1957

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Exchequer Court of Canada

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89518—4

JUDGES

OF THE

EXCHEQUER COURT OF CANADA

During the period of these Reports:

PRESIDENT:

THE HONOURABLE JOSEPH T. THORSON
(*Appointed October 6, 1942*)

PUISNE JUDGES:

THE HONOURABLE J. C. A. CAMERON
(*Appointed September 4, 1946*)

THE HONOURABLE JOHN DOHERTY KEARNEY
(*Appointed November 1, 1951*)

THE HONOURABLE ALPHONSE FOURNIER
(*Appointed June 12, 1953*)

THE HONOURABLE JACQUES DUMOULIN
(*Appointed December 1, 1955*)

THE HONOURABLE ARTHUR LOUIS THURLOW
(*Appointed August 29, 1956*)

DISTRICT JUDGES IN ADMIRALTY OF THE EXCHEQUER COURT OF CANADA

The Honourable FRED H. BARLOW, Ontario Admiralty District—appointed October 18, 1938.

The Honourable SIDNEY ALEXANDER SMITH, British Columbia Admiralty District—appointed January 2, 1942.

The Honourable W. ARTHUR I. ANGLIN, New Brunswick Admiralty District—appointed June 9, 1945.

His Honour HAROLD L. PALMER, Prince Edward Island Admiralty District—appointed August 3, 1948.

The Honourable Sir BRIAN DUNFIELD, Newfoundland Admiralty District—appointed May 9, 1949.

The Honourable HENRY ANDERSON WINTER, Newfoundland Admiralty District—appointed May 9, 1949.

The Honourable Sir ALBERT JOSEPH WALSH, Newfoundland Admiralty District—appointed September 13, 1949.

His Honour VINCENT JOSEPH POTTIER, Nova Scotia Admiralty District—appointed February 8, 1950.

The Honourable ARTHUR IVES SMITH, Quebec Admiralty District—appointed June 16, 1950.

The Honourable ESTEN KENNETH WILLIAMS, Manitoba Admiralty District—appointed February 26, 1952.

SURROGATE JUDGE IN ADMIRALTY OF THE EXCHEQUER COURT OF CANADA

ALFRED S. MARRIOTT, Q.C., Ontario Admiralty District—appointed February 21, 1957.

ATTORNEY-GENERAL OF CANADA:

The Honourable STUART S. GARSON, Q.C.
The Honourable EDMUND DAVIE FULTON, Q.C.

SOLICITOR GENERAL OF CANADA:

The Honourable W. ROSS MACDONALD, Q.C.
The Honourable LÉON BALCER, Q.C.

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CORRIGENDUM

At page 252 the word "equivocally" appearing in line 3 should read "unequivocally".

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CASES

DETERMINED BY THE

EXCHEQUER COURT OF CANADA

AT FIRST INSTANCE

AND

IN THE EXERCISE OF ITS APPELLATE JURISDICTION

BRITISH COLUMBIA ELECTRIC RAILWAY COMPANY LIMITED — APPELLANT;

AND

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

1956
Apr. 17, 18
1957
Jan. 15

Revenue—Income tax—Income Tax Act 1948, S. of C. 1948, c. 52, s. 12(1)(a) and (b)—Capital or income—"An outlay or expense . . . made or incurred . . . for the purpose of gaining or producing income . . ."—"An outlay, loss or replacement of capital . . ."—Appeal dismissed.

Appellant carried on business as a public utility for transportation of freight and passengers through certain municipalities situate in the Lower Fraser Valley of British Columbia. It also controlled a subsidiary company, B.C. Motor Transportation Ltd., operating as a motor carrier of passengers. Appellant's passenger service had been carried on for a number of years at a heavy annual loss. In 1950, permission was granted to appellant Company by the Public Utilities Commission to discontinue its passenger car service and B.C. Motor Transportation Limited was at the same time authorized to substitute its motor bus facilities against B.C. Electric Railway Co. paying a lump sum of $220,000 to the five municipalities concerned, this money being a contribution towards the improvement of their local roads.

B.C. Electric Railway wrote off this $220,000 contribution to operations over a 10-year period, deducting for the taxation years 1950 and 1951 from its gross income proportionate amounts of such amortization. These deductions were disallowed by the Minister of National Revenue and an appeal from that decision was taken to this Court.

Held: That the outlay made by the appellant Company was primarily expended for the purpose of putting an end to a continuing loss and not for the direct purpose of gaining or producing income within the meaning of the Income Tax Act.

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2. That the outlay made by appellant is a payment on account of capital within the meaning of *The Income Tax Act*, and, therefore, the appeal must be dismissed.

APPEAL under the Income Tax Act.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Vancouver.

John L. Farris, Q.C. and *W. H. Q. Cameron* for appellant.

K. E. Eaton for respondent.

DUMOULIN J.:—This appeal was heard at Vancouver, B.C., on the 17th and 18th of April, 1956.

The appellant objects, in respect of taxation years 1950 and 1951, to the disallowance of two items in the sums of $5,499.99 and $22,000, as deductions from gross revenue in computing its taxable income.

On April 13 last, the parties signed and filed an Agreed Statement of Facts, which simplified many of the points at issue and lent added conciseness to the respective and conflicting arguments of the litigants.

The pertinent facts may be set out as follows:

British Columbia Electric Railway Company Limited carries on business as a public utility for transportation of passengers and freight and has been in existence since 1897. It also controls a wholly-owned subsidiary called B.C. Motor Transportation Limited, operating in British Columbia as a motor carrier of passengers.

In 1907, another company, Vancouver Power, had concluded agreements with five British Columbia municipalities, all situate in the Lower Fraser Valley, viz.—Surrey, Langley, Matsqui, Sumas and Chilliwack, under which this Company "agreed to construct and operate a line of railway for the transportation of passengers and freight between the cities of New Westminster and Chilliwack . . ." (Agreed Statement of Facts, para. 4).

Vancouver Power extended the stipulated carrier accommodation to the public from 1910 to 1924, when it transferred its railway service to appellant who assumed the rights and obligations relating thereto.

Apparently this deal failed to fulfil appellant's expectations since it is admitted that "over a period of years prior

to 1950, the passenger revenue per annum, the number of passengers carried per annum and the revenue per passenger on the railway had declined substantially." (Statement of Facts, para. 7).

In 1950, ". . . it was estimated by the appellant that if bus service were substituted for rail service for the carriage of passengers in the Fraser Valley, an annual improvement in income of $65,702 could be achieved as follows:

Annual saving on railway passenger service		$ 167,440
Less railway passenger revenue .....$	82,495	
Less deficit from bus operations	19,243	
		101,738
Net annual improvement ..		$ 65,702"

The deficit in the cost of passenger service—"including a net fair return" of unrevealed percentage, was set at $309,094, whereas freight service netted a profit of $779,183, in 1949.

The Agreed Statement of Facts then points out (para. 12) that maintaining passenger service would entail immediately or almost "one of two classes of capital expenditures of major proportion." "If the line were to remain electrified, then (a) because the electric transmission voltage throughout the lower Fraser Valley was being changed over in the fall of 1950 from 34,000 to 60,000 volts; and (*b*) because of obsolescence in the electric substations built to serve the railway when it was originally constructed, capital expenditures of about $490,000 would have to be made on electric installations, and in addition some $200,000 would have to be spent on the replacement of passenger tram cars which had also been in operation since about the time the railway was constructed. The total would be approximately $690,000." The substitution of diesel equipment, if resorted to, would cost between $400,000 and $600,000. As a finishing touch to this more than sombre picture, no practical rate structure could be made to stabilize the operating costs of passenger service on the railway.

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Rail passenger service could not be abandoned without the authorization of the Public Utilities Commission of British Columbia, (called the P.U.C. for short). See the Public Utilities Act of British Columbia, R.S.B.R. 1948, chapter 277, particularly sections 7 and 20.

In 1949, the appellant sought to obtain permission from the P.U.C. to discontinue its passenger line "and at the same time caused its subordinate company, B.C. Motor, which already operated bus service on other routes in the Fraser Valley, to make a concurrent application for the right to operate in the five municipalities above referred to." This demand, of course, was contingent upon leave being granted to discontinue the unprofitable rail passenger service.

Both applications were heard jointly in March 1950 by the P.U.C., but met with strong opposition on the part of the five municipalities concerned, who argued that their roads were too narrow to allow a satisfactory bus service, and, in winter, liable to periodical closings.

These objections were eventually dispelled by means of negotiations; British Columbia Electric Railway undertaking to pay to the Districts of Surrey and Langley $50,000 each and again $40,000, respectively to the Matsqui, Sumas and Chilliwack Districts, making a sum total of $220,000.

These contributions towards the improvement of local roads were effected in 1950, with the consequent results that, on September 20 of that year, the P.U.C. issued an order, sanctioned by Order-in-Council (Ex. E), enabling appellant to discontinue its passenger railway service in the above named municipalities, substituting therefor B.C. Motor's bus transportation system. British Columbia Electric also agreed to resume *temporarily* passenger service on its line if autobus transportation were "cancelled for more than a short while" (Exhibit D).

It was then decided by the appellant company to write off to operations, over a ten year period approximately, the payments totalling $220,000. For the taxation year 1950, an amount of $5,499.99 was deducted accordingly, and a further sum of $22,000 was written off in 1951, but, as seen, were disallowed by the Minister of National Revenue.

The oral evidence consisted entirely in Mr. George Grainger Richardson's testimony, on appellant's behalf. This witness, a chartered accountant since 1927, belonging to the firm of Clarkson, Gordon & Company, periodically audits the appellant's books.

Mr. Richardson briefly outlined his professional belief that the $220,000 disbursed by the Company for the above mentioned purposes "should be deducted from profit over a certain period of years, and charged against income because made with a view of producing income", noting, however, that "he could point to no established precedent in text books for a specific payment comparable to the present one." It is Mr. Richardson's opinion that a correct application of accountancy principles would lead him to charge to income a payment made to get rid of an "onerous franchise" while any payment for a "new franchise" should be chargeable to capital. His final statement was that any payment producing an asset "which could not be capitalized properly, although made with a view of increasing income by reducing expenditure, should be imputed against income".

I am confronted with the oft-recurring complication of having to draw a dividing line between a capital outlay, therefore non-deductible from gross income, and an operational expenditure exempted from taxation if incurred for the purpose of gaining or producing income.

Both parties rely upon practically identical statutory provisions: the appellant on sections 4, 12(1)(*a*) and 12(1)(*b*) of the Income Tax Act, Statutes of Canada, 1948, Chapter 52; the respondent on the latter provisions of the Act plus sections 2 and 3.

The paramount clauses, needless to say, are subsections (1)(*a*) and (*b*) of section 12 which although of current knowledge may suffer repetition.

> 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,*

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Let us now examine the conflicting claims raised.

On May 5, 1955, the respondent confirmed his previous re-assessment "as having been made in accordance with the provisions of the Act and in particular on the ground that the amounts of $5,499.99 in 1950 and $22,000 in 1951, being parts of payments amounting to $220,000 made to five municipalities, were not outlays or expenses incurred by the taxpayer for the purpose of gaining or producing income within the meaning of paragraph (*a*) of subsection (1) of section 12 of the Act, but were capital outlays within the meaning of paragraph (*b*) of the said subsection (1) of section 12".

Appellant, on the other hand, attempts to rebut this interpretation by alleging that the payments or expenses concerned were of a revenue character, and especially intended to produce income by lessening the operating expenses. Basically the Company's franchise would not be "affected nor cancelled but merely altered or modified".

From a practical point of view what were originally the main objects and motives which eventually brought about this transaction? The severance of a deteriorating contractual tie, entailing heavy deficits, coupled with an attempt to escape the imminent obligation of incurring capital expenditures necessitated to increase the power line voltage; for substituting modernized electric substations for "obsolescent" ones, and to renew the Company's worn out rolling stock.

Regarding the three latter needs, had they been lived up to, as such, none would have challenged the true character of expenses incurred as being capital outlays, specifically within the taxing field of section 12(1)(*b*). It therefore remains that this matter, in its incipient stage at least, related, in a considerable degree, to taxable operations.

Regarding its primary objective: stopping the yearly outflow of funds occasioned by an unprofitable railway passenger service, British Columbia Electric bargained for and obtained, against due monetary consideration, its release from this serious predicament (*vide* Ex. D and E).

Of this the immediate consequence was not so much an "increase or production of income", though it could indirectly lead to such a result, as a reduction of an accruing

deficit susceptible, eventually, of being written off against capital reserves. For argument's sake, let us reverse the situation and suppose that in 1950-51 British Columbia Electric Railway had expended moneys in fitting up passenger service with a consequent profit instead of a $309,000 loss, *then* the requisite expense would primarily have been "incurred for the purpose of gaining or producing income from property or a business of the taxpayer".

To better illustrate this opinion, may I quote from Sir Lyman Duff C.J. in *The Montreal Light, Heat & Power Consolidated v. The Minister of National Revenue* (1):

> From a business point of view the main object of the transaction was to secure a reduction in the rate of interest and thereby, of course, to increase profits. Every one of these expenditures was part of the cost of borrowing capital from the lenders who took up the new issue of bonds, or of repaying the borrowed capital to the holders of the existing bonds; in other words, part of the cost of acquiring borrowed capital, or of repaying borrowed capital. Such expenses do not appear to me to come within section 6(*a*) as expenses incurred *in the process of earning the income, which is the test to be employed in the application of that subsection.*

The learned Chief Justice continues:

> Of course there is a sense in which, as a rule, all expenditure properly made by a joint stock company . . . may be said to be an expenditure incurred for the purpose of earning profits, *but the distinction between the expenditures made in the actual process of earning profits and other expenditures made on account of capital, or otherwise, is one which it is absolutely essential to maintain, if the Statute is to be workable.*

Still, at page 94, The Chief Justice cautions against any hard and fast rule when he approvingly cites Lord Justice Romer who, in *The European Investment Trust Co. Ltd. v. Jackson* (2), said that "the effect of the decisions mentioned is that the question in each case is a question of fact".

Previously, and in similar vein, Mr. Justice Maclean, then President of this Court, in the same affair of *Montreal Light, Heat & Power* (3), also had opined that

> It (the issuing of redeeming bonds and incidentals) did not increase the revenue but *it decreased the fixed capital charges of the business, and could not, therefore, have been incurred exclusively to earn the net profits or gains to be assessed.*

(1) [1942] S.C.R. 89 at 91. (2) 18 Tax Cases 1.
(3) [1941] Ex. C.R. 21 et seq.

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Here it may be in order to reproduce the appropriate section as it read in 1941 (R.S.C. 1927, c. 97, s. 6).

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.

The present text, prescribed by the Statutes of Canada, 1948, c. 52, s. 12(1)(*a*), has suppressed the apparently stringent adverbs, without appreciably altering the meaning and aim of the law, as will be sensed by comparing its former and latter wordings.

I would now quote at some length from Lord MacMillan's notes, again in the *Montreal Light, Heat & Power v. Minister of National Revenue* (1). In those three excerpts, the nice distinction between outlays with income producing intent and payments on account of capital is thoroughly elaborated. His Lordship wrote at page 133:

It is important to attend precisely to the language of s. 6. If the expenditure sought to be deducted is not for the purpose of earning the income, and wholly, exclusively and necessarily for that purpose, then it is disallowed as a deduction. If the expenditure is a payment on account of capital it is also disallowed.

Regarding the statutory criterion, Lord MacMillan is of opinion (p. 133, *in fine*) that

Expenditure, to be deductible, *must be directly related to the earning of income.* The earnings of a trader are the product of the trading operations which he conducts.

These operations involve outgoings as well as receipts, and the net profit or gain which the trader earns is the balance of his trade receipts over his trade outgoings. It is not the business of either of the appellants to engage in financial operations. The nature of their businesses is sufficiently indicated by their titles. It is to those businesses that they look for their earnings . . . their financial arrangements are quite distinct from the activities by which they earn their income. No doubt, the way in which they finance their businesses will, or may, reflect itself favourably or unfavourably in their annual accounts, but expenditure incurred in relation to the financing of their businesses is not in their Lordships' opinion, expenditure incurred in the earning of their income within the statutory meaning.

Some twenty-five lines further down, at page 134, we find that:

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 businesses, and the benefit which they derived was not earned by them in their businesses.*

(1) [1944] A.C. 126.

It should be said of the actual appellant company that "the businesses it looks to for its earnings" cannot consist in a curtailment of its franchise—a capital asset if ever there was one,—through buying off the opposition manifested by five municipalities. And again, assuredly,: "in the history of . . . (British Columbia Electric Ry.), this financial readjustment, (for such it was to all practical intents), . . . was an isolated episode, unconnected with the day to day conduct of its businesses, and the benefit derived was not earned in the course of its business." Abating a loss, such as the present one, doubtless bears a collateral relationship to possible profit-making, but it is not, as would be essential, its parent in the direct line (*si ita dicere licet*).

At trial, the gist of the arguments, regarding the accurate analysis of this compromise, was on appellant's behalf, that "basically the Company's franchise is neither annulled nor cancelled but altered or modified, nothing but a change in the mode of operation"; to which respondent retorted that relief from passenger service liability "amounted to an abandonment of a portion of the Company's charter, a cancellation of the railway passenger service".

The Public Utilities Commission's order of discontinuance (Exhibit E), December 20, 1950, certainly brought about more than "a change in the mode of operation", since the Company, thereafter, waived its right, and completely ceased to operate the passenger line, if one keeps in mind that B.C. Motor Transportation Limited is, at law, a totally distinct entity, operating, moreover, a different "mode" of transportation.

Neither can I derive much weight from the claim that we would have here a mere alteration or modification of the franchise.

Etymologically, "altering", if not a radical transformation, is, at the least, a partial change. In the present instance, altering the charter undeniably worked a material change in one of those component obligations pertaining to the essence of corporate existence.

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I am strongly impelled to hold that an outlay of $220,000, under the known circumstances, was not expended for the purpose, primarily, "of gaining or producing income" within the statutory meaning.

In his reply, counsel for the appellant argued that "the permission granted to abandon passenger service may at any time be revoked and annulled", quoting sections 120 of the Public Utilities Act (1948 Statutes of British Columbia, c. 277) and 3 of Exhibit E.

Once more, I feel unable to share this opinion. Section 120 simply purports that "The powers vested in the Commission by this Act shall apply notwithstanding that the subject-matter in respect of which the powers are exercisable is the subject-matter of any agreement or Statute . . . ", while clause 3 of the Order (Ex. E—Dec. 20, 1950) provides for the maintenance of passenger car service pending the improvement of municipal roads, and also that British Columbia Electric Ry. . . . "shall, as an emergency measure, whenever bus service is cancelled for more than a short while, operate them, i.e. passenger cars, by means of a diesel locomotive to restore rail passenger service temporarily . . ."

Such texts hardly support a claim that the P.U.C. order "may, at any time, be revoked or annulled"; particularly in view of the fact that its article 2 expressly sets out the schedule of indemnities to be paid as a prerequisite condition. Surely so onerous an undertaking is not open to any arbitrary abrogation.

Reverting anew to the Supreme Court's decision in *Montreal Light, Heat & Power Consolidated v. The Minister of National Revenue* (*supra*), it seems of interest to cite the following lines from Davis J.'s notes (p. 105):

> Once the practical necessity appears for amortization over a period of years of any large expenditure actually incurred in a particular taxation year, the real character of the expenditure emerges as something quite different from those ordinary annual expenditures which fall naturally into the category of income disbursements.

Spreading over a period of ten years, on a strictly amortization scale, a disbursement of this kind, in my mind, imparts added plausibility to its being a capital expenditure.

The decision in *Anglo-Persian Oil v. Dale* (*Inspector of Taxes*) (1) was frequently relied upon by the appellant as a clear instance of amortized payments which, nevertheless, were held to be of a revenue character and deductible by the latter company in ascertaining its net profits.

It could well be that any similitude between that and the present case would reach no deeper than a superficial level as briefly analysing the facts may show.

In 1914, Anglo-Persian Oil Company entered into an agreement with S.S. & Co. under which the latter were appointed agents of the company to manage its business in Persia and the East for a term of ten years. The remuneration having proved larger and more onerous than had been anticipated by the Company, the Company determined to bring the agency to an end, and thenceforth to do their own agency work in the East. Accordingly in 1922 the Company entered into an agreement with S.S. & Co. by which it was agreed that "the agency should be terminated . . . while in return the Company should pay S.S. & Co. 300,000 pounds". This huge forfeit . . . "was treated in the Company's accounts as a revenue payment, and was (successfully) charged to revenue in instalments of 60,000 pounds for five years".

A material difference between that case and the present one becomes immediately apparent. To buy out S.S. & Co. Anglo-Persian Oil did not need to "alter or modify" their Letters Patent or Act of Incorporation. Neither were they, in so doing, changing their "charter" powers, but only changing their agent, something quite different. No public authority, such as the P.U.C. was required to sanction this purely bilateral deal. Hence, it would appear to follow that the amortization factor, in Anglo-Persian Oil, lends but a rather pale and insignificant colour to the subject-matter.

British Columbia Electric Railway also focussed its transaction in the light of a re-arrangement of affairs, reducing yearly expenses, but which failed to bring any new asset into existence.

Even this submission seems doubtful, since one might argue that, in 1950, the Agreement (Exhibit D) and corresponding P.U.C. order (Exhibit E) indirectly brought an

(1) [1932] 1 K.B.D. 124, 146.

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"asset" into functional being, namely, the B.C. Motor Transportation Limited, the appellant's subsidiary, whose gains were expected to relieve appellant's gross income to the tune of $65,702 annually, reducing, *pro tanto*, the operating deficit.

A litigation somewhat more in line with our case than *Anglo Persian Oil* is that of *Countess of Warwick Steamship Company v. Ogg* (1), where a company contracted for the construction of a ship and paid down 30,000 pounds. Subsequently, the contract was cancelled on payment of an additional 30,000 pounds. Held: "that the whole 60,000 pounds (to get rid of an onerous contract) was capital outlay".

Finally, I will cite two other precedents, those of *Vallambrosa Rubber Company v. Farmer* (2) and *British Insulated & Helsby Cables v. Atherton* (3).

In the first of these two cases, Lord Dunedin, President of the Court of Sessions, wrote (p. 525):

> . . . in a rough way I think it is not a bad criterion of what is capital expenditure, as against what is income expenditure, to say that capital expenditure is a thing that is going to be spent once and for all, and income expenditure is a thing that is going to recur every year. . . .

Viscount Cave, L.C., in *British Insulated & Helsby Cables v. Atherton* (*supra*), approvingly mentioned this opinion (p. 213, *in fine*):

> . . . when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or *an advantage* for the enduring benefit of a trade, I think that there is very good reason, in the absence of special circumstances leading to an opposite conclusion, for treating such an expenditure as properly attributable not to revenue but to capital. For this view there is already considerable authority.

Perhaps a last but ancillary question remains to be disposed of: the relative interplay of accountancy principles, which can be attended to by way of a reference to Shaw and Baker's work on *The Law of Income Tax* at page 147:

> The profits are to be arrived at on ordinary commercial principles, subject to such provisions as require a departure from such ordinary principles, e.g., the prohibition of certain deductions.

(1) [1924] 2 K.B. 292. (2) [1909-10] S.C. 519; 5 Tax Cases, 529, 536.
(3) [1926] A.C. 205.

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At page 183:

The general rule as regards trade expenses is that a deduction is permissible which is justifiable on business and accountancy principles; but this rule is affected by certain specific statutory provisions. To the extent (but to that extent only) that ordinary business and accountancy principles are not invaded by statute, they prevail.

Accountancy rules to the contrary, if such they be, I must persist in my belief that the outlay of $220,000 incurred by the appellant in 1950 was "a payment on account of capital" within the statutory meaning of Chapter 52 of the Statutes of Canada, 1948, section 12(1)(*b*), and properly assessable.

Therefore, I hold that the tax payable by the appellant for its 1950-1951 taxation years having been lawfully and correctly assessed, this appeal of the appellant from its 1950-1951 income tax assessment should be dismissed with costs.

Numerous other authorities were examined, but are not inserted here because they either would be deemed repetitious or inapplicable.

Judgment accordingly.

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May 26, 27, 28

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Jan. 25

SCULLY SIGNAL COMPANY .....PLAINTIFF;

AND

YORK MACHINE COMPANY LIMITED DEFENDANT.

Patent—Infringement—Disclosure—Mechanical equivalents doctrine, application of—The Patent Act, 1935, S. of C. 1935, c. 32, s. 35.

Plaintiff sued for infringement of its patent for a device whose purpose was to provide an audible signal for a fuel tank or the like continuously operable until the liquid level in the tank reached a predetermined point. The specification made reference to a dependent tube which projected downward into the tank. A whistle connected to the upper end of the tube provided the audible signal. Claiming clause 9 referred to "means providing a second vent passage of smaller capacity and an audible signal arranged to be sounded by gaseous fluid escaping through the said smaller vent passage. . . ."

The defendant, whose device made use of a whistle controlled by a float and plunger, but not of a dependent tube, pleaded non-infringement, insufficiency as to claiming clause 9, and anticipation.

As to the plea of insufficiency, the plaintiff relied solely on claiming clause 9 and submitted the claim was broadly drawn, the phrases in question referred not to the tube but to openings in the whistle and

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that, in any event, the tube was not an essential part of its invention. It also claimed that use of the float and plunger achieved the same result as the tube and was therefore a mechanical equivalent.

Held: That the subject matter of the plaintiff's invention as disclosed in the whole specification related only to a device in which the dependent tube was an essential part. The doctrine of mechanical equivalents had therefore no application and, in any event, the defendant's device was not the mechanical equivalent of the plaintiff's dependent tube. *Marconi v. British Radio Telegraph and Telephone Co. Ltd.*, 28 R.P.C. 181 at 217; *R.C.A. Photophone Ld. v. Gaumont-British Picture Corpn. Ld.*, 53 R.P.C. 167 at 197; *J. K. Smit & Sons Inc. v. McClintock*, [1940] S.C.R. 279 at 285.

2. That the phrases "means providing for a second vent passage of smaller capacity" and "an audible signal arranged to be sounded by a gaseous fluid escaping through the smaller vent passage", mean the dependent tube and not the openings in the whistle.

ACTION for infringement of patent.

The action was tried before the Honourable Mr. Justice Cameron at Toronto.

Christopher Robinson, Q.C. and *Roy Saffrey* for plaintiff.

Gareth E. Maybee, Q.C. and *J. A. Legris* for defendant.

CAMERON J.:—This is an action brought by one company against another for the infringement of a Canadian patent No. 378571 (issued on December 27, 1938) which it will be convenient to refer to hereinafter as Mathey's Patent—Alcide E. Mathey, the inventor, having assigned his rights therein to the plaintiff. The plaintiff—an incorporated company having its head office at Cambridge, Massachusetts—claims a declaration that as between the parties the patent is valid and has been infringed by the defendant, an injunction, damages, and the usual claim for delivery up or destruction of articles in the possession of the defendant made in infringement of the said patent.

The defendant is a company having its head office in Ontario. It admits that the title to the Letters Patent is in the plaintiff. A large number of defences were raised in the Statement of Defence and in the Particulars of Objections, but at the trial counsel narrowed his case to three specific matters: (1) non-infringement; (2) that the claiming clause 9 on which the plaintiff relies is ambiguous and bad on the ground of insufficiency; and (3) that the claim is not new but was anticipated by prior inventions.

Mathey's patent is a signal device known as a Liquid Level Indicator and is more particularly designed for indicating the liquid level in a fuel tank or the like, normally closed except for the provision of filling and vent openings. The purpose of the invention is to provide an audible signal for such a tank which shall be continuously operable until the liquid level in the tank has reached a predetermined point and which thereafter will cease to function. The device is called a "Ventalarm."

One of the uses to which the device has been applied—and there are many others—is in connection with the filling of fuel oil tanks in residences and buildings. Before turning to a precise description of the device itself, it will be helpful, I think, to describe briefly the use to which it is put when used on such tanks. The pipes which are used to fuel and vent the fuel oil tank are, of course, outside the building. The tank itself, being in the basement, is not readily observable by the tank wagon operator and in the absence of a suitable warning device, the operator or an assistant would be required to enter the building to measure the amount of oil remaining in the tank, ascertain how much could be safely added, and give warning when the tank was filled so as to prevent spillage if the tank were filled beyond its capacity. As stated in the specification, "it is desirable to provide simple and efficient means, inasmuch as the tank is not readily observable, by virtue of which the admission of a predetermined level in the tank may be determined by the operator from the outside. In the plaintiff's device this is accomplished through the provision of an audible signal device—a whistle—which commences to operate as soon as fuel enters the tank and is continually operable as the level rises, until the latter reaches a point predetermined by the extension of a pipe or tube into the tank. Thereafter, the audible signal is stilled by trapping of the lower end of the tube through the rising liquid level. The increased pressure due to continued filling of the tank is conveniently vented by a relief valve operable upon pressure exceeding predetermined levels."

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In describing the device itself and the precise manner in which it operates, I shall use the language of the specification itself.

In the illustrated embodiment of the invention, the usual vent pipe is disconnected from the vent opening, and a casing is threaded thereinto at its lower end and connected with the vent pipe. This casing has a vent opening of ample size for the requirements of the tank, and may be provided with a seat which is normally engaged by a generally spherical valve member. This spherical valve member is connected to a dependent tube which projects downwardly into the tank a predetermined distance, the valve supporting the tube in predetermined position during normal operation. The upper end of the tube is connected with a whistle, which, as shown, is located within the valve. If desired, the space between the whistle and valve may be filled with solder to impart greater weight to the assembly and aid in the retention of the valve on its seat.

In the ordinary operation of the device, as liquid is caused to enter the tank through the filler pipe the gas and/or vapor under pressure is driven out through the tube and thence through the whistle, creating a constant audible alarm. This continues until the liquid level has risen to a point where the lower end of the tube is trapped. Thereafter further escape of vapors from the upper portion of the tank through the tube is prevented and the whistle ceases.

During the preliminary filling up to the given level the valve normally rests upon the seat and causes substantially all of the vapor to pass through the whistle or signal device. If the pressure due to rapid filling, however, exceeds a predetermined amount, the entire tube assembly will be elevated from its seat and permit some of the vapors to be bypassed about the signal device. If after trapping of the lower end of the tube the filling is also continued the upper portion of the tank may be also vented in this same manner by elevation of the assembly from its seat. It will thus be seen that the relief valve serves the dual function of venting against excessive pressure until the predetermined level is reached, and thereafter relieving pressure if continued filling of the upper part of the tank is carried on. It will be also observed that as this type of tank is more frequently than not round or oval in cross-section, the location of the vent is not always such that the pendant tube will hang vertically, and the employment of the generally spherical valve permits the tube to assume a natural position without the necessity of guides or other means, and insures the operation of the signal device and the operation of the relief vent without danger of the valve binding or otherwise becoming constricted or failing to properly seat.

The defendant's device which allegedly infringes the plaintiff's patent is called the York Vent Signal. Like the plaintiff's device it is also a liquid level indicator designed for indicating the liquid level in a fuel tank, or the like, which is normally closed except for the provision of fill and vent openings. Likewise, its purpose is to provide an audible signal for such a tank which shall be continuously

operable until the liquid level in the tank has reached a predetermined point and which thereafter will cease to function.

Ex. No. 3 is a sample of the defendant's device. It also comprises a casing which is threaded into the top of the tank, the vent pipe being connected with its upper portion; and when installed the major portion of the casing is below the top of the tank. The casing is hollow and of ample size for the requirements of the tank. It is provided with a seat which is normally engaged by a generally spherical member and centrally located therein is a whistle of much the same type as in the plaintiff's device. The whistle is of the conventional type used for that purpose and centrally located therein are the two usual small openings. As liquid enters the tank through the filler pipe, the gas or vapour under pressure is driven upward through the openings in the whistle, creating a constant audible alarm. During the preliminary filling up to the given level, the valve and its whistle rest upon the seat of the casing due to their weight and to the weight of the rod and float attached thereto, and thereby substantially all of the gas or vapour is caused to pass through the whistle or signal device. It is obvious, I think, that if the pressure due to rapid filling exceeds a predetermined amount, the entire valve assembly with its whistle, and the dependent rod and cork, will be elevated from the valve seat and permit some of the vapours to be by-passed about the signal device. It will be noted particularly that in the defendant's device the vented gas goes from the tank directly to the openings in the whistle and is not led thereto by a dependent tube.

In the defendant's device, means are also provided for causing the whistle to cease when the liquid in the tank has risen to a predetermined level. This is accomplished by means of a cork suspended below the level of the casing by a rod or plunger. When the liquid in the tank rises to the level of the cork, the latter floats, and as more liquid is added the cork rises, carrying upwards with it the rod on which it is suspended. The rod moves upwards through the apertures in the lower part of the casing and through the aperture in the lower part of the valve (the valve in the meantime remaining in the seat of the casing) until

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its upper portion completely covers the lower opening in the whistle, whereupon the whistle ceases. If thereafter filling is continued, the cork and rod will continue to rise, carrying with them the valve assembly, and in this manner the upper portion of the tank is also vented by elevation of the valve assembly from its seat.

It will be seen, therefore, that the devices of both plaintiff and defendant are combined signal and relief valves, that they comprise a casing, a vent designed to relieve the normal pressure in the tank when being filled, which normal venting is so designed as to provide a continuously audible whistle while the tank is being filled, means by which the whistle ceases when the tank has reached its predetermined level, and also a vent designed to provide for the venting of gas or vapour when the pressure in the tank is excessive due to rapid filling, and also from the top of the tank after the predetermined level of the liquid has been reached if filling continues thereafter.

The essential differences between the two devices are that in the plaintiff's the normal venting is carried to the whistle through the dependent tube and the audible signal ceases when the opening in the lower end of the tube is trapped by the rising liquid; while in the defendant's device there is no dependent tube, the normal venting is carried directly to the openings in the whistle and the audible signal ceases when the upper end of the rod supporting the cork is raised so as to close the vent opening in the whistle.

It will be convenient to consider first the defence of non-infringement.

Now the plaintiff relies solely on claiming clause 9 of the Letters Patent, which is as follows:

In combination with a closed tank for the reception of fluid, a supply conduit leading into the tank, and a combined signal and vent device comprising a casing fixed in an opening in the upper portion of the tank, said casing having therethrough a vent passage of large capacity open at one end into the interior of the tank and open at its other end externally of the tank, a valve normally closing said passage, said valve being constructed and arranged automatically to open and vent the tank in response to abnormal pressure within the tank, *means providing a second vent passage of smaller capacity, and an audible signal arranged to be sounded by gaseous fluid escaping through said smaller vent passage, the smaller vent passage and whistle being of such capacity as to vent the tank under normal filling conditions without unduly increasing the pressure in the tank.*

Now what does that claim mean? I find it necessary to consider only the latter part of the claim which I have italicized, there being no dispute or uncertainty as to the meaning of the former part. Counsel for the plaintiff says that the claim is broadly drawn. He contends that the phrases "second vent passage of smaller capacity" and "the smaller vent passage" refer not to the "dependent tube" which I have mentioned above, but to the two small openings in the whistle; he says also that Claim 9 does not include any reference to a dependent tube. The effect of the interpretation so put forward on behalf of the plaintiff (if accepted) is to advance a claim to a monopoly for a device which does not include a dependent tube. If the plaintiff is entitled to a monopoly for such a claim, then, if one disregards for the moment any consideration as to the defendant's method of stopping the whistle by the use of a float, the devices of the plaintiff and defendant in principle would be almost identical and would achieve the same results.

Counsel for the defendant submits on the other hand that neither the claim itself nor the specification read as a whole permit of that interpretation, but that when the claim is properly read it includes the dependent tube and that such tube is an essential integer of the combination which Mathey invented and disclosed. I agree with that submission.

The duties of disclosure required of an inventor in consideration for the grant of a valid monopoly in respect of his invention are found in s. 35 of *The Patent Act*, 1935, the relevant portions of which are as follows:

35. (1) The applicant shall in the specification correctly and fully describe the invention and its operation or use as contemplated by the inventor, and set forth clearly the various steps in a process, or the method of constructing, making, compounding or using a machine, manufacture or composition of matter, in such full, clear, concise and exact terms as to enable any person skilled in the art or science to which it appertains, or with which it is most closely connected, to make, construct, compound or use it. In the case of a machine he shall explain the principle thereof and the best mode in which he has contemplated the application of that principle. In the case of a process he shall explain the necessary sequence, if any, of the various steps, so as to distinguish the invention from other inventions. He shall particularly indicate and distinctly claim the part, improvement or combination which he claims as his invention.

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(2) The specification shall end with a claim or claims stating distinctly and in explicit terms the things or combinations which the applicant regards as new and in which he claims an exclusive property or privilege . . .

In the case of *Minerals Separation North American Corp. v. Noranda Mines Ltd.* (1), Thorson P. in referring to such duties said: "The description of the invention must also be full; this means that its ambit must be defined, *for nothing that has not been described may be validly claimed.*"

I have recited above the essential parts of the disclosure and it is not necessary to repeat them in full. It is sufficient to say that in my opinion the only invention disclosed by the specification is one in which the dependent tube is an essential part. The specification says this: "According to the present invention, this (i.e., the manner in which the attainment of a predetermined level in the tank may be determined by the operator from the outside) is accomplished through the provision of an audible signal device which is continuously operable as level rises until the latter reaches a point predetermined *by the extension of a pipe or tube into the tank.* Thereafter, the audible signal is stilled *by trapping of the lower end of the tube through the rising liquid level.*" Later it recites: "This (i.e., the audible alarm) continues until the liquid level indicated at 40 has risen to a point *where the lower end of the tube 30 is trapped.* Thereafter, further escape of vapours from the upper portion of the tank *through the tube 30* is prevented and the whistle ceases."

There is no suggestion in the disclosure that the dependent tube may be dispensed with, that any other equivalent may be substituted for it, or that the cessation of the whistle may be accomplished by the oil entering the passages in the whistle itself. The specification, however, does say that there is a pipe or tube and that it extends into the tank. In the drawings attached to the specification, Fig. 1 represents a section in elevation of a conventional tank equipped with the plaintiff's device—a ventalarm which has actually been put into use; and Fig. 2 illustrates a modified form of the same type of device. Both include the dependent tube. In Fig. 2 the whistle is at the bottom

(1) [1947] Ex. C.R. 306 at 316.

of the tube which projects downward into the tank and the vent thereon, which is designed to relieve unusual pressure, is situated on the tube above the whistle but of necessity within the tank itself.

Nor am I able to find that Claim 9, whether read by itself or with the disclosure, is a claim for the device without the dependent tube. I agree with the submission of counsel for the defendant that the phrases "means providing for a second vent passage of smaller capacity" and "an audible signal arranged to be sounded by a gaseous fluid escaping through said smaller vent passage," mean the dependent tube and not the openings in the whistle itself. I find further support for that opinion in the fact that in the next phrase in the claim, "the smaller vent passage and whistle being of such capacity as to vent the tube", reference is made to two things, namely, "the smaller vent passage" *and* to the "whistle."

Counsel for the plaintiff submits, however, that the dependent tube is not an essential part of the invention, but merely an addition thereto. He points to the fact that its dimensions are not given, that its length is purely a matter of choice under given circumstances and that it may be reduced or extended in length as may be decided, according to whether it is desired to completely fill the tank or stop the filling at a lower level—and that is so. Some evidence was introduced which suggested that the device might operate successfully without any tube, but no one with a complete knowledge of the facts could say that he had ever seen it operated successfully. It is a significant fact that while the plaintiff company made tests of its device without a dependent tube, all those manufactured and sold—about 3,500,000 in all, including about 300,000 in Canada—were equipped with the dependent tube.

Mr. W. K. Phillips, Manager of the Customers' Service Department of the Oil Heating Division of Sherwood Brothers, Inc., of Baltimore, Maryland, gave evidence as to the very extensive use by his firm of the plaintiff's "Ventalarm" and its many advantages over other devices. He stated that the elimination of the dependent tube would in his opinion make no difference in the operation of the

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signal and that if given his choice he would prefer the whistle without the tube. In cross-examination, however, it became apparent that while he was present at a test made by his company at which he was informed that the dependent tube had been eliminated entirely (he seems to have reached the conclusion that it functioned satisfactorily), he had not in fact seen the actual "Ventalarm" which was then used and had no personal knowledge as to whether there was, in fact, a dependent tube of some length. He did not even know the purpose of the experiment. It was apparent that he was not very familiar with the manner in which the "Ventalarm" is normally installed. He said that his company had issued instructions that the dependent tube—or "stub" as he calls it—should be cut to a length of $2\frac{1}{2}$ inches for flat tanks, and $3\frac{1}{2}$ inches for upright tanks, but he could not say whether the lower end of the tube when so cut would be the specified distance below the casing, below the valve or below the whistle. His opinion, therefore, that the signal would operate as successfully without any dependent tube as with a tube, is of no value and it is significant that all the signals installed by his company are equipped with a dependent tube.

