Toronto 1967 Mar. 14-16

BETWEEN:

ALGOMA CENTRAL RAILWAY ..... APPELLANT;

AND

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

Income tax—Deductions—Business expense—Expenditure by railway company to obtain geological information of area—Exploitation of area by public contemplated—Whether a current or capital expense—Income Tax Act, s 12(1)(b)

Because of a decrease in the volume of traffic carried by appellant's railway in an unpopulated area appellant employed mining geologists to survey the area with the intention of making the information thereby obtained available to the public in the hope that it would lead to development of the area and so produce traffic for its railway.

Held, the sum paid for the survey was deductible as a current business expense: it was not a payment on account of capital within the meaning of s. 12(1)(*b*) of the *Income Tax Act.* Neither the geological information directly obtained as a result of the expenditure nor the possibility of an increase in railway traffic resulting from exploitation of the area as a result of the use of such information, both of which objects appellant had in view in making the expenditure, was an advantage for the enduring benefit of its business.

British Insulated and Helsby Cables Ltd. v. Atherton [1926] A C. 205; *B.C. Electric Ry Co. v. M N R.* [1958] S C R. 133; *Sun Newspapers Ltd. v. Fed Com'n of Taxation* (1938) 61 C L R 337; *Ounsworth v. Vickers, Ltd.* [1915] 3 K B. 267; *Regent Oil Co v Strick* [1965] 3 W L.R. 636; *Van Den Berghs Ltd. v. Clark* [1935] A C. 431, distinguished

APPEAL from income tax assessments.

R. F. Wilson, Q.C. for appellant.

D. G. H. Bowman and *J. R. London* for respondent.

JACKETT P. (orally):—This is an appeal directly to this Court from the assessments of the appellant under Part I of the *Income Tax Act* for the taxation years 1960, 1961 and 1962.

In so far as the appeal for the 1962 taxation year raised a question as to the deductibility of an amount of $6,149.32 representing logging taxes, interest and penalties in respect of the 1957 and 1959 taxation years, the parties have agreed that there is to be judgment without costs, allowing the appeal and referring the assessment back to the

respondent for reconsideration. In that connection, I should say that judgment will go in that form, and without any direction as to whether there is to be any, and if so what, re-assessment in respect of that amount of $6,149.32, because the parties have expressly agreed that the respondent is to re-consider the matter without any condition being imposed upon what action, if any, he is to take as a result of that re-consideration.

There remains for decision a question as to whether certain amounts paid by the appellant to Franc. R. Joubin & Associates Mining Geologists Limited (hereinafter referred to as the "Joubin company"), being

(*a*) $43,603.40 in respect of 1960

(*b*) $85,189.06 in respect of 1961

(*c*) $138,369.41 in respect of 1962

are deductible in computing the appellant's profits from its business for those respective years for the purposes of Part I of the *Income Tax Act*.

The appellant, at all relevant times, operated a railway and a line of steamships. The part of Ontario serviced by the appellant was, to a substantial extent, unpopulated, with the result that there were very serious limitations on the possibilities open to the appellant for obtaining new customers for its transportation businesses, when the advent of the Trans-Canada Highway and pipelines and dieselization of the Canadian National Railway resulted in a diminution of the volume of traffic that would otherwise have been carried by it. A large part of the unpopulated land through which the appellant's railway ran belonged to the appellant and the balance was, for the most part, Crown land.

In these circumstances, in July, 1960, the appellant arranged with the Joubin company for a survey over a period of five years of the mineral possibilities of the unpopulated lands in question at an average cost of approximately $100,000 per year. This arrangement was made with the intention of making information arising from the survey available to interested members of the public in the hope and expectation that it would lead to development of the area (possible mines, secondary industry, etc.) that would

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produce traffic for the appellant's transportation system. The expenditures in dispute were made to the Joubin company pursuant to that arrangement.

Considerable evidence was led by the appellant to show that the geological surveys were carried out, that a substantial group of persons had manifested an interest in the area in a concrete way, and that the company was continuing up to the present time with similar work of gathering geological information concerning the area and making it available to interested members of the public, doing so in more recent times by staff in the employ of the appellant rather than by an independent contractor. This evidence tends to support the more direct evidence concerning what I regard as the significant fact, namely, that the appellant embarked on the survey programme, and therefore made the expenditures in question, for the reason that I have already outlined.

The two provisions upon which the respondent relied in the reply to the Notice of Appeal as prohibiting the deduction of the amounts in dispute in the computation of the appellant's profits are paragraphs (*a*) and (*b*) of subsection (1) of section 12 of the *Income Tax Act,* which read as follows:

> 12. (1) In computing income, no deduction shall be made in respect of
>
> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer,
>
> (*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,

At the hearing, however, it was common ground that the expenditures in dispute were made by the appellant for the purpose of gaining or producing income from property or a business of the appellant and, therefore, that the deduction of such amounts in computing the appellant's profits for the respective years is not prohibited by section 12(1)(*a*) of the *Income Tax Act.*

The respondent took the position, however, that the expenditures in dispute were either outlays "of capital" or payments "on account of capital" within the meaning of those expressions in section 12(1)(*b*) of the *Income Tax Act* and that their deduction in computing the profits from the appellant's business for the years in question is, there-

fore, prohibited by that provision. The appellant disputed the position so taken by the respondent. The question so raised is the sole question that remains to be decided in the appeal.

