1957

Jan. 14-15

Jan. 22

BETWEEN:

THE ROYAL TRUST COMPANY .....APPELLANT;

AND

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

Revenue—Income tax—The Income War Tax Act, R.S.C. 1927, c. 97, s. 6(a)—The Income Tax Act, 1948, S. of C. 1948, c. 52, ss. 3, 12(1)(a)—Deductibility of social club admission fees and membership dues paid for senior officers—Whether payments made in accordance with ordinary principles of commercial trading or well accepted principles of business practice—Whether payments made or incurred for the purpose of gaining or producing income from the business—Admission fees and membership fees recurring expenses of appellant.

The appellant had its head office in Montreal and branches and agencies in various parts of Canada. Its business covered a wide range of activity of a fiduciary and personal nature, of which the most important was that of acting as executor and trustee of estates and trusts. It used several means of getting business and gaining or producing income from it but believed that personal contacts by its officers produced the best business results. It required its senior executive officers and branch managers and their assistants to develop personal contacts with those persons from whom it might reasonably expect trust company business. It was part of its policy to require such officers to take an active part in the community life of the locality in which they operated so that when one of its officers was appointed to a position which called for the maintenance or promotion of its business he was required to join a social club in his community, take an active part in community organizations and campaigns, join a service club and the local chamber or board of trade and generally make himself known in the community. The appellant paid the social club admission fees and annual membership dues of such officers. It had followed this practice for many years but had never claimed a deduction of the amounts so paid until it did so in its income tax return for 1952. The Minister disallowed the deduction and the appellant appealed to the Income Tax Appeal Board which dismissed its appeal and the appellant appealed from its decision to this Court.

Held: That the principles for the computation of income are not defined in the Act and that it must be ascertained on ordinary principles of commercial trading or well accepted principles of business practice. *Gresham Life Insurance Society v. Styles* [1892] A.C. 309 at 316 followed.

2. That the extent of the prohibition of the deduction of an outlay or expense under section 12(1)(*a*) of *The Income Tax Act* is less than that of a disbursement or expense under section 6(*a*) of the *Income War Tax Act*.

3. That in a case under *The Income Tax Act* the first matter to be determined in deciding whether an outlay or expense is outside the prohibition of section 12(1)(*a*) of the Act is whether it was made or incurred by the taxpayer in accordance with the ordinary principles of com-

mercial trading or well accepted principles of business practice. If it was not, that is the end of the matter. But if it was, then the outlay or expense is properly deductible unless it falls outside the expressed exception of section 12(1)(*a*) and, therefore, within its prohibition.

4. That the payments of admission fees and annual membership dues made by the appellant were made in accordance with principles of good business practice for trust companies.
5. That, while section 12(1)(*a*) requires that an outlay or expense must, in the case of a taxpayer engaged in a business, have been made or incurred by him for the purpose of gaining or producing income from his business in order to come within the exception specified in the section, it is not necessary that the outlay or expense should have resulted in income. *Consolidated Textiles Limited v. Minister of National Revenue* [1947] Ex. C.R. 77 at 81 followed.
6. That in a case under *The Income Tax Act* if an outlay or expense is made or incurred by a taxpayer in accordance with the principles of commercial trading or accepted business practice and it is made or incurred for the purpose of gaining or producing income from his business its amount is deductible for income tax purposes.
7. That the payments made by the appellant were made by it for the purpose of gaining or producing income from its business.
8. That the connection between the appellant's gain or production of income from its business and the payments made by it was not remote.
9. That, although the admission fees were paid once and for all for the officers for whom they were paid, they were recurring expenses so far as the appellant was concerned.
10. That the appeal must be allowed.

APPEAL from decision of the Income Tax Appeal Board.

The appeal was heard before the President of the Court at Montreal.

H. H. Stikeman, Q.C. and *J. N. Turner* for appellant.

Maurice Paquin, Q.C., and *Francois Auclair* for respondent.

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

THE PRESIDENT now (January 22, 1957) delivered the following judgment:

This is an appeal from the decision of the Income Tax Appeal Board, *sub nom. No. 262 v. Minister of National Revenue*[1], dated May 4, 1954, dismissing the appellant's appeal against its income tax assessment for 1952.