Mr. Scully, President of the plaintiff company, said that his company advised users of the "Ventalarm" to use a dependent tube of such length as would ensure that when its lower end was trapped by the oil, there would still be space in the tank for about 15 gallons. He said that some users might cut it off at the bottom of the casing, but that "they would not go up in there", meaning within the casing itself; and by that I think he could mean only one thing, namely, that the tube could not be completely eliminated from the device if satisfactory results were to be obtained.

Indeed, it is obvious on the evidence that the "Ventalarm" would not be successful without a dependent tube of some length. From an examination of Ex. 4 and from the evidence, it is apparent that the whistle is within the casing and entirely above the top of the tank. That being so, the whistle itself would not be trapped by the oil until the tank had been filled to capacity. If the whistle ceased only then, the oil remaining in the fuel line would be forced

into the vent pipe even if the operator at the tank wagon were able to shut off the supply immediately, which in all likelihood he could not do. Moreover, the evidence points strongly to the undesirability of filling the tank to the point where the valve member (which includes the whistle) would be submerged in oil and to the desirability of causing the whistle to cease at some distance below the tank level so as to avoid spillage and possibly make provision for some expansion.

My conclusion on this point, therefore, is that Claim 9 is a claim for a device which includes the dependent tube referred to in the disclosure and as shown in the drawings forming part thereof.

For the reasons stated, I also find that the dependent tube forms an essential part of the combination which Mathey invented. I state that conclusion because of the effect it may have on the next question to be considered, namely, does the defendant's device infringe that claim?

As I have stated above, the essential difference between the devices of the plaintiff and defendant is that in the case of the "Ventalarm," a dependent tube is used for the dual purpose of leading the air or gas direct to the whistle to produce a constantly audible signal, and to provide means by which the signal is stopped when the oil in the tank traps the lower end of the tube; whereas the defendant's device has no dependent tube (the air under normal pressure going directly to the whistle) and the means used for causing the signal to cease is a float and plunger functioning in the manner which I have stated. It is submitted on behalf of the plaintiff that the use of the float and plunger accomplishes the same result as the dependent tube, namely, to cause the whistle to cease, and is therefore a mechanical equivalent.

The problem of infringement by mechanical equivalents is referred to in Terrell and Shelley on Patents, Ninth Edition, at p. 148. The authors refer to *Marconi v. British Radio Telegraph and Telephone Co. Ltd* (1), where Parker, J. said:

> It is a well-known rule of Patent law that no one who borrows the substance of a patented invention can escape the consequences of infringement by making immaterial variations. From this point of view, the

(1) (1911) 28 R.P.C. 181 at 217.

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question is whether the infringing apparatus is substantially the same as the apparatus said to have been infringed . . . where the Patent is for a combination of parts or a process, and the combination or process, besides being itself new, produces new and useful results; everyone who produces the same results by using the essential parts of the combination or process is an infringer, even though he has, in fact, altered the combination or process by omitting some unessential part or step and substituting another part or step, which is, in fact, equivalent to the part or step he has omitted . . . If that part of the combination, or that step in the process for which an equivalent has been substituted, be the essential feature, or one of the essential features, then there is no room for the doctrine of equivalents.

Later, in *R.C.A. Photophone Ltd. v. Gaumont-British Picture Corpn Ltd. et al.* (1), Romer L.J. approved of the principle so laid down by Parker J. in the *Marconi* case, and continued:

The word in this passage to which I should like to call particular attention is the word "unessential". It is only in respect of unessential parts of an invention to which the principle of mechanical equivalent can be applied. The principle is, indeed, no more than a particular application of the more general principle that a person who takes what in the familiar, though oddly mixed metaphor is called the pith and marrow of the invention is an infringer. If he takes the pith and marrow of the invention he commits an infringement even though he omits an unessential part. So, too, he commits an infringement if, instead of omitting an unessential part, he substitutes for that part a mechanical equivalent. But it is not the province of the Court to guess what is or what is not the essence of the invention; that is a matter to be determined on an examination of the language used by the patentee in formulating his claims. In the case of *Submarine Signal Co. v. Henry Hughes & Sons, Ld.*, (1931) 49 R.P.C. 149, I thought that the patentee had clearly indicated that an electric oscillator was an essential feature of the invention described in his eleventh claim. I consequently held that the defendant, who had not used an electric oscillator, but something that might properly be described as mechanical equivalent of it, had not infringed. Further reflection has not caused me to change the view that I then expressed. The patentee in that case had made the electric oscillator part of the pith and marrow of his invention and the principle of mechanical equivalent was inapplicable.

Reference may also be made to *J. K. Smit & Sons Inc. v. McClintock* (2).

Some reference was made to *Electrolier Manufacturing Co. Ltd. v. Dominion Manufacturers Limited* (3), but I do not think that case is helpful to the plaintiff. There Rinfret, J. (now C.J.C.), speaking for the full Court, said at p. 443:

What the appellant did—and in that his infringement truly consists—was to take the idea which formed the real subject-matter of the invention. It does not matter whether he also adopted the substitution of the two

(1) (1936) 53 R.P.C. 167 at 197. (2) [1940] S.C.R. 279 at 285.
(3) [1934] S.C.R. 436.

holes for the bar in the pivoting means. The precise form of these means was immaterial. In the language of the patent, they could be changed "without departing from the spirit of the invention".

That is the essential distinction which must be made between this case and those of *The P. & M. Company v. Canada Machinery Corporation Limited* (1), and of (2) *Gillette Safety Razor Company of Canada, Limited v. Pal Blade Corporation, Limited,* relied on by the appellant. In the *P. & M.* case, the appellant's invention was one of mechanical detail. It was held that the use of a different method not embodying the specified mechanical contrivance did not fall within the ambit of the claims. In the *Gillette* case, the patentee had claimed the blade as a subordinate invention in addition to the main or principal invention consisting in the complete safety razor. The subject-matter, if any, of the subordinate invention was found to consist in the particular form and position of the holes in the blade; and it was held no infringement to have punched in a razor blade holes of a different form and in a different position. In such cases, so it was decided, the patentee must make plain the metes and bounds of his invention, and he will be held strictly to the thing in which he has claimed an exclusive property and privilege. In both cases, it was found there was no infringement because the alleged infringing article was not the precise mechanism claimed for by the patentee. In this case, the situation is entirely different. Assuming, but not admitting, that the pivoting means used by the appellant are not precisely and exactly covered by the claims of the patent, the article placed on the market by the appellant embodies the principle itself of Pahlow's invention. The appellant has taken that which constitutes the patentable article in Pahlow's disclosure. Both handles are in all material respects the same.

The appellant's counsel was able to point to only three differences:

(*a*) the substitution of the holes for the pivot bar, and that has already been discussed.

(*b*) the dependent lug on the bendable finger; and that is not mentioned in claim 1, so that, at all events, it would not affect the question of infringement.

(*c*) the shoulder or transverse rib on the top and near the upper end of the grip; and that is given only as optional in the specification. It is an immaterial part of the mechanism.

At best, the appellant has borrowed the essence of the patented structure with a small variation in its unimportant features or its non-essential elements; and we would say, as Lord Davey, in *Consolidated Car Heating Company v. Came* (3), that, according to any fair interpretation of the language of the specification, he has taken, in substance, the pith and marrow of the invention, with all its essential and characteristic features, except in details which could be varied without detriment to the successful working of it. There is no difference in the main elements of the two structures. There is no difference in the operation. Both perform the same function in the same way. Above all, "the spirit of the invention" was infringed.

In that case it was found that the defendant's device had infringed that of the plaintiff. But it is most apparent that the precise forms of the means set out in the plaintiff's

(1) [1926] S.C.R. 105. (2) [1933] S.C.R. 142.
(3) [1903] A.C. 509 at 515, 517, 518.

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patent were immaterial, the patent itself stating that they could be changed "without departing from the spirit of the invention." In the instant case nothing of that sort is to be found. I am of the opinion that the subject-matter of the invention made by Mathey as disclosed in the whole specification, related only to a device in which the dependent tube was an integral and essential part. The doctrine of mechanical equivalency has therefore no application in this case.

From what I have said above, it is apparent also that there is a substantial difference in one of the main elements of the two structures as well as a difference in their operation. While the "dependent tube" and the "cork and plunger" may achieve substantially the same result—namely, to cause the whistle to cease—they do not perform that function in the same way. For that reason, I am of the opinion that in any event the defendant's cork and plunger is not the mechanical equivalent of the plaintiff's dependent tube.

Reference may usefully be made to *Hosiers Ltd v. Penman Ltd.* (1) and to *J. K. Smit and Sons, Inc. v. McClintock* (2).

For the reasons which I have given, I have come to the conclusion that the plaintiff has failed to establish that the defendant's device infringes its patent. It will not be necessary, therefore, to consider any of the other defences raised.

The action will therefore be dismissed with costs to be taxed.

Judgment accordingly.

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(1) [1925] Ex. C.R. 93 at 100. (2) [1939] Ex. C.R. 121 at 126.

GEORGES DAURAY .....SUPPLIANT;

AND

HER MAJESTY THE QUEEN .....RESPONDENT.

1956
May 29
1957
Jan. 16

Revenue—Customs—Seizure—Forfeiture—Motor car used to guide another laden with smuggled goods—Whether seizure and forfeiture of pilot car valid under s. 181(1) of Customs Act—The Customs Act, R.S.C. 1952, c. 58, ss. 158-166, 181(1), (2).

The suppliant sought by Petition of Right to set aside the decision of the Minister of National Revenue, made under s. 161 of the *Customs Act*, that suppliant's motor car be forfeited. The Petition declared that the car had been seized illegally because when seized it contained no goods illegally imported into Canada and no proof was made that it had ever been used in the importation or subsequent transportation of goods liable to forfeiture under the *Customs Act*. The Statement of Defence alleged that the petitioner was one of a group engaged in the smuggling of American cigarettes and that, after locating buyers, he had used his car to guide the driver of a truck laden with such cigarettes to buyers in Montreal, where delivery was made; that the car as intermediary was thereby specially made use of in the subsequent transportation of goods liable to seizure under the *Customs Act* and the Minister was justified in ordering its forfeiture.

At the trial the suppliant testified that he had never used his car for purposes forbidden by the Act and had never smuggled cigarettes. He admitted he had sought out buyers, communicated the orders to one Guilotti and undertaken to see that the smuggled cigarettes owned by the latter were delivered by a trucker engaged by Guilotti for that purpose. Guilotti testified that, in the winter of 1953, he had sold some 80,000 cigarettes to the petitioner and had seen them loaded in the petitioner's car, which he identified as being one and the same as that subsequently seized. The Court rejected the evidence of the suppliant and his witnesses and accepted that of Guilotti.

Held: That the petitioner had made use of his motor car for the removal and subsequent transportation of goods (cigarettes) liable to forfeiture. In consequence, the penalty provided by s. 181(1) of the *Customs Act* should be maintained and the Petition of Right dismissed.

Per Dumoulin J.: I agree with the view expressed by Fournier J. in *Richard v. The Queen*, [1954] Ex. C.R. 687, that s. 181 of the *Customs Act*, R.S.C. 1952, c. 58, defines a separate and distinctive offence in each of its subsections, that is to say in subsection one, a sort of offence *in rem* arising out of the actual use of the seized vehicle for the subsequent transportation of smuggled goods, with its forfeiture as a penalty; and in subsection two, the personal offence of having assisted in the removing or subsequent transporting of such goods, an offence punishable by fine or imprisonment or by both.

PETITION OF RIGHT for an order of the Court to set aside the seizure and forfeiture of suppliant's automobile made under the provisions of the *Customs Act*.

The action was tried before the Honourable Mr. Justice Dumoulin at Montreal.

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Gérard Ally for suppliant.

I. J. Deslauriers, Q.C. for respondent.

DUMOULIN J.:—Cette cause fut entendue à Montréal le 29 mai 1956.

Le 22 février 1954, à Bedford, province de Québec, un constable de la Gendarmerie royale saisissait l'automobile du pétitionnaire pour le motif

que ledit véhicule a servi à l'importation ou au transport subséquent de marchandises passibles de confiscation, aux termes de la Loi des douanes, savoir: des cigarettes.

Le véhicule saisi en était un de marque de fabrique "Meteor", modèle de 1953, numéro de série 0273453-11090, dont le prix d'achat, en janvier de l'année précitée, aurait été $2,550 (pétition de droit, article 5).

Les formalités indiquées aux articles 158 à 166 de la Loi sur les douanes (S.R.C., 1952, c. 58) s'ensuivirent de part et d'autre. Le 26 mai 1954, le pétitionnaire recevait avis de la part du ministre du Revenu national que son automobile était confisquée.

Dauray excipant de cette décision, le ministre refusa de la déférer à la cour, refus qui détermina le contestant à intenter une pétition de droit, produite le 4 août 1954.

Le requérant postule la rescision du décret de confiscation, mainlevée de la saisie et remise de son véhicule parce que (article 12 de la pétition de droit):

. . . la voiture-automobile n'a jamais servi à l'importation ou au transport subséquent de marchandises passibles de confiscation, tant comme principale que comme pilote.

Cet article 12 de la pétition de droit est le seul à offrir une fin substantielle de non-recevoir dans le présent litige.

Voyons maintenant ce que l'intimée, par sa défense, qui à toutes fins logiques tient lieu de plainte, reproche à Georges Dauray pour justifier la confiscation de l'automobile.

Les articles 12, 13 et 14 de cette pièce allèguent que, durant les mois de février et mars 1953, Dauray, faisant alors partie d'une clique de contrebandiers adonnés à l'importation illicite de cigarettes, aurait conclu des arrangements ". . . pour le transport subséquent d'une très grande quantité de cigarettes américaines, illégalement importées

au pays et qui étaient alors frappées de confiscation en vertu de la Loi des douanes" (art. 13). Puis, précisant davantage le grief, les articles 15 et 16, dont suit la reproduction textuelle, allèguent que:

15. A la suite de ces arrangements faits, le pétitionnaire avait fait des ententes avec un monsieur (sic) Maurice Guy pour que celui-ci fasse le transport desdites cigarettes concernées, illégalement importées, pour être livrées auxdits messieurs Jean Guy Légaré et Paul Desjardins, cependant que le pétitionnaire se servait de sa voiture-automobile, de marque Meteor, modèle 1953, portant le numéro de série 0273453-11090 pour diriger cedit transport subséquent desdits effets, frappés de confiscation en vertu de la Loi des douanes, et ladite voiture-automobile servait spécialement comme intermédiaire dans la direction dudit transport subséquent (*The automobile was specially made use of in the subsequent transportation of these goods liable to seizure under the Customs Act.*);

16. *Que le pétitionnaire a aidé* ou de quelque autre manière favorisé l'importation illégale *et/*ou *le transport subséquent de ces effets frappés de confiscation en vertu de la Loi des douanes,* à savoir: une grande quantité de cigarettes américaines illégalement importées au pays, et qui furent par la suite saisies en vertu de la Loi des douanes cependant que le transport subséquent desdites cigarettes avait été sous son contrôle sans excuse légitime.

L'article 17 de la défense rapporte que le 12 avril 1955, à Montréal, l'actuel réclamant s'est reconnu coupable d'avoir comploté avec, entre autres, les dénommés Maurice Guy et Paul Desjardins, la perpétration d'un acte criminel consistant à effectuer l'importation puis le transport subséquent de cigarettes américaines d'une valeur de plus de $200 sans l'apurement des droits prescrits en pareil cas.

La confiscation, au sujet de laquelle je dois me prononcer, ne saurait être maintenue, à mon sens, qu'en fonction du premier paragraphe de l'article 181 de la Loi sur les douanes, dont voici la teneur:

181 (1) Tous les navires, avec leurs canons, palans, agrès, apparaux et équipements, *et les véhicules,* harnais, gréments, chevaux et bestiaux *qui ont servi à importer, décharger, débarquer ou enlever ou à transporter subséquemment des effets passibles de confiscation en vertu de la présente loi, doivent être saisis et confisqués.*

Dès ici, j'ajouterai que je partage l'avis exprimé par mon savant collègue, M. le juge Fournier, dans *Richard v. The Queen* (1) à l'effet que l'article 181 du chapitre 58 des Statuts revisés de 1952 définit une infraction particulière et distincte dans chacun de ses deux paragraphes, soit, au paragraphe (1), une sorte d'offense *in rem* découlant de l'utilisation matérielle du véhicule saisi pour le transport

(1) [1954] Ex. C.R. 687.

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subséquent des objets de contrebande, avec la confiscation comme sanction; puis, au paragraphe (2), l'offense personnelle d'avoir aidé à l'enlèvement ou au transport ultérieur des effets tarifés, violation punie d'une amende ou de l'emprisonnement, ou même de ces deux peines à la fois.

Si, comme je le pense après maintes lectures des articles 15 et 16 de la défense, l'intimée a voulu faire référence au premier paragraphe de l'article 181, force m'est de reconnaître que la rédaction aurait pu serrer de plus près le texte de la version française.

Cependant, pourquoi cette citation presque textuelle de l'article 181 (1), en sa partie déclarative, *version anglaise*, sinon pour dissiper l'équivoque quant à l'offense reprochée: *"The automobile was specially made use of in the subsequent transportation of these goods liable to seizure under the Customs Act."* (défense, art. 15, *in fine*).

Je tiens, en conséquence, que l'avis de saisie et les allégations de l'intimée ont suffisamment trait à l'infraction passible de la confiscation, pour autant qu'il y ait une preuve corroborative, et je passe à la revision des témoignages.

Le premier témoin entendu fut le pétitionnaire, Georges Dauray, dont la véracité subissait des éclipses chaque fois qu'il pouvait lui paraître opportun de mentir. Cette appréciation péjorative qualifie également une partie des assertions formulées par le témoin suivant, Maurice Guy, je le signale dès ici.

Que prétend Dauray? Que depuis janvier 1953, date d'acquisition de l'auto, il ne l'aurait jamais utilisée à des fins illicites ou autrement interdites par la Loi sur les douanes. Il n'aurait pas davantage importé des cigarettes de provenance américaine, mais convient qu'il repérait des acheteurs de pareille marchandise et refilait ces commandes à un certain Pierre Guilotti: "C'est arrivé, dit-il, que je me suis occupé que des cigarettes soient livrées chez Légaré et Desjardins (garagistes à Montréal); j'ai compté les cigarettes à chaque fois pour voir si c'était bien le nombre." Tout cela, précise Dauray, à raison d'une modique commission de cinq sous (0.05c.) le carton de 200 cigarettes. Il nous apprend ensuite que Guilotti (l'importateur), Maurice Guy (le camionneur) et lui se concertaient à l'Ami du Passant, un hôtel au Mont Saint-Grégoire, petite localité

de la rive sud, près Montréal, ajoutant: "La nature de mes conversations avec Guy, c'était d'acheter des cigarettes de Guilotti qui a donné des ordres à Maurice Guy de transporter des cigarettes à Montréal aux endroits que je lui indiquais."

Les deux copains, Guy et Dauray,—je résume la version de ce dernier,—quittaient en même temps Mont Saint-Grégoire, le premier, pour prendre livraison des cigarettes, l'autre, dans son automobile, précédant Guy au point de réunion: le pont Jacques-Cartier. De cet endroit, tous deux gagnaient la destination finale, le garage Légaré-Desjardins.

Selon le témoin, deux fois la semaine, quelques semaines durant, Guy et lui "se rencontraient" chez les chalands réguliers, Desjardins et Légaré, à Montréal, l'un, afin d'effectuer la livraison de cigarettes, le second, pour en vérifier les quantités et en toucher le prix, dont il faisait remise, selon le cas, à Guy ou Guilotti; après déduction de sa commission de 0.05c. par carton. A chacun de ces voyages, Georges Dauray se servait de son automobile. Quant aux rendez-vous à l'auberge L'Ami du Passant, il essaie de laisser croire qu'il n'y en aurait eu qu'un, puis en porte le nombre à "trois au moins".

Maurice Guy vient ensuite. Il accepta d'effectuer le transport de cigarettes de contrebande pour le compte de Guilotti, et d'en assurer la livraison aux endroits que lui indiquerait Dauray. A maintes reprises, il rencontra, pour les fins précitées, Guilotti, accompagné de Dauray qui révélait les adresses des clients et traçait la route à suivre. "On s'est entendu", déclare Guy, "lors de la première livraison, que nos deux autos s'achemineraient en même temps et que nous stopperions au pont Jacques-Cartier, et que, de là, n'étant pas familier avec les lieux, je suivrais Dauray jusque chez Desjardins et Légaré". Ces "visites" variaient en nombre d'une à trois par semaine.

L'épouse du pétitionnaire n'apporte rien qui vaille d'être retenu, sinon qu'accompagnant son mari, elle eut connaissance de deux rencontres avec Guy au pont Jacques-Cartier, d'où Dauray la reconduisait chez sa mère, domiciliée sur la rue Wolfe, à Montréal.

Le témoin suivant, Jean-Guy Légaré, garagiste, avoue qu'en 1953 il transigea l'achat de cigarettes de contrebande

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avec Dauray; Guy assumant le soin des livraisons. Ces deux individus, chacun dans leur auto, parvenaient ensemble au garage, une fois exceptée, quand Dauray précéda Guy. Il y eut, selon Légaré, sept ou huit livraisons en présence de Dauray.

Le dernier à se faire entendre, et le seul à créer l'impression de ne pas vouloir tromper la Cour, fut le dénommé Pierre Guilotti qui, entre autres choses je présume, partage avec Dauray le douteux honneur d'être le *diabolus ex machina* du complot.

Guilotti relate simplement *qu'en 1953, pendant l'hiver,* Georges Dauray acheta de lui *et pour son propre compte de trois à quatre cents cartons de cigarettes frauduleusement importées.* Cette forte quantité de tabac, soit soixante ou quatre-vingt mille cigarettes, à 200 unités par carton, *fut chargée dans l'auto de Dauray qui s'en était porté acquéreur. Le témoin identifie l'automobile "Meteor", de Dauray, dans laquelle furent placées les 80,000 cigarettes plus ou moins, comme étant bien celle dont la saisie fut effectuée l'année suivante.* Il est à sa connaissance personnelle que le pétitionnaire "patrouillait" le trajet et précédait Guy au garage Légaré, faits dont il fut témoin à cinq ou six reprises.

Je n'ai aucun motif de révoquer en doute l'assertion de ce témoin. Dans l'hiver de 1953, comme on le lui reproche aux articles 12, 14, 15 et 16 de la défense, Georges Dauray a fait servir le véhicule moteur, présentement sous la garde du ministère, *à l'enlèvement et au transport subséquent des effets (cigarettes) passibles de confiscation.* En conséquence la sanction portée au paragraphe 1 de l'article 181 de la Loi sur les douanes doit recevoir son application.

La pétition de droit est rejetée; la décision du ministre du Revenu national, datée le 26 mai 1954, touchant l'avis de saisie, numéro 68742/38526, de ce ministère (douanes et accise), et qui confisquait l'automobile du pétitionnaire, marque et année de frabrique "Meteor, 1953", indice de série 0273453-11090, est ratifiée; la confiscation du véhicule ci-dessus décrit étant déclarée légale et valable à toutes fins que de droit. L'intimée pourra recouvrer du pétitionnaire débouté tous ses frais et honoraires taxables.

Judgment accordingly.

ERIC MOODY .....APPELLANT;

AND

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

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Revenue—Income tax—Arbitrary assessment—Personal and living expenses —Cheques on hand at beginning of period deemed income in year received—Depreciation in value of machinery not explanation of increased wealth—Bonds purchased before period considered as assets on hand when period commenced—Appeal allowed in part—The Income Tax Act, R.S.C. 1952, s. 46(6).

Appellant, a bachelor farmer, was assessed for income tax on the basis of the increase in his wealth attributable to income over the period from 1948 to 1951 inclusive.

Appellant contended that the amount fixed by the Minister for his living expenses for the four year period was too high and that certain cheques received in payment for services rendered and which he had on hand but had not cashed at the beginning of the period should be considered as assets on hand at the beginning of the period. Appellant also contended that the increase of wealth over the period was accounted for by depreciation on machinery and also that $1,000 of the increase resulted from the sale of bonds of that amount acquired before 1948 and sold during the period.

Held: That the appellant's contention in respect of the cost of living failed as the appellant had not discharged the onus of proving that the Minister's figures were wrong.

2. That the depreciation in the value of machinery allowed to the appellant as a charge against his income did not account for any of the increase in his wealth during the period.

3. That the cheques on hand at the beginning of the period were income in the year they were received by the appellant, not in the year in which he cashed them.

4. That on the evidence the appellant had discharged the onus of satisfying the Court that he had the bonds in question at the beginning of the period and that the proceeds of sale of them during the period should not be considered as income in fixing the increase of appellant's wealth attributable to income over the period.

APPEAL under The Income Tax Act.

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

S. H. Nelson for appellant.

M. E. Moscovich, Q.C. and *A. L. DeWolf* for respondent.

THURLOW J.:—This is an appeal from the judgment of the Income Tax Appeal Board dated October 15, 1955, dismissing the appellant's appeals from his income tax assessments for the years 1948, 1949, 1950 and 1951. The issue

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in the appeal is the amount of the appellant's income for the years in question, the appellant asserting on his part that tax has been assessed on a net income far in excess of his actual income for each of the years in question, and the respondent, on the other hand, denying this assertion and invoking the provisions of s. 47 of the Income War Tax Act, R.S.C. 1927, c. 97, and s. 42, s-s. 5 of The Income Tax Act, c. 52 of the Statutes of Canada 1948, now cited as The 1948 Income Tax Act, in support of the assessments made by him.

The appellant is a bachelor and resides at Cardston, Alberta, where he operates a farm owned by another party. He filed income tax returns for the years in question. His income, as disclosed in the returns, is reported on the basis of cash received less cash expended and is derived almost entirely from the sale of wheat and livestock produced on the farm and from interest on bank deposits. In these returns he reported as follows:

For 1948, a net income of $1,098.42;
For 1949, a loss of $51.79;
For 1950, a net income of $1,150.71;
For 1951, a loss of $1,572.74.

Thus calculated, his income for the whole four-year period would total $624.60.

The Minister was not satisfied with the information in these returns.

On August 14, 1952, in response to what the appellant refers to as "a demand from Calgary to send in a net worth", the appellant sent to the Director of Income Tax at Calgary a statement purporting to show the appellant's assets at December 31, 1947 and at December 31, 1951.

This statement shows that on December 31, 1947 the appellant had bank deposits totalling $29,966.73, an outstanding loan due him of $2,000, certain cheques referred to as "cheques held *re* Thompson settlement" amounting to $1,644.91, an account receivable *re* Thompson settlement of $300, and machinery at a depreciated value of $1,448.35. The total of these items is $35,359.99.

The same statement also shows that on December 31, 1951 the appellant had bank deposits totalling $38,246.40

and machinery at a depreciated value of $6,920.21. The total of these items is $45,166.61, thus indicating an increase in the appellant's assets over the period amounting to $9,806.62. The loan, cheques and account receivable had, in the meantime, been paid and the appellant had acquired and paid for additional machinery at a cost to him of $8,713.25, less $175 received for a 1930 Ford car which he traded in on the purchase of a truck. The statement also shows that in the meantime he had received $330 in connection with a road allowance. The nature of this receipt is not in evidence, but it and the $175 allowed for the Ford car have been treated as capital receipts and not as income. After deducting the total of these capital items, that is to say $505, from the increase of $9,806.62 above mentioned, the statement showed a figure of $9,301.72 attributable to income. To this was added $1,600 for cost of the appellant's living for the four years to make a total of $10,901.72. While neither the statement nor the letter which accompanied it expressly states what the resulting figure represents, I think it is clearly intended to indicate the appellant's total income for the four-year period.

The evidence does not disclose just what occurred next, but it is in evidence that on or about March 18, 1953 a re-assessment of the appellant's income for the years in question was made. The appellant then employed another accountant, who prepared another statement also purporting to show the appellant's assets at December 31, 1947 and at December 31, 1951. This the appellant forwarded to the Director of Income Tax at Calgary on April 11, 1953, with a letter prepared by the accountant but signed by the appellant himself, in which he expresses disagreement with the figures in what is referred to as "the net worth statement set out on VZA 70977." The latter document is not in evidence. The letter goes on to say that the appellant has checked his records and has had the enclosed net worth statement prepared from them. With the letter and statement the appellant also enclosed a payment of $1,000, stated in the letter to be "on account of the additional tax which may be determined by the adjusted re-assessments from your office." The statement indicated an increase in the appellant's net worth over the four-year period, amounting to $605 for capital gains and $6,930.38 on

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account of income. To this figure, as well, was added $1,600 for personal living expenses and $518.14 for income tax paid, to reach a total figure of $9,048.52. Again there is no express statement as to what the figure represents, but obviously it is intended to represent the appellant's total income for the four-year period. The difference in result between the income shown in this statement and that submitted on August 14, 1952 is largely accounted for by the fact that, in the later statement, the appellant deducted $1,699.44 for debts allegedly owed by him at the end of the period. No debts were shown as owing at the beginning of the period on either statement.

Subsequently, on September 10, 1954, the Minister made the re-assessments which are in dispute in this appeal. In making them, the Minister started with the amount of $9,048.52 shown in the appellant's statement of April 11, 1953 as attributable to income, but to this figure he made a number of adjustments, the effect of which was to increase the amount to $14,733.65. Two of these adjustments are disputed, and the appellant's contentions in respect of them are dealt with later in this judgment. The remainder were not questioned, and on the evidence before me I do not think any of them can be successfully challenged. The disputed items are, first, an increase from $1,600 to $2,826.34 made by the Minister in the estimate of the cost of appellant's living for the four years which increased the appellant's income, as assessed, by $1,226.34, and, second, the disallowance of the amount of the Thompson cheques, above mentioned, as assets at the beginning of the period, which disallowance had the effect of further increasing the appellant's income, as assessed, by $1,644.91. In making the re-assessment, the Minister apportioned the $14,733.65 over the four years as follows:

1948	$4,125.42
1949	$2,210.05
1950	$5,156.78
1951	$3,241.40

and assessed the appellant accordingly.

Notices of objection from the appellant followed, and on December 20, 1954 the Minister confirmed the assessment for the year 1948 as having been made in accordance with

the provisions of the Income War Tax Act and, "in particular, on the ground that section 47 of the Act provides that the Minister shall not be bound by any return or information supplied by or on behalf of a taxpayer and, notwithstanding such return or information, the Minister may determine the amount of tax to be paid by any person; that in the absence of proper proof and accounting records and upon investigation and in view of all the facts the Minister has under the said section 47 determined the amount of tax to be paid by the taxpayer for the year 1948".

On the same day the Minister also confirmed the assessments for the years 1949, 1950, and 1951 as having been made in accordance with the provisions of The 1948 Income Tax Act and, in so doing, invoked and exercised on similar grounds the provisions of s-s. 5 of s. 42 of that Act in respect of the appellant's income for the years 1949, 1950, and 1951.

The appellant appealed to the Income Tax Appeal Board but did not appear when his case was called, and his appeal was dismissed for want of prosecution. He thereupon appealed to this Court.

S. 47 of the Income War Tax Act, under which the Minister proceeded in respect of the appellant's income for the year 1948, is as follows:

> 47. The Minister shall not be bound by any return or information supplied by or on behalf of a taxpayer, and notwithstanding such return or information, or if no return has been made, the Minister may determine the amount of the tax to be paid by any person.

The effect of this section is set out as follows in *Dezura v. Minister of National Revenue* (1) at p. 15:

> The result is that when the Minister, acting under section 47, has determined the amount of the tax to be paid by any person, the amount so determined is subject to review by the Court under its appellate jurisdiction. If on the hearing of the appeal the Court finds that the amount determined by the Minister is incorrect in fact the appeal must be allowed to the extent of the error. But if the Court is not satisfied on the evidence that there has been error in the amount then the appeal must be dismissed, in which case the assessment stands as the fixation of the amount of the taxpayer's liability. The onus of proof of error in the amount of the determination rests on the appellant.
>
> This view of the nature of the Minister's power under section 47 is, I think, a reasonable one. It is consistent with the other provisions of the Act and complete and equitable administration of it. The object of an assessment is the ascertainment of the amount of the taxpayer's taxable income and the fixation of his liability in accordance with the provisions

(1) [1948] Ex. C.R. 10.

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of the Act. If the taxpayer makes no return or gives incorrect information either in his return or otherwise he can have no just cause for complaint on the ground that the Minister has determined the amount of tax he ought to pay provided he has a right of appeal therefrom and is given an opportunity of showing that the amount determined by the Minister is incorrect in fact. Nor need the taxpayer who has made a true return have any fear of the Minister's power if he has a right of appeal. The interests of the revenue are thus protected with the rights of the taxpayers being fully maintained. Ordinarily, the taxpayer knows better than any one else the amount of his taxable income and should be able to prove it to the satisfaction of the Court. If he does so and it is less than the amount determined by the Minister, then such amount must be reduced in accordance with the finding of the Court. If, on the other hand, he fails to show that the amount determined by the Minister is erroneous, he cannot justly complain if the amount stands. If his failure to satisfy the Court is due to his own fault or neglect such as his failure to keep proper accounts or records with which to support his own statements, he has no one to blame but himself. A different view of the nature of the Minister's power under section 47, namely, that it is not subject to the specific provisions of the Act and that the amount of his determination is not subject to review by the Court would lead to such extraordinary results, without any need or justification for them, that they ought not to be considered as having been within the intention of Parliament.

S-s. 5 of s. 42 of The 1948 Income Tax Act, applicable to the years 1949, 1950, and 1951, is as follows:

(5) The Minister is not bound by a return or information supplied by or on behalf of a taxpayer and, in making an assessment, may, notwithstanding a return or information so supplied or if no return has been filed, assess the tax payable under this Part.

While the wording of this section differs somewhat from that in s. 47 of the Income War Tax Act, its result is, I think, the same in its application to the determination by the Minister of the appellant's income and his assessment of tax payable by the appellant for 1949, 1950, and 1951.

The only witness called at the trial of the appeal was the appellant. In his evidence, he stated that his income, as reported in his income tax returns, was correct, and he produced a large number of vouchers relating to receipts of income and disbursements in connection with the operation of the farm for each of the years in question. The latter are incomplete as to both income and expenditures and, in my view, they add nothing to the credibility of the appellant's evidence. In cross-examination, the appellant admitted that he had charged depreciation in two years on a tractor which he had never, in fact, purchased, and he also admitted that he had charged depreciation on a combine at list price, when in fact he had purchased the combine at a considerable discount from the list price. He is able to

read and write, and I formed the impression at the trial that he is an able and intelligent man and that, despite his evidence to the contrary, he understood the statements which he submitted well enough to appreciate what was in them and their purpose and effect. A perusal of his evidence since the trial has served to confirm this impression. Several times, when questioned as to particular items, he displayed a ready appreciation of the effect of the answer to the question by offering additional information favourable to his cause. Yet, he had no comprehensive or adequate explanation for the very substantial increase in his net worth despite the modest income reported in his returns.

In the light of his failure to explain this increase satisfactorily, even to the extent reported in his letter of April 11, 1953, and of his forwarding a payment of $1,000 on account with the same letter, as above mentioned, and of his admissions in respect of depreciation charged, I am not prepared to accept as credible his evidence that the income reported in his returns is correct. Indeed, I am satisfied that his returns are quite unreliable. The appellant's case for disturbing the assessments by this approach accordingly fails.

The appellant, however, also attacks the assessments by endeavoring to show that his income has been incorrectly calculated by the Minister, and in support of this attack he raises the following contentions:

1. That the increase in the estimate of the cost of appellant's living as altered by the Minister is not warranted;
2. That the Minister was wrong in disallowing the Thompson cheques as assets on hand at the beginning of the four-year period, and in treating the amount of them as income during the period;
3. That the depreciation allowed on farm machinery accounts for part of the increase in appellant's assets;
4. That he had Victory bonds at the beginning of the period which were not included in the list of his assets at the beginning of the period and that he sold them during the period and their proceeds are included in his bank deposits at the end of the period and account for part of the increase which was assessed as income.

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1. In calculating the appellant's income by reference to the increase in his assets, the Minister, as well as the appellant's accountants, added to the increase an amount which they estimated to be the amount or value of income used by the appellant for his own living. Both the appellant's accountants estimated this at $400 a year, and the appellant gave evidence that he considered that amount was correct. He is a man of frugal habits, but he produced no evidence to confirm his estimate. I think it is safe to assume that he has not exaggerated this figure. Moreover, he admitted that his is an estimate only of money expended by him and does not include any allowance for the value of produce produced on the farm and consumed by him. While estimating his own living expenses at $400 a year, he charged at the rate of $600 a year for board for his employees. The Minister estimated the appellant's cost of living at $656.67 for 1948, $698.62 for 1949, $728.87 for 1950, and $742.18 for 1951, a total of $2,826.34. The increases were explained to the appellant by reference to increases in the cost of living in general over the years. The appellant should be in the better position to estimate the cost of his own living, but I have no confidence in his estimate and on the evidence as a whole I am not satisfied that the Minister's estimate is incorrect.

2. The next item challenged is the amount of $1,644.91, referred to as Thompson cheques, which the appellant says he held at the beginning of the period and which were cashed in June, 1951. These cheques were in payment for services rendered by appellant and were income. In both financial statements the cheques are shown as having been on hand at the beginning of the period. The Minister, however, disallowed and deducted them as assets on hand at the beginning of the period, apparently on the ground that the amount was not to be treated as received or as assets on hand until the cheques were cashed and that, when they were cashed, they became income. The letter of October 8, 1954, written to the appellant by the Director of Taxation at Calgary (Ex. C), suggests that the cheques were not treated as income in the years when they were received, and this may serve to explain, if not to justify, the disallowance of the item. In the absence of some special circumstance indicating a contrary conclusion such as, for example, post-

dating or an arrangement that the cheque is not to be used for a specified time, a payment made by cheque, although conditional in some respects, is nevertheless presumably made when the cheque is delivered and, in the absence of such special circumstance, there is, in my opinion, no ground for treating such a payment other than as a payment of cash made at the time the cheque was received by the payee. The evidence discloses no reason why the cheques in question should not have been treated as income in the year or years when they were received by the appellant, and I do not think it was optional either for the appellant or the Minister to treat them as income when cashed, as opposed to when they were received, or to include them as income in any year other than the year in which they were received. Accordingly, I think the appellant's objection in respect of this item is entitled to prevail.

3. The appellant's counsel further contends that the depreciation on machinery allowed over the four-year period would result in additional money in the appellant's hands at the end of the period and thus account for a corresponding increase in the appellant's assets. This argument is untenable. If the value of a piece of machinery shown in the statement were the same at the beginning and at the end of the period, and if depreciation in the meantime had, in fact, been allowed, the argument might be correct. But here examination of the statement shows that the values of the several pieces of machinery shown at the end of the period are less by the amount of depreciation allowed than they were at the beginning of the period (or at the time of purchase in the case of items purchased during the period). Thus the depreciation allowed cannot account for any of the increase in the appellant's assets.

4. The remaining objection raised by the appellant relates to the proceeds of sale of some Victory bonds which the appellant says he purchased through a bank before the beginning of the period and which he sold in 1948, the proceeds of sale having been deposited in one of his bank accounts and thus accounting for part of the increase shown in them at the end of the period. His statement that he had these bonds and sold them is not corroborated, though I fancy there must be some record of them in existence, as he

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says he left them at the bank. Moreover, they were not reported in either financial statement as assets held at the beginning of the four-year period. The appellant explains this by saying:

> That statement is correct but there was Victory Bonds I bought between 1940 and 1945 and I cashed those in 1948 and they were in the bank. In fact, they were bought by the bank and I left them there and they kept them for me, and I clipped the coupons and interest and I added this interest to my yearly returns, but those bonds were sold in April 1948 and then the money was left right in there. There was about a little over $1,000. I don't think they should be in the net worth statement at all but I didn't know at that time.

While the appellant might have raised this point at an earlier stage and obtained an adjustment without the necessity of an appeal, in the absence of contradiction or of any serious challenge in cross-examination to this part of the appellant's evidence, I accept his statement that he had the bonds at the beginning of the period and sold them during the period, and I find that they account for $1,000 of the increase in his assets.