The position is, therefore, that, if the expenditures were outlays "of capital" or payments "on account of capital", within the meaning of those expressions in section 12(1)(*b*), the appeal must be dismissed, and, if they do not fall within either of those expressions, the appeal must be allowed, in so far as the expenditures in question are concerned.

Leaving aside allowances in respect of depreciation, obsolescence or depletion, section 12(1)(*b*) prohibits the deduction of

(*a*) "an outlay . . . of capital",

(*b*) "a(n) . . . loss . . . of capital",

(*c*) "a(n) . . . replacement of capital",

or

(*d*) "a payment on account of capital".

As far as I know, the precise significance of these various expressions in section 12(1)(*b*) has not been the subject of judicial consideration. Whether or not there might be "an outlay . . . of capital"[1] that would escape the prohibition in section 12(1)(*a*) and would not fall within the expression "a payment on account of capital", I need not consider, for, as far as the expenditures in dispute are concerned, I am satisfied that, if they are not payments on account of capital, they are not, within the meaning of section 12(1)(*b*) outlays "of capital". I propose to consider, therefore, whether the expenditures in dispute were payments "on account of capital". In other words, the question, as I understand it, is: Is such an expenditure in substance "a revenue or a capital expenditure"? (See *British Insulated and Helsby Cables v. Atherton Ltd.*[2] per Viscount Cave, L.C. at page 213.)

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[1] A distribution on winding up or on reduction of capital would presumably be an outlay "of capital" but not a payment "on account of capital". It may be that all outlays "of capital" are adequately covered by section 12(1)(*a*) and need not have been covered by section 12(1)(*b*).

[2] [1926] A.C. 205.

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The "usual test" applied to determine whether such a payment is one made on account of capital is, "was it made 'with a view of bringing into existence an advantage for the enduring benefit of the appellant's business' "? See *B.C. Electric Ry. Co. Ltd. v. Minister of National Revenue*[1] per Abbott J. at pages 137-8, where he applied the principle that was enunciated by Viscount Cave in *British Insulated and Helsby Cables, Ltd. v. Atherton, supra,* and that had been applied by Kerwin J., as he then was, in *Montreal Light, Heat & Power Consolidated v. Minister of National Revenue*[2].

The question is therefore whether what the appellant in this appeal had in "view" when it made the expenditures in dispute was "an advantage for the enduring benefit" of its business within the meaning of the test as it has been developed by the decisions. As I understand the respondent's position, it depends on an affirmative answer to that question. I do not overlook the fact that the respondent placed emphasis on various other factors as deserving some consideration. I have not, however, been able to appreciate how any of such factors are relevant on the facts of this case.

What the contractor contracted for and received for the expenditures in dispute was information produced by geological surveys that could be placed in the hands of interested members of the public. That is what the appellant had in "view" as the immediate and direct result of the expenditures that it was making. The respondent does not, however, suggest, as I understand it, that such information was "an advantage for the enduring benefit" of the appellant's business within the meaning of the test.

However, the appellant also had in "view", in one sense of the word, the possibility that, as a consequence of placing such information in the hands of appropriate members of the public, some of them would be attracted to the area through which the appellant's railway ran, would conduct exploration operations, would make mineral finds, and would develop mines, with the consequence that businesses of various kinds would be established in the area and thus a substantial volume of traffic would find its way on to the appellant's transportation systems, which traffic would not

[1] [1958] S.C.R. 133.

[2] [1942] S.C.R. 89 at 105.

otherwise find its way there. This is the "advantage for the enduring benefit" of the appellant's business that, according to the respondent's submission, the appellant contemplated bringing into existence by the expenditures in dispute.

As the test upon which the respondent relies has been established by judicial decisions, reference must be made to the circumstances to which it has been applied by such decisions to find the answer to the problem raised by the respondent's submission as to whether the "advantage" envisaged by the taxpayer when making the expenditure that the test contemplates is whatever is acquired as an immediate consequence of the expenditure or is the ultimate effect on the taxpayer's business that is expected to flow from what is so acquired. A further question must also be considered, even if that question is answered in the affirmative, as to whether a mere increase in the volume of the taxpayer's business—no matter how large that increase may be—is an "advantage" of the taxpayer as contemplated by the test.

Without attempting to survey all of the cases in which the test has been applied, the following may be referred to as being representative:

1. In the *British Columbia Electric* case, the appellant was required to make a payment of $220,000 to municipalities for the improvement of roads as a condition precedent to being granted leave to discontinue a railway passenger service and to have a subsidiary company operate a substitute bus service with a consequent improvement in its overall financial position for the future. The payment of $220,000 was held to be a payment on account of capital.