In its income tax return for that year the appellant claimed, under the head of "Sundries", that it was entitled,

[1] (1955) 13 Tax A.B.C. 33.

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in computing its taxable income to deduct as an expense the sum of $9,527.29 which it had paid to various social clubs in payment of the admission fees and annual membership dues of certain officers who were members of such clubs. Of this amount $1,200 was for admission fees and $8,327.29 annual membership dues. In assessing the appellant the Minister, as appears from the notice of reassessment, dated September 21, 1954, and mailed February 8, 1954, added the sum of $9,527.29 to the amount of taxable income reported by it. The appellant objected to the assessment but the Minister confirmed it. The appellant then appealed to the Income Tax Appeal Board which dismissed its appeal. It is from that decision that the appeal to this Court is brought.

The appeal involves consideration of sections 12 (1)(*a*) and 12(1)(*b*) of *The Income Tax Act*, Statutes of Canada 1948, Chapter 52, which provide 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.

The issue in the appeal is whether the payments made by the appellant constitute an outlay or expense made or incurred by it for the purpose of gaining or producing income from its business within the meaning of the exception expressed in section 12(1)(*a*) of the Act and, therefore, outside its prohibition. The issue is a novel and important one. This is the first case in which the deductibility of such an expense falls to be considered by this Court and the amount involved over a period of years if the appellant succeeds in its appeal will be very large.

The facts are not in dispute. Evidence on behalf of the appellant was given by Mr. J. Pembroke, its president, Mr. C. Harrington, its assistant general manager and manager of its Toronto branch and Mr. A. Gilmour, its financial adviser and tax consultant. Counsel for the respondent did not call any witnesses.

The appellant has its head office at Montreal and has 16 branches and 3 agencies, 1 branch being in London,

England, and the other branches and the three agencies being in various parts of Canada from Newfoundland to British Columbia. Its largest branch is in Montreal and its next largest branches are in Toronto and Vancouver.

The appellant's business, as its name implies, covers a wide range of activity of a fiduciary and personal nature. It gives assistance in the planning and preparation of wills and trust deeds and supervises and manages estates and trusts; it acts as trustee of pension plans and under bond and debenture issue indentures; it acts as agent for corporations in the transfer and registration of shares; it manages corporate and personal investment portfolios; it acts as agent in the purchase and sale of real estate and manages properties; and it accepts deposits from its customers and clients. The most important part of its business is that of acting as executor and trustee of estates and trusts, which was described as the "bread and butter" part of its business, and its next most important activities are those of acting as trustee under bond and debenture issue indentures and as agent for corporations for the transfer and registration of their shares.

The appellant uses several means for getting business and gaining or producing income from it. While it is in somewhat the same position as lawyers and accountants it has one advantage over them in that it is free to advertise and it uses this means extensively. But its major effort to attract business is based on its belief, as the result of many years of experience. that personal contacts by its officers produce the best business results. The appellant, therefore, requires its senior executive officers and such other of its officers as are charged with the maintenance and promotion of its business, such as, for example, its branch managers and their assistants, to take every opportunity to develop personal contacts with those persons from whom it might reasonably expect trust company business. It is part of its policy to require such officers to take an active part in the community life of the locality in which they operate. Consequently, when one of its officers is appointed to a position which calls for the maintenance or promotion of its business he is informed that he is required to join a social club in his community, take an active part in community organizations and campaigns such as Red Feather and other community welfare drives, join a service club and the local chamber of

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commerce or board of trade and generally make himself known in the community. He is to be regular in his attendance at club meetings and functions, take his part in club committee work and serve as a club officer if required to do so.

The details of the appellant's policy are carefully worked out. It decides which of its officers should join social clubs. They are those that would be likely to come into personal contact with clients or prospective clients, such as, for example, in addition to senior executive officers, branch managers and their assistants, trusts and estates officers, supervisors of pension funds, supervisors of investment folios, stock transfer officers and managers of real estate. The appellant also designates the clubs to which its officers should belong and takes the necessary steps for their introduction and admission.