For the foregoing reasons, the assessments should be revised so as to reflect the deduction from the appellant's income for the four-year period of the sum of $1,644.91 in respect of the Thompson cheques and the sum of $1,000 in respect of the proceeds of sale of Victory bonds. The appeal will be allowed to this extent and the assessments referred back to the Minister for revision accordingly.

As the appellant has succeeded in respect of the Thompson cheque item which, in itself, is a substantial one and which, by itself, would have made it necessary for him to appeal, he is entitled to his costs.

Judgment accordingly.

MINERALS LIMITED ..... APPELLANT;

AND

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

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Feb. 4

Revenue—Income tax—Capital gain—Company incorporated to acquire freehold mineral rights with power to deal in petroleum and natural gas leases—Profit from sale of leases—Capital gain or profit from business—The Income Tax Act, 1948, S. of C. 1948, c. 52, ss. 3, 4, 127.

The appellant company in the course of its main operation (the acquiring of freehold mineral rights) and for the purpose of promoting the operation, acquired a number of petroleum and natural gas leases. In the 1951 taxation year it sold the leases in a single transaction and thereby realized a profit. The Minister assessed the profit as income assessable to tax under ss. 3 and 4 of *The Income Tax Act*, S. of C. 1948, c. 52, as the profit of a business carried on by the appellant. The appellant appealed to the Income Tax Appeal Board which affirmed the assessment. The appellant appealed from the Board's decision contending that the sum assessed was a capital profit realised from the sale of an investment.

Held: That the acquiring of the leases was not an ordinary investment of the appellant's funds but an activity engaged in as part of its profit-making operations. Trading and dealing in mineral leases was one of the classes of profit-making activities authorized by the appellant's Memorandum of Association. The business carried on by the company included an operation of taking petroleum and natural gas leases to advance the main operation but at the same time with a view to making a profit by selling or otherwise dealing in them and the profit ultimately realized by their sale was not a capital profit but a gain made in an operation of business in carrying out a scheme for profit-making. It was accordingly income and properly assessable.

APPEAL from a decision of the Income Tax Appeal Board.

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

R. A. MacKimmie, Q.C. and *J. R. Smith* for appellant.

J. L. McDougall, Q.C., and *A. L. DeWolf* for respondent.

THURLOW J.:—This is an appeal from the judgment of the Income Tax Appeal Board (1), dismissing the appellant's appeal from its income tax assessment for the year 1951, whereby income tax was assessed upon a sum of $140,084.89 in addition to the amount reported by the appellant as its income for that year. The sum in question was a profit realized by the appellant in 1951 upon a sale of petroleum and natural gas leases held by it.

(1) (1955) 55 D.T.C. 492; 13 Tax A.B.C. 365.

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The appellant contends that this sum was a capital profit realized on the sale of an investment, while the respondent contends that it was income assessable to tax under ss. 3 and 4 of *The Income Tax Act*, S. of C. 1948, c. 52, as the profit of a business carried on by the appellant in the year in question.

These sections are as follows:

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

Section 127(1) also provides:

127. (1) In this Act,

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

The issue is one of fact. In *Californian Copper Syndicate v. Harris* (1) the test for determining it is expressed thus:

It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realize it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an Act done in what is truly the carrying on, or carrying out, of a business.

* * *

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

In the main, the facts are not in dispute, and the real problem lies in determining the proper inferences to be drawn from them and in applying the test to them. To appreciate the problem it is necessary to keep in mind the

(1) (1904) 5 T.C. 159 at 165, 166.

difference between freehold mineral rights in land on the one hand and leases to prospect for and remove minerals from the land on the other.

In the year 1949, there were in the province of Saskatchewan many farmers and other persons who owned the minerals, including oil and natural gas, which might be found in their lands. Many of these owners, particularly those in the vicinity of the City of Regina, had granted leases of their petroleum and natural gas rights to oil companies or other individuals, but there were some owners who had not done so. The leases were of a standard form, giving the lessee the right for ten years to prospect for and take oil and natural gas from the land and providing for payment to the owner of an annual rental of ten cents per acre until prospecting operations were undertaken on the property, and for royalty payments amounting to one-eighth of the value of any oil or gas that might be produced.

On December 1, 1949, a company named Farmers Mutual Petroleums Ltd. was incorporated under *The Companies Act* of the province of Saskatchewan, the purpose of which was to acquire freehold mineral rights from as many owners as possible and, by thus creating a "pool" of mineral rights, to enable the several owners to share in the royalties from minerals that might be produced from any of the properties transferred to it. The company was organized and promoted by William Harrison Riddle, a man of experience as a promoter in some branches of the oil business. By an agreement dated December 13, 1949, the company appointed Mr. Riddle, who is described as an "oil operator", to be its promoter and organizer for five years, with the exclusive right to solicit membership in the company on the basis of its prospectus. The prospectus provided that membership in the company should be based on an exchange of freehold mineral rights for stock in the company, the company issuing one ordinary share without nominal or par value for each acre of mineral rights transferred to the company and further undertaking to reserve and hold an undivided one-fifth interest in all mineral rights transferred to it in trust for the member transferring the same.

By the agreement above mentioned, Mr. Riddle agreed to pay the costs and expenses of incorporating and organizing the company and the entire cost of obtaining subscriptions

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and acquiring the mineral rights, to act as the organizer and promoter of the company for five years, to employ and pay all necessary agents and employees and generally to pay all the operating expenses of the company for the five-year term. In return for his services and to reimburse him for money expended, the company agreed to hold in trust for him one-fifth of all the mineral rights acquired by it.

Pursuant to this agreement Mr. Riddle, and later the appellant company, which on June 1, 1950 assumed his obligations and acquired his rights thereunder, secured transfers from the owners to Farmers Mutual Petroleums Ltd. of the mineral rights in some 750,000 acres of land. The latter company then held an undivided three-fifths of these mineral rights in its own right, an undivided one-fifth of them in trust for the owner who had transferred them and an undivided one-fifth of them in trust for the appellant company.

When acquiring the mineral rights, Mr. Riddle and the appellant in each case also obtained for Farmers Mutual Petroleums Ltd. an assignment of the owner-lessor's rights under the petroleum and natural gas lease. The company thus became entitled to the rents and royalties payable under the leases and held these rights, as well, for itself, the former owner and the appellant company in the same proportions. Through this arrangement any owner who had transferred his mineral rights to the company became entitled to share as a member of the company in three-fifths of the royalty from any minerals that might be produced from lands the minerals of which were thus vested in the company. If the land from which minerals were produced happened to be his own, that owner would be entitled in addition to one-fifth of the royalty from the minerals so produced, and in every case the appellant company would be entitled to one-fifth of the royalty. As the rentals from rights under lease served to provide a revenue to Farmers Mutual Petroleums Ltd. from which to pay taxes on its rights, and as there was no practical chance of prospecting being carried out on properties not under lease to an oil company, it was necessary in order that the scheme should be equitable to all the members that all the mineral rights taken should be in a position to provide the same rental revenue to the company and have a like chance as well of

having oil or gas produced from them. It, therefore, was made a requirement of Farmers Mutual Petroleums Ltd. that the mineral rights should be under lease before the company would accept the transfer. This presented no difficulty at the outset of the operation, as the mineral rights in the lands in the neighbourhood of Avonhurst near Regina, where the canvass was commenced, were all under lease, but as the agents' work took them further afield they encountered cases where there was no lease in existence. Mr. Riddle had been engaged in acquiring leases for himself and other parties some time prior to the commencement of this operation, and when the operation was begun he was under the impression that there was not a lease to be had, believing that all the mineral rights were under lease to one oil company or another. When, in the course of soliciting owners on behalf of Farmers Mutual Petroleums Ltd. for transfers to that company of their mineral rights, he or his agents found that the rights were not under lease, he himself proceeded to take a lease, at first in his own name, and after June 1, 1950 in the name of the appellant company. The leases obtained by Mr. Riddle in his own name prior to June 1, 1950 were transferred to the appellant at that time and these, together with the leases taken by the appellant after June 1, 1950, covered a total of 81,000 acres of mineral rights. On or about May 5, 1951 the appellant company in a single transaction sold to Amigo Petroleums Ltd. all of these leases (with the exception of a few which were rejected because the title was unsatisfactory) at the rate of $2 per acre and thereby realized the profit of $140,084.89 which is the subject of this appeal.

The position taken by the appellant is that the whole purpose of the appellant company was to carry out Mr. Riddle's contract of December 13, 1949 with Farmers Mutual Petroleums Ltd. and by so doing to acquire for itself a one-fifth share of the mineral rights, rents and royalties transferred by the owners to Farmers Mutual Petroleums Ltd., that when in the course of carrying out this purpose the appellant encountered an owner whose mineral rights were not under lease it would have preferred that the owner grant a lease to some oil company, but that to require the owner to negotiate a lease on his own involved delays and the probable loss of the opportunity to get the transfer

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of mineral rights through the owner changing his mind in the meantime, and that, in these circumstances, the appellant took the lease not as a business venture in itself but simply as an accommodation to the mineral owner and as a practical expedient to clear the way for the owner to transfer his mineral rights to Farmers Mutual Petroleums Ltd. From this position it is argued that the moneys expended in acquiring the leases were an investment of capital outside the scope of appellant's business and not made for the purpose of making a profit and that the sale of the leases, made as it was in a single transaction involving all the leases held by the appellant, was simply a realization of the investment.

A number of cases were cited in support of this submission, but all of them turn on their own facts, and they are helpful only as illustrations of the application to particular situations of the test already mentioned. The true nature of the transaction giving rise to the profit is to be determined on the facts of each particular case. In the case at bar this involves consideration of the objects for which the appellant company was organized and what its business and undertakings were.

The appellant company was incorporated under *The Companies Act* of the Province of Saskatchewan on May 30, 1950 with a nominal capital of $20,000, and throughout the material period Mr. Riddle was in complete control of it. Paragraph 3 of its memorandum of association is as follows:

> 3. *The objects for which the Company is established are the* prospecting for, locating, *acquiring, managing,* developing, working *and selling, mineral claims* and mining properties, and the winning, getting, treating, refining and marketing of minerals therefrom, *and the exercise of such powers as are incidental to or conducive to the attaining of the above objects, that is to say:*
>
> (*a*) To search for, recover and win from the earth natural gas, petroleum, salt, metals, minerals, and mineral substances of all kinds, and to that end to explore, prospect, mine, quarry, bore, sink wells, construct works or otherwise proceed as may be necessary to produce, manufacture, purchase, acquire, refine, smelt, store, distribute, sell, dispose of and deal in petroleum, natural gas, oil, salt, chemicals, metals, minerals, and mineral substances of all kinds, and all products of any of the same, *to trade in, deal in and contract with reference to lands* and products thereof, *or interests in land,* mines, quarries, wells, *leases,* privileges, licences, concessions, *and rights of all kinds, covering, relating to or containing or believed to cover, relate to or contain, petroleum, natural gas, or oil,* salt, chemicals, metals, minerals *or mineral substances of any kind.*

(*b*) To carry on the business of a manufacturer and refiner of natural gas, oils, grease, petroleum and all products thereof, *to deal in,* import and export, prospect for, open development on, work, improve, maintain and manage, *acquire by purchase, lease or otherwise and sell, lease or otherwise dispose of,* natural gas, petroleum, *oil lands,* oil, grease, chemicals *or rights or interests therein,* and to purchase, buy, sell and deal in natural gas, crude petroleum oil and other oils, grease and other products thereof; to sink oil wells, natural gas wells, to erect, acquire, buy, purchase, lease or otherwise maintain and operate all refineries or plants, to work the same; to store, tank, warehouse, refine, crude petroleum oil or other oils, grease and chemicals; to construct and operate pipelines for transportation of natural gas and oil; to construct and maintain gas and oil works on the property of the Company, to do all acts, matters and things as are incidental or necessary to the due settlement of the above objects or any of them, to carry on the business of bonded warehouses, customs brokers, and storage warehouses.

(*c*) To manufacture, import, export, buy, sell, and deal in goods, wares and merchandise of all kinds, and without limiting the generality of the foregoing to manufacture, compound, refine and purchase and sell chemicals, dye stuffs, cements, minerals, superphosphates, soap, fertilizers, paints, varnishes, pigments, polishes, stains, oils, acids, alcohols, coal, coke, coal tar products and derivatives, peat, peat products, rubber, rubber goods and products, medicines, pharmaceutical supplies, chemical and medicinal preparations, articles and compounds, separately or in combination and under all conditions and at all stages of preparation, and manufacture of all plastics and plastic materials, supplies and manufactured articles of every kind whatsoever and related products and by-products.

(*d*) To buy, sell and deal in, plant, machinery, implements, equipment, conveniences, provisions and other things capable of being used in connection with operations respecting petroleum or natural gas, or other minerals, and natural products, required by the Company and its workmen, and others employed by the Company, including its patrons and customers.

I have italicized certain expressions which I think contemplate activities of the kind carried on by the appellant, at least insofar as the mineral leases in question are concerned. Removed from the remaining expressions, the italicized portions read thus:

The objects for which the Company is established are the acquiring, managing, and selling mineral claims and the exercise of such powers as are incidental to or conducive to the attaining of the above objects; that is to say:

(*a*) to trade in, deal in, and contract with reference to lands or interests in land, leases, and rights of all kinds covering, relating to, or containing or believed to cover, relate to, or contain petroleum, natural gas, or oil, or mineral substances of any kind;

(*b*) to deal in, acquire by purchase, lease, or otherwise, and sell, lease or otherwise dispose of oil lands or rights or interests therein.

Prima facie activities of the company falling within these objects are the business of the company or a part of it, and the profits from such activities are income liable to tax.

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Anderson Logging Co. v. The King (1); *Gairdner Securities Limited v. Minister of National Revenue* (2).

The burden of displacing this presumption and of proving that the profit did not arise in the course of carrying out the profit-making operations of the company is on the appellant.

It was not suggested, and I do not think it could be successfully argued, that this company was anything other than a company organized for the purpose of engaging in operations with a view to making a profit.

On June 1, 1950, the day following its incorporation, the company purchased from Mr. Riddle, described in the agreement as the vendor, for $10,000, payable on or before December 1, 1950, the following:

> Firstly—the business of the Vendor and the goodwill thereof as promoter and organizer of Farmers Mutual Petroleums Ltd., as now carried on by the Vendor at the said City of Regina.
>
> Secondly—all furniture, fixtures, equipment, and office machines to which the Vendor is entitled in connection with the said business as set forth in Schedule "B" hereof, and signed by the Parties for identification.
>
> Thirdly—all stocks of stationery, forms and office supplies of the said business.
>
> Fourthly—the full benefit of all pending contracts and engagements to which the Vendor is entitled in connection with the said business.
>
> Fifthly—all the right, title and interest of the Vendor in and to the said Agreement made between the Vendor and the said Farmers Mutual Petroleums Ltd., dated the 13th day of December, A.D. 1949, or in any way connected therewith or arising therefrom, including all mineral rights and interests in mineral rights and land heretofore or hereafter acquired by the Vendor pursuant to the said Agreement, which said Agreement has been assigned by the Vendor to the Purchaser, a copy of which said Assignment is hereunto annexed as Schedule "C" to this Agreement.
>
> Sixthly—the residue of the term of the Lease now unexpired on the premises in which the said business is now carried on, and the Vendor hereby assigns to the Purchaser the residue of the said term.
>
> Seventhly—all other property to which the Vendor is entitled in connection with the said business.

The appellant accordingly acquired and had a business or undertaking to carry on practically from the time of its incorporation. It was a business or venture in which, by expending certain moneys and performing certain services, the appellant was to become entitled to certain rights, and I think it was accurately described as a business. After

(1) [1925] S.C.R. 45.

(2) [1952] Ex. C.R. 448; [1954] C.T.C. 24; 54 D.T.C. 1015.

acquiring this business, the appellant company became the employer of the agents who were soliciting transfers of mineral rights to Farmers Mutual Petroleums Ltd., it carried out Mr. Riddle's contract with that company, and, as above mentioned, it also took leases on mineral rights in the course of these operations and ultimately sold them. It does not appear to have engaged in any other operations or activities throughout the period from the time of its incorporation to the time of making the sale of the leases.

What then is the nature of the activities by which the appellant acquired and sold the leases? Were these activities a part of the profit-making operations of the company, or were they an ordinary investment and subsequent realization of capital?

The evidence does not show how many of the 750,000 acres of mineral rights acquired for Farmers Mutual Petroleums Ltd. were obtained before or how many were obtained after the appellant assumed the undertaking, nor does it show how many of the 81,000 acres on which the appellant ultimately held leases were taken on lease after it commenced operations. It does appear, however, that the 81,000 acres were comprised in some 303 leases. A list of these leases is attached as a schedule to the formal offer of sale made by the appellant to Amigo Petroleums Ltd. (ex. 7), and this list gives, in the case of each lease, a date which is called the anniversary date of the lease. The dates so given range over a period of slightly more than a year, the earliest date being January 13, 1950 and the latest January 20, 1951. There are eight leases for which the anniversary date given is later than December 13, 1950, six of them in December, 1950 and two in January, 1951. In the case of each of these eight leases, if what is given in the schedule as the anniversary date is not the actual date of the lease, the date of the lease itself could conceivably be one year earlier and still follow the making of the agreement of December 13, 1949 between Mr. Riddle and Farmers Mutual Petroleums Ltd. But as to the remaining 297 leases, it is impossible, consistently with the evidence as to when and how they were acquired, that the date of any of them could be earlier by a year than the date given as the anniversary date on this exhibit, as in such case the lease would antedate the making of the agreement between

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Mr. Riddle and Farmers Mutual Petroleums Ltd. In my opinion, it follows that, in the case of each of these 297 leases, the date given in the schedule as the anniversary date is, in fact, the date of the lease itself. Of these 297 leases, four are dated in January, 1950, one in April, 1950, and ten in the last few days of May, 1950, making a total of fifteen leases taken prior to the time when the appellant company took over the operation. From this, I conclude that, in the course of its operations between June 1, 1950 and January 20, 1951, a period of less than seven months, the appellant negotiated and entered into some 282 separate leases of petroleum and natural gas rights. Apparently for convenience in carrying out this part of its activities, the appellant had obtained a supply of printed lease forms. The terms of these leases follow those of the form used by Mr. Riddle himself but have the appellant's name printed in them in several places, as well as the address of its solicitors as the place at which notices may be given to it.

The funds required to finance the activities of the appellant were provided by advances made to it by two oil companies who advanced a total of $147,500. There is no evidence as to what portion, if any, of the $10,000 consideration money payable by the appellant to Mr. Riddle under the contract dated June 1, 1950, already referred to, was to represent the value, if any, of the leases which he then transferred to the company, but of the advances received by the appellant $26,349.11 was charged in its accounts as expended in acquiring the leases which it obtained. The agents were paid a commission on the transfers of mineral rights which they obtained, but the evidence does not show whether or not any commission was paid to them for obtaining the leases.

There is no evidence as to whether or not the question of taking these leases was ever considered at any meeting of the directors of the appellant company, nor was any evidence offered of any directors' minute relating to them or to the intention or purpose of the company in taking them. Evidence was, however, given by Mr. Riddle on commission in the United States. He stated that his purpose in promoting Farmers Mutual Petroleums Ltd. was to acquire for himself a one-fifth interest in the mineral rights, that in

carrying out this purpose he did not take the leases with the purpose of selling them but rather as an accommodation to the owners, and that the purpose for which the appellant company was formed was "to give perpetuity to the operations" that he personally had with Farmers Mutual Petroleums Ltd.

Speaking of his intention as to the leases, he said in examination in chief:

Q. What did you intend to do with the leases you took to accommodate these farmers and get them in this Farmers Mutual?

A. Well, we didn't know, *I tried to get McQueen and Mewburn to take those leases and they didn't want the leases.*

Q. This was prior to incorporation?

A. No, I don't remember just when; *we talked about those leases several times, what we would do with them. We could not make up our mind but we knew we had to pay if we kept them long enough.*

In cross-examination, he said:

Q. So that you had annually an obligation if you wanted to retain that lease, you had the obligation to pay that annual rental under the lease, is that right?

A. Yes.

Q. Now, then, I am correct in this, this was done as a systematic method of by-passing delays in connection with negotiation, or the giving by the farmer of the petroleum and natural gas lease to some major oil company?

A. *No, I didn't say it was our intention to give it to the major oil companies, we had no intention of doing that,* in fact, it was just a stepchild and I didn't know what I was going to do, frankly.

Messrs. McQueen and Mewburn were associated with and in control of the oil companies which advanced the funds to finance the operations of the appellant company, and Mr. Riddle had previously been engaged in obtaining petroleum and natural gas leases on his own and their behalf. It also appears from Mr. Riddle's evidence that another oil company showed some interest in obtaining the leases in question and in obtaining other petroleum and natural gas leases as well and that Amigo Petroleums Ltd., who ultimately bought the leases, before doing so offered as much as five dollars per acre for some of them.

The following also appears in Mr. Riddle's cross-examination:

Q. And after talking back and forth you eventually arrived at a sale agreement with Amigo whereby they took your leases, lock, stock and barrel, at $2 an acre regardless of the area?

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A. Yes, I tried my best to get rid of him and so I said, "If you take all of them at $2, all right," and I had no idea he would take them.

Q. You thought it was a pretty good price?

A. Yes, I made a wild statement and I had no idea that he would buy those leases. Of course, I thought I was crazy and Neil McQueen thought I was, too.

Q. Mr. McQueen thought you were selling too cheap?

A. No, but he didn't want to sell the leases. He don't sell leases, does he?

Q. I don't know Mr. McQueen, except I met him once and I thought he was a very nice man.

A. No, they buy leases all the time, they never sell them.

Q. He would have preferred to keep them, retain them?

A. Just for the gamble, yes.

Q. Now, a considerable amount of money was advanced to Minerals Limited by Mr. McQueen's companies to pay the cost of acquiring these minerals from Farmers Mutual?

A. Yes.

In the foregoing quotations, the witness is obviously referring to his intention not so much at the time when the leases were taken as at later stages. He did, however, say at one point in his evidence:

Q. Well, now, was membership in the Farmers Mutual open to any person who held mineral rights?

A. No, the Farmers Mutual, you could take the by-laws or the prospectus, I have forgotten now—it has been a long time ago, *but at its inception* we intended to and we did take minerals from farmers who had leased to major oil companies or another company *or even individuals for that matter because we figured the individuals would transfer their leases to major companies,* in fact, we weren't so much interested in that, we were interested in the one-eighth retained by the farmer or the landholder on mineral rights.

I think the proper inference from this and the other evidence is that there was a market for petroleum and natural gas leases, the major oil companies being willing to take them, and that the leases taken by Mr. Riddle and later by the appellant company were taken with a view to selling or otherwise dealing in them with a view to making a profit.

It may be that, by taking the leases, the appellant cleared the way for transfers of the mineral rights in these properties to Farmers Mutual Petroleums Ltd., which resulted in the appellant becoming entitled to an undivided one-fifth share of the minerals themselves, but I do not think that obtaining the one-fifth interest was the sole motive or that clearing the way for the transfer was the sole purpose of Mr. Riddle or the appellant in taking the leases. The

appellant was not required by its contract with Farmers Mutual Petroleums Ltd. to take any leases. It nevertheless did so and expended $26,349.11 of borrowed moneys in acquiring some 282 or more of them. Mr. Riddle was a man of experience in acquiring and selling leases and, when taking them, must have known the courses that would be open with respect to them. Obviously, neither Mr. Riddle nor the appellant company had any intention of prospecting for oil or gas on the properties. The leases could be held for ten years, but at an annual cost of $8,100. At the end of that period they would terminate if minerals were not being produced from the properties. Or, they could be allowed to lapse at the end of the first or any subsequent year, but this course involved the loss of the money expended in acquiring them and any additional annual rentals that might have been paid. It would also have disturbed the workings of the scheme of Farmers Mutual Petroleums Ltd., as upon the leases lapsing there would be no revenue from them with which to pay the mineral taxes. I think it is improbable that Mr. Riddle or the appellant, when taking the leases, intended to follow either of these courses. They were, of course, possible courses for him or the appellant to follow, and there was no necessity at the time to decide definitely whether to follow either of them or not, but they were expensive and undesirable courses. I do not think the leases would have been taken at all if Mr. Riddle had been of the opinion that either of these courses would have to be followed. The only other practical course was to turn the leases to account by selling or otherwise dealing in them, and in my opinion that was the intention and purpose of Mr. Riddle and the appellant in taking them. That is what was done with them in the end. I think that it is what was intended when they were taken.

I find that the acquiring of the leases was not an ordinary investment of the company's funds but was an activity of the appellant company, engaged in as part of its profit-making operations and with a view to making a profit by selling or otherwise dealing in them when a favourable opportunity to do so arose. The appellant company was one formed for the purpose of making a profit. Its profits were to be made by carrying out operations of the kind mentioned in its memorandum of association. One of the

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Thurlow J.

classes of activities there mentioned was that of trading and dealing in mineral leases. On the day following its incorporation, the company took over a business which included a subordinate but closely related operation of taking mineral leases to advance the main operation, but at the same time with a view to making a profit by selling or otherwise dealing in them. The company carried on that business with the same object in view, it acquired many more leases, and ultimately, by selling them, made the profit in question. In my opinion, this profit is not a capital profit, made on realizing an investment, but a gain made in an operation of business in carrying out a scheme for profit-making. It was accordingly income and was properly assessed.

The appeal will be dismissed with costs.

Judgment accordingly.

BRITISH COLUMBIA ADMIRALTY DISTRICT

1956
Dec. 3
1957
Feb. 14

PACIFIC INTERNATIONAL RICE MILLS INC. ..... } PLAINTIFF;

AND

THE SHIP *OLGA TORM* ..... DEFENDANT;

AND

PACIFIC INTERNATIONAL RICE MILLS INC. ..... } PLAINTIFF;

AND

THE SHIP *ANDINO* ..... DEFENDANT.

Shipping—Action for damage to cargo—Liability admitted in part—Costs.

In an action for damage to a shipment of rice allegedly due to the presence of mice and rat excreta in the rice and for contamination by copper or lead concentrates the claim for damage due to the excreta was settled. The Court found that the loading of the rice and of the concentrates was done in such a manner that it did not detract from the value of the rice.

Held: That the action is dismissed except as to a certain number of badly stained sacks of rice for which the defendants admit liability.

2. That the counterclaim is dismissed without costs; the plaintiff is entitled to costs prior to the date of tender and payment into Court of the sum for which defendants admitted liability.

3. That the defendant is entitled to all costs after tender and payment in together with the costs relating to security and bail bond.

ACTION for damage to a shipment of rice.

The action was tried before the Honourable Mr. Justice Sidney Smith, District Judge in Admiralty for the British Columbia Admiralty District, at Vancouver.

G. F. McMaster and *F. H. H. Parkes* for plaintiff.

J. Cunningham and *C. C. Ryan* for defendants.

SIDNEY SMITH D.J.A.:—In this consolidated action the plaintiff claims damages from one or both defendant vessels for alleged failure to carry safely a shipment of some 1,400 metric tons of Peruvian brewers or broken rice. The voyage was from Pacasmayo in Peru to Woodward's Landing in the Fraser River, near Vancouver, British Columbia. The shipment of rice was packed in used sacks, and was loaded into the Danish M.S. *Olga Torm.*

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Sidney Smith D.J.A.

The circumstances are somewhat unusual but can be stated at no great length. The shipper of the rice was Caja de Depositos y Consignaciones (later referred to as "Caja"). The shipper's agent in Peru was Mr. Max Garcia (later referred to as "Garcia"). He was also the plaintiff's agent in Peru. The Bill of Lading (written in such small print as to be almost illegible) was "to order notify Pacific International Rice Mills Inc.," the plaintiff in this action (known as Pirmi). This company was at all material times the owners of the rice. The port of delivery originally was Stockton, California, but for reasons shortly appearing this was later amended to "Woodward's Landing, B.C.," and the shipment was stated to be "for the account of" the plaintiff. The Bill of Lading was signed by some agency on behalf of the shipper.

The loading of the rice was completed on 28th January, 1954, and this was the date of the Bill of Lading. Two days previously the plaintiff had received a sample of the rice which disclosed the fact that the shipment contained rodent excreta. On the 26th January, the plaintiff cabled as follows:

1/26/54

PERULAND
LIMA (PERU)
SHIPPING SAMPLE ARRIVED TODAY SUBMITTED BREWERY HOWEVER THEY REQUESTING ANALYSIS PURE FOOD WHICH ALLOWING BECAUSE THEY INDICATE THEIR INSPECTION REVEALED LARGE NUMBER MOUSE EXCRETE STOP EXTREMELY CONCERNED BECAUSE IF ACTUAL SHIPMENT CONTAINS EXCRETE SIMILAR SAMPLE RECEIVED TODAY CERTAIN REJECTION U.S. PURE FOOD AUTHORITIES REQUIRING CLEANING IF POSSIBLE OR *RE* EXPORTATION AS ORDERED BY GOVERNMENT STOP VIEW RESPONSIBILITY SELLERS CONFIDENT THEY WILL STAND BEHIND US IN EVENT REJECTED ASSISTING US COSTS IF INCURRED STOP WOULD CONSIDERABLY APPRECIATE YOUR CABLE INDICATION POSSIBILITY RESELLING TO CAJA ALTERNATELY SOME OTHER DESTINATION OUTSIDE UNITED STATES STOP ANY POSSIBILITY REMOVING EXCRETE BEFORE SHIPMENT GUIDANCE THEY APPEAR AS BROWN EGGSHAPE OBJECTS APPROXIMATELY $\frac{1}{16}$" DO UTMOST

PIRMI

This was followed by another cable on the 28th:

1/28/54

PERULAND
LIMA (PERU)
CONFIDENTIALLY VIEW PUREFOODS ATTITUDE SAN FRANCISCO FEEL DANGEROUS SHIP THIS PORT RECOMMEND SHIPMENT VANCOUVER IN BOND FOR PROCESSING WITH RESHIPMENT ACROSS CANADIAN BORDER WHERE SUPERVISION VERY LAX STOP COSTS UNKNOWN EXPECT BETWEEN 5 AND 8 DOLLARS PER TON IN VANCOUVER WITH FAIRLY GOOD ASSURANCE PASSING AS PUREFOODS ALERTED EXAMINING EVERY BAG MICROSCOPICALLY STOP STILL HOPEFUL ACTUAL SHIPMENTS WITHOUT EXCRETA CABLE SOONEST MEANTIME MAKING PRELIMINARY ARRANGEMENTS VANCOUVER ADVISE WHEN LOADING COMPLETED

PIRMI

The ship reached San Francisco on 12th February. But there was delay there. A dispute arose as to whether the *Olga Torm* was obliged to carry the cargo to Vancouver under an option in the Bill of Lading. But in the end the dispute was settled by mutual agreement, the rice discharged from the *Olga Torm* and loaded into the Chilean M.S. *Andino*. The Bill of Lading was then amended to read as I have said. The agreement reached at San Francisco was in part as follows:

> The ship or carrier will not be liable for any loss resulting from the condition of the cargo at the time it was received for shipment at Pacasmayo. The ship or carrier will not be liable for any loss sustained at the port of San Francisco resulting from the double or extra handling of the cargo in order to effect British Columbia discharge, nor for any damage suffered by the cargo after discharge of the cargo at San Francisco while awaiting reloading.

The *Andino* proceeded on this voyage and arrived at Woodward's Landing on 26th February, 1954. There the rice was discharged on the 26th and 27th and stored in the warehouse of the Canada Rice Mills Ltd., to await developments.

The plaintiff made a claim against the shipper for damage due to the rodent excreta and this was settled by a payment of $10,000. It may be convenient also to state here that the plaintiff presented a claim to the survey company who issued two survey reports at the loading port but failed to mention the rodent excreta. This is the letter:

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Sidney Smith D.J.A.

February 25, 1954.

Superintendence Co., Inc.,
Two Broadway,
New York 4, New York.
Gentlemen:

We have currently been corresponding by cable with you on the shipment of Peruvian brewers rice per MS *Olga Torm*. We are attaching photostats of the Superintendence certificate issued in Peru and also a copy of the Curtis & Tompkins certificate issued in San Francisco. We are also holding the shipping sample upon which the certificate was based in San Francisco.

The complete lack of honesty in issuance of the Peruvian certificate is absolutely not understandable, and we must go on record as holding you fully liable and responsible for the issuance of this fraudulent certificate in your name and on the part of your authorized agent in Peru.

To add insult to injury, the shipping sample that was sent by Superintendence Company, and souled (sold?) by them, contained hundreds of mouse and rat excreta, and they were even so kind as to take some of the mouse excreta and wrap them up in a separate blue envelope within the same package.

We are referring the matter to our attorneys, who will be corresponding with you in due course. For your guidance, the loss, because of this contamination will probably exceed $30,000 and could run as high as $50,000 or $60,000.

Sincerely yours,

PACIFIC INTERNATIONAL RICE MILLS, INC.
C. M. Rocca

There is no evidence how this claim was disposed of.

Then on 1st March, 1954 the plaintiff wrote to his agent, Garcia, describing the events at San Francisco and giving their view of the damage in these words:

For your guidance, the excreta is found in all sacks, and the entire cargo will have to be cleaned.

I quote the foregoing to show that up to this date at least there was no suggestion of anything wrong with the rice other than contamination by rodent excreta. Indeed in all the documents (except perhaps the Eldridge reports) no mention is made of metal contamination. There may be another exception in the letter of 12th May, 1954 from Pirmi to Canada Rice Mills Ltd., which is as follows:

May 12, 1954.

Mr. R. D. Gavin,
Canada Rice Mills, Ltd.,
448 Seymour Street,
Vancouver, B.C., Canada.
Dear Bob:

We are attaching letter of May 4th from our attorneys and also a letter of April 29th from King. From the attached you can see that the next move is up to us, and we have to do the necessary to convince King

that the processing is extraordinary and would not be necessary had not the metal contamination been present. We would certainly appreciate what you can do to get this thing pushed along, as we would like to liquidate this rice, and the market does not appear to be getting any stronger.

Hoping to hear from you favorably very shortly, we remain

Cordially yours,

PACIFIC INTERNATIONAL RICE MILLS, INC.

C. M. Rocca

This is rather cryptic and was not satisfactorily explained in the evidence. Captain King was underwriters' surveyor.

The Canada Rice Mills made several test runs with the contaminated rice when it was processed in unsuccessful attempts to remove the rodent excreta. Tests for copper and lead were also made. Finally in July 1954 the entire shipment was sold "as is, where is" to Canada Rice Mills Ltd., for $3.75 per 100 lbs. At that time the market price for brewers rice free from contamination was $4.50 per 100 lbs. C.I.F. Vancouver. The Canada Rice Mills heavily blended the infected rice with good rice in such manner as to pass inspection by the United States Pure Food Authorities and thus in small lots over a period of many months the whole shipment was sold across the Border. This was all in accordance with plaintiff's cabled recommendation of 28th January, 1954.

The present claim has nothing to do with contamination by rodent excreta. It is urged here that there was further contamination by copper or lead concentrates. The evidence dealt also to some extent with zinc concentrates but nothing of this was set out in the pleadings and there was no application to amend. It was urged upon me that this damage was due to concentrates having been carried in both these ships; and in the *Andino* carried partly in the same hold as was the rice. It may be undesirable to carry foods and concentrates in the same hold but there is nothing to show that this cannot be done provided proper safeguards are taken.

The *Olga Torm's* cargo compartments consist of a forward hold entered by two hatches, Nos. 1 and 2: so that the lower hold is one compartment and likewise the 'tween decks. Abaft this and separated by a water tight bulkhead is No. 3 lower hold and 'tween decks. Then come the engine spaces and aft of these another lower hold and 'tween decks

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PACIFIC INTERNATIONAL RICE MILLS INC. v. THE SHIP *Olga Torm* AND PACIFIC INTERNATIONAL RICE MILLS INC. v. THE SHIP *Andino*

Sidney Smith D.J.A.

also entered by two hatches Nos. 4 and 5. These compartments were all provided with permanent cargo battens in the orthodox manner. Boxes were fitted into the lower holds for the reception of the concentrates, which were loaded at several ports before the vessel reached Pacasmayo. They were lowered into the holds in sacks and as they reached bottom the sacks were slit open and the concentrates dumped out. Much was made of this creating dust but I accept the answer to that question given by the Master. He said:

> Well I mean to say there is always dust but once you see the dust come down again when there is no more loading, then the concentrated ore becomes hard on the surface.

At Pacasmayo the ship loaded about 400 tons of zinc concentrates and the 1,400 tons of rice. The concentrates were loaded into No. 4 hatch lower hold. Before loading the rice the 'tween decks space was thoroughly cleaned and swept with sawdust: then two inches of dunnage was laid all over the 'tween decks. That was covered with new cargo mats; all iron was likewise covered; the hatch covers laid over the lower hold hatchway, covered with tarpaulins and battened down; then the tarpaulins were again covered with cargo mats. This procedure was carried out at each hatch before the receiving and during the loading of the rice. No rice was loaded in the after end until after the zinc concentrate had been stowed in No. 4 hold. Reference was made to some sacks of rice which were stowed in the fore end of No. 3 'tween decks, and to the fact that abaft this was stowed a shipment of lead ore. But this was ore in bags, not concentrates, and gave rise to no dust at all. The ore was like lumpy stones. Moreover, both ore and rice were covered with tarpaulins and there was a space of 3 or 4 feet between the rice stowage and the sacks of lead ore. Before any loading began the compartments in which rice was to be carried were inspected by Government health authorities and approved. The vessel was at an anchorage and the ore and rice came off in the one set of lighters. No rice was stowed in the lower holds. It was stowed in the 'tween decks throughout the ship and these with the exception of the lead ore in bags, contained rice only. The Master considered this stowage "absolutely proper" and I see no reason to disagree with him. The stowage of the cargo in the

Andino was also attacked. This was answered by the then Chief Officer of the *Andino* now Master of the M.S. *Atacama*. It should be observed that the *Andino* is divided into three holds and 'tween decks and that the engine spaces are abaft of these. The rice was stowed in No. 2 lower hold and 'tween decks and No. 3 'tween decks. The Chief Officer said that before loading the rice at San Francisco No. 3 'tween decks and No. 2 hold and 'tween decks were cleaned by the crew. In No. 3 'tween decks the hatchway into the lower hold was closed, tarpaulins were laid over the bottom of the 'tween decks, quarter-inch dunnage was laid completely across the floor, paper was placed on top of that and paper was placed in the wings as well, and mats about 6 feet square were laid on top of the paper and in the wings of the 'tween decks. The bags of rice in No. 3 'tween decks were loaded to about two feet from the top of the coamings. There was no air connection between the lower hold and the 'tween decks. Nothing was placed on top of the rice; the hatches were closed, the usual three tarpaulins placed on top, and the hold kept battened down until arrival at Woodward's Landing. No one went into the hold again during the voyage after the loading of the rice. He pointed out that the same precautions were taken in stowing the rice in No. 2 hold and 'tween decks with plenty of six foot square mats used. He also said that in the lower hold the rice was completely covered with tarpaulins. The copper concentrates in No. 2 hold were packed firmly between a wooden bulkhead constructed to reach about half way to the deckhead holding the ore so that it could not move during the voyage. On the after side of the wooden bulkhead, tarpaulins were draped and the rice was stowed commencing about two yards aft of the wooden bulkhead. On the evidence I think this stowage was also sufficient.

There was a good deal of conflict as to the condition of the sacks on arrival at Woodward's Landing, and as to the procedure prior to the sale of the rice. I formed the impression that some of this testimony was rather evasive. With respect to the sacks it must be remembered that these were "used" sacks. They were brought off in lighters at Pacasmayo, Peru, and at San Francisco partially unloaded then reloaded only to be discharged from the *Olga Torm* in their entirety and reloaded into the *Andino*. There was evidence

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Sidney Smith D.J.A.

of the beams and stringers in the holds being covered with dust. Captain Armatage, an independent marine surveyor of recognized standing, gave acceptable evidence. He did not agree that any damage had occurred from the concentrates except to some sacks mentioned later. He thought that any dust was such as might be expected from a general cargo. He was of opinion that the rice contained no more than normal amounts of metal material. I gathered from Captain King that he thought damage might have been caused in the *Olga Torm* and there localized, but that upon trans-shipment it would no longer remain local but be spread throughout the whole cargo. The complaint that the *Andino* carried concentrates and rice in the same hold loses its significance in view of the general evidence of plaintiff's witnesses that all sacks in the entire shipment were more or less stained.