2. In the *British Insulated and Helsby Cables* case, the taxpayer, for competitive reasons, felt the need of a pension fund for its employees. To place the fund on a sound actuarial basis, it made a payment of 31,784 pounds to the trustees of the fund that it established so that the past years of service of the then existing staff could rank for pension. That payment was held to be on capital account.

3. In *Sun Newspapers Limited v. The Federal Commissioner of Taxation*[1], a newspaper made a payment of 86,500 pounds under a contract designed to prevent the publication of a competing paper. That payment was held to be

[1] (1938) 61 C.L.R. 337.

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on capital account. (This case is to be contrasted with *Commissioner of Taxes v. Nchanga Consolidated Copper Mines, Ltd.*[1] where it was held that a payment of 1,384,569 pounds to compensate a competitor for going out of production for one year was a payment on current account.)

4. In *Ounsworth v. Vickers, Limited*[2], the taxpayer made a payment of 97,431 pounds as a contribution to the cost of dredging a channel and constructing a deep water berth. The work was done by a harbour authority, who undertook the maintenance of the resulting channel berth. The work had to be done so the taxpayer could deliver ships from its shipbuilding works. The contribution apparently had to be made by the taxpayer in order to persuade the harbour authority to do the work. The contribution was held to be on capital account.

5. In *Regent Oil Co. Ltd. v. Strick*[3], lump sums were paid by an oil company to operators of garage and filling station premises as consideration for the operators entering into arrangements under which the operators gave the oil company an interest in their business premises and were bound to take their oil supplies from the oil company. The lump sums were held to be on capital account.

6. In *Van Den Berghs, Ltd. v. Clark*[4], a payment of 450,000 pounds received for giving up rights under a quasi-partnership type of contractual arrangement between the taxpayer and a foreign company in a similar business was held to have been received on capital account.

In all these cases, and in the other cases referred to in the various decisions to which reference was made during the argument, the *"advantage"* that was held to be of an enduring benefit to the taxpayer's business was the thing contracted for or otherwise anticipated by the taxpayer as the direct result of the expenditure. In all such cases it was the "advantage" so acquired that, it was contemplated, would endure to the benefit of the taxpayer's business. In my view, the information received by the appellant here, in consideration of the expenditures in dispute, is not such an "advantage" of an enduring benefit to the taxpayer's business.

[1] [1964] 1 All E.R. 208 (P.C.).
[2] [1915] 3 K.B. 267.
[3] (1965) 3 W.L.R. 636.
[4] [1935] A.C. 431.

Having reached that conclusion, it is not necessary to say more. I should add, however, that in my view, once it is accepted that the expenditures in dispute were made for the purpose of gaining income, on the view, as I understand it, that they were part of a programme for increasing the number of persons who would offer traffic to the appellant's transportation systems, I have great difficulty in distinguishing them in principle from expenditures, made by a businessman whose business is lagging, on a mammoth advertising campaign designed to attract substantial amounts of new custom by some spectacular appeal to the public. Such an advertising campaign is designed to create a dramatic increase in the volume of business. In a very real sense, it is designed to benefit the business in an enduring way. According to my understanding of commercial principles, however, advertising expenses paid out while a business is operating, and directed to attracting customers to a business, are *current* expenses. They are not, in the sense of Viscount Cave's rule, made with a view to "bringing into existence" an "advantage" for the enduring benefit of the business. If this be true of advertising expenses, in my view, it is equally true of other expenses incurred while the business is running with a view to increasing the volume of that business—so long as such expenses are incurred for the purpose of gaining income in such a way that their deduction is not prohibited by section 12(1)(*a*)[1]. I can see no difference in principle between the two cases.

The appeal is allowed. The 1960 and 1961 assessments are referred back to the respondent for re-assessment on the basis that the amounts of $43,603.40 and $85,189.06, referred to in paragraph A(1) of the Notice of Appeal, are deductible in computing the appellant's profits for the 1960 taxation year and the 1961 taxation year, respectively. The 1962 assessment is referred back to the respondent for

(*a*) reconsideration of the sum of $6,149.32 representing logging taxes, interest and penalties referred to in

[1] There can be expenditures that, in a broad sense, are made to improve the position of the business and that, nevertheless, do not escape the prohibition in section 12(1)(*a*). See, for example, *Canada Safeway Ltd. v. Minister of National Revenue*, [1957] S.C.R. 717.

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paragraph A(2) of the Notice of Appeal, and for any re-assessment that may arise from such reconsideration, and

(*b*) for re-assessment on the basis that the sum of $138,369.41 referred to in paragraph A(1) of the Notice of Appeal is deductible in computing the appellant's profit for the 1962 taxation year.

The respondent is to pay the appellant's costs of the appeal other than costs that are attributable to the dispute concerning the amount referred to in paragraph A(2) of the Notice of Appeal.