The appellant's branches have a large measure of autonomy. Each branch has its own manager and one or more assistant managers and other officers. The branch manager with the advice of his local advisory board exercises his own judgment in matters of detail but, of course, always within the limits of policy established by the head office. It is he who recommends which of his branch officers should be members of social clubs, for it is within his jurisdiction to decide what expenditures should be made. The amount paid for club dues is treated as an item of the cost of the branch operation so that expenditures for membership dues are carefully watched.

The appellant has followed this policy for a great many years but it did not claim a deduction of the amounts paid by it in furtherance of it prior to the claim made in its income tax return for 1952. This was made on the advice of its financial adviser and tax consultant. Mr. Pembroke stated that at the outset the appellant's policy might have been considered as a long term business project but it had been in effect for such a long time and been so successful in its results on a day to day, month to month, and year to year basis that it has become part of the appellant's regular short term policy.

It was in pursuance of this policy and in accordance with its long business practice that the appellant paid the social club admission fees and annual membership dues that are in question in this action. Altogether, in 1952 it paid for

78 officers, the details of which appear in a list filed as Exhibit 2. This shows the names of the clubs, the names of the officers and the positions they hold with the appellant and the amounts paid for admission fees and annual membership dues. As I have already stated, the annual membership dues came to $8,327.29 and the admission fees to $1,200. This was for 5 officers who first joined clubs in that year.

As a general rule the appellant paid the admission fees and annual subscription dues directly to the clubs of which its officers were members. But there might be instances in which the officer paid the fees and dues himself in which case he was reimbursed for the expenditures he had made on the appellant's behalf.

In addition to the amounts in dispute the appellant in 1952 also paid $395.97 for the annual dues of its officers who were members of service clubs and $2,398.70 for the annual dues of its officers who were members of chambers of commerce or boards of trade. The details of these payments appear in lists filed as exhibits 3 and 4. The payments to the service clubs, chambers of commerce and boards of trade were allowed as deductions and are not here in issue. Objection was taken to the reception of this evidence on the ground of irrelevancy. But while I agree that the allowance of these payments by the Department does not necessarily clothe it with validity and cannot have any effect on the issue in this appeal, I think that the evidence is admissible as indicative of one of the means used by the appellant for the purpose of gaining and producing income from its business.

The appellant also paid the monthly club accounts of its officers. The deduction of the amounts so paid was allowed by the Department and they are not in issue. I should merely refer to the fact that while membership in the social clubs was intended for the promotion of the appellant's business and the fees and dues were paid for that purpose the officers who were members of them were not precluded from using the club facilities for their own social purposes but it was an understood rule that if they did so they would carefully check the items in the monthly accounts that were personal to themselves and pay such amounts themselves.

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The evidence is conclusive that the appellant's policy has resulted in business for it from which income was gained or produced. Mr. Pembroke belonged to three social clubs in Montreal and one in Ottawa. He used their facilities frequently and discussed business at them. He gave several specific instances of obtaining substantial business for the appellant by reason of being able to invite persons to lunch at one of the clubs and discuss business with them there. His officers frequently reported similar situations. He stated that the appellant's business was largely of a personal and confidential nature and that many persons could not find the time to go to the appellant's office but could go to one of the clubs. To that extent the club, in his opinion, was an extension of the appellant's office facilities. On many occasions a remark made at the club gave him a lead that he could follow up and a discussion there might end up with a will or a trust or a pension fund for the appellant. This did not mean that if he had not been a member of the club he would not have obtained the business. He might have done so but it was not as likely. Mr. Pembroke said that the appellant regarded its policy as an extension of its advertising but attached greater importance to it in that the use of the club facilities resulted in more direct dealing with persons from whom the appellant as a trust company might expect the bulk of its business.

Mr. Harrington's evidence was to the same effect. He was appointed manager of the appellant's Toronto branch and supervisor of its Ontario branches in 1952. Prior to that time he had been in the Montreal branch. He stated that he joined two clubs in Toronto and that the appellant paid his dues there. He found in his first year at Toronto that the fact that he was able to join social clubs there greatly facilitated his start in business. Before he went there steps had been taken to have his name proposed for membership and he was instructed to take an active part in the life of the clubs, meet the members and endeavor to get information that would result in business. He gave specific examples of having obtained profitable business for the appellant through joining the clubs. Soon after he arrived in Toronto he met at one of the clubs, a person whose company had just successfully floated a bond issue and he was able to get

a deposit from him of over a million dollars. One of his officers was able through his membership in a club to obtain about 25 will executor appointments. A luncheon discussion at the club with a lawyer resulted in the management of a $600,000 investment portfolio. And in his capacity as supervisor of the Ontario branches he had knowledge of business resulting to the appellant from membership in clubs.