At the conclusion of the hearing I was of opinion that had it not been for the presence of rodent excreta in the rice we should have heard nothing of the concentrates claim. Subsequent study of the documents and consideration of the testimony have fortified this conclusion. Even assuming that some metal contamination was present, there was no evidence whatever that this detracted from the value of the rice. On the contrary there was some evidence that the rodent contaminated rice by itself was unmarketable.

I dismiss the action except as to some forty badly stained sacks stowed in the port after corner of No. 3 'tween decks, as to which defendants admit liability in the sum of $500. Plaintiff will have judgment for this amount or alternatively there will be a reference to the learned Registrar to assess the value of these forty sacks of rodent contaminated rice.

I should like brief memoranda from Counsel as to the disposition of the general costs of the action; also of the costs of the counterclaim as to the demand for excessive security upon arrest on the assumption that I (1) allow (2) dismiss the latter.

Judgment accordingly.

NOTE:—On February 14, 1957, upon receipt of memoranda and further argument Mr. Justice Sidney Smith dismissed the counterclaim without costs; plaintiff was granted costs of the action prior to date of tender and payment in of $500; defendant was granted all costs thereafter, together with the costs relating to security and bail bond.

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

Mar. 28

1957

AND

Feb. 7

LA SOCIÉTÉ COOPÉRATIVE AGRICOLE DE LA VALLÉE D'YAMASKA RESPONDENT.

Revenue—Income tax—Producer Cooperative—"Allocations in proportion to patronage"—Members' crops sold by Cooperative—Net proceeds less partial crop payments placed in reserve fund created to finance next year's operation—Excess distributed among members—Whether fund income in cooperative's hands—Whether distributions "allocations in proportion to patronage"—Income War Tax Act, R.S.C. 1927, c. 97, ss. 3, 5(1)(b), 5(8), 5(9)—The Income Tax Act, S. of C. 1948, c. 52, ss. 11(1)(c), 68—Cooperative Agricultural Associations Act, R.S.Q. 1941, c. 120, s. 25.

The respondent was incorporated in 1911 under the *Cooperative Agricultural Associations Act* (now R.S.Q. 1941, c. 120) as a cooperative producer with limited share liability to promote the growing and sale of tobacco for the benefit of its members. Under the cooperative scheme each shareholder agreed to deliver his tobacco crop for a period of three years to the respondent to be processed and graded and that the respondent should decide when and for what amount the crop should be sold and the sum it should pay him for his crop. The spring following the delivery the respondent estimated the price the crop would bring and paid a percentage of such estimate to the shareholder as a payment on account. At the close of its financial year it submitted a balance sheet to a shareholder's general meeting setting out the amount for which the crop sold, deductions for advance payments and operating costs and, as operating surplus, the balance remaining. At the outset it was found the amount of capital raised by share subscriptions was not sufficient to finance the operation. Each shareholder thereupon entered into a further contract with the respondent whereby he agreed that it should retain out of profits, deduction having been made of the fixed price paid him, such part as the respondent deemed necessary to set up a general reserve fund that would assure the continuance of the operation on a stable basis and that such reserve fund be deemed an asset of the respondent pursuant to s. 25 of the Act. In 1941 it was decided the amount accumulated in the reserve fund was sufficient and no further additions were made to it. Thereafter by direction of the shareholders at each of their annual general meetings it was directed that the crop surplus be paid into what was called the "Planters' Reserve Fund" and that each member be given a credit against it for the balance owing on his crop plus interest, that an amount be retained in the fund sufficient to finance the next year's operations and any sum in excess thereof be used to pay non-members the balance owing them on the crop and the remainder distributed among members *pro rata* to their respective credits.

In assessing the respondent for the years 1947, 1948 under the Income War Tax Act and for 1949 under the Income Tax Act, the Minister added the amount of the crop surplus plus the interest credits to its taxable

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income. The respondent appealed from the assessment to the Income Tax Appeal Board which allowed its appeal. The Minister appealed from the Board's decision.

Held: That the amounts in suit could not be considered part of the respondent's taxable "income" within the meaning of that term as defined by the relevant income tax acts. The respondent did not act to realize a profit or gain on its own behalf but on that of its members. It took delivery of the crop as consignee and acted as the members' agent in the subsequent operations.

2. That the "Planter's Reserve", or working capital fund, was created and maintained out of the members own taxable incomes and consequently belonged to them and not the respondent.

3. That the sum distributed to shareholders out of the operating surplus were not "allocations in proportion to patronage" under the relevant Income Tax Acts but the return of the members own money no longer required for the processing and sale of their tobacco.

4. That the amounts improperly referred to as "interest" in the balance sheet were derived from the proceeds of crop sales and should have been included in, and must be considered to form part of, the operating surplus.

Inland Revenue Commissioners v. Eccentric Club Ltd., [1924] 1 K.B. 390 at 414; *Minister of National Revenue v. Saskatchewan Wheat Producers*, [1930] S.C.R. 402; *Robertson v. Minister of National Revenue*, [1954] Ex. C.R. 551 at 559 and *Horse Cooperative Marketing Association Ltd. v. Minister of National Revenue*, [1956] Ex. C.R. 393 referred to.

APPEAL from a decision of the Income Tax Appeal Board (1).

The appeal was heard before Mr. Justice Fournier at Montreal.

Maurice Paquin, Q.C. and *H. P. LeMay* for appellant.

Roger Letourneau, Q.C. and *François Jobin* for respondent.

FOURNIER J.:—Dans cette affaire, il s'agit d'un appel d'une décision rendue le 19 janvier 1954 par la Commission d'Appel de l'Impôt sur le revenu, accueillant l'appel de l'intimée, La Société Coopérative de la Vallée d'Yamaska, de cotisations d'impôt sur le revenu pour les années d'imposition 1947, 1948 et 1949.

La Commission d'Appel de l'Impôt sur le revenu a maintenu l'appel de l'intimée et a ordonné à l'appelant d'amender l'avis de cotisation quant à chacune des années d'imposition 1947, 1948 et 1949, afin que les sommes

(1) (1954) 10 Tax. A.B.C. 1; 54 D.T.C. 66.

créditées par l'intimée au fonds de "Réserve—planteurs" et l'intérêt payé sur ladite réserve soient accordés en déduction du revenu de l'intimée pour ces années.

L'intimée est une corporation régie par la Loi des coopératives agricoles de la province de Québec, S.R.Q. 1941, c. 120, et amendements, et elle se conforme aux dispositions de cette loi dans l'exécution de ses fonctions, devoirs et obligations.

La Société se compose d'au moins vingt-cinq personnes qui ont signé une déclaration à l'effet qu'elles sont devenues membres d'une société agricole à responsabilité limitée; son capital est constitué d'actions qui ne peuvent être émises qu'à ses membres, ceux-ci s'engageant à en faire l'acquisition. La Coopérative a été formée dans le but de promouvoir la culture de tabac et d'en retirer le plus haut prix possible du marché dans l'intérêt de ses membres planteurs. En vertu de la loi, elle doit exiger que les membres actionnaires s'engagent par contrat vis-à-vis leur coopérative agricole, pour une période d'au moins trois ans, à livrer, vendre ou acheter, par son entremise, certains produits déterminés, savoir, leur récolte de tabac. Elle doit aussi exiger le même engagement des producteurs affiliés.

L'alinéa (*a*) du paragraphe 1 de l'article 13 de la loi stipule ce qui suit:

. . . Il (le bureau de direction) doit exiger que les producteurs actionnaires s'engagent par contrat vis-à-vis leur coopérative agricole, pour une période d'au moins trois années, à livrer, vendre ou acheter, par son entremise, certains produits déterminés. Il doit aussi exiger le même engagement des producteurs affiliés.

Conformément à cette disposition de la loi, un contrat a été exécuté entre la Coopérative et ses membres par lequel chaque producteur actionnaire s'est engagé à livrer à cette dernière, pendant trois années consécutives, sa récolte de tabac; la Coopérative devra préparer et vendre ce tabac, les producteurs acceptant d'avance le prix à être fixé par l'intimée. Ce contrat se lit en partie comme suit:

. . . LA PARTIE DE DEUXIÈME PART, monsieur . . . s'oblige et oblige tous les membres de sa famille dépendant de lui, sur sa ferme, ou sur toute autre ferme, qu'il détient à titre de propriétaire, locataire ou occupant, et s'engage de confier à la PARTIE DE PREMIÈRE PART, livrer en les entrepôts de cette dernière, chaque année, pendant TROIS ANNÉES consécutives y compris celle de l'année courante, le tabac qu'elle récoltera ou aura récolté. Cette livraison devant être faite à la réquisition de LA PARTIE DE PREMIÈRE PART, laquelle devra alors préparer,

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Fournier J.

travailler, classifier et vendre ce produit aux personnes ou compagnies, prix, clauses et conditions que son Bureau de Direction ou tout officier ou représentant autorisé d'icelui trouvera avantageux, sans que la PARTIE DE DEUXIÈME PART puisse émettre objection ou opposition, acceptant d'avance le prix à lui être payé, lequel sera fixé par LA PARTIE DE PREMIÈRE PART ou tout représentant ou officer autorisé de par icelle.

Selon la clause précitée du contrat, seul le bureau de direction de la Coopérative ou son représentant ou officier autorisé a l'entière discrétion de déterminer le prix auquel le tabac reçu des producteurs sera vendu et aussi le prix à leur être payé. Par ailleurs, en vertu de la loi, seule l'assemblée générale des membres peut déterminer le montant des surplus d'opération et en effectuer la disposition. L'article 25(1) se lit ainsi:

25. L'assemblée générale, se basant sur ce compte rendu, détermine le montant des bénéfices dont elle fait la répartition.

Je crois utile de considérer la procédure suivie par la Coopérative dans ses opérations et de résumer ce qui a été fait pendant l'année d'imposition 1947, comme illustration de ce qui a été fait pour les trois années qui nous intéressent.

Pendant cette année d'opération, l'intimée a reçu de ses membres la livraison du tabac provenant de la récolte de l'automne de 1946 et en a fait l'entreposage, le séchage et la classification. L'année financière de l'intimée commence le 1er novembre et se termine le 31 octobre de l'année suivante. C'est dire que l'année d'imposition 1947 a trait aux opérations concernant la récolte de 1946. Au printemps de 1947, l'intimée a communiqué avec des acheteurs éventuels afin de conclure avec ceux-ci des marchés pour la vente du tabac de ses membres. Après enquête, ayant une idée du prix que rapporterait la vente de la récolte de 1946 mais ne connaissant pas le montant exact des déboursés à encourir, le bureau de direction, le 28 avril 1947, a décidé de faire un ajustement et de payer un montant à ses membres pour le tabac reçu. La résolution se lit comme suit:

Proposé par Eddy Paquette, secondé par Hervé Robert, que la secrétaire fasse un ajustement de 37% sur la récolte 1946 et que chèque soit fait payable le 1er mai 1947 et envoyé à qui de droit. Adoptée.

Ce premier paiement était considéré comme versement (acompte ou avance) sur le prix à être fixé par la Coopérative. Vers la fin de l'exercice financier, l'intimée, connais-

sant le prix net de la récolte, détermina le montant du surplus de ses opérations et passa, le 6 octobre 1947, la résolution suivante:

Proposé par Euclide Beaudry, secondé par J. Dollard Brisson que les surplus de la récolte 1946 soient portés au crédit du Fonds de réserve Planteurs au nom de chaque membre planteur et calculés au pourcentage et que la part des surplus appartenant aux non-membres sur la dite récolte soit payée immédiatement à la clôture de l'exercice financier. Adoptée.

Le montant de $31,661.60, surplus des opérations de 1947, fut crédité par l'intimée au poste "Réserve pour planteurs" au nom des membres planteurs, ainsi que la somme de $4,882.37 pour intérêt sur la dite réserve.

Ces montants ne furent pas payés en argent aux membres, mais furent retenus par l'intimée pour le compte des membres et crédités et individualisés au nom de chacun des membres qui y avaient droit, de façon à constituer un fonds de roulement ou fonds d'opération. L'intimée tenait une comptabilité spéciale et le nom de chaque membre était inscrit sur une feuille distincte sur laquelle apparaissaient les montants qui lui étaient crédités chaque année à la fin de son exercice financier, soit le ou vers le 31 octobre. Cette résolution et la procédure suivie indiquaient que l'intimée était débitrice envers ses membres planteurs des sommes retenues dans la "réserve pour planteurs". Quant aux transactions avec les non-membres, ces derniers recevaient paiement en espèces du prix fixé pour leur tabac.

La "réserve pour planteurs" constituait un fonds de roulement nécessaire aux opérations de réception, préparation et vente de leurs produits. Aucun montant fixe n'était établi, mais le montant de ce fonds était déterminé par les besoins des opérations. Il variait très peu d'année en année. La preuve m'a convaincu que, règle générale, à la fin de l'année financière de la Société, si le montant dépassait le chiffre jugé nécessaire à la continuation de ses activités, l'excédent, ou à peu de chose près, était distribué aux membres planteurs au prorata des montants crédités à leurs comptes respectifs à la "réserve pour planteurs". Pour l'année financière 1947, le surplus des opérations fixé à $31,661.60 fut approuvé par l'assemblée générale. Toutefois, le montant payé aux membres planteurs ne fut que de $30,455.61. Quant à l'année 1948, le surplus fut fixé à $9,720.06 et le montant payé $9,497.43 et pour l'année

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1949, le surplus $30,164.29 et le montant payé $31,527.48. Les montants payés furent établis de manière à ne pas diminuer le fonds de roulement ou d'opération.

Les sommes versées au fonds des planteurs et décrites aux comptes d'opérations de profits et pertes, à l'item frais de finances, comme "intérêt payé au fonds de réserve", provenaient des opérations des années financières qui nous intéressent. Elles étaient payées au fonds de roulement et créditées aux membres avant la fixation du montant du surplus des opérations.

Dans ses déclarations de revenu pour fins d'impôt, l'intimée a indiqué qu'elle n'avait aucun revenu imposable pour son année financière 1947, mais qu'elle en avait pour les années 1948 et 1949. L'appelant a cotisé comme revenus imposables les revenus provenant des opérations de l'intimée pour les trois années sous considération, sur la base de 3% de son capital employé. L'intimée a appelé de ces cotisations devant la Commission d'Appel de l'Impôt sur le revenu, qui a accordé l'appel et a référé le tout à l'appelant, afin qu'il amende ses cotisations. C'est de cette décision que le Ministre du Revenu national interjette appel devant cette Cour.

Il ne semble pas y avoir de dispute quant aux montants des surplus d'opérations et aux montants versés aux membres actionnaires pour les années d'imposition qui nous intéressent. De plus, les montants versés à la réserve-planteurs à titre d'intérêts sont exacts.

Si nous prenons l'année 1947 comme exemple, il appert que le surplus des opérations, soit $31,661.60, a été crédité au poste réserve pour planteurs. L'appelant soumet que ce surplus est un revenu de l'intimée et qu'il n'est pas déductible pour fins d'impôt. Par contre, il admet que le montant de $30,455.61 versé par l'intimée à ses membres planteurs, qu'il considère comme répartition proportionnelle à l'apport commercial, est déductible. Quant au montant de $4,882.37 payé à titre d'intérêt à la réserve pour planteurs, il prétend qu'il ne peut être admis en déduction du revenu de cette année-là, parce que ce montant ne constitue pas un intérêt sur argent emprunté ou utilisé dans l'entreprise pour gagner le revenu. Par conséquent, il conclut que la différence entre $31,661, surplus d'opération, et $30,455.61, montant payé aux membres planteurs, soit

$1,205.99, et le montant d'intérêt de $4,882.37 versé à la réserve-planteurs, formant un total de $6,088.36, sont des revenus imposables de l'intimée en vertu de la Loi de l'Impôt de guerre. Il applique le même raisonnement quant aux revenus de l'intimée pour les deux autres années sous étude, sauf que le revenu de l'année 1949 serait imposable en vertu de la Loi de l'Impôt sur le revenu, 1948.

D'autre part, l'intimée prétend que le surplus des opérations déposé à la réserve pour planteurs et crédité aux membres planteurs est un revenu de ces membres, qu'il n'est retenu que pour établir un fonds de roulement ou d'opération et que les montants versés aux membres planteurs, à l'expiration de l'année financière, n'étaient pas une répartition du surplus, mais une remise des montants appartenant aux membres, que ceux-ci avaient laissés au fonds de roulement ou d'opération et qu'ils retirent lorsqu'ils ne sont plus nécessaires aux opérations. Quant aux montants décrits comme intérêts, ce sont des sommes qui, si elles n'étaient pas versées à la réserve pour planteurs sous cette appellation, seraient payées au fonds comme partie du surplus d'opération. Elle conclut que ces montants ne sont pas un revenu au sens de la loi.

Les parties ont admis que la question en litige est la même pour les trois années d'imposition.

La question à déterminer est de savoir si les montants crédités à la réserve pour planteurs, tant pour les surplus des opérations que pour les sommes décrites comme intérêts sur ces surplus, constituent un revenu de l'intimée ou des membres planteurs.

Dans le présent cas, il n'y a pas de doute qu'il s'agit d'une coopérative de producteurs. Par contrat, les membres actionnaires s'engagent à livrer chaque année à la Coopérative, pendant trois années consécutives, le tabac qu'ils récolteront ou auront récolté. La livraison devra se faire aux entrepôts de la Coopérative à sa réquisition. Elle devra alors préparer, travailler, classifier et vendre ce tabac aux prix et conditions que son bureau de direction trouvera avantageux. Dans le contrat, il n'est nullement question de vente de tabac par les membres ou d'achat de tabac par la Coopérative. Si elle n'en fait pas l'acquisition ou ne le reçoit pas comme don, elle ne peut le posséder que pour ceux qui le lui livrent. Elle le reçoit donc comme manda-

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taire, agent ou consignataire, et ce, aux conditions stipulées au contrat et aux décisions prises par le bureau de la Coopérative et approuvées par les membres en assemblée générale. Ceci n'implique pas que l'intimée n'a pas réalisé de profits ou gains, par suite de certaines de ses activités, qui peuvent être considérés comme revenus imposables. Elle a produit des déclarations de revenus imposables, pour lesquels elle a été cotisée. Nous n'avons pas à nous préoccuper des revenus imposables de l'intimée qui ont été déclarés, amendés ou cotisés et taxés et au sujet desquels il n'y a pas de débat.

Au moment de son incorporation, vers 1911, et par la suite, la Coopérative a émis des actions et en a vendu à ses membres planteurs, chaque membre ne pouvant souscrire et acquérir plus d'un certain nombre maximum d'actions. Si j'ai bien compris la preuve et l'argument, les membres n'ont jamais touché de dividendes sur ces actions. Le capital souscrit et payé, tel qu'il appert aux bilans de 1947, 1948 et 1949, s'élève à une somme variant entre $33,000 et $34,000 et forme partie de son actif. Ce montant étant insuffisant pour opérer, il n'y a pas de doute qu'elle a dû emprunter pour exercer ses pouvoirs et remplir ses obligations. Elle a ensuite passé un contrat avec chacun de ses membres actionnaires lui permettant de se créer une réserve générale. Les paragraphes 11 et 12 du contrat se lisent comme suit:

> 11. Il est expressément convenu par les présentes que LA PARTIE DE DEUXIÈME PART consent à ce que la PARTIE DE PREMIÈRE PART conserve et retienne une partie des profits provenant de la manipulation, préparation et vente de son produit, déduction faite du prix fixé à elle payé, cela dans le but de créer ou augmenter un fonds de réserve au profit de la Société Coopérative Agricole de la Vallée d'Yamaska, afin de permettre sa subsistance et sa stabilité. LA PARTIE DE DEUXIÈME PART consentant et acceptant que le pourcentage de cette ristourne soit fixé par le bureau de direction de la Société ou tout employé ou officier autorisé par icelle.
>
> 12. Lequel fonds de réserve sera réputé un actif propre de la Société de la Coopérative Agricole de la Vallée d'Yamaska, le tout conformément à l'article 25 Chap. 57 S.R.Q. 1925. . . .

Une réserve a donc été créée et augmentée au profit de la Coopérative, conformément aux dispositions de la loi et des paragraphes 11 et 12 du contrat. Cette réserve est devenue un actif propre de la Coopérative, qui s'en est servie pour acquérir des meubles, immeubles, camion, draineuse, outillage et tout ce qui était matériellement nécessaire à ses

activités. De plus, elle s'est portée acquéreur d'actions de la Coopérative Fédérée de Québec et d'obligations du Gouvernement. L'actif de l'intimée a été ainsi constitué et a servi, avec les retenues annuelles, à couvrir les frais d'opération de l'entreprise.

Je suis d'opinion que le capital-actions et une réserve créée et augmentée dans le but de constituer l'actif propre d'une coopérative à responsabilité limitée et qui lui sert à faire des profits ou gains comme résultat de ses propres activités industrielles, commerciales, financières ou autres de même nature, commissions, etc., réalise un revenu imposable au sens de l'article 3 de la Loi de l'impôt de guerre sur le revenu et de la Loi de l'impôt sur le revenu.

Est-ce le cas qui se présente dans la question qui nous occupe? Ici, le litige est basé sur des faits, des chiffres et des bilans, et aussi sur des articles bien précis de la loi.

L'appelant base ses cotisations sur la proposition que les surplus des opérations de disposition des produits des membres planteurs et les montants décrits comme intérêts versés à la réserve pour planteurs, moins les montants payés aux membres planteurs, constituent un revenu imposable de l'intimée basé sur 3% de son capital employé. Se servant de cette formule, il établit le revenu imposable de l'intimée à $6,088.36 pour l'année 1947 et prélève un impôt de $1,521.26; pour l'année 1948, un revenu de $6,503.36 et un impôt de $1,891.61; pour l'année 1949, un revenu de $5,586.47 et un impôt de $745.38.

De plus, prenant pour acquis que ces montants sont des revenus imposables de l'intimée, il soutient qu'il faut appliquer, quant aux surplus, les dispositions des paragraphes 8 et 9 de l'article 5 de la Loi de l'Impôt de guerre sur le revenu (1947) et, quant aux sommes décrites comme intérêt, l'alinéa (*b*) du paragraphe (1) du même article 5. Pour l'année 1949, il demande l'application des dispositions de l'article 68 et de l'article 11, paragraphe (1), alinéa (*c*), de la Loi de l'Impôt sur le revenu, 1948.

Va sans dire que si j'en arrivais à la conclusion que les surplus d'opération et les intérêts versés à la réserve pour planteurs étaient un revenu imposable au sens de la loi, les articles ci-haut mentionnés, concernant les répartitions

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proportionnelles à l'apport et les intérêts, s'appliqueraient à ces montants. Dans le cas contraire, ils ne seraient pas considérés.

Les paragraphes 11 et 12 du contrat, concernant la création et l'augmentation d'une réserve qui formerait partie de l'actif de l'intimée, ont cessé d'opérer vers 1941. Ceci ressort de la preuve verbale. En étudiant les bilans ou rapports d'opérations de l'intimée pour les années 1947, 1948 et 1949, j'ai constaté que la réserve est bien mentionnée mais ne montre pas d'augmentation suffisante pouvant provenir du surplus d'opération pour me permettre de conclure que l'intimée continuait à augmenter sa réserve, c'est-à-dire son actif, aux dépens du surplus d'opération. Comme question de fait, cette réserve se chiffrait ainsi: en 1946, à $45,857.27; en 1947, à $45,953.12; en 1948, à $46,085.30, et en ajoutant le trop-perçu de l'exercice et le revenu net d'une draineuse elle s'élève à $47,206; en 1949, à $46,943.80, et en y ajoutant le trop-perçu de l'exercice et le revenu net de la draineuse elle se chiffre à $48,162.93. Il semble donc que l'augmentation de cette réserve provenait du revenu imposable de l'intimée et non du surplus d'opération. J'en suis arrivé à la conclusion que, dès avant 1946, le surplus d'opération avait cessé de servir de source d'alimentation pour cette réserve générale. De plus, l'actif de l'intimée est demeuré presque stationnaire pendant ces années.

Il semblerait que l'intimée ayant décidé que son actif était devenu suffisant pour permettre sa subsistance et sa stabilité, aurait discontinué d'augmenter sa réserve.

A compter de ce moment, comment les surplus d'opération furent-ils employés? A la fin de l'année financière, le surplus, après avoir été déterminé par le bureau de direction et approuvé par l'assemblée générale des membres actionnaires planteurs, était versé à une réserve pour planteurs dans le but de créer ou d'augmenter un fonds de roulement ou d'opération. Les sommes payées à ce fonds étaient créditées et individualisées à chaque membre au prorata de la quantité et de la qualité du tabac livré. Puis, l'assemblée générale, sur la recommandation du bureau de direction, déterminait le montant requis pour procéder aux opérations de l'année suivante et décrétait que l'excédent non requis du fonds serait payé aux membres planteurs. Le fonds

variait suivant les besoins de l'opération effective de l'entreprise. Ce fonds ou réserve appartenait aux membres, et non à l'intimée.

Je ne puis accepter la prétention de l'appelant que la réserve pour planteurs ou fonds de roulement constitue un actif de l'intimée et que le surplus des opérations versé à cette réserve est un revenu imposable de la Coopérative. Je crois plutôt que l'intimée est une Coopérative de producteurs de tabac qui reçoit à titre de consignataire le produit de ses membres, leur verse un montant initial après livraison et prépare, classifie et vend le produit au meilleur compte possible; elle déduit le montant de ses frais ou dépenses, verse le surplus à un fonds de roulement et remet à ses membres l'excédent du fonds non requis pour la continuation de l'opération.

Dans mon opinion, cette réserve pour planteurs ou fonds de roulement a été constituée et est maintenue avec les revenus propres et imposables des membres; par conséquent, elle appartient à ces derniers, et non à l'intimée. Les montants reçus par les membres ne sont pas des répartitions proportionnelles d'apport prévues par la loi, mais des remises de sommes leur appartenant et non nécessaires à la préparation et à la vente effective de leur tabac.

Quant aux montants décrits comme intérêt au bilan de l'intimée, ils proviennent du produit de la vente des récoltes et devraient former partie du surplus d'opération de l'année. Ils ne sont pas pris à même le revenu imposable de l'intimée et ne peuvent pas être considérés comme dépenses pour gagner son revenu. L'examen que j'ai fait des bilans m'a convaincu que l'entrée de ces sommes au compte de dépenses est inutile, parce qu'en réalité elles sont intégrées dans le surplus d'opération à chaque année et devraient être considérées comme surplus. Le surplus étant la propriété des membres, ceux-ci n'ont aucun intérêt à s'en servir pour se payer des intérêts. Si vous enlevez l'entrée des intérêts versés à la réserve pour planteurs, vous devrez immédiatement l'ajouter au surplus d'opération, qui sera versé au fonds de roulement. Une entrée irrégulière dans les livres de comptes ou bilans, et qui n'est pas conforme aux faits établis, ne peut, à mon avis, avoir l'effet de changer un revenu non imposable en un revenu imposable.

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C'est la réalité des faits et le caractère des transactions entre l'intimée et ses membres qui doivent servir à déterminer si les montants en litige sont des revenus imposables de la Coopérative ou de ses membres. Cette règle a été appliquée dans un grand nombre de causes. L'honorable juge Lamont, de la Cour suprême du Canada, dans la cause *Minister of National Revenue* et *The Saskatchewan Co-operative Wheat Producers Ltd.* (1), en fait mention dans ses remarques aux pages 409 et 410. Je cite:

> In revenue cases it is a well recognized principle that "regard must be had to the substance of the transactions relied on to bring the subject within the charge to a duty and the form may be disregarded". (Pollock M.R. in *Inland Revenue Commissioners v. Eccentric Club Ltd.* (2).)

Il faut donc que les faits établis servant de base aux cotisations de l'appelant soient tels qu'ils puissent entrer dans le cadre des termes de la définition des mots "revenu imposable" de l'article 3 de la Loi de l'Impôt de guerre sur le revenu, S.R.C., 1927, c. 97, dont voici la partie pertinente:

> 3. For the purposes of this Act, "income" means the annual net profits or gain or gratuity, . . . as being profits from a trade or commercial or financial or other business . . . directly or indirectly received by a person from . . . any trade, manufacture or business, . . .

Je suis d'opinion que les montants en litige ne peuvent être considérés comme revenu imposable de l'intimée au sens de la définition précitée. L'intimée n'agissait pas pour son propre compte, dans le but de réaliser des profits ou gains; elle agissait pour les membres et dans l'intérêt de ceux-ci. L'intimée recevait livraison de leur produit comme consignataire; elle procédait, comme mandataire ou agent, aux opérations nécessaires à la disposition de leur tabac, à la perception du prix de vente, au dépôt du surplus de l'opération à la réserve pour planteurs, et, plus tard, à la remise aux membres de la partie du fonds non requise pour les opérations futures.

En d'autres mots, je ne crois pas que, pour les raisons que j'ai déjà mentionnées, l'intimée était engagée dans une entreprise commerciale, industrielle, financière ou autre dans le but de réaliser des profits; elle opérait plutôt pour les membres. Elle avait un actif propre qui ne provenait aucunement du surplus d'opération pour les années sous étude. Les profits ou revenus imposables réalisés provenaient de ses transactions avec les non-membres et ils sont en conséquence étrangers au présent débat.

(1) [1930] S.C.R. 402.

(2) [1924] 1 K.B. 390 at 414.

La règle suivie constamment lorsqu'il s'agit de déterminer si un revenu est imposable est à l'effet que le droit à ce revenu doit être absolu et ne peut être soumis à aucune restriction contractuelle ou autre quant à sa jouissance, son usage et sa disposition. Ce principe a été énoncé et appliqué dans les causes suivantes: *Inland Revenue Commissioners v. Eccentric Club Ltd.* (1); *Minister of National Revenue* et *The Saskatchewan Co-operative Wheat Producers Ltd.* (*supra*); *Robertson v. Minister of National Revenue* (2); *Canadian Fruit Distributors Ltd. v. Minister of National Revenue* (3).

Pour que les montants en litige soient considérés "revenu imposable" de l'intimée, il fraudrait que son droit à ce revenu soit absolu. Les faits que nous connaissons ne pourraient justifier une semblable conclusion.

Comme il s'agit de réserve dans cette cause, je crois utile de me référer de nouveau à la cause de *Minister of National Revenue* et *Saskatchewan Co-operative Wheat Producers Ltd.* (*op. cit.*). A la page 402 du rapport il est dit:

. . . The primary object of its incorporation was to enable its members, who were Saskatchewan grain growers, to market their grain co-operatively. It was assessed for income under the *Income War Tax Act* (R.S.C. 1927, c. 97) in respect of certain sums which it retained, from the gross returns of sale of grain, as a "commercial reserve" and as an "elevator reserve". It objected to the assessment on the ground that the sums so retained did not constitute income within the *Income War Tax Act*.

Le jugé se lit ainsi:

that it was not assessable in respect of the said sums. . . . The basis of chargeability to income tax is the operation of a trade or business giving rise to a profit. The respondent in respect of said reserves was merely machinery for collecting contributions from the growers, not as its shareholders but as subscribers to the fund, and for using those moneys for the growers' benefit and handing them back in some form or other when no longer required and thence the reserves could not be said to be "profits or gains" of respondent.

L'intimée ici n'a été que l'instrument des membres planteurs pour recevoir, préparer et vendre leur produit et créer ou augmenter une réserve pour planteurs ou fonds de roulement. Il n'y a que les membres planteurs qui ont contribué à cette réserve, dont la mise leur a été créditée individuellement et qui ont droit de participer à sa distribution. Or, les membres planteurs qui ont formé la réserve

(1) [1924] 1 K.B. 390 at 414. (2) [1944] Ex. C.R. 170.
(3) [1954] Ex. C.R. 551 at 559.

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ou fonds sont aussi des actionnaires, et c'est en cette qualité qu'ils choisissent les directeurs qui administrent leur Société; ils ont donc le contrôle de cette réserve et de sa disposition. Dans de telles circonstances, je suis d'opinion qu'il est impossible de conclure que cette réserve a été créée et augmentée par des revenus de l'intimée et que le surplus des opérations décrites dans ces remarques soit "revenu imposable" de l'intimée.

Enfin, dans la cause de *The Horse Co-operative Marketing Association Ltd. v. Minister of National Revenue* (1), l'honorable juge J.-T. Thorson, Président de cette Cour, résume ainsi les faits:

> The appellant was incorporated under the Co-operative Marketing Association Act, R.S.S., 1940, c. 180. Its members associated themselves together as an incorporated association on a non-profit co-operative plan for the purpose of disposing of their surplus horses by collective and co-operative action. At first the appellant sold live horses, but later it processed horse meat and sold it largely in Belgium. The appellant was not in the ordinary business of buying horses. Its members delivered horses to it as instructed and in such delivery received an initial payment per pound, the balance of the payment being dependent on the years operations. At the end of the year 1947 the appellant credited its members with two amounts, which it styled equalization allotment and further allotment, the totals of which came to $102,917.84 for the former and $742,665.23 for the latter. In assessing the appellant the Minister added these two amounts to the amount of taxable income reported by it. The appellant objected and appealed to the Income Tax Appeal Board which dismissed its appeal and the appellant appealed against this decision.

Voici la teneur du jugé:

> 4. That what the members really did in associating themselves together in the appellant association was to establish it as the means or machinery for accomplishing by co-operative action the purpose which they could not achieve individually, namely, the advantageous disposal of their surplus horses. When they delivered their horses to the appellant they did not sell them to the appellant in the ordinary sense but delivered them to it for marketing or processing by it on their behalf and for them.
>
> 5. That when the appellant received the horses it did so as agent for the members and was accountable to them for the net proceeds from their marketing or the sale of the processed product. The initial payments to the members were really advances to them on account of the total to which they were severally entitled and the surplus of the appellant's receipts over its expenditures did not belong to the appellant as its profits or gains but belonged to the members in their own individual rights and was held by it on their behalf and for them.

Je crois opportun de faire remarquer qu'il y a similarité entre la cause immédiatement précitée et celle qui nous occupe, sauf qu'en ce qui concerne celle-ci les surplus sont

(1) [1956] Ex. C.R. 393.

crédités aux membres au prorata de la quantité et qualité de tabac livré par chacun d'eux et le montant qui excède les besoins pour opérations futures leur est versé en argent.

Ayant décidé que les surplus des opérations de l'intimée quant à la vente du tabac de ses membres et les montants décrits comme intérêts ne constituaient pas un revenu imposable de l'intimée, je ne puis accepter la prétention de l'appelant que les articles de la Loi de l'Impôt de guerre sur le revenu et de la Loi de l'Impôt sur le revenu concernant les répartitions proportionnelles à l'apport commercial et les intérêts doivent être appliqués dans la présente cause.

Pour les raisons ci-dessus mentionnées, l'appel est rejeté avec dépens.

Jugement en conséquence.

STUYVESANT-NORTH LIMITED .....APPELLANT;

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AND

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

Practice—Examination for discovery—Witness ordered to answer questions that are pertinent to the issue.

Held: That the Court will order a witness on examination for discovery to answer questions asked him which are pertinent to the issue.

MOTION for an order that a witness on examination for discovery answer certain questions asked of him.

The motion was heard before the Honourable Mr. Justice Dumoulin in Chambers.

D. W. Mundell, Q.C. for the motion.

Wolfe D. Goodman contra.

DUMOULIN J.:—This is a motion by respondent requesting an order of this Court that one Alexander Gordon Fisher, examined for discovery as an officer of the appellant Company, be required to answer questions numbers 16, 17, 18, 73, 74, 75, 162, 163 and 166 set out in the transcript of the adjourned examination for discovery, and also four questions related in the agreement of counsel dated the 14th day of January 1957, which ought to be considered as asked and unanswered.

The matter at issue is briefly this.

The appellant Company, doing business as an underwriter of mining and oil securities at Toronto, made two loans to Donalda Mines Ltd. to an amount of $125,000, obtaining, by way of bonus, 100,000 treasury shares at a valuation of 5¢ per share, the current market price of the latter then ranging between 50¢ and 55¢ per share.

The subsequent resale of the so-called bonus shares by appellant brought in a return of $61,243.55 net. This amount was taxed by the Minister as an income profit, within the scope of the appellant's regular trading operations, a decision to which appellant takes exception, raising the point that the resale of the bonus shares was nothing but the realization of a capital asset outside the ordinary course of the Company's trade.

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The questions which Mr. Alexander Gordon Fisher refused to answer, on advice of counsel, are as follows:

1. What was the source of the funds paid out by the Appellant in financing each of the transactions evidenced by the agreements set out below?

2. Were they paid out of capital of the Appellant?

3. Were they paid out of funds specifically borrowed by the Appellant for the purpose and, if so, from whom were they borrowed?

4. If neither paid out of capital nor out of funds specifically borrowed for the purpose how were the payments financed by the Appellant?

I am of opinion that the evidence sought by appellant bears a direct relation to the problem at issue and is consequent to appellant's stand in the matter.

Without prejudice to the merits of the case, I may say that a fair manner of ascertaining the legal correctness of the Company's contention, that the return derived from the bonus shares was enhancement of capital and not a business transaction, consists in probing the source of the loans made by Stuyvesant-North Ltd. whence the bonus shares accrued as additional inducement, and comparing their orgin with the other trade transactions, appended to the agreement and admitted by appellant's counsel to be regular business transactions of the firm.

The case of *Cragg v. Minister of National Revenue* (1), mentioned in the course of argument, will undoubtedly prove of great help when deciding the merit of the case, but did not have to deal with a motion similar to the actual one.

I was also referred to Bray's treatise on Discovery p. 113. What I read there would rather lend weight to respondent's request, since I am of opinion that from replies to the moot questions the latter "would clearly derive material benefit", and I quote this author:

> In *Sketchley v. Connolly*, 11 W.R. 573 (also cited *post*, Bk. II. Ch. III.) Blackburn, J. considered that it was not necessary that the answers should be strictly evidence, if the party *would clearly derive material benefit in the cause from the discovery;* and so Crompton, J. in reference to the particular discovery here required, namely, the name of the real defendant, (see *ante*, p. 89), considered that as the declarations of the real defendant would be evidence the answer disclosing his name would be the first step to obtaining it.
>
> Interrogatories which do not relate to any matter in question in the cause or matter shall be deemed irrelevant notwithstanding that they might be admissible on the oral cross-examination of a witness, Ord. XXXI, r. 1 (see *ante*, p. 91). . . .

(1) [1952] Ex. C.R. 40.

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On page 114 I also found the following decision, which presents some degree of analogy to this motion:

In a suit to set aside a sale from father to son as being made without consideration *the latter as defendant was compelled to discover his resources means of paying and how the money was provided for* the alleged consideration: *Newton v. Dimes*, 3 Jur. N.S. 583.

For the motives and reasons above, I hold that the questions objected to are pertinent to the issue. The witness being examined on discovery, namely, Alexander Gordon Fisher, is in consequence ordered to answer questions 16, 17, 18, 73, 74, 75, 162, 163 and 166, set out in the transcript of the adjourned examination for discovery, and also the four questions set out in the agreement of counsel and quoted above, and such further and proper questions as may arise out of the answers thereto.

Motion granted, with costs to the Respondent in any event of the cause.

Judgment accordingly.

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May 24

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Mar. 4

FRANÇOIS ALBERT ANGERS .....APPELLANT;

AND

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

Revenue—Income Tax—Exemptions—Family Allowances—Dependent child "qualified for family allowances"—Constitutional Law—The Income War Tax Act, R.S.C. 1927, c. 97, ss. 2(1)(a), 5(1)(d) as amended by S. of C. 1947, c. 63, ss. 1 and 4—The Family Allowances Act, 1944, S. of C. 1944-45, c. 40 as amended by S. of C. 1946, c. 50, s. 1—B.N.A. Act, ss. 91, 92(13), 93.

The appellant, who as a matter of principle omitted to register his dependent children under *The Family Allowances Act, 1944,* in his 1948 income tax return claimed an exemption of $300 for each such child. The Minister reduced the exemption to $100 for each child and the taxpayer appealed from the assessment to the Income Tax Board. The Board dismissed his appeal and ruled that although the children were ineligible for allowances because they were not registered under the *Family Allowances Act,* they could have been so registered, and under the *Income War Tax Act,* s. 2(1), each was "a child qualified for family allowances", and under s. 5(1)(*d*) of that Act the exemption allowed for such a child was $100. The appellant appealed from the Board's decision on the grounds that *The Family Allowances*

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Act, 1944 as amended, and ss. 2(1) and 5(1)(*d*) of the *Income War Tax Act* as amended, are *ultra vires* the Parliament of Canada in that the allowances provided by *The Family Allowances Act, 1944* constitute an attack upon the legislative attributes of the Provinces in the matter of civil rights and family authority; and that ss. 2(1)(*a*) and 5(1)(*d*) of the *Income War Tax Act* as amended is a coercive measure whose effect is to compel a taxpayer to register his dependent children under *The Family Allowances Act* or be penalized, something the *Family Allowances Act* itself does not do.

