters by subsections 5(*a*) and 6(*a*) of the plea "in forming and managing an Underwriting Group and Soliciting Dealers Group (or Facilitating Group in 6(*a*)) to facilitate subscriptions for the new common shares . . . and in consideration of the agreement by the Underwriters to use their best efforts to maintain an orderly market in the rights evidenced by the subscription warrants".

All similar assistance and endeavours on the Underwriters' part are nothing but services rendered in the actual sale and disposal of the shares for which they were paid by the taxpayer "an aggregate commission" or "aggregate fee" as dealers in securities. Since these disbursements fall within the exclusion written in s. 11(1)(*cb*)(iii), the appellant cannot succeed on this point.

2. Amounts of $46,738.89 and $121,980 are claimed as deductible in sections 5(*c*) and 6(*c*) of the Notice of Appeal "in consideration for the services of the Underwriters for the performance of all administrative and clerical work involved in processing warrants tendered by shareholders in the course of exercising their rights to subscribe for and purchase the new common shares of the Appellant . . ."

Both parties agreed that this related to clauses 12 of exhibits A-4 and A-7, the "Agreement Letters" of November 23, 1959 (first issue of shares) and June 7, 1961 (second issue). I am quoting from ex. A-4:

12. The Company as soon as practicable after the expiration of the Subscription Offer, shall pay a *commission of 17½c* (12½c in A-7) to each member of the Soliciting Dealer Group for each common share for which such member procures a subscription, provided such procurement is evidenced by the appearance of the name of the firm in the blank space provided in the subscription form on the face of the warrant. Payment will be made to the head office of such firm.

Mr. Warren Hurst himself, in cross-examination, had to admit the wide discrepancy between the motivations advanced in the written plea and the text just recited; adding that the Company paid these commissions to various brokerage firms by means of 260 cheques in 1960 and 92 for the 1961 issue of stock.

In this second instance, namely, the issue raised in paragraphs 5(*c*) and 6(*c*) of the appeal, the entitlement to a monetary reward on a percentage ratio uniquely depends on a perfected sale, bearing no relation whatever to the amount of pain or trouble if unsuccessfully exerted, and in this connection "commission" or "fee" are absolute synonyms. Here again it is beyond doubt that such commissions were earned by individual members of the Soliciting Dealer Group or Facilitating Group "on account of services rendered . . . as salesman . . . or a dealer in securities in the course of . . . selling the shares" of the appellant, and are, therefore, assessable to income tax according to s. 11(1)(*cb*)(iii).

The appellant frequently invoked ruling No. 18 of the Toronto Stock Exchange, under date of April 28, 1959, filed as ex. A-11, specifically alluded to in paragraph 5(*c*) of the Notice of Appeal. It indeed appears that the "service charges on exercising rights" therein foreseen only apply as between a salesman or dealer and his personal client, a buyer of shares. I am unable to find in the agreements or prospectuses any stipulation linking ruling 18 to the Company. If, perchance, it did, then, its provisions would conflict nevertheless with the relevant statutory enactments and, inasmuch, be of no avail.

For the reasons above, this appeal should be dismissed with all taxable costs against the appellant company.

Appeal dismissed.