There is no doubt that the appellant considered that its expenditures were in accordance with good business practice. Its experience over a long period was certainly to that effect. According to Mr. Pembroke, it was desirable that in the larger cities its officers should be members of several clubs in order to meet as many persons as possible but it was also vital in the smaller centres that its representative should belong to a club there. Indeed, as Mr. Pembroke put it, his failure to join might do him and the appellant active harm through creating the belief in the community that he was anti-social.

Moreover, the evidence shows that other trust companies, competitors of the appellant, followed the same policy as it does and considered it good business practice to do so. Mr. Pembroke's evidence was to that effect and it was confirmed by Mr. Harrington. As he put it, it was the general opinion of trust companies that it was important and essential and good business practice to have officers in social clubs and pay their club fees and dues. And finally, Mr. Arthur Gilmour, an experienced chartered accountant with the firm of Clarkson, Gordon and Company, expressed the opinion, as an accountant, that the amount paid to the clubs was a proper and necessary deduction in determining the amount of the appellant's profits and gains.

On these uncontradicted facts I proceed to consideration of the principles to be applied. The statutory provision primarily involved is section 12(1)(*a*) of *The Income Tax Act*, to which I have already referred. For convenience, I repeat its terms:

> 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.

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This section replaced section 6(*a*) of the *Income War Tax Act*, R.S.C. 1927, Chapter 97, which provided:

> 6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> (*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income;

It is clear that the range of deductibility of an outlay or expense under *The Income Tax Act* is greater than that of disbursements or expenses under the *Income War Tax Act*. But there are certain tests of deductibility that are as applicable in the case of the later enactment as they were in the case of the earlier one.

This Court has occasion in several cases under the *Income War Tax Act* to consider what should be the primary approach to the question whether a disbursement or expense was deductible for income tax purposes. I dealt with this question at length in *Imperial Oil Limited v. Minister of National Revenue*[1] and need not repeat what I said there beyond pointing out that it was held there that the deductibility of disbursements or expenses was to be determined according to the ordinary principles of commercial trading or well accepted principles of business and accounting practice unless their deduction was prohibited by reason of their coming within the express terms of the excluding provision of section 6(*a*). I went on to say the section ought not to be read with a view to trying to bring a particular disbursement or expense within the scope of its excluding provisions, but that if it was not within the express terms of the exclusions its deduction ought to be allowed if such deduction would otherwise be in accordance with the ordinary principles of commercial trading or well accepted principles of business and accounting practice. It is manifest from the reasons for judgment in that case that the first approach to the question whether a particular disbursement or expense was deductible for income tax purpose was to ascertain whether its deduction was consistent with ordinary principles of commercial trading or well accepted principles of business and accounting practice and that if it was the next enquiry should be whether the deduction was within or without the exclusions of section 6(*a*). My only present observation is that I should have omitted the reference to accounting practice which I made in that case.

[1] [1947] Ex. C.R. 527.

In the case of *Daley v. Minister of National Revenue*[1] I carried the analysis a step further and expressed the opinion that it was not correct to look at section 6(*a*) as the authority, even inferentially, for permitting the deduction of a disbursement or expense. I put my view, at page 521, as follows:

> The correct view, in my opinion is that the deductibility of the disbursements or expenses that may properly be deducted "in computing the amount of the profits and gains to be assessed" is inherent in the concept of "annual net profit or gain" in the definition of taxable income contained in section 3. The deductibility from the receipts of a taxation year of the appropriate disbursements or expenses stems, therefore, from section 3 of the Act, if it stems from any section, and not at all, even inferentially, from paragraph (*a*) of section 6.