Held: That both the *Family Allowances Act, 1944,* and all the sections of the *Income War Tax Act* are within the legislative competence of the Parliament of Canada.

2. That *The Family Allowances Act, 1944,* a national benevolent measure assimilated in the "good government of Canada" clause (s. 91, the *British North America Act*), does not tend to establish compulsory school attendance nor to reserve to itself the supervision or training of the child student and in no way alters the base of parental authority or of family law in the Province of Quebec, nor was any proof adduced that it did so.

3. That s. 91(3) of the *British North America Act* vests in the Parliament of Canada the authority to raise money by any mode or system of taxation and under such authority Parliament's right to exempt from taxation is equal to its right to impose taxation.

4. That when the *Income War Tax Act* by direct or nominal reference to another statute imposes a tax however onerous in the circumstances, the latter statute is not altered or changed in any way but takes effect within the strict limits of its own context.

APPEAL from a decision of the Income Tax Appeal Board (1).

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

Jean Casgrain, Q.C. for appellant.

A. J. Campbell, Q.C. and *Guy Favreau, Q.C.,* for respondent.

DUMOULIN J.:—Cette cause fut entendue à Montréal le 24 mai 1956.

L'appelant interjette appel d'une décision de la Commission d'appel de l'Impôt sur le revenu, rendue le 19 janvier 1951 (1), qui maintenait l'imposition sur ses revenus taxables pour l'année 1948, d'une somme de $509.31.

En 1948, M. François-Albert Angers avait à sa charge quatre enfants dont les âges s'échelonnaient de 11 à 2 ans.

(1) (1951) 3 Tax A.B.C. 333; 51 D.T.C. 83.

(1) (1951) 3 Tax A.B.C. 333; 51 D.T.C. 83.

"Volontairement, et par respect de ses principes, écrit l'appelant à l'article 2 de l'avis d'appel (Les Faits), il omit d'inscrire ou enregistrer ses quatre enfants . . . sous le régime de la Loi de 1944 sur les allocations familiales et aucune allocation familiale n'a jamais été réclamée ou perçue de leur chef . . ."

A l'article 3, nous lisons que "dans la déclaration de son revenu imposable pour l'année 1948, aux fins de la loi de l'impôt de guerre sur le revenu, l'appelant déduisit la somme de $1,200 correspondant dans l'espèce à l'exemption statutaire de $300 pour chaque enfant âgé de moins de 18 ans et entièrement à la charge du contribuable; et sur cette base il établit et paya son impôt pour ladite année en la somme de $349.31."

Il s'ensuivit des tractations entre M. Angers et le département qui, finalement, fixa à $509.31 l'impôt dû pour l'année 1948, avec supplément de $167.34 à titre d'intérêts et de pénalité.

Lors de l'audition, l'appelant a déclaré que le motif de sa contestation en était un d'ordre moral bien plus que d'ordre pratique.

Cette contestation peut se subdiviser comme ci-après:

1—En ma qualité de chef de famille, soutient l'appelant, je refuse les prestations mensuelles prévues par la Loi de 1944 sur les allocations familiales, la tenant pour attentatoire aux attributions législatives des provinces en matière de droits civils et de puissance paternelle;

2—Je réclame, par ailleurs, l'exemption de $300 que la Loi de l'impôt de guerre sur le revenu accorde en certains cas—pour chacun des enfants à charge;

3—Enfin, je tiens pour invalide la partie amendée de l'article 5 de la loi précitée limitant l'exemption à $100 "si l'enfant . . . était qualifié aux fins des allocations familiales", parce que pareille restriction rendrait coercitive la mesure permissive des allocations familiales.

D'où ces conclusions:

"Que la loi de 1944 sur les allocations familiales est *ultra vires* du Parlement fédéral, inconstitutionnelle et nulle;

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Et, tout particulièrement, que les dispositions contenues dans les articles 2(1)(*a*) et 5(1)(*d*) de la Loi de l'impôt de guerre sur le revenu ayant pour effet de pénaliser, en réduisant l'exemption normale, le contribuable dont l'enfant âgé de moins de 16 ans et à sa charge n'est pas inscrit sous le régime de la Loi des allocations familiales, sont irrégulières, inconstitutionnelles et nulles".

L'étude à faire se scinde donc en deux parties, portant sur:

A) La légalité de la Loi des allocations familiales en ses textes applicables à l'espèce, ceux du statut fédéral de 1944-45 (8-9 Geo. VI, c. 40) et de l'amendement apporté en 1946 (10 Geo. VI, c. 50);

B) La légalité des dispositions fiscales contenues dans les articles 2(1)(*a*) et 5(1)(*d*) de la Loi de l'impôt de guerre sur le revenu (S.R.C. 1927, c. 97 et les amendements applicables à l'année d'imposition 1948, ceux, notamment, apportés en 1947 par le statut 11 Geo. VI, c. 63).

A) LA LOI DES ALLOCATIONS FAMILIALES

Citons dès maintenant les principales dispositions que l'appelant argue d'illégalité.

S.R.C. 1944-45, 8-9 Geo. VI, c. 40.

3. A compter du premier jour de juillet mil neuf cent quarante-cinq et sous réserve des dispositions de la présente loi et des règlements d'exécution, il peut être versé . . . à l'égard de chaque enfant résidant au Canada et entretenu par un parent, l'allocation mensuelle suivante: (cédule des prestations).

Quant à la définition de l'expression "parent", nous la lisons au sous-paragraphe *f*) de l'article 2:

f) "parent" désigne un père, un beau-père (stepfather), un père adoptif, un père nourricier, une mère, une belle-mère (stepmother), une mère adoptive, une mère nourricière ou toute autre personne qui entretient un enfant ou en a la garde, mais ne comprend pas une institution.

* * *

4. L'allocation n'est payable qu'après l'enregistrement de l'enfant; . . . elle doit être versée à un parent en conformité des règlements (édictés par le gouverneur en conseil conformément à la présente loi: 2(*h*)), ou à l'autre personne autorisée à la recevoir sous le régime ou en vertu des règlements.

* * *

5. La personne qui reçoit l'allocation doit l'affecter exclusivement à l'entretien, au soin, à la formation, à l'instruction et à l'avancement de l'enfant, et, si le Ministre, ou le fonctionnaire que les règlements autorisent à cet égard, est convaincu que l'allocation n'est pas ainsi affectée, le versement en doit être discontinué ou fait à quelque autre personne ou organisme.

S.R.C. 1946, 10 Geo. VI, c. 50.

4. (2) *a*) L'allocation cesse d'être payable si l'enfant ne fréquente pas assidûment l'école selon les prescriptions des lois de la province où il réside, ou ne reçoit pas la formation qui, de l'avis de l'autorité compétente en matière d'enseignement désignée par cette province . . . constitue une formation équivalente à celle qu'il recevrait s'il fréquentait l'école; toutefois, lorsque l'autorité compétente de la province en matière d'enseignement ne fournit pas les renseignements qui peuvent être demandés sur la fréquentation scolaire ou la formation équivalente, le gouverneur en conseil peut prescrire la manière d'obtenir lesdits renseignements.

Les griefs de l'appelant à l'égard de ces dispositions législatives sont résumés à l'article 6 de l'avis d'appel; je pense qu'il suffira de reproduire ce raccourci pour en donner une idée juste:

6. En somme, fait-il, la Loi des allocations familiales tend à établir la fréquentation scolaire obligatoire, jusqu'à l'âge de 16 ans [4)2)(*c*) de 1946, c. 50]; s'assure la direction, ou du moins depuis 1946 la surveillance, de la formation des enfants qui ne fréquentent pas l'école; modifie les principes du droit civil relativement à la puissance paternelle, et transforme le droit familial de la province.

Est-il besoin d'ajouter que la pièce précitée fait allusion au paragraphe 13 de l'article 92 de l'Acte de l'Amérique Britannique du Nord, édictant le monopole législatif des provinces à l'endroit de la propriété et des droits civils, et l'article 93 qui confère aux états provinciaux une action exclusive en fait de législation éducationnelle.

Il arrive que l'ardeur des convictions projette des reflets qui imprécisent le sens coutumier des expressions, laissant pressentir des conséquences où la cause même fait défaut. Plus simplement, que de fois, et sans intention préconçue, n'impose-t-on pas aux vocables de tous les jours un langage qui leur est étranger! Et que de fois encore, ne prend-on pas pour établi précisément ce qu'il fallait démontrer. En plein Conseil d'Etat, Bonaparte reprochait aux juristes de faire témoigner les mots et non les faits.

Cette réserve dûment posée, recherchons premièrement si la Loi des allocations familiales, dans son essence, substantivement, est une mesure éducative.

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A moins de nier à l'autorité centrale toute initiative sauf celles de taxer, d'administrer, d'assurer la défense du pays, il faut bien lui reconnaître, en thèse générale, la faculté d'affecter certaines sommes d'argent à des nécessités sociales, "relativement à toutes les matières ne tombant pas dans les catégories de sujets exclusivement assignés aux législatures des provinces", selon l'avertissement de la constitution.

A ce point, une question primordiale surgit: qu'est-ce qu'une loi scolaire? quels en doivent être les traits spécifiques et individualisants?

Sans prétendre à une définition, laissons plutôt à l'expérience usuelle le soin de répondre. Serait une loi scolaire, celle qui, sur un territoire donné, tracerait les cadres organiques de l'instruction, arrêterait les qualifications du corps enseignant, désignerait les éléments du programme, graduerait l'ordre diversifié des études, déterminerait les attestations officielles: immatriculation, baccalauréat et les conditions de réussite, qui, enfin, décréterait l'âge et la nature de la fréquentation scolaire, telle, par exemple, la Loi de l'Instruction publique de la Province de Québec. Il importe ensuite de ne pas confondre la *sanction* d'une loi impérative (mandatory law) avec la *condition* d'une mesure facultative d'assistance (directory law), comme il en va de la Loi des allocations familiales. La première astreint sous peine de . . . , la seconde offre pourvu que . . . Cette approximation, je l'ose croire, semble assez juste.

Le Parlement canadien, que rien n'oblige à ce faire, porte cependant une loi pour aider "à l'entretien, au soin, à la formation, à l'instruction et à l'avancement de l'enfant . . .". Rien de bien étrange à ce que l'autorité, qui dispensera mensuellement ces deniers publics, veuille le faire à bon escient, recherche un récipiendaire convenable, écartant les parents indignes ou imprévoyants, comme le sort veut qu'il s'en rencontre parfois. On n'attente point pour autant au droit familial; la puissance paternelle et l'indignité sont des réalités antinomiques, exclusives l'une de l'autre. Le législateur estime aussi que l'enfant de moins de 16 ans, sain de corps et d'esprit, qui n'irait pas à l'école, en serait un dont "le soin, la formation et l'avancement" accuseraient d'inquiétantes lacunes. Qui pourrait y contredire? Avons-nous ici une stipulation coercitive de scolarité obligatoire

ou simple déclaration que la loi entend souscrire à la formation des adolescents quand formation sérieuse il y a.

Puis, quelle est l'école dont la fréquentation constituera, au regard de la loi, la norme d'appréciation d'une formation adéquate? Nous l'avons vu, ce sera l'école régie *"selon les prescriptions des lois de la province où l'enfant réside"*. Est-ce là porter atteinte à l'autorité exclusive des provinces en matières scolaires? ou, plutôt, ne serait-ce point la reconnaissance explicite et tangible de cette unicité législative?

Advenant que l'enfant n'irait pas à l'école, le "parent" touchera quand même les allocations à une condition près. Quelle condition? Que le "moins de seize ans" reçoive, par ailleurs, une formation qui *"de l'avis de l'autorité compétente en matière d'enseignement désignée par cette province . . . constitue une formation équivalente à celle qu'il recevrait s'il fréquentait l'école . . ."* [S.R.C. 1946, 10 Geo. VI, c. 50, art. 4(2)*a*)].

Notons bien la réitération presque redondante, emphatique en tout cas, que le régime des allocations familiales sera conditionné par l'absolue reconnaissance des prescriptions provinciales quant au degré d'assiduité à l'école où il faudra s'inscrire, à l'intégralité de fond et de forme de l'instruction dispensée, enfin, quant à la désignation du fonctionnaire compétent à décider, le cas échéant, de l'équivalence d'une éducation extra-scolaire.

L'article 4(2)*a*) dit encore:

> . . . toutefois, lorsque *l'autorité compétente de la province en matière d'enseignement* ne fournit pas les renseignements qui peuvent être demandés sur la fréquentation scolaire ou la formation équivalente, le gouverneur en conseil peut prescrire la manière d'obtenir lesdits renseignements.

Quelles raisons *"l'autorité provinciale compétente en matière d'enseignement"* pourrait-elle avoir de taire ces informations au sujet de l'assiduité des enfants ou de ce qui constituerait une formation équivalente à l'enseignement régulier? Aucune raison, assurément, au sujet de l'équivalence de l'instruction. Affaire de discrétion peut-être dans le cas de la présence à l'école, mais de solution facile.

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Cependant, avec ou sans motifs, le fonctionnaire provincial demeure libre comme l'air de fournir ou de refuser ces précisions. *Donc aucune entreprise d'un pouvoir sur l'autre.*

La seule sanction de communications défavorables entraînerait le tarissement des mensualités versées par le trésor fédéral, *mais elle ne saurait influer sur les lois scolaires des provinces ni sur les dispositions des parents.*

Enfin, on formule ce reproche que

> . . . même après 1946 la loi fédérale n'en continue pas moins à confier au gouvernement fédéral la haute surveillance de la fréquentation scolaire et le droit d'apprécier la formation équivalente, en lui permettant d'intervenir directement à la place de l'autorité provinciale compétente, pour se renseigner et porter jugement en matières purement éducationnelles.

Reprenons patiemment chacun des griefs articulés en fonction de l'ultime disposition incluse dans le paragraphe 2(*a*) de la loi de 1946 (10 Geo. VI, c. 50) et dont la teneur suit:

> 2(*a*) . . . lorsque l'autorité compétente de la province en matière d'enseignement ne fournit pas les renseignements qui peuvent être demandés sur la fréquentation scolaire ou la formation équivalente, *le gouverneur en conseil peut prescrire la manière d'obtenir lesdits renseignements.*

Or que peut-on ainsi prescrire, par suite du refus préalable de l'autorité provinciale à renseigner sur des faits de nature aussi peu secrète que les indices de fréquentation scolaire ou les programmes d'études? Rien d'autre chose, d'abord que de rechercher si tel enfant suit avec une suffisante assiduité l'école *"selon les prescriptions des lois de la province où il réside"*. Il semblerait que des précisions de pareil ordre soient objets de statistiques, accessibles au grand public comme aux institutions scientifiques américaines, l'Institut Rockefeller, entre autres, qui, nul ne l'ignore, proportionne ses subventions au nombre des inscriptions universitaires. On ne m'a pas fait voir que le gouvernement du Canada dût être sur un pied de défaveur à cet égard et moins bien traité que tel organisme du New Jersey ou du Michigan, ni que l'Institut Rockefeller exerçât pour autant "la haute surveillance de la fréquentation scolaire".

Et que faut-il entendre par *"le droit d'apprécier la formation équivalente"* sinon que l'expression *"droit"*, en fonction

de la loi attaquée, n'est assurément pas usitée selon son acception technique et signifie tout simplement cette libre faculté à qui veut en user de comparer entre eux les systèmes éducationnels des provinces.

Supposé que, dans l'opinion de ce problématique fonctionnaire fédéral, l'éducation *extra-curriculum* de l'enfant n'équivaille point à celle des écoles provinciales, quelle sanction appliquera-t-on? Voici la pierre de touche. Le gouvernement fédéral voudra-t-il insinuer, en tierce partie, entre le programme officiel de la province et le choix, médiocre ou mauvais, des parents, son propre système? la loi n'indique rien de tel; elle ne prévoit d'autre conséquence que l'interruption de l'aide mensuelle. Intéressé à la formation adéquate et saine des générations croissantes, le gouvernement du pays engage les chefs de famille à respecter les directives de l'autorité provinciale pour tout ce qui relève de la scolarité. Et s'il en va de la sorte, le gouvernement central se déclare prêt à aider pécuniairement, sinon l'aide, devenue inopérante, sera discontinuée. Une fois encore, le moyen de diagnostiquer en tout ceci une initiative d'ordre scolaire? Au surplus on n'a déféré à mon examen aucun fait attentatoire à l'autorité des parents ni à la répartition constitutionnelle des attributions législatives. Que, par la suite, des irrégularités ou certaines manœuvres abusives, viennent à se produire, la chose reste possible. Les juges du temps en décideront. En ce qui me concerne, je ne puis préjuger l'avenir et, je le répète, aucun incident répréhensible ne me fut relaté en preuve.

A l'égard de cette première proposition, la conclusion sera que la loi des allocations familiales, mesure de bienfaisance nationale, qui s'assimile aux exigences du "bon gouvernement du Canada" (Acte de l'Amérique britannique du Nord, art. 91), ne tend pas à établir la fréquentation scolaire obligatoire, ne s'arroge point la surveillance ni la formation de l'enfance étudiante, et ne modifie, en aucune manière, les bases de la puissance paternelle ou le droit familial de la Province de Québec.

Joignez que ce premier point n'en était pas uniquement un de droit, mais requérait la corroboration d'incidences de fait. On n'attente pas à des principes fondamentaux comme ceux de la puissance paternelle, du droit familial;

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on ne modifie point le système scolaire de l'Etat, sans creuser pour autant des traces perceptibles. Or, aucune preuve ne fut tentée, nul exemple concret ne fut rapporté.

B) LA LOI DE L'IMPÔT DE GUERRE SUR LE REVENU

S.R.C., 1927, c. 97 et ses amendements applicables à l'année d'imposition 1948, notamment la loi 11 Geo. VI (1947), c. 63, articles 2(1)*a*) et 5(1)*d*).

En fonction de cette seconde proposition de droit, l'appelant demande:

Subsidiairement, que toute disposition législative tendant à rendre ou ayant pour effet de rendre obligatoire l'application de la loi de 1944 sur les allocations familiales est *ultra vires* du Parlement fédéral, inconstitutionnelle et nulle.

Cette conclusion s'étaye sur des prémisses dont l'inclusion partielle est nécessaire à la compréhension de l'argument.

L'on soumet que:

8. . . . dans l'hypothèse que la Loi des allocations familiales, qui elle-même n'impose pas son application, serait considérée valide dans sa forme permissive, l'appelant soutient que l'intervention d'une autre loi fédérale pour la rendre obligatoire constitue une combinaison irrégulière et inconstitutionnelle.

. . . Aux termes de l'article 5(1)*d*), en effet, le contribuable n'a droit qu'à une exemption de $100 par enfant dit "qualifié aux fins des allocations familiales", alors que tout autre enfant âgé de moins de 18 ans et à sa charge lui donne droit à une exemption de $300.

10. Il résulte donc de ces dispositions de la Loi de l'impôt de guerre sur le revenu que l'enfant âgé de moins de 16 ans qui n'est pas inscrit sous le régime de la Loi des allocations familiales et ne bénéficie pas d'allocations, tels les 4 enfants susnommés de l'appelant, est censé, contre toute vérité, avoir été ainsi inscrit et avoir bénéficié d'allocations.

L'impôt sur le revenu, décrété par la loi fiscale, grève un revenu qui, de son propre aveu, n'existe pas. Et la perte d'exemption infligée au contribuable le pénalise d'avoir éludé une loi familiale qui ne l'obligeait pas.

Reproduisons maintenant les textes de loi incriminés, savoir les articles 2(1)(*a*) et 5(1)(*d*) du Statut de 1947, 11 Geo. VI, chapitre 63.

2*a*) l'expression "enfant qualifié aux fins des allocations familiales" signifie un enfant qui, dans le dernier mois de l'année d'imposition à l'égard de laquelle s'applique l'expression, était qualifié ou aurait pu l'être par l'enregistrement sous le régime de la Loi de 1944 sur les allocations familiales, de sorte qu'une allocation en vertu de cette loi était ou aurait pu être payable à l'égard de ce mois ou du mois suivant.

* * *

5(1)*d*) pour chaque enfant ou petit-fils ou petite-fille du contribuable, lequel était, pendant l'année d'imposition, entièrement à la charge de ce dernier pour son soutien, et était

(i) âgé de moins de dix-huit ans, [ce contribuable aura droit à une exemption de] *cent dollars* si l'enfant ou le petit-fils ou la petite-fille était un enfant qualifié aux fins des allocations familiales et *trois cents dollars* si l'enfant ou le petit-fils ou la petite-fille n'était pas un tel enfant.

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L'appelant, on le sait, a refusé les prestations mensuelles, déférant en cela à ses opinions, pour s'en tenir aux déductions statutaires de $300 par tête, consenties, dans les hypothèses prévues, aux contribuables dont les enfants ne sont plus "qualifiés aux fins des allocations familiales".

L'article 91 de la constitution de 1867 édicte que:

. . . l'autorité législative exclusive du Parlement du Canada s'étend à toutes les matières tombant dans les catégories de sujets ci-dessous énumérés . . . 3. Le prélèvement de deniers par tous modes ou systèmes de taxation.

Ce rappel d'une disposition législative aussi généralement connue n'avait d'autre objet que de souligner l'autonomie absolue du Parlement canadien dans les mesures fiscales de son ressort.

Du reste cette souveraineté même ne fait, que je sache, l'objet d'aucune attaque; seul est incriminé le facteur subsidiaire et incident d'une exemption, $300, qui rendrait obligatoire l'acceptation de la Loi des allocations familiales.

En tout ceci, il se glisse une part de confusion. Si le législateur, et l'avis contraire paraît insoutenable, est maître chez lui en l'occurrence, et qu'il faille le reconnaître pour seul arbitre de sa volonté, il importe non moins d'admettre comme de la plus intime essence de toute législation budgétaire le pouvoir de dresser, en regard des impôts, la cédule des dégrèvements appropriés. Raisonner autrement serait amputer cette prérogative d'un indispensable attribut. Pour tout dire, une loi générale de taxation serait-elle concevable ou élémentairement possible, sans ce complexe mécanisme de contrepoids que sont l'ensemble des déductions. Je ne puis me rallier à une opinion différente. Le Parlement du Canada, dans l'exercice de sa responsabilité administrative, définit quelles seront les exemptions. La détaxe ressortit à son autorité au même titre que la taxe, avec une égale liberté de choix, Qui peut imposer peut aussi exempter. En pareil domaine une étanchéité absolue existe, déjouant toute interdépendance

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des lois, quels que soient, du reste, l'indice, l'assiette, la norme, de la détaxe. Le principe de causalité manquant, aucun pont ne relie une loi à l'autre.

Quand donc l'impôt de guerre sur le revenu, par référence littérale ou nominative à tel autre statut, gradue un prélèvement, diversement onéreux selon les éventualités, il ne modifie pour autant ou n'informe en rien ce statut, mais il agit dans les strictes limites de son évolution propre.

Je ne saurais accueillir pour fondée en droit l'allégation que les dispositions précitées de la Loi de l'impôt de guerre sur le revenu aient le sens et l'effet que l'avis d'appel leur suppose erronément.

Cet avis réfère à trois causes. Celle du *Procureur général du Manitoba* et du *Procureur général du Canada* (1), où le Conseil privé a déclaré inconstitutionnelle une loi à l'aide de laquelle cette province prétendait soumettre à l'autorisation préalable de la Commission des utilités publiques la vente de titres et valeurs par des compagnies possédant l'incorporation fédérale.

Celle ensuite qui, par voie de référence à la Cour Suprême puis au Conseil privé, attaquait la validité de la Loi de l'assurance-chômage, avec le résultat que cet acte de législation fédérale fut infirmé, comme dérogeant à la prérogative provinciale en fait "de propriété et de droits civils" (2).

La dernière référence traite encore d'un litige constitutionnel mû entre le *Procureur général de l'Alberta* et le *Procureur général du Canada* (3). L'Alberta fut empêchée de frapper de droits le commerce de banque, pareille faculté relevant de la législation fédérale seulement.

L'autorité des décisions rendues en dernière instance et, l'on me permettra de l'ajouter, mon intime conviction, font que j'adhère bien volontiers au principe énoncé en ces trois causes. En effet, il demeure interdit aux législatures fédérale ou provinciales de rechercher, par voies latérales, ce que la constitution soustrait à leur atteinte directe. Au surplus, ce n'était pas là innover. Mais avais-

(1) [1929] A.C. 260 à 267, 268. (2) [1937] A.C. 355, à 367.
(3) [1939] A.C. 117, à 130.

je une difficulté de cette nature à trancher, quant à savoir si la Loi des allocations familiales empiète ou pas sur l'initiative et le contrôle exclusif des provinces en matière d'éducation?

Dans l'instance présente, l'examen des textes, l'analyse des faits, m'induisent à proclamer la constitutionnalité de la Loi des allocations familiales, celle aussi, et en tous ses articles, de la Loi de l'impôt de guerre sur le revenu, toutes deux de la compétence du Parlement canadien.

Par les motifs qui précèdent, l'appel est rejeté; l'intimé aura droit à tous ses honoraires taxables.

Jugement en conséquence.

BRITISH COLUMBIA ADMIRALTY DISTRICT

1957
Feb. 28,
Mar. 1
Mar. 12

CANADIAN PACIFIC RAILWAY COMPANY ..... PLAINTIFF;

AND

VANCOUVER TUG BOAT COMPANY LIMITED ..... DEFENDANT.

Shipping—Collision—One vessel standing too long before taking avoiding action—One vessel trying to pass ahead of other vessel—Assessment of damages and costs.

Held: That where, in a collision between plaintiff's vessel and that of defendant, plaintiff's vessel was partly to blame for standing too long before taking avoiding action and defendant's vessel was partly to blame for deliberately trying to pass ahead of plaintiff's vessel making collision inevitable, the negligence must be assessed one quarter to plaintiff and three quarters to defendant.

ACTION for damages caused by collision of two vessels.

The action was tried before the Honourable Mr. Justice Sidney Smith, District Judge in Admiralty for the British Columbia Admiralty District, at Vancouver.

A. G. Harvey and *F. H. Britton* for plaintiff.

J. I. Bird and *A. F. Campney* for defendant.

SIDNEY SMITH D.J.A.:—This collision occurred at the western entrance of the First Narrows, Vancouver Harbour, about 8 p.m. on 13 October 1955 in clear, dark weather. The vessels concerned were the plaintiff's car and passenger

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Sidney Smith D.J.A.

steamer, *Princess Elaine,* bound in from Nanaimo, and the defendant's tug *La Bonne,* having lashed along her starboard side the Barge *V.T. 25.* The *La Bonne* was bound for False Creek. The Master of the *Elaine* saw the green light of the *La Bonne* on his port bow but wrongly thought she was bound towards either Point Grey or Point Atkinson, and that she would momentarily show her red light and thus pass port to port. In this he was mistaken and must be held partly to blame for standing on too long before taking avoiding action. I formed the opinion that both Masters were men of integrity.

Much the greater blame, however, attaches to the *La Bonne* for she deliberately tried to pass ahead of the *Elaine* making collision inevitable. No doubt, too, she was carried further to the west by the three knot ebb tide then running but this should have been within the contemplation of her Master.

I must hold the *La Bonne* three-quarters to blame and the *Elaine* one-quarter, with corresponding costs.

If need be there will be a reference to the learned Registrar.

Judgment accordingly.

1956

Sept. 25

1957

Apr. 2

THOMPSON CONSTRUCTION (CHEMONG) LIMITED ..... } APPELLANT;

AND

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

Revenue—Income—Income tax—New engine purchased to replace worn-out unit of power shovel—Whether "an outlay . . . made . . . for the purpose of . . . producing income from . . . business of the taxpayer" or "an outlay . . . on account of capital"—The Income Tax Act, S. of C. 1948, c. 52 as amended, ss. 11(1)(a), 12(1)(a) and (b), 20(4)(a) and (b).

The appellant, a road-building contractor, in 1949 purchased a used power shovel powered by a 125 h.p. diesel engine for $27,075. Up to the end of the taxation year 1952 the shovel was treated by both parties as a depreciable asset and under regulations authorized by s. 11(1)(*a*) of the *Income Tax Act* the annual capital cost allowances claimed and allowed had for depreciation purposes reduced the shovel's book value to $9,268. In 1953 the engine, in need of major repairs, was

replaced by a new one at a cost of $8,894 less $3,200, the trade-in value of the old engine, or a net cost of some $6,000. The appellant in its income tax return for that year deducted the latter amount as an outlay incurred for the purpose of gaining income from its business. The Minister disallowed the amount as an expense, added it to the appellant's declared taxable income and then deducted 30 per cent thereof as a capital cost allowance. An appeal from the assessment to the Income Tax Appeal Board, at which the appellant offered no evidence, was dismissed. On appeal from the Board's decision the the appellant contended that the net outlay for the new engine was an expense incurred for the purpose of gaining income from its business and was therefore within the exception stated in s. 12(1)(*a*) of the Act and consequently deductible in full. The respondent submitted that it was an outlay on account of capital and barred by s. 12(1)(*b*).

Held: That in determining whether an outlay or expense was incurred for the purpose of gaining or producing income from a business and therefore within the exception stated in s. 12(1)(*a*) of the *Income Tax Act,* sub. para. (*a*) cannot be read by itself or as providing the sole test of deductibility; and even if the outlay passes the primary test referred to in *The Royal Trust Co. v. Minister of National Revenue* [1957] C.T.C. 32; D.T.C. 1055; the deduction will be denied if it be specifically excluded by any other provision of the Act.

2. That, although as a general rule repairs necessitated by wear and tear of equipment used in the business are allowed as deductions (although no specific reference is found in the *Income Tax Act* regarding "repairs") if the outlay brings into existence a capital asset, such as a new piece of machinery, such outlay will not be allowed as a deduction.

3. That the outlay here brought into existence a new capital asset, namely the new engine, *Minister of National Revenue v. Dominion Natural Gas Co.* [1941] S.C.R. 19, and consequently could not be considered an outlay on revenue account. (The Court was influenced in part by the magnitude of the outlay when related to the value of the power shovel as a whole.) *Samuel Jones & Co. (Devondale) Ltd. v. C.I.R.* (1950-52) 32 T.C. 513 and 518.

4. That to allow a deduction in full as an operating expense of an outlay such as this which brought into existence a new capital asset would be to frustrate the clear intent of the provisions of s. 11(1)(*a*) of the Act and the regulations passed thereunder in regard to capital cost allowances.

5. That the outlay for the purchase of a new engine would properly be considered in accounting practice as a capital expenditure because of the enduring nature of the new asset.

APPEAL from a decision of the Income Tax Appeal Board.

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

W. J. Anderson for appellant.

D. W. Mundell, Q.C. and *J. D. C. Boland* for respondent.

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THOMPSON CONSTRUCTION (CHEMONG) LTD. v. MINISTER OF NATIONAL REVENUE

CAMERON J.:—This is an appeal from a decision of the Income Tax Appeal Board (1) dated April 24, 1956, dismissing the appellant's appeal from a re-assessment dated June 29, 1955, in respect of the appellant's taxation year ending March 31, 1953. At the Board hearing no evidence was led on behalf of the appellant and the chairman held that in view of the complete lack of evidence there was nothing before him to warrant any change in the re-assessment.

The principal facts are not in dispute. The business of the appellant is that of general contracting, its work consisting mainly of road building. In May 1949, it purchased a used Model 6, Northwestern power shovel at a cost of $27,075; it was of the type shown on page B of Exhibit 1. It was powered by a Murphy M.E.6 diesel engine having a rated capacity of 125 h.p.; the engine was probably new when it was installed in the shovel in 1948 although there is no clear evidence on that point. The shovel was used by the appellant in its operations in Ontario and Newfoundland in 1949, moving approximately 130,000 cubic yards of earth and rock. In each of the next three years it was used in Newfoundland moving about 100,000 cubic yards of rock and earth annually. These operations, particularly in Newfoundland, were said to be of an extremely heavy and rugged nature, entailing an unusual amount of wear and tear on the shovel and its parts, including the engine. In the spring of 1951, the engine was completely overhauled at a cost of about $3,500. In 1952 further sums of $900 for parts and $600 for labour were expended in repairing the engine. These outlays were allowed as deductions for the year in which they were incurred.

In January 1953, the directors of the appellant company found that major repairs were again needed, both for the shovel and the engine. It was estimated that the cost of putting the engine in good condition would be approximately the same as had been expended on it in 1951, namely, $3,500. The directors, however, came to the conclusion that it would be wiser to install a new engine; accordingly the appellant then purchased a new Caterpillar D. 13,000 engine with a rated capacity of 125 h.p., at a cost of $8,894, and installed it in the shovel. Exhibit 2 is

(1) (1956) 15 Tax A.B.C. 62; 56 D.T.C. 204.

the conditional sale contract entered into by the purchase of the engine, dated January 26, 1953; it shows that Crothers Limited (the vendors) in part payment of the purchase price took over the old engine, allowing therefor a trade-in value of $3,200. With some adjustments, the net cost of the new engine to the appellant totalled $6,006.13.

In computing its income tax return for the taxation year ending March 31, 1953, the appellant showed an item of expense entitled "Repairs to shovel—$11,671.32". Included in that amount was the net cost of the new engine, namely, $6,006.13. In re-assessing the appellant, the respondent disallowed the latter amount entirely as an expense, added it to the declared taxable income and then deducted 30 per cent. thereof ($1,801.84) as a capital cost allowance. The appellant objected to that assessment, its stated reasons being—

> We feel that it is most essential that the full maintenance of our equipment be allowed as an expense when incurred during the period it is in operation and earning income.

By his Notification, the respondent confirmed the assessment as having been made in accordance with the provisions of the Act and in particular on the ground that—

> The cost of a Caterpillar D. 13,000 engine claimed as a deduction from income was not an outlay or expense incurred by the taxpayer for the purpose of gaining or producing income within the meaning of paragraph (*a*) of subsection (1) of section 12 of the Act, but was a capital outlay within the meaning of paragraph (*b*) of the said subsection (1) of section 12.

Forming part of the appellant's return is a schedule of fixed assets and capital cost allowances as at March 31, 1953. This statement shows that since the purchase of the power shovel (including the engine) in 1949 at a cost of $27,075, the shovel had been treated as a depreciable asset and the capital cost allowance in respect thereof had been allowed annually under the regulations authorized by the provisions of s. 11(1)(*a*) of the *Income Tax Act*. It is common ground that up to the taxation year ending March 31, 1952, the shovel as a whole was treated by both parties as being within Class (*h*) of Class 10 of Schedule B to the Regulations, namely, "contractors' movable equipment (including portable camp buildings)", the rate of capital cost allowances in such being 30 per cent. The statement that I have referred to also shows that at

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March 31, 1952, depreciation of $17,788.27 had been taken on the shovel, thus reducing its book value as of that date to $9,286.73. In the statement referred to, a further 30 per cent. depreciation was claimed and allowed, thus reducing the book value as of March 31, 1953, to $6,500.71. For depreciation purposes, that amount would have correctly shown the book value of the shovel as a whole had the old engine not been replaced.

As both parties rely on the provisions of s. 12(1) of the *Income Tax Act*, 1948, as amended, I will quote at once the relevant portions thereof as they were in the taxation year in question:

> 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,

For the appellant it is submitted that the net outlay for the new engine was an expense incurred for the purpose of gaining or producing income from its business and was therefore within the exception stated in para. (*a*); and that consequently it is deductible in full. Further, it is submitted that the outlay was not of a capital nature and did not fall within the provisions of para. (*b*). The respondent, on the other hand, submits that the outlay was not incurred for the purpose of gaining or producing income from the appellant's business within the meaning of the exception stated in para. (*a*), but rather was an outlay on account of capital and therefore barred from deduction by the provisions of para. (*b*).

I must admit that I have found some difficulty in ascertaining the precise meaning of para. (*a*). If an outlay or expense falls within the exception therein as being one made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer, does it necessarily follow that the outlay is deductible if it has also passed the primary test referred to by the President of this Court in *The Royal Trust Company v. M.N.R.* (1)—namely, that it was made or incurred by the taxpayer in accordance with the ordinary principles

(1) [1957] C.T.C. 32; D.T.C. 1055.

of commercial trading, or well accepted principles of business practice? In that view, the deduction of expenses not prohibited by para. (*a*) is thereby "granted". Support for that view may be found in *Smith v. Incorporated Council of Law Reporting for England and Wales* (1) (referred to in Simon's Income Tax, Vol. 2, p. 202), in which Scrutton J. said:

> That form of words contemplates that certain deductions are to be allowed; what one finds is that certain deductions are prohibited, but in some cases the prohibition is in this form: "No deductions shall be made except"; and from that system of exceptions one ascertains, rather unscientifically as it seems to me, what deductions are in fact allowed.

The difficulty I have found in accepting that view of the matter is that the phrase "for the purpose of earning *the* income" found in the former s. 6(1)(*a*) of the *Income War Tax Act* has been interpreted to mean "in the process of earning the income" (*Minister of National Revenue v. Dominion Natural Gas Co. Ltd.* (2)). That subsection was considered generally as referable only to operating and maintenance expenses. Under the *Income Tax Act,* however, a very similar phrase, "for the purpose of gaining or producing income therefrom (property) or for the purpose of gaining or producing income from a business", used in s. 20(4)(*a*) and (*b*), is made clearly applicable to s. 11(1)(*a*) which is the statutory authority for the deduction of *capital* cost allowances. It is perhaps arguable, at least, that para. (*a*) of s. 12(1) is broad enough in its terms—and when considered by itself—to permit the deduction of all outlays or expenses made or incurred for the purpose of producing income whether such outlays be of a capital or revenue nature.

I am satisfied, however, that whatever be the true interpretation to be put upon para. (*a*) of s. 12(1), it cannot be read by itself or as providing the sole test of deductibility. The primary test is that referred to above in the *Royal Trust Company* case. Moreover, if the outlay in question passes the test of the excepting portion of the paragraph, its deduction will be denied if it be specifically excluded by any other provision of the Act. For example, para. (*c*) of s. 12(1), relating to exempt income, is clearly an additional

(1) 6 T.C. 477 at 482. (2) [1941] S.C.R. 19.

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limitation to the general limitations of para. (*a*). Similarly, if the outlay be within the ambit of para. (*b*) (*supra*), the deduction will not be allowed.

In a broad sense it may be said that the outlay for the new engine was an expense incurred for the purpose of earning the appellant's income. The same might be said of all outlays of capital for all types of buildings, machinery and the like, to be used in the business. In the instant case, the provision of a new engine enabled the appellant to earn income from the operation of the shovel without the likelihood of frequent breakdowns. The real question, therefore, is whether that outlay was one, the deductibility of which was prohibited by para. (*b*).

For the appellant, it is submitted that the outlay here in question was in the nature of a repair; that by reason of the rugged nature of the company's operations, the old engine had worn out to a substantial extent; that to put it in a condition in which it could be used for the purpose of producing income for the appellant it was necessary either to incur heavy repair bills or, alternatively, to replace the worn-out engine, and the latter alternative was decided upon. Then it is said that the engine was merely a subsidiary part of the "entirety", that is, the power shovel; that the replacement of the engine was therefore not a replacement of the "entirety" but merely of a subsidiary part of the whole. It is pointed out that the new engine was of precisely the same rated capacity as the former engine and did not constitute an improvement over the old engine; that the replacement of the engine merely restored the shovel to its original condition so that it could continue to earn revenue.

By this argument it is sought to bring the case within the decision of the Court of Session in *Samuel Jones & Co. (Devonvale), Ltd. v. C.I.R.* (1). The headnote in that case is as follows:

> The Company carried on a trade of processing paper. A chimney of its factory was replaced because of its dangerous condition but the replacement did not constitute an appreciable improvement. The Company claimed a deduction in computing its profits for Income Tax purposes of the cost of removing the old chimney and building the new one.
>
> On appeal before the Special Commissioners it was contended for the Company that the chimney was an integral part of a unit, which unit was the factory as a whole; that the expenditure on the new chimney was

(1) (1950-2) 32 T.C. 513.

to maintain the revenue-earning capacity of the factory; and that removal of the old chimney was in the nature of a repair. It was contended on behalf of the Crown that the replacement of the chimney was capital expenditure; that the expenditure incurred should be borne by the owner as such and not by the trader; and that any deduction should be given under Rule 8(*a*) of No. V of Schedule A, and not under Schedule D. The Commissioners held that the cost of replacement of the chimney was capital expenditure but allowed the cost of removing the old chimney.

Held, that the whole cost of replacing the chimney (including the cost of removing the old chimney) was an admissible deduction.

In that case the Lord President (Cooper) said at page 518:

. . . but so far as this case is concerned the facts seem to me to demonstrate beyond a doubt that the chimney with which we are concerned is physically, commercially and functionally an inseparable part of an "entirety", which is the factory. . . It is doubtless an indispensable part of the factory, doubtless an integral part; but none the less a subsidiary part, and one of many subsidiary parts, of a single industrial profit-earning undertaking.

So viewing the matter I am unable to see why the expense incurred in relation to this transaction should not be treated as an admissible revenue expenditure on repairs, and I am in part influenced in reaching that conclusion by the fact that the factory as a whole is insured for something in the region of £165,000 whereas the expense incurred in taking down the old chimney and building the substitute is only a matter of £4,300 or about 2 per cent. The line of approach which in a case of this kind impresses me as preferable to that adopted by Rowlatt, J., is that which was taken by the Privy Council in *Rhodesia Railways, Ltd.*, [1933] A.C. 368, which although relating to quite a different type of subject seems to me to afford a sounder basis in authority, in so far as authority is needed, for the contention which the Company has brought before us.

It is of particular interest to observe that the Lord President was influenced in reaching his conclusion by the fact that the expense incurred in taking down the old chimney and building the substitute represented about 2 per cent. only of the fully insured value of the factory as a whole. Lord Carmont, who agreed with the opinion of the Lord President, was apparently influenced by the same consideration as shown by the concluding paragraph of his opinion: "The money value of the renewal was relatively insignificant. . . ." The other member of the Court, Lord Russell, gave no separate opinion but expressed himself as in full agreement with the opinions of the other members of the Court.

It may be conceded that as a general rule repairs necessitated by the wear and tear of equipment used in the business are allowed as deductions, although no specific refer-

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ence is found in the *Income Tax Act* regarding "repairs". It may also be conceded that in normal circumstances the repairing of machinery frequently involves the necessity of *replacing* worn-out parts. But I think it is clear that if the outlay brings into existence a capital asset, such as a new piece of machinery, such outlay will not be allowed as a deduction.

In the instant case I have reached the conclusion that the outlay in question did bring into existence a new capital asset, namely, the new engine. The evidence is that the old engine was in use for at least five years and at the end of that period still had a substantial commercial value. It is probable that the new engine would have a useful life of at least the same number of years. The expenditure therefore brought into existence an advantage for the enduring benefit of the trade and which should be considered to be a capital asset (*Minister of National Revenue v. Dominion Natural Gas Co. Ltd.* (1)). In reaching the conclusion that the outlay was not one on revenue account, I am influenced in part, as were the members of the Court of Session in the *Samuel Jones* case (*supra*), by the magnitude of the outlay when related to the value of the power shovel as a whole. As pointed out above, the total cost of the new engine exceeded the written down value of the shovel as a whole after deducting all capital cost allowances made to the end of the appellant's taxation year 1953.

It seems to me, also, that to allow a deduction in full as an operating expense of an outlay such as this and which brought into existence a new capital asset, would be to frustrate the clear intent of the provisions of s. 11(1)(*a*) and the regulations passed thereunder in regard to capital cost allowances. As I have stated above, claims for capital cost allowances were made in previous years in respect of the power shovel as a whole and were allowed. It was considered as a capital asset and having been purchased with the engine was treated as one asset. If, for example, the appellant had purchased separately a drill and an engine to operate it, it would have been entitled to claim capital cost allowances in respect of each. If, after a few years' use, it had been considered advisable to replace that engine with a new one, the appellant would have been

(1) [1941] S.C.R. 19.

required to bring into account the amount received on the sale so that depreciation already received might (in a proper case) be recovered, and also the cost of the new engine, so as to ascertain the amount to which the fixed rate of depreciation would be applied. I am unable to conclude that it should be otherwise merely on the ground, as in the instant case, that the engine was installed in the power shovel. The engine clearly was a marketable entity, readily detached from the power shovel by the removal of a few bolts, and capable of being used for other purposes. I am of the opinion that under the *Income Tax Act* and the special provisions relating to capital cost allowances, the sale of a capital asset—or of a substantial part thereof as in the instant case—and the replacement of the asset or part so sold by the acquisition of a new asset or such part, must be dealt with only as has been done in this case by the respondent in assessing the appellant.

I have not overlooked the evidence given by the witness J. S. Clark on behalf of the appellant. He has been a public accountant for twenty years and the auditor of the appellant company since its formation. He was of the opinion that it was in accordance with good business and accounting practice to charge the net cost of the engine as an operating or maintenance expense of the year. He said that when a replacement or repair did not add to the value of the asset, the outlay in respect thereof should be regarded as an operating or maintenance expense. He stated that he relied on the authority of Professor Smails' book on Public Accounts but did not supply me with the precise reference. I shall have a word to say later in regard thereto.

Even if the test suggested by the witness be correct, it does not support the appellant's case when one considers the facts. It could scarcely be denied that the installation of the new engine did add to the value of the power shovel. The difference in value of the old and new engines as shown by the conditional sales contract was approximately $5,000, and surely that must have increased the value of the shovel by a very substantial amount.

As I have been unable to find the Canadian textbook of Professor Smails referred to by the witness Clark, I think that he probably had in mind that author's text on Account-

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ing Principles and Practice. In the 5th Edition of 1954, the author, in commenting on the distinction between capital expenditures and revenue expenditures, states the modern view by referring to two American authors, as follows:

> The modern view can best be expressed by quotation from two American authors. "One phase of the distinction between capital and revenue is presented by the terms 'capital expenditure' and 'revenue expenditure.' The former relates to an expenditure for property of a life duration extending over several accounting periods, the latter to an expenditure for property which will be consumed within one accounting period. This particular distinction is perhaps not especially significant; it refers to the first classification of expenditures between those expected to be charged against revenue, and those expected to be charged to an asset account and thus carried forward into succeeding periods. The really important distinction between capital and revenue charges is that which is effectuated at the end of the accounting period, when all the accounts are reviewed for the purpose of separating consumed costs from unconsumed costs." (T. H. Sanders, *Progress in Development of Basic Concepts*, p. 13.)
>
> "Some writers have suggested that the distinction between capital and income is a fundamental principle of accounting. However, the distinction in accounting today between so-called capital expenditures and income expenditures does not rest on any such essential difference in the nature of the property acquired as that between land and other property which is often stressed in the field of economics. The distinction rests rather upon the relation between the length of the useful life of the property acquired and the length of the accounting period for which income is being determined. A capital expenditure is one, the usefulness of which is expected to extend over several accounting periods. If the accounting period were increased from the customary year to a decade, most of what is now treated as capital expenditure would become chargeable to income, while if the period were reduced to a day, much of what is now treated as current maintenance would become capital expenditure." (G. O. May, Financial Accounting, p. 45.)

I need not comment on this opinion of Professor Smails except to state that it does not warrant the interpretation placed thereon by the witness Clark. It does seem, however, to support the view which I have expressed that the outlay for the purchase of the new engine would properly be considered in accounting practice as a capital expenditure because of the enduring nature of the new asset.

For these reasons, I am of the opinion that the appeal fails. Accordingly, it will be dismissed and the assessment affirmed. The respondent is entitled to costs after taxation.

Judgment accordingly.

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

1956
Sept. 26
1957
Apr. 8

AND

RUSSEL E. GIBSON ..... RESPONDENT.

Revenue—Income—Income Tax—No distinction between profits on sale of subdivision lots and on houses erected thereon—Lots and houses both part of building contractor's inventory—Profits from both income from a "business" and taxable—Income War Tax Act, R.S.C. 1927, c. 98, s. 3 —The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 127(1)(e)—The Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 139(1)(e).

The respondent, a coal dealer, in order to secure a site on which to build a home, in 1939 purchased 29 acres of orchard land on the eastern boundary of the town of Simcoe, subdivided it into lots and registered the plan of the subdivision as "Simcoe Heights". Up until 1947 respondent did little to improve the orchard or to sell lots but when the town annexed the property in that year he entered into an agreement with a building contractor to finance him in building houses on the property and share the profits arising from their sale. Building operations were carried on accordingly from 1947 to 1953 and the respondent in his annual declarations of income included his share of such profits but not his profits on the sale of the lots themselves. On reassessing the respondent for the period the Minister added $29,690.50 to the respondent's declared income to cover the total profit realized on the sale of the lots. The respondent appealed in respect of the addition to the Income Tax Appeal Board on the grounds that the proceeds from the sale of the lots was a capital gain and not income. The Board allowed his appeal and the Minister appealed from the decision.

In 1952 the respondent purchased a property known as the Booth farm for the purpose of putting on a plan of subdivision and realizing a profit on the sale of lots or of houses he proposed erecting thereon with his associate the building contractor. Only about half the land was suitable for a housing project. The remainder was swamp land and for a time the respondent thought it worthless and offered it to the town as a gift for a park. His offer was not accepted but shortly thereafter when the respondent found a valuable deposit of black muck on it and proposed removing it, the town, believing its water supply might thereby be impaired, paid him $20,000 for it. The payment, made in 1953, was treated by the respondent as a capital gain but the Minister considered it taxable and added it to the respondent's declared taxable income. The respondent appealed from that portion of the reassessment. His appeal was disallowed by the Income Tax Appeal Board and he cross-appealed to this Court.

Held: That the only reasonable conclusion to be drawn from the established facts was that the respondent fully intended at the time he purchased the Simcoe Heights property to dispose of the lots as soon as conditions were favorable for him to do so. This was indicated by his arranging for the preparation of the subdivision plan prior to completing his purchase and to its registration at considerable cost immediately after the purchase was made. *McGuire v. Minister of National Revenue,* [1956] Ex. C.R. 264, distinguished.

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2. That no distinction was to be drawn between the profits realized on the sale of the buildings and the profits realized on the sale of the lands on which the buildings were erected. Both were profits from carrying on the business of a building contractor both under the *Income War Tax Act* and *The Income Tax Act*.

3. That the respondent was admittedly carrying on the business of a building contractor in each of the years in question and the operations carried out clearly fell within the term of "business" both in the *Income War Tax Act* and *The Income Tax Act*.

4. That the sale of the lots and the sale of the buildings could not be segregated. They formed a necessary part of the building operation as a whole and were part of the respondent's inventory in carrying on that business and since the respondent in the sales in question was using the property for the purposes of his trade or business the profits therefrom were properly taken into account in computing his taxable income. *Hudson's Bay Co. v. Stevens*, 5 T.C. 424, referred to.

5. That no distinction could be drawn between the low ground and the other portion of the Booth farm. The whole property constituted the respondent's inventory and the profits arising from the purchase and sale of each constituted income from a "business" within the meaning of that term in ss. 3 and 4 as further defined in s. 139(*e*) of *The Income Tax Act*.

APPEAL from a decision of the Income Tax Appeal Board.

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

E. D. Hickey and *J. D. C. Boland* for appellant.

N. E. Byrne for respondent.

CAMERON J.:—This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board (1) dated November 25, 1955 allowing the respondent's appeals from re-assessments made upon him for the years 1947 to 1952, both inclusive, and allowing his appeal in part for the year 1953. There is also a cross-appeal by the respondent in respect of his appeal from that portion of the re-assessment for the year 1953 which was disallowed by the Board. Certain profits were received by the respondent in each of these years upon the sales of real estate and the question for determination is the familiar—but frequently difficult—one of determining whether such profits are of a capital nature as contended for by the respondent, or constitute taxable income as submitted by the appellant.

(1) (1955) 14 Tax A.B.C. 110; 9 D.T.C. 618.

In this type of case it is necessary to consider the whole course of conduct of the taxpayer viewed in the light of all the surrounding circumstances. It is desirable, therefore, to record at once certain facts which are either admitted in the pleadings or are fully established by the evidence. At all material times the respondent has resided at Simcoe, Ontario, where he has carried on the business of a coal dealer. In August, 1939, he purchased for $4,500 the orchard portion of a farm comprising about 29 acres and situated on the eastern boundary of the town of Simcoe. Prior to the completion of the purchase, the respondent had made arrangements with a friend—the witness M. T. Gray, who was a land surveyor—to complete a survey and lay out a plan of the property. Exhibit 1, introduced by the respondent, is a copy of the "Plan of Simcoe Heights (the name given the property by the respondent), being a subdivision of part of Lot No. 1 . . . ." It was registered in the County Registry Office on November 17, 1939. Undoubtedly, the survey and the preparation of the plan were undertaken at or immediately after the purchase was completed.

Exhibit 1 shows that the property was subdivided into some 121 lots, that streets were laid out, that wooden stakes were placed to mark the corners of each lot and that more substantial iron bars of the type used by surveyors were placed at street intersections and other necessary places. It also shows that prior to registration the respondent had secured the assent of all necessary parties, namely, the Municipal Council of the town of Simcoe, the Highway Department of Ontario, the Municipal Council of the township of Woodhouse (in which township the property was then located), and the Ontario Municipal Board. Then there are the usual certificates by the surveyor and the owner, in the latter of which the respondent stated that all the streets within the survey "are hereby dedicated as public highways". The total cost to the respondent of the survey, plan, legal expenses, securing the necessary consents and similar disbursements leading up to the registration of the plan, was approximately $3,600, of which amount $800 was paid to the surveyor Gray.

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Shortly after the end of the second World War, there was an increased demand for building lots and in each of the years 1945 and 1946 the respondent sold 4 of the lots on Simcoe Heights. As the present appeals do not relate to those years, I merely record the sales as part of the respondent's activities in regard to Simcoe Heights.

In 1947 several matters of importance to the respondent occurred. Due to the increase in population of Simcoe, there was a great demand for building lots and residences. As of January 1, 1947, the whole of Simcoe Heights (except one lot) was incorporated into the town of Simcoe; the respondent states that he took no part in the annexation proceedings. In the same year the respondent entered into an agreement with the town of Simcoe by which Lots 1 to 12 inclusive on Simcoe Heights, Subdivision 191 and adjacent property of the town of Simcoe, were re-subdivided. Exhibit 3 is substantially the plan of such re-subdivision, registered on April 28, 1947, as Plan 267. It may be noted that Exhibit 3 is dated the 17th of September, 1946. In the same year the respondent exchanged 6 or 7 of the lots in Simcoe Heights for other lots owned by the town. The matter is not quite clear, but I infer from the respondent's evidence and the particulars listed on Exhibit 6 that after the exchange he was the owner of all of the lots on Plan 267, except small portions previously sold by him. In that year, also, the respondent decided to interest himself in the construction and sale of houses on his property. Accordingly, he entered into an arrangement with a building contractor, one Ryerse. No written agreement was produced but I infer from the evidence that Ryerse was to supervise the construction and the respondent was to arrange for all financial matters and purchase of all material. Ryerse was to receive his wages and also 25 per cent. of the "patronage dividends" and the same proportion of the net profits arising from the sale of the *buildings;* the balance was to be retained by the respondent as his profits. The profits, however, were confined to the profits on buildings only, the respondent considering the land to be his own separate asset.

In pursuance of this plan, the respondent and Ryerse built and sold a substantial number of houses on Plan 267 in 1947 and 1948. Exhibit 6, which is the list of sales made from that plan in the years 1946 to 1948 inclusive, lists 10 sales in 1947 and 3 in 1948. The respondent's evidence is that of the 13 lots owned by him at the time Plan 267 was registered, 11 were sold with houses erected by him and his associate; one was sold as a lot and at the date of the hearing he had one lot still unsold.

Precisely the same operations were carried out in regard to the orchard property shown on Exhibit 1. Buildings were erected and sold. Exhibit 5 is a list of such sales for 1945 to 1953 inclusive. Excluding those made in 1945 and 1946, the annual sales from Plan 191 were as follows:

1947	14
1948	8
1949	3
1950	8
1951	2
1952	3
1953	4

A small number of sales were also made in 1954, 1955 and 1956. The evidence is not clear as to how many of these sales were of lots only, but I infer from the evidence as a whole that a very substantial number, if not all, were sales of lots on which the respondent and his associate had built and sold houses.

It may be noted here that following the annexation of Simcoe Heights in 1947, the respondent in that and the next year expended about $2,500 in grading the roads and clearing the property. From 1947 to 1951 the municipality installed sewers and water supplies.

The respondent stated that in 1947 he first acquired income from the contracting business. It is apparent that he considered the profits which he realized from the construction and sale of houses to be taxable profits as in all of the years in question he included in his declared income his share of the profits from such sales, excluding therefrom, however, any profit realized on the sale of the *lots* which are on Plan 191 or Plan 267. There is some suggestion in his evidence that he may have included such profit

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in and after 1951. In any event, the pleadings in this Court make it clear that in re-assessing the respondent for the years in question, the appellant added certain amounts to the declared income of the respondent, the amounts stated for each of the years "for the sale of seventy-two and one-half lots of land known as Simcoe Heights". That is admitted in the Reply to the Notice of Appeal; and at the hearing counsel agreed that there was now no dispute as to the various amounts added (a total of $29,690.50) should it be found that they constituted taxable income. The respondent's appeal to the Income Tax Appeal Board in respect of the addition of these amounts to the respondent's declared income was allowed and from that decision the Minister has appealed to this Court.

Before considering this appeal, I think it advisable to now record another transaction of the respondent relating to his cross-appeal.

The respondent stated that in 1952 there was a heavy demand in Simcoe for building lots and residences. In July of that year he bought for $35,000 the Booth farm, consisting of about 88 acres, situated immediately adjacent to the west boundary of the town of Simcoe. His purpose in buying the property was admittedly to put on a plan of subdivision and to realize a profit on the sale of lots or of houses which he later constructed in cooperation with his building contractor, in the same manner as had been done on the Simcoe Heights property. Part of the Booth farm was on high ground and suitable for residences. On this portion he laid out and registered three plans, the whole comprising about 185 lots. On sales made in 1952 and 1953 he says he reported his entire profits thereon as income and was taxed accordingly.

The remaining portion of about 46 acres was low-lying and swampy and unsuitable for building purposes. At one time he considered it valueless and offered it to the municipality as a gift for use as a park, but his offer was not accepted. Later, a quantity of valuable black muck was found thereon; he proposed to drain this portion so that the muck could be removed and sold, but as this operation would have interfered with the town waterworks system he was not allowed to do so. In December, 1952, he sold the

low-lying part to the town of Simcoe for $20,000, receiving payment therefor in January, 1953. As he considered it a capital gain, he did not include any portion of this amount as income for the year. The Minister, however, considered that it was taxable income and took it into consideration when re-assessing him for that year, adding an additional sum (the amount of which is not now in dispute) to his taxable income. The respondent appealed also from that portion of the re-assessment but his appeal was disallowed by the Board. He now cross-appeals to this Court in regard to that item.

I shall first consider the cross-appeal relating to the $20,000 received in 1953 upon the sale of the unsubdivided portion of the Booth farm. The Minister, asserting that it was income from a business, relies on certain sections of *The Income Tax Act* which in 1953 were as follows:

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

139. (1) In this Act,

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

Now the respondent stated quite clearly in evidence that he purchased the Booth farm for the purpose of putting on a plan and disposing of it at a profit. He says, also, that he considered the lower part quite valueless. In his Notice by Way of Cross-Appeal, he alleged that the vendor would not separate the land and that he was obliged to buy the entire farm or none at all. In evidence, however, he said that he could have purchased only the high land but that as the price would have been the same as for the entire farm, he purchased the whole. In connection with the sale of the lots and buildings on the Booth subdivision, he says he "pushed" the sales in the usual way by advertising, interviews and the like. Admittedly, as to the purchase and sale of the high ground, the respondent

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was in business and his profits on that part of the operation were properly considered by him as taxable profits. I can perceive no distinction between this operation and that relating to the other portion of the Booth farm. There is nothing to indicate that the low ground was in any proper sense to be held as an investment. Only a few months elapsed between its purchase and sale and in the meantime the respondent had been endeavouring to dispose of it or to turn it to account in some way. I am quite satisfied that even at the time of purchase, it was in the respondent's mind that he would not retain any part of the Booth property but would dispose of it in some convenient way, and, if possible, at a profit. The whole property constituted his inventory. It is not unusual for a purchaser of land to find that not all of his property is adapted to subdivision and that he must find other ways of disposing of the surplus. That was the case here and the fact that the low-lying land was sold *en bloc* does not affect the matter in any way.

I am quite satisfied that the profits arising from the purchase of the Booth farm and the sale of the large portion of the subdivided part and of the low-lying part, constituted income from a "business" within the meaning of that term in sections 3 and 4 as further defined in section 139(1)(*e*). Accordingly the cross-appeal will be dismissed.

The main appeal remains to be considered. As with the cross-appeal, the onus of proving the re-assessment to be erroneous is on the respondent (*Minister of National Revenue v. Simpson's Limited* (1)). The appeals relate to the years 1947 to 1953. For the respondent it is submitted that the profits realized were not income, but merely the proceeds of the realization of a capital asset, namely, the Simcoe Heights property. The appellant says that the profits in question were profits from a business.

For the years 1947 and 1948 the matter is to be determined under the then provisions of the *Income War Tax Act*, which was as follows:

3. For the purposes of this Act, "income" means the annual net profit or gain or gratuity whether ascertained and capable of computation as being wages, salary, or other fixed amount or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial

(1) [1953] Ex. C.R. 93.

or other business or calling directly or indirectly received by a person . . . or from any trade, manufacture or business . . .; and shall include . . . and also the annual profit or gain from any other source including

For the years 1949 to 1953 *The Income Tax Act* applied. I have set out above the provisions of s. 3 and 4 thereof which were the same throughout the entire period. Section 139(1)(*e*), also set out above, appeared as s. 127(1)(*e*) in the years 1949 to 1952.

The respondent states that for some time prior to 1939, he had been considering the purchase of a lot on which to erect a residence for himself; for that purpose he required only about one-half acre. The owner of the farm on which the orchard was located would not agree to selling such a small portion but was willing to sell the farm as a whole, or the orchard. As the respondent's wife approved of that particular location, the respondent bought the orchard.

He says he acquired the property with the intention of erecting a residence for his own use on a portion thereof and of retaining the rest as an investment; the trees in the orchard had been badly neglected and he planned to bring them back into production and thereby increase his income. At the hearing he stated that he could not say that in 1939 there was no market for the lots but added that there was little likelihood of disposing of them then as only a small portion thereof was accessible to a public highway and there were no sewers or water mains. In furtherance of his plan, he entered into an agreement with a nurseryman—the witness Piggott—to care for the trees; the development, he says, was to continue for five years, but the evidence indicates that very little was done and that no income was derived from the trees at any time. For some two years Piggott did a small amount of pruning and spraying but only one account of some $15 for such work was produced, although there may have been other small accounts. Nothing further was done in developing the orchard, due, it is said, to the shortage of labour in wartime.

The respondent also states that while he actively promoted the sale of lots and buildings on the Booth property by advertising and the like, he did nothing to push the sales in Simcoe Heights; in all cases he says the purchasers came to him. He could not say, however, what efforts his associate Ryerse had made to further the sales.

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He added, also, that one of his reasons for selling the Simcoe Heights lots was that taxes had increased following the annexation to the town of Simcoe.

When considering the important question as to the intention of the respondent at the time of the purchase, it is important to bear in mind that what he was seeking originally was a small lot on which to construct his own home. He acquired the 29 acres merely because the former owner would not sell one building lot. There is no evidence that the respondent had any knowledge of farming or fruit-raising. The most significant evidence, however, is that relating to the survey of the property and the preparation and registration of the plan, some of the details of which I have set out above. I reject entirely the respondent's suggestion that he was "pressured" by his friend, the witness Gray, to lay out the whole property in lots and register a plan and that he finally agreed to do so because of the financial needs of Gray. That evidence is not supported by that of Gray himself. The respondent says that all he really needed was an outline sketch of the small lot on which his home was to be built and as required by the proposed mortgagee thereof. Had that been so, such a plan could have been prepared at very little expense and there is no evidence to show that for such a limited purpose it was necessary to secure the various consents and certificates shown on Exhibit 1 or to register any plan.

The fact is that he expended about $3,600 in all in that connection (only $800 of which went to Gray) and in addition he laid out a further sum of about $2,500 in the succeeding years in grading the roads, clearing the land and the like. The only reasonable inference from the established facts is that even prior to the time of purchase he had in mind selling lots as the opportunity arose. The plan as registered was necessary for one purpose only, namely, to facilitate sales of lots. His residence was built on a lot facing on the public highway and there was therefore no need of laying out roads or dedicating them as public highways if his intention was merely to hold and operate the orchard for his own use. Such dedication would have been most disadvantageous to the working of the orchard.

There is no difficulty, therefore, in reaching the conclusion that the respondent fully intended at the time he purchased Simcoe Heights to dispose of the lots as soon as conditions were favourable for him to do so. No doubt his plans were held up due to war conditions, building restrictions and the like. His first sales were made in 1945 and 1946 and apparently were of vacant lots.

The evidence is not very clear as to whether all the 72½ lots referred to in the pleadings had been improved by the addition of buildings prior to sale, or whether some were sold as lots. It is probably the case that some lots and some lots with buildings were sold, but I was not asked to find that there was any distinction between such sales so far as income tax is concerned. Further, the evidence is not clear as to whether all the 72½ lots referred to were originally part of the orchard (Exhibit 1) or whether some were lots received by the respondent at the time of his exchange of properties with the town of Simcoe in 1947. I infer from the evidence as a whole that the lots now in question included those received at the time of the exchange and that all of the property shown in Exhibits 1 and 3 were known as "Simcoe Heights".

It is admitted by the respondent that none of the profits received from the sales of these lands were included in his income tax returns. He considered the sales of *lands* to be merely the realization of a capital asset. Now the respondent's own evidence is that for all the years in question he considered himself to have been carrying on a business separate and apart from that of his coal business. He stated that he first acquired income from the contracting business in 1947 and that business continued throughout.

As for the lots acquired by exchange from the town of Simcoe in 1947, he says they were suitable for building purposes, that he bought and used them for that purpose only and sold them as soon as buildings were constructed. As to these lots, it is clear that they were not acquired as an investment but for the purpose of sale at a profit at the earliest possible moment. In my view, no distinction can be drawn between the profits realized on the sale of the buildings thereon (and which he did report as taxable income) and that realized on the sale of the lands on

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which the buildings were erected. Both were profits from carrying on the business of a building contractor. They are therefore profits from a business both under the *Income War Tax Act* and *The Income Tax Act*.

There remains only the question regarding the profits from the sales of the land which originally formed part of the orchard. In support of his submission that the respondent was merely realizing a capital asset and that the profits so realized were not profits from a business, counsel for the respondent referred me to the decision of Hyndman D. J. in *McGuire v. M. N. R.* (1). That case, however, is clearly distinguishable on the facts. There the taxpayer in 1940 purchased a farm as a residence and with the intention of operating it as a farm. After operating it as such for some years, he found that it was not a paying proposition; then he had an opportunity of selling a small lot but found that under *The Planning Act* he could not convey the title until he had prepared and registered a plan of subdivision. In compliance with that requirement he laid out and registered a plan of some 52 lots. In the years 1949 to 1952 he sold 20 lots. Hyndman D. J. allowed the taxpayer's appeal from assessment to tax on the profits so realized. He was of the opinion that at the time of purchase, McGuire had no intention of reselling any of the land, but intended merely to operate it as a farm; that the registering of a plan some seven or eight years after the purchase was done solely because of the requirements of *The Planning Act*, and that in so selling his own property McGuire was not engaged in a business but was merely realizing unused portions of his own property. In the present case, however, the respondent arranged for the preparation of the subdivision plan prior to completing his purchase and had it completed and registered at a very considerable cost immediately after the purchase was made, indicating very clearly, as I have stated above, his intention of disposing of the lots as soon as there was a demand for them.

Moreover, as I have pointed out above, the respondent was admittedly carrying on the business of a building contractor in each of the years in question. In 1947 he

(1) [1956] Ex. C.R. 264.

acquired by exchange further land suitable for building. In all the years, he and his associate built houses for sale and entered into building contracts with purchasers, purchased materials, employed labour, placed mortgages, and did everything one would expect building contractors to do. Such operations fall clearly within the term "business", both in the *Income War Tax Act* and *The Income Tax Act*. In my opinion, the sales of the 72½ lots now in question cannot be segregated from the sale of the buildings. They formed a necessary part of the building operation as a whole and were part of the respondent's inventory used in carrying on that business. Reference may be made to the well-known case of *Hudson's Bay Company v. Stevens* (1), in which the Court had to determine whether the Hudson's Bay Company carried on a trade in buying and selling land by which they made a profit. Farwell L. J., at p. 437, pointed out the distinction between dealing with one's property as owner and dealing with it as a trader, in these words:

> It is clear, therefore, that a man who sells his land, or pictures, or jewels, is not chargeable with income tax on the purchase-money or on the difference between the amount that he gave and the amount that he received for them. But if instead of dealing with his property as owner he embarks on a trade in which he uses that property for the purposes of his trade, then he becomes liable to pay, not on the excess of sale prices over purchase prices, but on the annual profits or gains arising from such trade, in ascertaining which those prices will no doubt come into consideration.

In the present case, the respondent in the sales in question was using his property for the purposes of his trade or business and in my opinion the profits therefrom are properly to be taken into account in computing his taxable income.

In both the Reply to the Notice of Appeal and in the cross-appeal, the respondent challenged the method used by the Minister in computing the profits for each year. At the hearing, however, these claims were abandoned and it was agreed that the profits as such were properly determined.

(1) (1903-11) 5 T.C. 424.

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Accordingly, for the reasons which I have given, the Minister's appeal will be allowed, the cross-appeal of the respondent will be dismissed and all the assessments in appeal will be affirmed. The respondent will pay the costs of the appeal and of the cross-appeal after taxation.

Judgment accordingly.

1957

Feb. 15

Apr. 9

MONTREAL TRUST COMPANY, ROBERT OREM TORRANCE and MURRAY LAWRENCE DOWDELL, Executors of the Last Will and Testament of SAMUEL OREM TORRANCE, Deceased ..... APPELLANTS;

AND

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

Revenue—Succession duty—The Dominion Succession Duty Act, S. of C. 1940-41, c. 14, ss. 2(a)(k)(m)(n), 6, 7, 7(1)(d), 12—"Successor"—"Succession"—"Property"—Bequest to charitable organizations conditioned on payment of all succession duties is a succession to the other beneficiaries of the amount of succession duties assessed to each beneficiary—Legatees are successors to the condition and all rights pertaining to it—Appeal from Minister's assessment dismissed.

A testator by his will bequeathed all of his property to his trustees upon trust to convert the residue into money and after payment of certain legacies to divide the remainder of the residue into twelve equal shares, with which to set up three trust funds, known as the Wife's Fund, the Annuitants Fund and the Charities Fund. The beneficiaries of the Wife's Fund and the Annuitants Fund were persons required to pay succession duty by the *Dominion Succession Duty Act*, S. of C. 1940-41, c. 14. The trustees were required to hold the Charities Fund for two charitable organizations, successions to whom are exempt from succession duty under the Act, but receipt by them of the benefits bequeathed to them was conditioned upon these organizations paying all succession duties and inheritance and death taxes payable in connection with any insurance, gift or benefit given by the testator in his lifetime or by his will. Upon failure or refusal of the charities to pay the duties the trustees were required to apply the Charities Fund in payment of the duties adding any balance remaining after payment thereof to the Annuitants Fund. The respondent contended that the provision for payment of duties constituted an additional dutiable succession to each taxable beneficiary, equal in value to the

amount of the duties payable on succession to him and assessed accordingly, from which assessment of duties the executors appealed to this Court.

Held: That from the moment of the testator's death the right of the charities to the Charities Fund was but a right to the fund on their discharging the duties and until the condition is complied with the charities cannot get the fund and the trustees are obliged to hold it: the right passing to the charities is less than a complete and perfect right to the fund.

2. That the legatees are under the will the beneficiaries of the condition and are the successors to it, as well as to all rights pertaining to it.

3. That the effect of the condition is to attribute the Charities Fund to the payment of the duties and to create a charge for this purpose upon the Charities Fund in favour of the legatees.

4. That the right which the condition gives rise to in favour of the trustees is a form of security upon the fund itself to insure payment of the duties and it is an interest in the Charities Fund within the meaning of the expression "Property" as defined by s. 2(*k*) of the Act, and it is a right to which the legatees became entitled *by reason of* the disposition of the Charities Fund made by the testator and the disposition thus made was a succession within the meaning of that expression as defined in the Act: it is a right in the fund to have the fund held as a security for payment of the duties until the duties are paid, and the value of the right is equal to the amount of the duties, limited by the value of the Charities Fund itself.

5. That each of the legatees succeeded to an additional interest in property equal in value to the amount of the duties on his successions and that such successions were dutiable successions under the Act, and the appeal must be dismissed.

APPEAL under the Dominion Succession Duty Act, S. of C. 1940-41, c. 14 as amended.

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

J. De M. Marler, Q.C. and *Norman Seagram, Q.C.* for appellant.

D. W. H. Henry, Q.C. and *A. L. Dewolf* for respondent.

THURLOW J.:—This is an appeal by the executors of the will of Samuel Orem Torrance, deceased, from an assessment of succession duties made by the Minister of National Revenue on or about June 2, 1955 and confirmed by him on December 8, 1955 in respect of successions to property under the will of the said deceased. At the time of the testator's death, the *Dominion Succession Duty Act,* Statutes of Canada 1940-41 c.14 as amended, was in effect.

The testator, Samuel Orem Torrance, by will gave certain benefits to persons who are by the Act required to pay duty, and he also made certain provisions for two

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charitable organizations, successions to which are exempt from duty under the Act. The bequest to the charitable organizations was expressly conditioned upon these organizations paying all succession duties and inheritance and death taxes payable in connection with any insurance, gift, or benefit given by the testator in his lifetime or by his will. The question raised in the appeal is whether or not under the terms of the will the provision so made for payment of duties constituted an additional dutiable succession to each taxable beneficiary, equal in value to the amount of the duties payable on successions to him.

The testator, who was domiciled in Ontario, died on April 26, 1952, and his will, which is dated February 28, 1952, was admitted to probate on June 11, 1952. By it, he gave the whole of his property to his trustees upon trust after paying his debts and funeral and testamentary expenses and delivering certain specific articles of personal property to his wife and his two children, to convert the residue into money, to pay therefrom certain pecuniary legacies, and then to divide the remainder of such residue into twelve equal shares, with which the trustees were required to set up three trust funds.

The first of these funds was to be known as "the Wife's Fund". It was comprised of four of the shares and was to be administered as set out in the will for the benefit, first, of the testator's widow, then for his two children, and ultimately for certain of his grandchildren.

The second fund was to be known as "the Annuitants Fund". It was comprised of five shares and its beneficiaries were the testator's two children and ultimately certain of his grandchildren.

The third fund was to be made up of the remaining three shares and was to be known as "the Charities Fund". The provisions of the will with respect to this fund are as follows:

> IV. I give, devise and bequeath the whole of my property . . . to my trustees to hold upon the undermentioned trusts, namely
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> * * *
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> (4) To sell, call in and convert into money all the rest and residue of my estate . . .
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> * * *

(6) Upon my death to divide all the rest, residue and remainder of my residuary estate into twelve equal shares and to deal with such shares as follows

* * *

(*c*) My Trustees shall set aside the remaining three (3) of such shares as a trust fund to be known as "the Charities Fund" and shall invest and keep such fund invested and subject to the acceptance and performance by both the charitable organizations hereinafter named of the conditions hereinafter mentioned my Trustees shall divide the Charities Fund equally between the EAST TORONTO GENERAL HOSPITAL of Toronto and the FIRST AVENUE BAPTIST CHURCH of Toronto (to be used and applied for the general purposes of the said Church); the payment to the said Hospital, including any income then accrued on its share, to be made in one lump sum and the payment to the said Church, including any income accrued on its share or portion thereof to the time or times of payment to be made in three (3) equal annual instalments, commencing not later than one year after my death.

The bequests to the said EAST TORONTO GENERAL HOSPITAL and the FIRST AVENUE BAPTIST CHURCH hereinbefore contained and set forth are absolutely conditional upon both of the said charitable organizations agreeing within the period of six (6) months immediately following my death to pay, and upon each of them paying, respectively, to the complete exoneration of my Trustees and my estate, one-half of all succession duties and inheritance and death taxes, whether imposed by or pursuant to the law of this or any province, state, country, or jurisdiction whatsoever, that may be payable in connection with any insurance on my life or any gift or benefit given by me either in my lifetime or by survivorship or by this my Will or any Codicil thereto, and whether such duties and taxes be payable in respect of estates or interests which fall into possession at my death or at any subsequent time.

In the event of the refusal or failure of either or both of the aforementioned charitable organizations to accept and to perform the conditions hereinbefore set out in this paragraph (6)(*c*) imposed on them, then the bequests in their favour hereinbefore contained and set forth shall lapse and determine absolutely, and my Trustees shall hold and stand possessed of the said Charities Fund upon trust, firstly, to pay out of the said fund all succession duties and inheritance and death taxes whether imposed by or pursuant to the law of this or any province, state, country or jurisdiction whatsoever, that may be payable in connection with any insurance on my life or any gift or benefit given by me either in my lifetime or by survivorship or by this my Will or any Codicil thereto, and whether such duties and taxes be payable in respect of estates or interests which fall into possession at my death or at any subsequent time; and I hereby authorize my Trustees to pay any such duty or tax prior to the due date thereof or to commute the duty or tax on any interest in expectancy; and secondly, to add any balance of the Charities Fund remaining in their hands after making such payments of duties and taxes to the Annuitants Fund as a part thereof and thereafter to deal with the Annuitants Fund

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as so augmented in the same manner as the said Annuitants Fund is hereinbefore directed to be dealt with in paragraph (6) (*b*) of this Clause IV of my Will.

It has been agreed between the parties to the appeal that the testator, when referring in his will to the "East Toronto General Hospital of Toronto" intended the Toronto East General and Orthopedic Hospital and that both the Toronto East General and Orthopedic Hospital and First Avenue Baptist Church are charitable organizations within the meaning of s. 7(1)(*d*) of the *Dominion Succession Duty Act*. For the sake of convenience, I shall hereinafter refer to them as "the charities" and to the testator's widow, children, sisters, brother, and the grandchildren mentioned in the will as "the legatees".

It has also been agreed between the parties to the appeal that the aggregate net value of the testator's estate as defined in s. 2(*a*) of the *Dominion Succession Duty Act* was $938,175.72. Of this amount, the remainder of the residue which was to be divided into twelve equal shares and administered as above mentioned amounted to $843,177.22 and the three-twelfths comprising the Charities Fund was thus $210,794.31.

Following the death of the testator, the charities, after applying to the Supreme Court of Ontario for directions, accepted the bequest made to them in the testator's will, limiting their liability in so doing, however, to an amount not exceeding their prospective shares in the residue of the estate.

In making the assessment under appeal, the Minister first calculated the duties that would be payable by the several legatees upon their successions to property comprised in the specific bequests, the pecuniary legacies, the Wife's Fund, and the Annuitants Fund on the basis of these successions being the dutiable successions to the legatees and thereby arrived at a total amount of $176,699.45 in duties. He next proceeded to add to the dutiable value of the successions to each legatee from the above sources the amounts which he calulated to be the Ontario, Quebec, and Dominion succession duties and United States inheritance taxes payable by each legatee, on the assumption that the testator by his will had provided an additional gift for each legatee equal in value to the

amount of such duties and taxes payable by such legatee and that there had been a succession to each legatee of such additional gift. He then re-calculated the duties in the case of each legatee upon such higher amount. The effect was to increase both the dutiable values of the successions to each legatee and the rates of duty applicable thereto, and on this calculation the total Dominion Succession Duties amounted to $237,929.58. It is from the assessment of duties thus made that this appeal is taken.

The charging section of the Act is s. 6, by which it is provided as follows:

6. (1) Subject to the exemptions mentioned in section seven of this Act, *there shall be assessed, levied and paid* at the rates provided for in the First Schedule to this Act *duties upon* or in respect of *the following successions,* that is to say,—

(*a*) where the deceased was at the time of his death domiciled in a province of Canada, upon or in respect of the succession to all real or immovable property situated in Canada, and all personal property wheresoever situated;

Section 12 further provides:

12. (1) Every successor shall be liable for the duty by this Act levied upon or in respect of the succession to him provided that the duty in respect of any gift or disposition *inter vivos* to a successor shall also be payable by and may be recovered from the executor of the property of the deceased but such liability shall be in his capacity as executor only and for an amount not exceeding the value of the interest of the successor in the property administered by the executor.