This led to the statement that in some cases it was not necessary to consider section 6(*a*) at all, for if the deduction of a disbursement or expense was not permissible by the ordinary principles of commercial trading or accepted business and accounting practice, such as, for example, that of the disbursement in question in that case, that was the end of the matter and it was not necessary to make any further enquiry, for if ordinary business practice could not sanction the deduction the expenditure could not possibly fall outside the exclusions of section 6(*a*) but must automatically fall within its prohibition.

It is, therefore, erroneous to say that there was a departure or reversal in the *Daley* case (*supra*) from what was said in the *Imperial Oil Limited* case (*supra*) as to what should be the first approach to the question whether a disbursement or expense was deductible for income tax purposes.

The statement in the *Daley* case (*supra*) that the deductibility of a disbursement or expense was inherent in the concept of "annual net profit or gain", and stemmed from section 3 of the Act, if from any section, and not from section 6(*a*) was implicit in the reasons for judgment in the *Imperial Oil Limited* case (*supra*) but not expressed. For there, at page 530, I stated that the "profits or gains to be assessed", to use the opening words of section 6, were the net profits or gains described in section 3 as being taxable income, subject to section 6 with which section 3 must be read and pointed out that the principles for the computa-

[1] [1950] Ex. C.R. 516.

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tion of such profits or gains were not defined in the Act but were stated in judicial decision, and I referred to the statement of Lord Halsbury L.C. in *Gresham Life Assurance Society v. Styles*:[1]

> Profits and gains must be ascertained on ordinary principles of commercial trading.

And also to the approval by Earl Loreburn in *Ushers' Wiltshire Brewery, Limited v. Bruce*[2] of the statement that:

> profits and gains must be estimated on ordinary principles of commercial trading by setting against the income earned the cost of earning it.

It follows from this line of reasoning, which is as applicable in the case of *The Income Tax Act* as it was in that of the *Income War Tax Act*, that instead of saying that the range of deductibility of an outlay or expense is greater under section 12(1)(*a*) than that of a disbursement or expense under section 6(*a*) of the *Income War Tax Act* it would be more accurate to say that the extent of the prohibition of the deduction of an outlay or expense is less under section 12(1)(*a*) of *The Income Tax Act* than that of a disbursement or expense under the *Income War Tax Act*. Indeed, it was plainly intended that it should be so, with the result that the gap, if it may be so described, between the kind of an outlay or expense that is deductible according to ordinary principles of commercial trading and business practice and that which is deductible for income tax purposes is narrower now than it was under the former Act.

Consequently, if the correct approach to the question of whether a disbursement or expense was properly deductible in a case under the *Income War Tax Act* was the one which I have outlined, it follows, *a fortiori*, that it is the correct approach to the question of whether an outlay or expense is properly deductible in a case under *The Income Tax Act*. Thus, it may be stated categorically that in a case under *The Income Tax Act* the first matter to be determined in deciding whether an outlay or expense is outside the prohibition of section 12(1)(*a*) of the Act is whether it was made or incurred by the taxpayer in accordance with the ordinary principles of commercial trading or well accepted principles of business practice. If it was not, that is

[1] [1892] A.C. 309 at 316. [2] [1915] A.C. 433 at 434.

the end of the matter. But if it was, then the outlay or expense is properly deductible unless it falls outside the expressed exception of section 12(1)(*a*), and therefore, within its prohibition.

There is, in my opinion, no doubt that it was consistent with good business practice for a trust company like the appellant to make the payments in question. They were made as a matter of business policy that had been carefully considered, was well regulated and had been in effect for many years prior to the year in question. It was considered that the use of social club facilities by the appellant's officers was particularly suited to the kind of personal business done by a trust company and was a means for promoting business beyond that which advertising could produce. The experience over the years showed that the policy had worked out well and that its benefits to the appellant were real. Business contacts were made at the club and business was discussed there. Memberships in the clubs had produced profitable business for the appellant. Moreover, the appellant's competitors followed policies similar to the appellant's and the evidence is that it was considered good business practice for a trust company to have its business getting officers become members of social clubs and pay their admission fees and annual membership dues. In addition to the business and commercial judgment of the appellant's officers that the payments made by them were properly deductible as business expenses there was the opinion of Mr. A. Gilmour as an accountant, for what it is worth, that from an accounting point of view the deduction of the amount of the payments made by the appellant was a proper and necessary one for the ascertainment of its true profits and gains. Thus I find as a fact that the payments made by the appellant were made in accordance with principles of good business practice for trust companies.