(2) Subject to the provisions of subsection one of this section all the duties assessed and levied under this Act shall be payable by and may be recovered from the executor of the property of the deceased, provided that the liability of any executor under this subsection shall be a liability in his capacity as executor only and for an amount not exceeding the value of the property administered by him.

The primary liability for duty is thus imposed on the successor. The executor is also made liable, but liability is imposed on him only in his capacity as an executor. In practice, it may be that in most cases it is the executor who makes the payment, but it is important not to forget that what the executor uses to pay the duties is not his own property but the successor's property, that when the executor pays the duties he does so on behalf of the successor, and that the liability that is discharged when the duties are paid is primarily the successor's liability.

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The definitions contained in s. 2 of the Act include the following:

(*n*) "successor" means the person entitled under a succession.

(*m*) *"succession" means* every past or future *disposition of property, by reason whereof any person has or shall become beneficially entitled to any property* or the income thereof upon the death of any deceased person, either immediately or after any interval, either certainly or contingently, and either originally or by way of substitutive limitation, and every devolution by law of any beneficial interest in property, or the income thereof, upon the death of any such deceased person, to any other person in possession or expectancy, and also includes any disposition of property deemed by this Act to be included in a succession;

(*k*) *"property" includes* property, real or personal, movable or immovable, of every description, and *every estate and interest therein* or income therefrom capable of being devised or bequeathed by will or of passing on the death, and any right or benefit mentioned in section three of this Act;

The appellants contend that the method of assessment followed by the Minister is wrong. They submit that, by setting up the Charities Fund, the testator made a disposition, or more specifically a contingent disposition, to the charities of three-twelfths of the residue of his estate, that this disposition was a succession as defined in s. 2(*m*) of the Act, and that it is wholly exempt from duty under s. 7(1)(*d*) of the Act, both of the charities admittedly being charitable organizations within the meaning of that clause. They further submit that there was no disposition by the testator of the amount required to pay succession duties as, in the event of acceptance by the charities of the bequest to them of the Charities Fund, which event has occurred, the money required to pay the duties was not to be taken from the testator's estate at all but from the charities, and there could be no succession in respect of moneys which never belonged to the testator. In support of this submission, the appellants point to the words "by reason whereof" in s. 2(*m*) of the Act and argue that, even if it can be said that individual legatees became beneficially entitled to have the duties on their legacies paid by the charities, they did not become so entitled *by reason of* the disposition made by the testator or by that alone, but *by reason of* the acceptance of the Charities Fund and the payment of the duties by the charities, which introduced an entirely new or at least an additional reason by which the legatees became so entitled. As to this, it

may be noted that the argument applies equally well to answer the appellants' first submission that there was a succession to the charities of the whole of the Charities Fund as, if the argument is sound, the charities cannot have become entitled "by reason of" the disposition made by the testator alone but *"by reason of"* the disposition made by the testator plus the payment to be made by the charities. The appellants also contend that none of the legatees ever had any right to any of the duty moneys because none of the legatees could sue or recover the duties from anyone and thus never became beneficially entitled to any of them within the meaning of s. 2(*m*) of the Act.

The position taken by the Minister is that the testator disposed of his property in such a way as to provide for each legatee who, or whose gift, would be liable to be taxed, an additional legacy, the value of which is measured by the amount of duties and taxes that would be payable by that legatee in respect of, or from, his main legacy, that the additional legacy so provided in the case of each legatee is one to which the legatee is beneficially entitled and that the provision of it by the testator is a disposition falling within the definition of "succession" in s. 2(*m*) of Act.

It was not questioned that the legatees would ultimately benefit from the provisions made in the will with respect to the payment of succession duties, regardless of whether the duties were paid by the charities to exonerate the trustees from the payment of them or by the trustees, who would then obtain reimbursement from the charities, or by the application of the alternative provisions of the will in the event of the charities failing to pay.

In my opinion, the correct approach to determine the question whether or not there was an additional gift to each legatee equal in value to the amount of duties payable in respect of his succession lies in considering what it was that the testator, by his will, did with what he called the Charities Fund, with a view to determining what proprietary rights in this fund arose upon his death by virtue of the provisions of his will. The trustees have not had occasion to invoke what I shall call the alternative provisions of the will under which they are to apply the

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Charities Fund in payment of the duties, and as the charities have accepted the provision in their favour no occasion to apply the alternative provision may arise. Accordingly, the appeal falls to be decided upon the basis of the provision in favour of the charities being applicable.

In whom, then, was the ownership of the Charities Fund immediately after the death of the testator? Immediately prior to the testator's death, the fund belonged to him. Upon his death the whole property in it passed to some one or more persons. It was at that moment that the *Dominion Succession Duty Act* applied, if it applied at all, to the succession to this fund. It was at that moment that liability to tax arose if any became payable upon the succession to this fund or to any interest in it. If the testator by his will *disposed* of the Charities Fund in such a way that *by reason thereof* persons, whose successions are liable to tax under the Act, *became beneficially entitled* to the fund or to an *interest therein* the disposition of such interest would, in my opinion, be a succession within the plain meaning of that expression as defined in the Act and would accordingly be liable to tax.

Assuming that the charities ultimately pay the duties, their title to the Charities Fund will relate back and take effect from the time of the death of the testator and, in that event, their title will be a title to the whole of the Charities Fund, but I do not think it necessarily follows that no other person has or will have had any rights in or to the Charities Fund or any interest therein, pending compliance by the charities with the condition. In my opinion, upon and from the moment of the testator's death, the right of the charities to the Charities Fund was and has been subject to a very important exception or restriction. They can obtain the fund only by complying with the condition. Theirs is but a right to the fund on their discharging the duties. Until the condition is complied with, the charities cannot get the fund and the trustees are obliged to hold it. The right which passed to the charities on the testator's death by reason of the disposition of the fund made in the will is thus something less than a complete and perfect right to the fund.

Who then succeeded to the remaining rights in the fund? I have said that the appeal falls to be determined on the basis of the provisions of the will in favour of the charities being applicable. It does not follow, however, that all of the provisions of the will, including the alternative provision with respect to the Charities Fund, may not be read to aid in interpreting the disposition as a whole. Under the alternative provision, in the event of refusal or failure of the charities to perform the condition, the bequests in their favour were to lapse and the trustees were required to hold the fund, to pay the duties from it and to add any balance to the Annuitants Fund. Accordingly, had the event occurred, such balance, if any, of the Charities Fund would have provided an additional legacy to each beneficiary of the Annuitants Fund. But whether or not any balance remained to be added to the Annuitants Fund, I think it is also clear that there would have been dutiable successions to the whole of the Charities Fund. Both in principle and on authority, there would have been an additional legacy to each legatee equal to the amount of duties in respect of his successions. *Re Arlow* (1). In the event above assumed, viz. the refusal of the charities to accept the provision in their favour, the amounts required to pay the duties would be derived from the Charities Fund and would, at the testator's death, have been part of that fund. On his death each of those parts of his property passed to someone pursuant to the provisions of the will. That someone, in the case of the amount required to pay duty, could only be the legatee or the government levying the duties. I cannot think that it was the testator's intention on the terms of the will in question to confer a benefit upon the government, be it dominion, provincial, or foreign. Nor, in my opinion, does the will have any such effect since the governments concerned acquire their rights under or by virtue of their respective taxing statutes, rather than by virtue of a gift contained in the will. As I interpret the will, the provision for payment of duties is simply part of the testator's method of providing for the distribution of his property among the objects of his bounty, and in imposing the trust to pay the duties from

(1) [1954] Ex. C.R. 420.

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the Charities Fund the objects of the testator's bounty are not the governments but the persons for whose benefit the duties are to be paid; that is, the legatees. I think, therefore, that the legatees, and not the governments claiming duty, are the *cestuis que trust* under the alternative provisions for payment of duties from the Charities Fund.

Turning now to the provision in favour of the charities, it will be observed that the trustees are directed to *set aside* three shares as a trust fund and to invest and keep such fund invested and, subject to performance of the condition, to divide the fund equally between the charities, the payment to the hospital including any interest *then accrued* on its share to be paid in one lump sum. The expression *then accrued* refers to the time of division and its use indicates the testator's expectation that there would be an interval between his death and the time of division. The will does not expressly say for whose benefit the fund is to be *set aside* and held in the interval, but it is clear that the persons who benefit by performance of the condition are the same persons who would have benefited had the alternative provision been applicable, though in the latter event some of them might have benefited to a greater extent. Consequently, finding that the same persons are to benefit in the same way and much to the same extent in each of the two events provided for, it is an easy step to the conclusion that, despite the failure of the will to say so expressly, the legatees are under the will the beneficiaries of the condition and the successors to it, as well as to all rights pertaining to it. In this view, the fund is set aside and held during the interval upon trust for the legatees, as well as the charities.

The next point is to determine what right, if any, in the fund accompanied the benefit of the condition.

In *Jarman on Wills,* 8th Ed., p. 1448, the following statement appears:

> . . . In equity, words which require the devisee or legatee to pay money to third persons, or which give third persons a right to be paid money, are treated either as creating a charge on the property given, or as creating a personal liability on the devisee or legatee, or as declaring a trust in favour of the third persons; in every case it is a matter of construction of the particular language used.

Thus, in *Re Cowley*, 53 L.T. 494, a testator gave certain leasehold property to his son "subject to payment of debts, funeral and testamentary expenses", and it was held that those words were apt to create a charge on the property given but not to create any personal liability.

In the case cited, Kay J. said at p. 495:

In the absence of authority, I am not prepared to say that the gift of specific legacies contained in the present will, "subject to payment of debts, funeral and testamentary expenses", means anything but that the testator gives this property and the other property subject to payment of his debts, funeral and testamentary expenses. It does not seem to me at all intended that, whether or not the property is enough, the legatee is to pay the debts. It is commonly expressed in very different terms—"he paying the debts". Here I take the words only as amounting to a charge by the testator between that property and the other property. I think that the testator's son must be deemed to have elected to accept the legacies, subject to payment of the debts, funeral and testamentary expenses, but that he is not personally liable to pay such debts, funeral or testamentary expenses, or any part thereof.

The case is interesting as well in that the charge was enforced, not by creditors claiming the debts or expenses, but by the beneficiaries on whose legacies the burden of paying the debts would otherwise have fallen.

In *Wigg v. Wigg* (1), the testator had devised certain lands to his second son, Thomas, upon condition that he, the said Thomas, or his heirs should pay certain sums to some of the testator's grandchildren (children of Thomas), and in default of payment of all or part there was a clause of entry and distress. Thomas died in the lifetime of the testator. The eldest son of the testator entered on the lands as heir at law and sold the lands to a purchaser for a valuable consideration. The question raised was whether the provision for the grandchildren was a continuing charge on the lands in the hands of the purchaser. The Lord Chancellor, Lord Hardwicke, said at p. 382:

. . . It manifestly appears that the testator intended not only to make a provision for *Thomas* and his heirs, but also to make a provision for the six children who were then in being; and it would be very unfortunate, if not only *Thomas's* heirs should lose the benefit intended, but the six children also lose their small provision by the act of God; and this is such a construction as the court never will make but when necessitated to do it. But on the contrary the present is a case so circumstanced, as will induce a court of law, as well as equity to make as strong a construction as possible to support such a charge.

The defendants insist that this is only a condition annexed to the estate of *Thomas*, and his estate not taking effect, is void.

(1) (1794) 1 Atk. 381.

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But this is not a mere condition, but a conditional limitation, there being an express limitation over to the legatees in case of non-payment, who were to enter and hold in the nature of tenants by *elegit;* and there are many nice distinctions on these conditions arising by wills. *A.* devises lands to *B.* on condition to pay *C.* a sum of money, and no clause of entry; this is no charge on the estate to give the legatee of the money a lien on the lands, but the *heir at law* shall enter and take advantage of the breach of the condition, and yet in this court he shall be considered only as a trustee for the legatee.

But then the question will be, As *Thomas* died in the testator's life-time, and the estate descended to the heir at law, if the charges continue on the lands?

I think it is the same thing; whoever entered, it was to be only till payment of the legacy, and the heir at law might in this court redeem them, but the court will not put the legatees to such a circuity, but permit them to bring a bill to have the lands sold and the money raised.

This has been compared to a defective surrender of a copyhold pursuant to a will; but here it is different, for there the will is void, but sure a man may, by will, make an equitable as well as a legal charge on his estate, and this court will maintain it against the heir at law, and therefore the children are intitled.

In *Re Kirk* (1), a testator had devised land to one of his sons on the express condition that the son, his executors or administrators should, within three months after the testator's death, relinquish all claim to a sum of £3,400 due to him by the testator. The son died in the lifetime of the testator, leaving no issue, and a question arose as to whether the land included in the lapsed devise or the residuary personal estate should bear the onus of discharging the debt. It was held that the condition bound the land, notwithstanding the lapse of the devise, and that the debt of £3,400 must be discharged out of it.

Fry J., who tried the case, based his decision on the intention, as shown by the will, that the residuary estate should not bear the debt and that it was intended by the testator that the lands included in the devise should bear the debt, whether the devise was effective or not.

In the Court of Appeal, it was argued that the principle of *Wigg v. Wigg* was not applicable because in that case there was a legatee named who was to have the benefit of the condition and, therefore, there was a constructive trust for his benefit, but that in the case under appeal there was no legatee for whose benefit the condition was imposed, the only beneficiary being the estate generally.

(1) 21 Ch. D. 431.

This argument was rejected. Jessel, M. R., at p. 437, after referring to the will and observing that the testator directed that the debt should not be paid out of his residuary estate and that the question was whether or not the £3,400 was charged upon the land included in the lapsed devise, proceeded:

> Now the question has been argued with reference to certain authorities, but I should like to say first what my view of the authorities is. My view of those authorities is this, that though the words "on condition" may be used by a testator, he does not mean to leave it to the choice of the devisee to say whether or not the person who is to take the benefit which is the subject of the condition, is to have it or not. The form looks like it, but the substance is not so. The substance is that he intends the legatee or devisee to perform the condition, and the person who takes the benefit of it is to have it in any event. In other words, it is that he does not intend the devisee, by refusing to perform the condition, to disappoint the person whom I will call the legatee, nor does he intend the death of the devisee to disappoint the legatee.
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> Well, if that is the principle, the only question left is this, is there any sound distinction between a condition to pay a sum of money to a legatee, or an annuity to a legatee, or a condition to give a valuable thing to a legatee, and a condition that his personal estate shall be exonerated from a debt? I think there is no sound distinction. I think a direction to exonerate his personal estate from a debt is equivalent in substance to a gift to the person who would be entitled to the personal estate. It does not appear to me that this is to be limited to a residuary legatee, but that it extends to everyone, to creditors, to general legatees, to residuary legatees, and to whoever will get the benefit of the sum of money from which the personal estate is exonerated.
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> I think that is the substance of it, and I should therefore have come to the same conclusion as Mr. Justice *Fry* if there had been nothing in the will except the direction that *Robert* should exonerate the personal estate from the £3,400.

He then referred to several additional features appearing from the will and concluded by upholding the judgment under appeal. Brett, L. J. concurred and added:

> . . . I should have supposed that this case was governed by the case of *Wigg v. Wigg*, 1 Atk. 382, even if there had been no words of exception in the residuary clause. I cannot help thinking that the decision in the case of *Wigg v. Wigg* was that if a person leave an estate subject to the payment of an annuity, or a sum of money in this way, he attributes the estate to the payment of the annuity, and because he attributes the estate to the payment of the annuity, he charges the estate with the payment of the annuity. Therefore it seems to me here that the testator has attributed this particular estate to the payment of his debt, and if he has attributed this estate to the payment of his debt, he has thereby charged the estate with the payment of the debt, and therefore it comes precisely within the principle of *Wigg v. Wigg*.

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Cotton, L. J., after reviewing the will, proceeded:

> . . . when we take all these together I think we cannot but say that the testator's will shews that he intended that the son taking the estate should give up the £3,400 for the benefit of the persons interested in the personal estate. That is really just the same as if he had given this sum of £3,400 to somebody else not having any previous claim at all. Then that being so neither the wish of the devisee not to comply with the condition, nor his death so that the devise could not take effect, ought, in my opinion, to defeat what is the expressed intention of the testator on the face of his will, that his real estate should be charged with the £3,400 for the benefit of those interested in the personal estate; and that being so, although there is a lapse, yet the charge still remains in exoneration, in my opinion, of the personal estate.

Applying the same reasoning to the present case, it may be observed that the will clearly shows that it was the testator's intention that the various initial bequests to the legatees were not to bear the burden of the duties. The apparent intention is that the duties should be paid by the charities to whom the testator gives the Charities Fund. But the testator does not attempt to impose on the charities any enforceable personal obligation to pay the duties. Instead, he provides for the manner in which the duties are to be paid in the event that the charities do not pay them, and that manner is by paying them from the Charities Fund. And in the meantime, the trustees are to hold the fund. Accordingly, in my opinion, the effect of the condition is to *attribute* the Charities Fund to the payment of the duties and to create a charge for this purpose upon the Charities Fund in favour of the legatees.

In my opinion, the condition can also be construed as creating a trust in favour of the legatees. In *Jarman on Wills* at p. 1449 is the following statement:

> The Court has frequently construed a condition annexed to a devise or legacy, requiring the devisee or legatee to pay money to a third person, as a trust, particularly in order to enable the third person to claim the money notwithstanding the failure of the original devise or legacy.

In *Re Frame* (1), at p. 703 Simonds J. says:

> . . . A devise, or bequest, on condition that the devisee or legatee makes certain payments does not import a condition in the strict sense of the word, but a trust, so that, though the devisee or legatee dies before the testator and the gift does not take effect, yet the payments must be made; for it is a trust, and no trust fails for want of trustees.

(1) [1939] Ch. 700.

The foregoing is, I think, in accord with what is stated in *Wigg v. Wigg.*

But in either case, whether the right which the condition gives rise to in favour of the legatees is more properly described as a charge or as a trust, it is, in my opinion, a form of security upon the fund itself to insure payment of the duties, and it is an interest in the Charities Fund within the meaning of the expression "property" as defined in s. 2(*k*) of the Act.

This right is co-extensive with the difference between the whole property in the fund and the right conferred on the charities. It is a right to which, in my opinion, the legatees became entitled *by reason of* the disposition of the Charities Fund made by the testator and, in my opinion, the disposition thus made was a succession within the meaning of that expression as defined in the Act. The right is not, however, a right to the duties. It is a right in the fund to have the fund held as a security for payment of the duties until the duties are paid. But I think it is obvious that the value of the right is equal to the amount of the duties—limited, of course, by the value of the Charities Fund itself.

It follows from the foregoing that each of the legatees succeeded to an additional interest in property equal in value to the amount of the duties on his successions and that such successions were dutiable successions under the Act. Having so determined the main question, in my opinion, the method of calulation of the duties which the Minister followed and which was approved by this Court in *Re Arlow Estate* (*supra*) and *Re J. F. Weston Estate* (1) is not unfavourable to the appellants or any of the persons interested in the estate and affords them no ground for appeal.

The foregoing is, in my opinion, sufficient to dispose of the appeal, but in accordance with the suggestion made by counsel at the argument, if counsel wish to raise any question as to the arithmetical calculation of the duties,

(1) [1954] Ex. C.R. 445.

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MONTREAL TRUST CO. *et al.* *v.* MINISTER OF NATIONAL REVENUE

Thurlow J.

leave is reserved to them to speak to the matter before the judgment is entered. Subject to this, the appeal will be dismissed with costs.

Judgment accordingly.

BRITISH COLUMBIA ADMIRALTY DISTRICT

1957
Mar. 4, 5
Mar. 12

PACIFIC COYLE NAVIGATION COMPANY LIMITED ..... PLAINTIFF;

AND

CANADIAN PACIFIC RAILWAY COMPANY ..... DEFENDANT.

Shipping—Collision—Vessel not excused from stopping engines because it has a tow—Assessment of damages and costs.

The action is one for damages resulting from a collision between plaintiff's tug and defendant's tug with a barge in tow. The Court found that both vessels were going at an excessive speed and each failed to stop its engine on hearing fog signals, and that no proper lookout was kept on board plaintiff's tug.

Held: That the negligence must be assessed in the ratio of three quarters to plaintiff and one quarter to defendant.

2. That the fact that a vessel has a tow is no excuse for it not stopping its engines.

ACTION for damages resulting from collision between two vessels.

The action was tried before the Honourable Mr. Justice Sidney Smith, District Judge in Admiralty for the British Columbia Admiralty District, at Vancouver.

W. D. C. Tuck and *A. F. Campney* for plaintiff.

A. G. Harvey for defendant.

SIDNEY SMITH D.J.A.:—This suit concerns a collision in dense fog in English Bay between the plaintiff's tug *Newington* running light and the defendant's tug *Kyuoquot* having the barge *Transfer No. 9* in tow. The *Newington* had come down Howe Sound and had rounded Point Atkinson with the intention of anchoring in English Bay. The *Kyuoquot* bound outward had passed Prospect Point and was heading towards Point Grey.

I formed a poor opinion of the *Newington's* navigation. I doubt if any proper lookout was being kept on board and whether proper fog signals were being sounded. I find she was proceeding at an excessive speed in the prevailing conditions and that she failed to stop her engines upon hearing the fog signal of the *Kyuoquot* immediately prior to the collision.

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PACIFIC COYLE NAVIGATION CO. LTD. v. CANADIAN PACIFIC RY. CO.

Sidney Smith D.J.A.

On the other hand I had no trouble in accepting the evidence of the experienced seamen who testified for the defendant company. The *Kyuoquot* however was at fault too in that she was going at an excessive speed and she too failed to stop her engines on hearing the fog signal of the *Newington*. This signal appeared on the starboard beam of the *Kyuoquot* but it was forward of the beam *vis-a-vis* the barge. It is not a valid excuse for not stopping engines that the vessel concerned has a tow, *The Challenge and Duc D'Aumale* (1). The circumstance that the barge did not sound fog signals in no way contributed to the collision.

I find the *Newington* three-quarters to blame and the *Kyuoquot* one-quarter, with corresponding costs.

If necessary, the learned Registrar will hold a reference as to the damages.

Judgment accordingly.

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Apr. 30

May 2

ONTARIO ADMIRALTY DISTRICT

THOMAS A. NEIL ..... PLAINTIFF;

AND

NORTHERN SHIPBUILDING & REPAIR CO. LTD. ..... DEFENDANT.

Shipping—Action for damages allegedly caused plaintiff's schooner by defendant's ship—Defendant a gratuitous bailee—No negligence on part of defendant—Action dismissed.

Plaintiff claims for damages sustained by his schooner the *Heron* which had been purchased by him from an officer of defendant company who had given permission to plaintiff to moor the schooner at defendant's wharf. The damage was caused by another ship the *Magedoma* moored at the same dock at the same time and which by reason of unprecedented high water and terrific wind broke from the dock and shoved the *Heron* against the dock causing the damage complained of.

Held: That defendant was a gratuitous bailee and could only be responsible for damage caused by its negligence.

2. That the *Magedoma* had been reasonably and properly moored and defendant was not negligent in any way.

ACTION for damages.

The action was tried before the Honourable Mr. Justice Barlow, District Judge in Admiralty for the Ontario Admiralty District, at Toronto.

(1) [1905] P. 198.

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NEIL v. NORTHERN SHIP-BUILDING & REPAIR CO. LTD.

L. A. Fitzpatrick for plaintiff.

J. W. Thompson, Q. C. for defendant.

BARLOW D. J. A.:—The plaintiff as the owner of the schooner *Heron* claims for damages sustained by the *Heron* when, on the night of Hurricane Hazel on the 15th October, 1954, she was shoved against the dock of the defendant in the harbour at Bronte by the *SS. Magedoma,* which was also docked in the same harbour.

The *Heron* was purchased by the plaintiff from Harry D. Greb, a Vice-President of the defendant Company under a bill of sale dated the 5th day of June, 1954. The *Heron* was the personal property of Greb and had been moored while he owned it, in the harbour at Bronte, at a dock owned by the defendant. I accept the evidence of Greb that after the sale he told the plaintiff that he, the plaintiff, could continue to moor the *Heron* at the same dock. A number of other vessels were moored in the same harbour and at the same dock or nearby, among them the ship *Magedoma.* At no time was any arrangement made by the plaintiff with the defendant company, unless it can be said that the permission of Greb, the Vice-President of the defendant Company to moor the *Heron* there was an arrangement.

The *Heron* continued to be so moored when not in use during the summer of 1954, and no payment therefor was made or requested to be made. The fact that the defendant Company continued to permit the plaintiff to moor the *Heron* at its dock cannot place the defendant in a higher position than a gratuitous bailee. As such the defendant would only be responsible for damage caused by its negligence.

The *Magedoma* was moored some little distance from the *Heron* alongside the bank, with lines from its bow and its stern attached to two blocks of cement partly buried in the earth, each weighing about ten tons. On the night of Hurricane Hazel by reason of the unprecedented high water and terrific wind, the bow of the *Magedoma* pulled the block of cement to which its bow lines were attached, out into the river, and the bow of the *Magedoma* swung around in a 180 degree arc against the *Heron* shoving the *Heron* against the dock and thus causing the damage.

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Barlow D.J.A.

The question is: Was the *Magedoma* reasonably and properly moored? The *Magedoma* had been moored in the position in which she was at the time of Hurricane Hazel for some two years, and had withstood the spring freshets. The evidence of experienced and reputable witnesses satisfies me that the *Magedoma* was reasonably and properly moored, and that the defendant took all such reasonable precautions in her mooring as it would have done with its own goods. This is all that can be required from a bailee for reward, whereas I have already found that the defendant was in no higher position than a gratuitous bailee.

I cannot find that the defendant was negligent in any way.

The action will be dismissed with costs.

Judgment accordingly.

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May 30, 31
June 1

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May 1

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

AND

FRANKLIN W. TURNBULL ..... RESPONDENT.

Revenue—Income tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 3—Income or capital—"Profits from a trade or commercial or financial or other business or calling . . . or from any trade, manufacture or business . . . and . . . the annual profit or gain from any other source"—Isolated transactions entered into with a view to profit-making rather than investment—Profits from isolated transactions held to be taxable income—Appeals from Income Tax Appeal Board allowed.

The appeal is by the Minister of National Revenue from two decisions of the Income Tax Appeal Board which allowed respondent's appeal from his assessment for income tax under the circumstances outlined below.

Respondent with one Fell and three others purchased steel pipe from War Assets. Respondent and Fell also acquired the interest in the pipe of one of the original purchasers. The pipe was delivered to a company incorporated to supply gas to a town in the province of Saskatchewan which company delivered bonds to the four purchasers in payment therefor. The net result of this transaction was that respondent and Fell each received a profit of $1,792.67. This amount was added to respondent's income.

Respondent assigned a prospecting permit held by him to a company referred to as Bata receiving in payment therefor 100,000 shares of Bata stock which the appellant valued at fifty cents per share and after deducting $250, the sum paid by respondent for the permit, added $49,750 to respondent's income.

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Respondent on behalf of Fell applied for certain salt rights in the province of Saskatchewan which rights were later assigned to him by Fell and which rights he claimed were held in trust by him for himself and Fell and two others. They were finally disposed of to a company, respondent sharing in the price and royalties paid by it for such rights. The amount thus received by respondent was added to his income.

Appellant appealed from the decision of the Income Tax Appeal Board on the ground that such sums of money received by respondent were income and not capital gains.

Held: That the pipe was not purchased as an investment and was disposed of to the only one possible purchaser and shipped direct to it, the price agreed upon being more than double the cost to the purchasers. The profit thereon was properly assessed as income to the respondent.

2. That with regard to the salt rights the only reasonable interpretation of the evidence is that neither respondent nor Fell intended that the salt rights should be held or developed as an investment.

3. That respondent Turnbull and his associates formed a syndicate for the purpose of buying and selling the pipe and the right to prospect for salt and these are properly classified as operations of business: it is of little significance that the respondent and Fell had no experience in this type of business or that there was relatively little organization for the purpose of the transactions; they were sufficiently acquainted with business matters to deal with transactions of this sort in which, having purchases at hand, it was unnecessary to do more than they actually did to effect the sales; the profit realized from these two transactions constituted taxable income of the respondent.

4. That from the evidence as a whole the only reasonable inference to be drawn is that the permit to prospect for gas and oil was not received as a *bona fide* investment but with the intention of turning it over forthwith at a profit to Bata; respondent did nothing in exploiting or developing the property in any way and the only expenditure he made in regard thereto was to pay the permit fee of $250 at the time he filed his application; respondent had signed a declaration of trust in favour of Bata a short time after his original application for the permit and before he had made a formal application therefor, the declaration containing no particulars to the number of shares of Bata to be issued to respondent; therefore the inference is that respondent in applying for the permit was acting on behalf of Bata or was confident that he could and would dispose of his permit at once to Bata, of which company he was then solicitor and a shareholder: the transaction was an operation of business in carrying out a scheme for profit-making the profits from which constitute taxable income.

5. That the fair value of the Bata shares is thirty cents per share or a total of $30,000.

APPEAL from decisions of the Income Tax Appeal Board.

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

J. D. Pickup, Q.C. and *F. J. Cross* for appellant.

J. M. Godfrey, Q.C. for respondent.

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CAMERON J.:—This is an appeal by the Minister of National Revenue from two decisions of the Income Tax Appeal Board, both dated February 10, 1955, one of which allowed the respondent's appeal from assessment for the year 1946, the other allowing in part only his appeal in respect of the year 1947. In his assessment for the year 1946, the Minister had added to the respondent's declared income certain sums received by the latter in that year in respect of the sale of pipe and the sale of salt rights, as well as the Minister's valuation of certain shares of stock received by the respondent upon the transfer of a Permit to Prospect for oil and gas. Similarly, he had added to the respondent's declared income for the year 1947 a further amount received by him in respect of the sale of the salt rights. Other matters in respect of the year 1947 were before the Board, but as there is no appeal from its decisions on such matters, they need not be referred to further.

The Minister has also appealed from two further decisions of the Board, both dated February 10, 1955, allowing the appeals of Arthur James B. Fell from assessment made upon him for the years 1946 and 1947. The items there in question were of precisely the same nature as those relating to the sale of pipe and the sale of salt rights in the instant case and arose out of the same transactions. By consent of counsel for all parties, it was agreed that the two appeals should be heard at the same time and that all the evidence adduced, where relevant, should be applicable to both cases.

Mr. Fisher, from whose decisions the appeals are now taken, expressed his opinion on the matters in appeal in this case as follows:

> As to the amounts received in the years 1946 and 1947 in respect of the gas lease, the pipe deal, and the salt lease, I have reached the conclusion that these were capital receipts arising out of isolated transactions which did not form part of the ordinary business of the appellant. This conclusion, however, has not been arrived at without considerable hesitancy.

Before me the respondent supports that conclusion. The Minister, however, submits that each item of profit so received was profit from a business and therefore taxable income by virtue of subsection (1) of section 3 of the *Income War Tax Act* which will be referred to later.

The respondent, Mr. Turnbull, is a solicitor who practiced his profession in Regina from 1910 to 1949; it appears, however, that during the years in question he had retired from general practice. In October, 1943, he incorporated Bata Petroleum Limited (hereinafter to be called "Bata"), a company formed for the purpose of exploring for oil and natural gas in Saskatchewan. He was solicitor for the company from its incorporation until 1951; its secretary from May 1946, to 1949, and a director from July 1948, to the end of 1949. The evidence does not disclose when he first became a shareholder but in 1944 he acquired 40,000 shares from Fell, said to be in payment of a bill for legal services performed on Fell's behalf. For services performed in reorganizing the company, Fell, in 1944, received 800,000 shares of Bata; he was never a director but was appointed business manager in December 1945. He says: "I was recognized as such all the way through".

In August 1944, Turnbull incorporated Unity Gas Supply Company, Ltd. (hereinafter to be called "Unity"), a company formed for the purpose of holding the franchise from the town of Unity, Saskatchewan, for the transmission and distribution of natural gas in that town. Both Turnbull and Fell were shareholders and directors of Unity from its inception until at least 1951; and Turnbull was its solicitor at all relevant times.

On February 15, 1945, the respondent incorporated Associated Development Company—hereinafter to be called "Associated". It was an engineering company and was formed also for the purpose of being the sales agent for Bata for the sale of natural gas. Both Turnbull and Fell were shareholders from its inception and Turnbull was a director and solicitor for the company at all relevant times.

The first matter relates to an item of $1,792.68 received by Turnbull in 1946 under the following circumstances. In the spring of 1945 Unity was preparing to proceed with the construction of its gas mains and for that purpose had placed an order for the required amount of pipe. It was necessary, however, to first secure governmental authority for the use of steel and in July 1945, such permission was refused; as a result the pipe which had been ordered was released and sold elsewhere. Shortly thereafter Fell, and

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another shareholder of Unity—one Beare—advised Turnbull that they had purchased pipe from War Assets and he was invited to contribute a portion of the purchase price. The purchase was made by five parties, including the respondent and Fell, four of whom were directors of Unity and three of whom were directors of Associated, which by contract with Unity was to install the pipes. Subsequently, one of the purchasers who was in need of funds sold his interest to Fell and Turnbull, each of whom as a result had a thirty per cent. interest in the pipe, the other two having each a twenty per cent. interest. The pipe was delivered to Unity in 1945 and after permission was received to use steel for that purpose, the pipe was placed in the ground. In 1946, the four purchasers were given $12,000 in bonds of Unity in payment for the pipe and it is agreed that the bonds were then valued at $11,880. The price was fixed by the company engineers at the market price which the engineers estimated would have been paid for suitable pipe in 1945. After deducting the amount paid to War Assets and shipping and welding charges to a total of $5,102.75, the respondent and Fell each received a profit of $1,792.67. That is one of the items added to the declared income of the respondent herein and of Fell.

The second item in dispute relates to the assignment by the respondent to Bata of his rights in a permit to prospect for petroleum and natural gas over a large area in the province of Saskatchewan. On December 14, 1945, he wrote to the Supervisor of Mines of the province (Exhibit 2), applying for a reservation under an agreement in order to prospect for petroleum and natural gas in the area named. In the reply to that letter (Exhibit 3) it was pointed out that the applicant would have to comply with certain new regulations, a copy of which would be supplied to him; and he was also informed that a portion of the area in question was then covered by an outstanding reservation and that the owner thereof would be given the first right to apply for that area under the new regulations, but that upon his failure to do so, that area would also become available. On March 4, 1946—some seven weeks before the respondent made a formal application for his permit—the respondent entered into an agreement with Bata called a Declaration of Trust (Exhibit 4). That

document recited that the respondent had applied for a permit to prospect for petroleum and natural gas, that the department was willing to grant such a permit with the exception of certain parts upon which a reservation had already been made, and contained the following recital:

> Whereas Bata Petroleums Limited wishes to acquire the beneficial interest of me, the said Franklin W. Turnbull, in the said lands, and has in consideration therefor agreed to issue certain shares of treasury stock of Bata Petroleums Limited to me or to my order.

Then, by the agreement, the respondent covenanted that in consideration of the premises and of one dollar

> I hereby agree that I shall from this date forward hold the beneficial interest above referred to in trust for Bata Petroleums Limited so that they may receive through me all benefits which might otherwise be derived by me from the said lands and the said reservation or permit upon the following conditions:

Bata, by the terms thereof, agreed forthwith to issue to Turnbull or his order "the shares above referred to" (the number of which was not specified in the agreement) and to assume all the obligations for which Turnbull might be liable under the permit or reservation.

On the following day the respondent again wrote to the Supervisor of Mines requesting a prospecting permit, and forwarded the fee of $250. In the reply thereto, dated March 8, 1946 (Exhibit A) the Supervisor of Mines pointed out that under the regulations he had given the holder of the prior reservation thirty days within which to make the new application for permit or have the reservation cancelled. Turnbull was also advised that it would be necessary for him to complete the enclosed application form. On April 17, he was advised that the outstanding reservation had been cancelled as of April 15 and he was again requested to complete and forward his application form. Exhibit C is a copy of such application dated April 24, 1946, "for a permit to conduct geological and/or geophysical surveys, examinations and investigations of the sub-surface geology"—in the lands stated. The "Performance" bond of $500 was paid to the province by Bata. The permit was issued to Turnbull in May 1946, and he received 100,000 shares of Bata stock pursuant to the agreement of March 4. In assessing the respondent for that year, the Minister added to his declared income the sum of $74,750, said to be the profit or gain received from the sale of the prospecting

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rights. In so assessing the respondent, the Minister had valued the shares at seventy-five cents each and allowed as a deduction therefrom the sum of $250 paid by the respondent for the permit. Following the notice of objection by the taxpayer, the Minister by his notification dated August 25, 1952, agreed to amend the assessment by reducing the said item of profit from $74,750 to $49,750, or a value of fifty cents per share. Through an oversight, however, the Minister in his notice of appeal to this Court failed to give effect to that deduction, but at the hearing it was amended accordingly.

The third transaction in which both the respondent and Fell were interested was as follows: On May 8, 1946, the respondent, *on behalf of Fell,* wrote to the Supervisor of Mines of the province of Saskatchewan (Exhibit 5) applying for a salt lease covering twelve sections of land (some weeks previously Bata had applied for such rights but the application was refused). He was advised by letter dated May 14 (Exhibit 6) that the new regulations regarding the issue of salt rights were being prepared and that in the meantime the area would be held for Fell and that a formal application could be made later. On June 10 Turnbull applied on behalf of Fell to have the area extended by the inclusion of several additional townships and he was advised by letter dated June 11 (Exhibit 8) that the additional area was so reserved. By assignment dated July 15, 1946 (Exhibit 9), Fell assigned all his interest in the salt rights to Turnbull for the express consideration of $1,000, the receipt of that sum being formally acknowledged. Turnbull states, however, that he then received nothing from Fell and that he is not sure why such a consideration was inserted. Then by letter dated July 23, 1946 (Exhibit 10), Turnbull agreed to sell to Associated Development Co. Ltd. all his interest in the salt rights

> for whatever sum your company may be able to secure for the said salt rights from Dominion Tar and Chemical Company at Montreal, Canada, or any subsidiary of the said Company which may be set up to acquire such salt rights from Associated Development Company Limited. Such monies shall be paid to me or my nominee or nominees as and when received by you, or such monies may be assigned to me or my nominee or nominees, and paid to me direct.

Prior to the date of that assignment, Dominion Tar and Chemical Co. Ltd. had approached Denton, president of

Associated, with reference to the salt rights. In some way or other the right to prospect for salt was transferred to Prairie Salt Company Limited (a subsidiary of Dominion Tar and Chemical Company) which, on November 22, 1946, received a license from the province of Saskatchewan (Exhibit 13) to explore for and remove salt in precisely the same area as that originally reserved for Fell. No license for such rights had issued at any time to Fell, Turnbull, or to any of their companies.

By an agreement dated November 20, 1946, between Associated and Prairie Salt Company, Ltd., arrangements were made for the supply of natural gas by the former to the latter's plant to be located near Unity. In addition, Prairie Salt Company was to pay to Associated $25,000 upon the execution of its salt license with the province of Saskatchewan, and a further $25,000 upon locating salt in the area, sufficient to warrant the opening of a second salt well. The consideration is expressed as follows:

(1) In consideration for *exploratory and development work already carried out by Associated resulting in the discovery of substantial salt bodies in the Unity area* and for the geological and other information relating thereto in the possession of Associated which are to be made available to the company (*i.e.*, Prairie Salt Company, Ltd.), the company hereby agrees to pay Associated the following sums of money—

It was further provided in the said agreement that Prairie Salt should pay to Associated a royalty of twenty cents on each ton of salt produced in any year up to thirty thousand tons, such royalty to be reduced to fifteen cents per ton for annual production in excess thereof.

That agreement was executed on behalf of Associated by its officers Denton and Turnbull. Dominion Tar and Chemical Company joined in the said agreement to guarantee performance of the said covenants by Prairie Salt Company and undertook to provide up to one million dollars to the latter company for the purpose of drilling salt wells and the construction of a salt plant.

Then on November 29, 1946, Associated wrote to Prairie Salt (Exhibit 14) as follows:

We hereby authorize you to pay to Mr. F. W. Turnbull the sums of money otherwise payable to or under contract between your company and ourselves and for such a payment this will be your good and sufficient authority.

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That letter was signed by Turnbull on behalf of Associated. Prairie Salt carried out its agreement and in 1946 Turnbull received $25,000 and in 1947 a further payment of a like amount.