I now come to the enquiry whether the deduction of the amount in question is prohibited by section 12(1)(*a*) of the Act or falls within its expressed exception.

The mere fact that an outlay or expense was made or incurred by a taxpayer in accordance with the principles of commercial trading and was consistent with good business practice does not automatically make it deductible for

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income tax purposes. If it were not so there would have been no need to couch the exception in section 12(1)(*a*) in the terms that were used. A similar thought was expressed in respect of the corresponding provision of the United Kingdom Act by Kennedy L.J. when he said in *Smith v. Lion Brewery Company Limited*[1]:

> It is clear that it is not every expenditure which is made by a trader for the promotion of his trade, and which, in fact contributes to the earning of profits, which is a permissible deduction from the estimate of profits for Income Tax purposes.

And an illustration of the kind of expenditure referred to, although made consistently with good business practice, that was not deductable as not coming within the exception of section 12(1)(*a*) and, therefore, within its prohibition is to be found in the decision of the Income Tax Appeal Board in *No. 237 v. Minister of National Revenue*[2]. There the Chairman of the Board held that the expense incurred by the taxpayer in paying its solicitor for his services in bringing about a tariff amendment that resulted in a saving of manufacturing costs to it was not an outlay or expense made or incurred for the purpose of gaining or producing income from its business and was, therefore, not deductible.

There is a specific limitation in the exception expressed in section 12(1)(*a*) on the kind of outlay or expense that may be deducted. It must have been made or incurred, in the case of a taxpayer engaged in a business, for the purpose of gaining or producing income from his business.

It is not necessary that the outlay or expense should have resulted in income. In *Consolidated Textiles Limited v. Minister of National Revenue*[3] I expressed the opinion that it was not a condition of the deductibility of a disbursement or expense that it should result in any particular income or that any income should be traceable to it and that it was never necessary to show a causal connection between an expenditure and a receipt. And I referred to *Vallambrosa Rubber Co. v. Inland Revenue*[4] as authority for saying that an item of expenditure may be deductible in the year in which it is made although no profit results from it in such year and to *Commissioners of Inland Revenue v. The*

[1] (1910) 5 T.C. 568 at 581.
[2] (1955) 12 Tax A.B.C. 230.
[3] [1947] Ex. C.R. 77 at 81.
[4] (1910) 47 Sc. L.R. 488.

Falkirk Iron Co., Ltd.[1] as authority for saying that it may be deductible even if it is not productive of any profit at all. I repeated this opinion in the *Imperial Oil Limited* case. The statements made in the cases referred to, which were cases governed by the *Income War Tax Act,* are equally applicable in a case under *The Income Tax Act.* The discussion of this point in the present case is, in a sense, academic, for even if it were necessary to show a causal connection between an expenditure and income it could be done in the present case. Both Mr. Pembroke and Mr. Harrington gave evidence of specific instances of profit actually resulting to the appellant from its expenditure.

The essential limitation in the exception expressed in section 12(1)(*a*) is that the outlay or expense should have been made by the taxpayer "for the purpose" of gaining or producing income "from the business". It is the purpose of the outlay or expense that is emphasized but the purpose must be that of gaining or producing income "from the business" in which the taxpayer is engaged. If these conditions are met the fact that there may be no resulting income does not prevent the deductibility of the amount of the outlay or expense. Thus, in a case under *The Income Tax Act* if an outlay or expense is made or incurred by a taxpayer in accordance with the principles of commercial trading or accepted business practice and it is made or incurred for the purpose of gaining or producing income from his business its amount is deductible for income tax purposes.

That is plainly the situation in the present case. I have already found that the payments by the appellant were made in accordance with principles of good business practice for a trust company. It is equally clear, in my opinion, that they were made by the appellant for the purpose of gaining or producing income from its business. The appellant's purpose was to increase its business through personal contacts of its officers with persons whom it would not otherwise readily reach. The clubs were to be used as extensions of its office facilities for persons who would rather go there than to its office. Its whole policy was for the purpose of furthering its business and so gaining or producing income from it. In my view, the payments in

[1] (1933) 17 T.C. 625.

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question were properly deductible and the Minister was in error in adding their amount to the taxable income reported by the appellant.

There are some further observations to be made. It was contended by counsel for the respondent that the deduction of the amount of the appellant's payments was prohibited by section 12(1)(*a*) on the ground that they were only remotely connected with its income earning process and not directly connected as the law required. In support of this contention he relied upon the statement of Lord Macmillan in *Montreal Coke and Manufacturing Company v. Minister of National Revenue* and *Montreal Light, Heat and Power Consolidated v. Minister of National Revenue*[1] where he said:

> Expenditure to be deductible, must be directly related to the earning of income.

On the strength of this statement counsel contended that the test of whether an outlay or expense is deductible under section 12(1)(*a*) is whether it was directly connected with gaining or producing income from the taxpayer's business and his submission was that the appellant's expenditures were not directly connected with its income earning process and that the relationship between its income and its payments of its officers' admission fees and annual membership dues was remote. I am unable to agree with this submission. Counsel's use of Lord Macmillan's statement in support of his contention is not warranted. I had occasion to refer to the statement in the *Imperial Oil Limited* case (*supra*) at page 544, with a view to placing it in its proper context. Lord Macmillan was dealing with the words "for the purpose of earning the income" in section 6(*a*) of the *Income War Tax Act* and drew a sharp distinction between two classes of expenditures, namely, those connected with the financial operations of the companies involved and those connected with their business. But since it was only through their business that they *earned* income only the latter expenditures could be deducted, and those that were connected with the financial operations, not being related to the business from which the companies *earned* income, could not be deducted. When Lord Macmillan made the statement that "an expenditure, to be deductible must be

[1] [1944] A.C. 126 at 133.

directly related to the earning of income", it was for the purpose of drawing a distinction between the two classes of expenditures he had been discussing: if the expenditure was to be deductible it could only be because it was related to the earning of income and not to the financial operations. Thus, counsel was not justified in using the statement in support of his contention. Moreover, the connection between the appellant's gain or production of income from its business and the payments made by it was not remote in any sense of the term.

Counsel's specific contention regarding the amount of the payments made for admission fees presents more difficulty. Put briefly, the submission was that when the appellant paid the admission fee when one of its officers joined a club this was a payment made once and for all in respect of that officer and it was, therefore, a payment on account of capital within the meaning of section 12(1)(*b*) of the Act, to which I have already referred, and its deduction was prohibited. In my opinion, there is no realistic reason for drawing a distinction between the payments for admission fees and those for annual membership dues. Both were made for the same purpose. The reality is that in the first year of an officer's membership in a club the payments are higher than in subsequent years. The admission fee is only the first in a series of payments. It does not create any asset for the appellant or confer any lasting or enduring benefit upon it. It would be lost if the annual membership dues were not paid. Mr. Pembroke and Mr. Harrington did not see any difference between the two kinds of payments. As Mr. Harrington put it the admission fees were paid, just as the annual membership dues were, to get the advantage of the club facilities for the advancement of the appellant's business and Mr. Pembroke considered that since they were not recoverable and no asset was acquired they were ordinary expenses of longer duration than the others. Moreover, although the admission fees were paid once and for all for the officers for whom they were paid they were recurring expenses so far as the appellant was concerned. I have already stated that admission fees for 5 officers were paid in 1952 and the evidence is that the amount of $1,200 thus paid in that year was about an average annual expenditure for admission fees.

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In my view, the payments for admission fees stand in the same position as those for annual membership dues. What I have said is subject to one slight adjustment. In respect of one of the amounts paid for admission fees there was a small item of $25 accruing to the appellant as a continuing share in the club and to that extent the amount paid is not deductible.

For the reasons given I find that the appellant, in computing its income for 1952, was entitled to deduct the sum of $9,527.29 which it had paid for club admission fees and annual dues, except for the sum of $25, and the assessment must be revised accordingly. The appeal herein must be allowed and the assessment referred back to the Minister for the necessary revision. The appellant is also entitled to costs.

Judgment accordingly.