The respondent states that he received these amounts in trust for himself and his three associates, Fell, Denton, and Whelehan; that his only interest therein was 15 per cent. and Fell's 35 per cent. Out of the first payment the respondent paid expenses totalling $2,251.90 for drilling a water well, aeroplane surveys, printing, testing, analyzing and auditing. After deducting these expenses, Turnbull received $3,412.21 in 1946 for his interest therein and in 1947 received his full share of the second payment amounting to $3,750. In the same way, Fell in 1946 received $7,961.84 and in 1947 $8,750.

The appellant in each of the years 1946 and 1947 added to the respondent's declared income $4,300 in respect of these transactions. It was agreed at the hearing, however, that these amounts were incorrect and that the net amounts received in those years by the respondent were as stated above.

Royalties in respect of the salt transaction were received in 1948 and thereafter. Turnbull states that half of the royalty of twenty cents per ton was given to Bata (although there was no legal obligation to do so) because the salt was discovered on land held by it. The remaining ten cents per ton has been divided between the four members of the Turnbull Trust, namely, Turnbull, Fell, Denton and Whelehan, the first two receiving 15 per cent. and 35 per cent. thereof respectively.

I shall first consider the purchase and disposition of the pipe and the salt rights as both Turnbull and Fell were concerned in these transactions. It is of importance to note the manner in which these purchases and sales were brought about. The financing was done through the "Turnbull Trust". I gather from the evidence that a bank account was opened in the name of Mr. Turnbull, in trust, and that all parties interested in the particular transactions contributed to the account in proportion to their interest in the transactions as needed, but that the account was operated by Turnbull alone. There was no written agreement between the individuals, Mr. Fell observing in his evidence

that "We live out West where you know we can trust people". He described the Turnbull Trust as one "to look after the affairs of the group as attorney". The whole arrangement he described as follows: "As the things were done and as money was or must be acquired for any expenses whatever, he would notify or tell us and we would put our money up to the Turnbull Trust. That is why, and when the money came in, like for myself as it happened, that distribution was made from the Turnbull Trust of the individuals' interests."

It is very clear from the evidence that the groups involved in these transactions operated as an informal syndicate for their mutual advantage and with the purpose of realizing a profit in proportion to their interest in the two transactions. Both Turnbull and Fell insist that at the time of the purchase of the pipe they had in mind only the purpose of assuring a supply of pipe so that the town of Unity would not lack gas in the approaching winter. It was also said that the Unity Gas Supply Company, Ltd., did not have funds to purchase pipe, but it is also clear that but a short time previously pipe had been ordered for Unity and there is nothing to indicate that at that time there was any problem of financing the purchase price or that Turnbull or Fell had then been called upon to assist in the purchase. It is clear that the pipe was not purchased as an investment for the purchasers had no use for it themselves and could derive no return from it as such. There was only one possible purchaser, namely, Unity, and after welding in suitable lengths, the pipe was shipped direct to that company. It is interesting to note, also, that at the time the pipe was sold by the syndicate to Unity, there was no discussion as to the sale price, the parties being content to let that matter stand, doubtless because of their close relationship to Unity and Associated. Later, the fair value was worked out by the engineers and accepted by the members of the syndicate. The price agreed upon was more than double the total cost to the syndicate. If the latter had no thought of profit in their minds, they could have accomplished their declared purpose of assuring a supply of pipe to Unity by re-selling the pipe at cost or by loaning the required amount to Unity. On this point,

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reference may usefully be made to the decision of Fournier J. in *Honeyman v. M.N.R.* (1)—a case similar in many respects to the instant one.

In regard to the purchase and sale of the salt rights, it is necessary to refer to other matters in evidence. Within a fortnight prior to Turnbull's application on behalf of Fell, Bata had applied verbally for the same salt rights and had been refused a permit (it would seem that Bata already had the right to explore for petroleum and natural gas in the same area). I find the respondent's evidence confusing and conflicting. He states that at the time of the original application he had no personal interest in it. Then he says that while the assignment by Fell to him dated July 15, 1946, is in form an absolute assignment, the consideration of $1,000 was never paid and he did not know why it was inserted. Later he says that while it was an outright assignment, there was no consideration and it was done as a matter of convenience. He states also that when he secured it from Fell, he held it in trust for Fell but found out later it was in trust for Denton, Fell, Whelehan and himself. On another occasion he says that from the time he got it, he held it in trust for these four. He states that in February 1947, after the first payment of $25,000 was received from Prairie, these four met together and made an agreement as to their respective interests, his own being 15 per cent. and that of Fell 35 per cent. That, he says, was the first date on which he actually knew what interest he personally had in the transaction. Fell, Whelehan and Turnbull were shareholders in Associated and the latter two were directors, Turnbull also being its solicitor. The four named parties never received their reservation or lease for the salt rights and paid out nothing to the province in respect of the application. While certain work was done by aeroplane surveys and in searching for suitable water supply and the like, none of such expenses appear to have been paid until after the receipt of the first payment from Prairie. It is significant to note, also, that in the agreement between Associated and Prairie (Exhibit 14) and signed on behalf of Associated by Denton and Turnbull, the consideration is said to be for "exploration and development

(1) [1955] Ex. C.R. 200.

work *already carried out by Associated* resulting in the discovery of substantial salt bodies". Fell states his intention in acquiring the salt rights as follows:

> When I got it I intended to, firstly, find out about the water—the water conditions—in order to properly locate near the rail and transportation—that part of the lease, and with a view to development of it—*to get something good for the company.*

He did not specify which company was to "get something good", but in the result both Associated and Bata benefitted, the former by securing a contract for the supply of gas to Prairie Salt and Bata by the receipt of half the royalty reserved.

It is quite apparent that the whole story was not told. If Fell intended to develop the salt rights himself, why did he assign them to Turnbull for a consideration which was never paid? Why was he looking for "something good for the company"? If Turnbull intended to develop the rights himself, why was he unaware of the nature and extent of his interest therein until after they had been sold? At page 59 of the evidence, Turnbull stated that whatever personal but undefined interest he had in the salt rights came into existence when he acquired the assignment from Fell on July 15, 1946; he disposed of all interest therein whether his own or that of his associates, eight days later for whatever sum Associated might secure from Dominion Tar and Chemical Company or its subsidiary. The conclusion is inescapable that prior to or immediately after he acquired any interest he had knowledge of the proposed arrangements between Associated and Dominion Tar and was prepared to dispose of the syndicate's interest forthwith.

The question to be determined is whether these profits from the sale of pipe and the disposition of the salt rights fall within the words "profits from a trade or commercial or financial or other business or calling . . . or from any trade, manufacture or business . . . and . . . the annual profit or gain from any other source" in section 3 of the *Income War Tax Act*.

Counsel for the respondent rightly agrees that the purchase of the pipe cannot be considered as an investment. He submits, however, that the acquisition of the salt rights was in the nature of an investment and that the profit

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realized therefrom was a capital gain. As to both transactions, he submits that they were isolated transactions not amounting to a business, and in their nature foreign to the type of business normally carried on by either Turnbull or Fell. I have already stated my opinion that in each case the transactions were entered into by the members of the syndicate for the purpose of profit-making; that, I think, was the real purpose of the formation of the Turnbull Trust. Moreover, it is well settled that even if they were isolated transactions, that fact by itself does not dispose of the matter. In that connection, reference may be made to *Edwards (Inspector of Taxes) v. Bairstow* (1); *Atlantic Sugar Refineries Ltd. v. M.N.R.* (2); and to *M.N.R. v. J. A. Taylor* (3). The only reasonable interpretation of the evidence is that neither Turnbull nor Fell intended that the salt rights should be held or developed as an investment. On Turnbull's own evidence he did not know at any time prior to realization what interest, if any, he had in the salt rights. The one agreement actually arrived at was as to the distribution of *profits* after they were realized by the sale. I think that Fell in his evidence correctly stated the purpose of the acquisition of the salt rights when he said that it was his intention "to get something good for the company".

In the *Atlantic Sugar Refineries case* (*supra*), Kerwin J. (now C.J.C.) at p. 709 stated the test to be applied—

> In *Ducker v. Rees Roturbo Development Syndicate,* [1926] A.C. 140, the House of Lords unanimously stated (and adopted) the test in the *California Copper Syndicate* case as being whether the amount in dispute was "a gain made in an operation of business in carrying out a scheme for profit-making".

In my view, the gains made from the transactions regarding the pipe and the salt rights fulfill this test. I have already stated my opinion that in both cases there was a scheme for profit-making. The syndicate of four members, called the Turnbull Trust, was formed for the purpose of buying and selling the pipe and the right to prospect for salt, and in my view these are properly classified in the circumstances of this case as operations of business. It is a matter of relatively little significance that the respondent and Fell had no experience in this type of business or that

(1) [1955] 3 All E.R. 48. (2) [1949] S.C.R. 706 at 708.
(3) [1956] C.T.C. 189.

there was relatively little organization for the purposes of the transactions. They were sufficiently acquainted with business matters to deal with transactions of this sort in which, having purchases at hand, it was unnecessary to do more than they actually did to effect the sales. (*Vide Edwards v. Bairstow—supra*).

For these reasons, I am of the opinion that the profit realized from these two transactions constituted taxable income of the respondent.

I must now consider the other transaction in which the respondent alone was interested, namely, the acquisition and sale to Bata of the right to prospect for gas and oil. As I have said, he received 100,000 shares of Bata stock in 1946. Counsel for the Minister endeavoured to establish that the respondent received these shares from Bata in payment of legal services rendered by him to Bata. On the evidence, however, I am satisfied that such was not the case, but that the shares were received in payment for the assignment of such rights as the respondent may have had in the permit to prospect for oil and gas. The question, therefore, is whether the value of these shares (less the sum of $250 paid by the respondent for the permit) is within the test which I have set out above when considering the other transactions. The submissions made on this matter were much the same as in regard to the salt transaction.

On the evidence as a whole, the only reasonable inference to be drawn is that the permit was not secured as a *bona fide* investment but with the intention of turning it over forthwith at a profit to Bata. The only evidence relating to this matter is that of the respondent himself. He says that he intended to have a physical survey of the area carried out and if it proved to be valuable, to attempt to develop it, to try to secure a continuing income from it after his retirement from the practice of law which he then contemplated. His evidence I find to be somewhat confusing and conflicting. He stated that Bata approached him regarding the acquisition of the permit after it was assured that the province was prepared to issue it to him, and that previously Bata had not shown any interest in that land. He admits, however, that while Bata had made no application for such rights, he, the respondent, "had felt out the

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department" at one time as to whether it would grant a permit to Bata and had been told that it would not do so, the department being of the opinion that Bata had all the land it could explore. The respondent did nothing whatever in exploring or developing the property in any way and the only expenditure he made in regard thereto was to pay the permit fee of $250 at the time he filed his application, some seven weeks after he had signed the declaration of trust (Exhibit 4) in favour of Bata. In the light of these facts and in the absence of any evidence other than that of the respondent, and particularly when it is seen that the declaration of trust was signed but a short time after the respondent's original application for the permit and before he had made a formal application therefore, and that the declaration of trust contained no particulars as to the number of shares of Bata to be issued to the respondent, there seems to be an inescapable inference that Turnbull in applying for the permit was acting on behalf of Bata or was confident that he could and would dispose of his permit at once to Bata, of which company he was then solicitor, and a shareholder. It is of some significance that while Fell (who had reorganized Bata, supplied funds for its development and was its manager for many years) gave evidence on other matters, he was not asked to corroborate the respondent's evidence as to when or why Bata became interested in securing the permit. Had it been an ordinary transaction at arm's length, it seems very doubtful that Turnbull, who drew the document, would have omitted the all-important question as to the number of shares which he was to receive in payment. In my opinion, this transaction was an operation of business in carrying out a scheme for profit-making, the profits from which constitute taxable income.

It therefore becomes necessary to determine a fair value for the 100,000 shares of Bata stock in the year 1946 when they were received by the respondent. As noted above, the Minister in assessing the respondent valued them at 75 cents per share, but subsequently and following the Notice of Objection, agreed to reduce the value to 50 cents per share. On the respondent lies the burden of establishing that that valuation is incorrect.

The shares of Bata were not listed on any exchange until 1951. Considerable evidence was therefore introduced as to actual sales made, the circumstances under which they were made, the assets and financial position of Bata. In endeavouring to place a value on the shares, I must keep in mind the statement by Viscount Simon in *Humphrey v. Gold Coast Selection Trust Ltd.* (1):

> If the asset takes the form of fully paid shares, the valuation will take into account . . . a number of . . . factors, such as prospective yield, marketability, the general outlook for the type of business of the company which has allotted the shares, the result of a contemporary prospectus offering similar shares for subscription, the capital position of the company, and so forth. There may also be an element of value in the fact that the holding of the shares gives control of the company. If the asset is difficult to value, but is none the less of a money value, the best valuation possible must be made. Valuation is an art, not an exact science. Mathematical certainty is not demanded, nor indeed is it possible.

The respondent received 30,000 of the shares in 1946 and the balance in May in that year. He states that at the time he negotiated the contract with Bata there was some informal discussion and that a value of 20 cents per share was mentioned, but no value was fixed. At the same time, he verbally agreed not to put the stock on the market, although there was no actual escrow agreement in writing. Up to the time of the hearing, he had not disposed of any of these shares, although he had bought and sold a very large number of Bata shares in the intervening years.

The company had been organized in October 1943, and shortly thereafter it was found to be in financial difficulties. As a result, Fell was brought in to assist in the financing of the company's operations and to reorganize its financial structure.

It had insufficient funds to finance its operations in prospecting for and developing oil and gas wells. It was therefore necessary to sell treasury shares, but in 1944 only 10,000 to 20,000 shares were disposed of. Early in 1945, the Toronto General Trusts Corporation at Regina was appointed as the company's transfer agent. A fiscal agent was appointed to sell shares and to supervise a number of salesmen who sold shares by making personal calls on prospective purchasers throughout the province. The salesmen received a commission of 25 per cent. on such sales. Four of the larger shareholders (including Fell) deposited

(1) (1948) 30 T.C. 209 at 240.

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150,000 of their own shares with the transfer agent under the terms set forth in a letter from Turnbull, as solicitor for the company, dated February 5, 1945 (Exhibit D). Therein it was provided that for each 5,000 treasury shares sold, 1,500 shares of the deposited stock were to be transferred to Fell (named as the sales representative) upon payment of 17½ cents for each share of the deposited stock so delivered. That agreement was to remain in effect until December 15, 1945, but the four depositors until April 30, 1945, were entitled to withdraw from the deposit one-half of the shares then remaining upon payment of 20 cents per share. In addition, five shareholders agreed without payment to deliver to Fell a total of 50,000 shares to be used in creating a fund to finance the sale of treasury stock, and the proceeds were used to supplement the commission paid to the salesmen engaged in selling treasury stock.

In 1945, authority was secured from the registrar under the Securities Frauds Prevention Act to sell the treasury shares for not more than 50 cents each. Some sales were made at that price, but in insufficient quantity to provide the needed working capital. Both Turnbull and Fell state that in order to "boost" sales, the company decided to apply for a further consent to sell stock at 70 cents per share and later at $1 per share, and these were secured. They said that advance notice of such proposed increase in the sale value was given to the salesmen so that they could advise prospective purchasers to buy at once rather than later when the sale prices would be increased. It was, in their opinion, purely a sales promotion scheme. Later in 1946, the company resolved to increase the sale price to $2 per share but it is not shown that the registrar's consent for sales at that price was ever obtained or that any sales were made under that resolution.

The financial books of the company were not produced and there is therefore no clear evidence as to what Bata received from the sales of treasury stock after payment of commission and expenses. Both Turnbull and Fell were uncertain as to the number of shares sold and the prices received in 1945 and 1946 as they had no adequate records at the hearing and were speaking from memory only of events which occurred some ten years earlier.

Exhibit J introduced by the appellant is a list of the number of shares of Bata transferred in 1946 and of transfer tax paid thereon according to the records of the transfer agent. The transfer tax properly chargeable was at the rate of one-tenth of 1 per cent. at the price or value on sales at less than $1 per share, and at one-quarter of 1 per cent. on sales of $1 to $5 per share. In practically every instance, the tax paid thereon was at the rate of one-tenth of 1 per cent. of the number of shares transferred which by itself might suggest a value or price of $1 per share, and I was asked by counsel for the appellant to find that such was the case. In the absence of any evidence by the official who computed the tax in the office of the transfer agent as to the information on which he acted, I am unable to draw any conclusion from the mere production of Exhibit J as to the sale prices. It may be that he was guided only by the last authorization from the registrar under the Securities Frauds Prevention Act permitting sales at one dollar. In fact, however, if the price or value had been $1 per share, the tax should have been at the rate of one-quarter of 1 per cent., or two and one-half times that actually paid. From time to time, the transfer agent claimed from Turnbull certain small amounts of tax on shares sold by him in amounts which might indicate that at a tax rate of one-tenth of 1 per cent. the shares were sold at one dollar. While he paid the amounts requested, I do not consider that that evidence alone constitutes proof that such sales were made by him at $1 per share, particularly as the sums demanded were very small and as many of the transfers so recorded represented resales by others to whom Turnbull had sold his shares.

Taken as a whole, the evidence indicates wide variations in the price at which the stock was sold. In December, 1945, Turnbull purchased 15,000 of the optioned shares at 17½ cents each. In 1946 he sold a few shares at a rate of 25 cents to 50 cents per share. In 1945 and 1946 some treasury shares were sold at 50 cents and a few at $1, but there is no clear evidence as to the number of shares so sold or as to the net amount received after payment of commission and bonus. An effort was made to sell 400,000 shares to a group in Montreal at 70 cents, but none were sold. Taking the evidence as a whole, it seems to me that the

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"target" for the company was to sell at 50 cents and that, while efforts were made to sell at higher prices, such attempts proved in the main unsuccessful, although a few shares were sold at a somewhat higher figure.

The financial position of the company in 1946 was not good. It lacked working capital and while a number of gas wells had been brought into production, there was but a limited outlet for the gas, namely, to the town of Unity. Its gross income in that year was $2,700 and the year's operations resulted in a substantial loss. In 1955, by which time the company had acquired additional outlets for the gas and had purchased the assets of several other corporations, Bata's income had increased to $138,000 and its shares were quoted at less than 20 cents.

Taking all the relevant facts into consideration, I have reached the conclusion that a price of 50 cents per share is substantially in excess of the fair value of the stock in 1946. Doing the best I can with the evidence before me and taking into consideration the important fact that the salesmen received a commission of 25 per cent. of the sale price plus a substantial bonus in an undetermined amount, I have come to the conclusion that a fair value to be put upon the respondent's 100,000 shares of Bata stock, as of 1946, is 30 cents per share, or a total of $30,000.

For the reasons which I have stated, the Minister's appeals for the years 1946 and 1947 will be allowed and the assessments made upon the respondent will be affirmed, subject to the following variations (for which purpose the appeals will be referred back to the Minister for re-assessment):

(*a*) For the year 1946, by reducing the amount received from the sale of salt rights from $4,300 to $3,412.21 and by reducing the value of the 100,000 shares of Bata stock from $49,750 to $29,750;

(*b*) For the year 1947, by reducing the amount received from the sale of the salt rights from $4,300 to $3,750.

The appellant is entitled to his costs after taxation.

Judgment accordingly.

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

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AND

ARTHUR JAMES B. FELL ..... RESPONDENT.

On May 1, 1957 the Honourable Mr. Justice Cameron also delivered judgment allowing the appeal of the Minister of National Revenue. Following are the reasons for judgment:

CAMERON J.:—This is an appeal by the Minister of National Revenue from two decisions of the Income Tax Appeal Board dated February 10, 1955, which allowed the respondent's appeals from assessments for the years 1946 and 1947. In his assessment for the year 1946, the Minister had added to the respondent's declared income certain profits received by the latter in that year in respect of the sale of pipe and the sale of salt rights. Similarly, in 1947 there was added to his declared income a further amount of profit received from the sale of salt rights.

By consent of the parties, this case was heard concurrently with the appeals of the Minister regarding assessments made upon one Franklin W. Turnbull in respect of the same years. In the *Turnbull* case, the same two transactions of purchase and sale of pipe and of salt rights were involved, as well as other matters. It was agreed that the evidence and argument submitted in that appeal should apply where relevant to this appeal.

Judgment has been given today in the *Turnbull* case (*ante* p. 140) allowing the Minister's appeals with certain variations as to the amounts involved.

For the reasons given in the *Turnbull* case, in so far as they refer to the same matters as are here in dipute, this appeal will be allowed and the assessments made upon the respondent for the years 1946 and 1947 will be affirmed, subject to the following variations (for which purpose the matter will be referred back to the Minister for re-assessment):

(*a*) For the year 1946 by reducing the amount of profits from sale of salt rights from $8,875 to $7,961.84;

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(*b*) For the year 1947 by reducing the amount of profit received from the sale of salt rights from $8,875 to $8,750.

The appellant is also entitled to his costs after taxation.

Judgment accordingly.

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Apr. 9

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

AND

VANCOUVER TUGBOAT COMPANY LIMITED ..... RESPONDENT.

Revenue—Income—Income Tax Act, S. of C. 1948, c. 52, s. 12(1)(b)—Capital or income—"An outlay, loss or replacement of capital . . ." —Installation of new engine in tugboat replacement of capital asset—Appeal from decision of Income Tax Appeal Board allowed.

Respondent operates a tugboat service on the Pacific coast of Canada in the performance of which its tugboats often cover distances exceeding 800 miles in a single voyage, and a trip may last from five to fifteen days. In 1951 it placed a new engine in one of its tugboats at a total cost of $42,086.71 which amount it claimed as a deduction from income for that year. This claim was allowed by the Income Tax Appeal Board from whose decision the Minister of National Revenue appealed to this Court.

Held: That the expenditure on the new engine was an outlay or replacement of capital within the meaning of s. 12(1)(*b*) of the *Income Tax Act* and not deductible from income since such expenditure, rather than repairing the old one, was undertaken once and for all in the expectation that the new engine would be more reliable than the rehabilitated old one would be and would operate more constantly and with fewer repairs and over a greater number of years than could be expected from the old one even if it were rehabilitated. The expenditure was not an annual one nor was it made solely to cover the accumulations of wear and tear incurred in a number of past years but was to prevent the necessity for so many repairs and loss of time in the future. The respondent's trade gained an advantage by the expenditure in that it has provided an engine which makes the tug more reliable, keeps it more constantly in service and enables it to earn greater revenue, at the same time avoiding the abnormal repairs formerly required and such advantage is of an enduring nature in that the anticipated life of the new engine is ten years, and the expenditure of $42,068.71 to replace a single part of the tug is one to replace a substantial portion of a capital asset rather than to renew some minor item in the course of carrying out the ordinary run of repairs.

APPEAL from a decision of the Income Tax Appeal Board.

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

D.T.B. Braidwood and *T. Z. Boles* for appellant.

William Murphy, Q.C. for respondent.

THURLOW J.:—This is an appeal by the Minister of National Revenue from the judgment of the Income Tax Appeal Board (1) allowing the appeal of the respondent against its income tax assessment for the year 1951.

The respondent company had an operating loss in the year 1952 which was augmented by an expenditure of $42,086.71 made in that year to purchase and install a new engine in one of its tugboats. It treated this expenditure as an operating expense, and pursuant to s. 26(*d*) of *The Income Tax Act*, S. of C. 1948, c. 52, it claimed a deduction from its 1951 income in respect of the loss incurred by it on its operations for the year 1952. The Minister, in assessing the appellant for the year 1951, disallowed the expenditure as a charge against revenue and thereby reduced the amount of the 1952 loss in respect of which the deduction could be claimed from the respondent's income for 1951. The expenditure was disallowed on the ground that it was capital. The respondent thereupon appealed to the Income Tax Appeal Board, which held that the expenditure was a current expense incurred by the taxpayer for the purpose of gaining or producing income from its business and that the engine was a replacement in the nature of a repair of a subsidiary part of an integral whole, *i.e.* the tugboat, and was not an outlay of capital. From this judgment, an appeal to this Court, as above mentioned, was taken by the Minister.

The grounds of appeal taken by the appellant are that the expenditure in question was not an outlay or expense incurred for the purpose of gaining or producing income within the meaning of s. 12(1)(*a*) of *The Income Tax Act* and, further, that it was an outlay on account of capital within the meaning of s. 12(1)(*b*) of the Act.

(1) 14 Tax A.B.C. 160.

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The respondent, on the other hand, submits that the expenditure was not a capital expenditure but a normal recurring repair item known to the towing industry in British Columbia, that the installation of the engine was the restoration or replacement of a subsidiary part of the whole rather than a replacement of the entirety, that the installation of the engine involved no change of design or over-all improvement of the tug and brought about no lasting benefit and that, accordingly, the expenditure was properly charged against revenue.

The respondent company operates a tugboat service on the Pacific coast of Canada. Its tugs operate between Vancouver and many other ports and cover distances up to and exceeding 800 miles in a single voyage. Trips from Vancouver to the ports and return take from five to fifteen days, depending on the distances to be covered. The voyages take the tugs and the barges and cargoes which they are towing into open waters, where there is always the danger of storms. A tug, the two barges it tows, and the cargo together frequently represent a value in excess of a million dollars. Many of the ports served have no rail service, and it is necessary to operate the towing service on a schedule in order to maintain satisfactory continuity in supplying and serving these ports and their industries. Facilities for repairing tugs and their engines are available at Vancouver, but only very minor repairs can be effected at the other ports. The service is carried on throughout the year, and regardless of weather, and it is clear that the success of the operation depends to a very great extent on maintaining the tugs, their engines and equipment in an efficient and dependable state of repair.

In 1951 the respondent company had nine tugs engaged in the service, seven of which it owned and two of which it had chartered. One of the tugs owned by the respondent company and operated by it in 1951 was the *LaVerne*. This was a wooden motor vessel which had been built in 1944 as a mine sweeper and had been purchased by the respondent company in 1947 from War Assets Corporation for $20,000. When purchased, the vessel was equipped with a single 600 b.h.p. Vivian diesel propulsion engine which had had practically no use up to that time. The

respondent company had the *LaVerne* refitted to suit its purposes as a tug at an additional cost of approximately $24,000. In 1949 she was employed in the respondent's towing service and operated satisfactorily, using the same engine which was in her when the respondent company bought her. However, in 1950 and 1951 more and more repairs to this engine were required and, as a result of frequent breakdowns of the engine the tug was tied up for repairs an abnormal amount of its time. In 1952 the respondent company was faced with the necessity of carrying out a complete overhaul and rebuilding of this engine, which would have cost $20,000. To replace the engine with a new Vivian engine of the same type would have entailed a cost estimated at $60,000. An opportunity having arisen for the respondent company to purchase a suitable new engine at a greatly reduced price, the respondent company did so and had it installed, the engine costing some $26,500 and the freight and installation of it costing $15,586.71, thus making up the $42,086.71 in dispute in this proceeding. The Vivian engine removed from the tugboat was not repaired but was scrapped, the respondent having tried without success to sell it. The new engine installed in the *LaVerne* was a 1944 model 600 b.h.p. Washington diesel engine, heavier in weight than the Vivian engine but not regarded as capable of producing more power than the Vivian engine. When it had been installed, the tug could not go any faster than before and thus could not make additional voyages by reason of increased speed. She could haul the same number of barges as before, but because the engine did not break down so often and the vessel did not spend so many hours undergoing repairs she was able to make more voyages and thus earn greater revenue.

The tugs operated by the respondent company have no definite predictable life span, but some are in service after thirty years, and it is not unreasonable to expect of a new one that it will have a useful existence of twenty years. Engines, on the other hand, have a shorter useful existence, some lasting five years, some eight, some ten. It will be observed that the useful life of the Vivian engine was apparently three years. The respondent company hoped that the Washington diesel installed in its

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place might last for more than ten years, but, of course, there is no means of knowing whether it will do so or not. In any case, it is not expected to last as long as the tug. With a fleet of tugs in operation, the matter of replacing engines is obviously one that must be faced frequently, though at irregular intervals.

The financial statement attached to the respondent's income tax return for 1951 shows the capital cost of the *LaVerne* as $44,052.17, that to the end of the year 1951 total capital cost allowance in respect of the tug amounted to $18,216.02, and that the undepreciated capital cost at December 31, 1951 was $25,836.15. The evidence, however, shows that the cost of replacing the *LaVerne* would be in the vicinity of $225,000.

While the appellant relies on both s-ss. (*a*) and (*b*) of s. 12 of *The Income Tax Act*, the real problem, as I apprehend it, is to determine whether or not the expenditure in question was one of a capital nature, as mentioned in s. 12(1)(*b*). If so, the expenditure is not deductible. In my opinion, it requires no detailed analysis to classify the expenditure in question as one made in accordance with the ordinary principles of commercial trading or well accepted principles of business practice, as that consideration is explained in *Royal Trust v. Minister of National Revenue* (1), for I think it is clear beyond doubt that the expenditure was not merely reasonable but one such as any prudent businessman would make under similar circumstances, in carrying on a business of the kind carried on by the respondent. I am also of the opinion that the expenditure meets and passes the test of s. 12(1)(*a*) as one made or incurred for the purpose of gaining or producing income from property or a business of the taxpayer, at the very least in the sense that it enabled the taxpayer to use the tug for more working hours each year. The problem thus narrows down to a consideration of whether or not the expenditure is excluded by s. 12(1)(*b*) as an admissible deduction. That subsection is as follows:

(1) [1957] C.T.C. 32.

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 or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,

The line between what are capital expenditures in general and what are revenue expenditures is not easy to define, and it is no less difficult to lay down any hard or fast rule to determine when expenditures similar to the one in question on capital assets will and when they will not be considered to be capital expenditures within the meaning of the subsection above quoted. Nor is the problem simplified by the consideration that good business practice would probably sanction the charging of the expenditure in question to either capital or revenue, depending pretty much on how cautious the attitude of the particular businessman or accountant in computing profits may be. Moreover, in seeking to solve the problem by reference to cases decided in other countries it must be borne in mind that there are very material differences in the taxing statutes from one country to another, which often accounts for the difference in the results of cases having many factual features in common. For example, in *Rhodesia Railways Ltd. v. Collector of Income Tax, Bechuanaland* (1) the provisions of the income tax proclamation there considered were quite different from those of *The Income Tax Act*. While prohibiting the deduction of losses or outgoings of a capital nature, the proclamation expressly authorized the deduction of expenditures for repairs to property occupied for the purpose of trade—in that case, a railway. It also expressly prohibited any allowance for depreciation on structures or works of a permanent nature. It did, however, make provision for an allowance for wear and tear on machinery but directed the Collector, in making the allowance, to take into account the amount allowed for repairs. The appellant sought to charge to revenue the cost of renewing rails and sleepers on about one-fifth of its line, but only insofar as the cost of such renewal was necessary to restore the line to its original condition. Lord Macmillan, in delivering the judgment of the Privy Council, after holding that

(1) [1933] A.C. 368.

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such expenditure was not capital but was chargeable to revenue as a cost of repairs within the meaning of the proclamation, said at p. 375:

> The appellants received no allowance for depreciation of their rails and sleepers under para. (c) and the Court below, following a decision of the Appellate Division of the Supreme Court of the Union under a similar statute, held that they were not entitled to any such allowance, on the ground that a railway line was a work of a permanent nature. Oddly enough, the inference was drawn from this that what the appellants could not get by way of depreciation they cannot have been intended to get by way of repairs. The inference, their Lordships would have thought, was rather the other way—namely, that having been allowed a deduction in name of repairs the appellants were not intended to get a deduction in name of depreciation in respect of the same permanent structure.

And in *Samuel Jones and Co. (Devonvale) Ltd. v. Commissioner of Inland Revenue* (1), where the cost of replacing a chimney which was an integral part of a factory was allowed as a proper charge against revenue, it is to be noted that the expenditure for the chimney was one to restore property on which there was no allowance for depreciation.

The Income Tax Act, on the other hand, has provision for deduction from income of such part of the capital cost of property as may be allowed by regulation and mentions such allowance in the same subsection, that is, 12(1)(*b*), by which the deduction of capital expenditures from revenue is prohibited. Moreover, s. 12(1)(*b*) is precise and comprehensive in its prohibition in that it prohibits the deduction of any outlay, loss, or replacement of capital, any payment on account of capital, or any allowance in respect of depreciation, obsolescence, or depletion except as expressly permitted by the Act.

I think it makes no difference whether the expenditure here in question is called an outlay or a replacement. If it is capital in its nature, it seems to me to be equally well described as an outlay or a replacement, depending on the time in relation to which it is viewed. Contemplating the tug as it was in 1947, the provision and installation of a new engine in 1952 is readily classified as a replacement. Considering the expenditure in relation to the tug as it was immediately before the work was done, it seems to me that the word "outlay" is apt to describe it.

(1) 32 T.C. 513.

How then is the question whether or not this expenditure was of a capital nature to be resolved? While there is no single determining test, a number of tests have, from time to time, been expressed, their usefulness in any particular case depending more or less on the particular circumstances. In *Vallambrosa Rubber Co. Ltd. v. Farmer* (1) the Lord President at p. 536 stated a test as follows:

> Now I don't say that this consideration is absolutely final or determinative, but in a rough way I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing that is going to recur every year.

The annual or continuous or recurring nature of the expense is thus one indication of an income, as opposed to a capital, expenditure. The test above mentioned was commented on by Rowlatt J. in *Ounsworth v. Vickers Ltd.* (2) at p. 273 as follows:

> . . . I take it, and indeed both sides agree, that no stress is there laid upon the words "every year": the real test is between expenditure which is made to meet a continuous demand, as opposed to an expenditure which is made once for all. Mr. Foote was, I think, right in saying that, assuming that dredging the channel is income expenditure if the respondents dredged year by year, it is none the less income expenditure because the dredging was not done for a year or two because it was not worth while to do so and was only done when it was seriously required to get rid of the mischief which had been growing all the time and which, theoretically, ought to have been kept down coincidently with its growth. Mr. Foote contended that, so far as the dredging of the channel was concerned, what was actually done was on the same footing as dredging actually done in the year, that is, that the respondents did in a single year dredging which they ought to have spread over a series of years, and therefore that the expenditure was income expenditure which as a matter of fact has been defrayed in one year although it ought to have been spread over several years. As regards the construction of the deep water berth, Mr. Foote contended that the expenditure was incurred in order to get out the particular ship, the *Princess Royal*. He argued that expenditure might be income expenditure although the work on which it was incurred endured beyond the year. I do not differ from that altogether, but it seems to me that the question must always be one of fact whether particular expenditure can be put against particular work, or whether it is to be regarded as *enduring expenditure* and serving the business as a whole.

In applying the test so expressed to the facts before him, Rowlatt J. said at p. 276:

> . . . After lengthy negotiations they, as I understand it, did this: they did not simply put right the default of the harbour authority; they entered into an agreement by which a new thing was done. They did not dredge only to enable their ships to get out merely by virtue of the dredging;

(1) (1910) 5 T.C. 529. (2) [1915] 3 K.B. 267.

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they adopted a different plan, namely, by constructing a deep water berth in which their ships could lie between the two tides, and therefore it seems to me that being placed in a difficulty they said to themselves "While we cannot get rid of this difficulty we shall create a new state of things to get round it". The position is just the same as if they had found that there was some new way by which they could get to the sea by digging a new channel at an insignificant expense. I think the true view of the facts in this case is that the whole of this expenditure by the respondents was incurred in making what was in fact a new means of access from their works to the sea, and that it was therefore not income expenditure but capital expenditure, and cannot therefore be deducted.

The creation of a new means of access to replace the old one was thus a capital item, even though the new means may not have been as advantageous as restoration of the old would have been. It was a new means of access, it was *enduring expenditure* for the benefit of the business as a whole rather than to enable the company to get one particular ship through the channel, and accordingly it was classified as a capital item. This case indicates that the method adopted to provide for something which might otherwise be a matter chargeable to revenue may stamp the expenditure as a capital one.

In *British Insulated and Helsby Cables v. Atherton* (1), a test which has been quoted and applied many times since was propounded by Lord Cave, L.C., at p. 213 as follows:

> But when an expenditure is made not only once and for all but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade, I think that there is a very good reason in the absence of special circumstances leading to an opposite conclusion for treating such an expenditure as attributable not to revenue but to capital.

In this test, the elements indicating that the expenditure is capital are, first, that it is made once and for all and, secondly, that it is made with a view to bringing into existence an asset or an advantage for the enduring benefit of the trade.

Yet another test is propounded by Lord Sands in *Commissioners of Inland Revenue v. The Granite City Steamship Co. Ltd.* (2), where he says at p. 14:

> Under the Income Tax legislation no allowance is permissible, in estimating annual profits, by way of deduction from annual income of capital outlay during the year of charge. As I had occasion to point out in the *Law Shipping Co., Ltd. v. Inland Revenue* (12 T.C. 621), 1924 S.C. 74, this is an arbitrary and artificial rule when the subject is a wasting

(1) [1926] A.C. 205. (2) (1927) 13 T.C. 1.

one that exhausts the capital, so that, if the business is to continue, there will have to be a renewal of capital outlay in a few years. In such a case a portion of the capital outlay is consumed in each year in earning the annual income. But the Income Tax Acts take no account of this consideration. Broadly speaking, outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment.

It was conceded at the argument that the cost of repairs to capital equipment is ordinarily a deductible item provided they have become necessary through the income-earning operations of the taxpayer. And it was not disputed that in general such repairs would ordinarily entail the replacement of parts that have become worn out. On the other hand, one of the arguments advanced by the appellant in the case was that the life of the tug was limited by the life of its engine and that consequently when the engine was worn out the tug ceased to exist as a tug. Thus in essence the tug was substantially being replaced when a new engine was installed. The same argument could be applied in the case of the wearing out of any minor, though vital, part, such as a drive shaft, a propeller, or a rudder, and would lead to the conclusion that replacement of such minor parts would be capital expenditure. This would leave small scope for repairs as a revenue item. The argument for the respondent, on the other hand, stressed the view that the capital unit is the tug and that all repairs including replacements necessary to restore the tug to its initial condition are revenue items so long as the parts replaced are subsidiary parts of the tug and not in substance a replacement of the tug itself. No doubt the meaning of the expression "repairs" is broad enough to encompass all items necessary to restore the property to its original condition, but unlike the proclamation applied in *Rhodesia Railways Ltd. v. Collector of Income Tax, Bechuanaland* (*supra*) *The Income Tax Act* nowhere mentions or declares all repairs to be deductible, and I do not think, especially in view of the provisions in the statute for capital cost allowances, that the costs of all items that can be classed as repairs are *ipso facto* revenue items.

In my opinion, the provisions of *The Income Tax Act* are converse to those interpreted in *Rhodesia Railways Ltd. v. Collector of Income Tax, Bechuanaland* (*supra*) with

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respect to structures or works of a permanent nature. One might usefully paraphrase the last clause of the passage above quoted to apply it to this case as follows: ". . . that, having been allowed a deduction for wear and tear in the name of capital cost allowance, the respondent is not entitled to a deduction in the name of repairs to restore the same property to its original condition." This view does not eliminate as a revenue item the ordinary run of repairs necessary to keep the tug in operation but, in my opinion, it does introduce the necessity to judge each expenditure for repairs by the tests above-mentioned in the light of the particular facts to determine whether or not such repair item is of a capital nature.

In the case at bar, the Vivian engine might have been restored to its original condition at a cost of $20,000. And on the evidence this would probably have been the course followed if the opportunity to purchase the new engine at a low price had not presented itself. Had this course been followed, presumably the prospect would have been that the engine would become unsatisfactory again in approximately the same length of service and again require abnormally heavy repairs and become undependable. I do not think it is necessary to resolve whether or not such expenditure, had it been made, could have been wholly charged to revenue. To overcome the drawbacks with the Vivian engine, whatever they were, when the opportunity to do so arose, the respondent undertook another, and undoubtedly a very reasonable course, namely the replacement of the engine with a new one. It was, nevertheless, a different course, one that resulted in an expenditure more than twice as great as that of restoring the Vivian engine, and one that, in my opinion, was undertaken once and for all in the expectation that the new engine would be more reliable than the rehabilitated Vivian would be and would operate more constantly, and with fewer repairs and over a greater number of years than could be expected from the Vivian even if it were rehabilitated. This expenditure was not an annual one, nor was it one made solely to cover the accumulation of wear and tear incurred in a number of past years. Presumably, that much could have been accomplished by the complete overhaul of the Vivian engine estimated to

cost $20,000. Presumably too, the respondent expected something additional for the expenditure of twice that amount. I think it may safely be said that the expenditure was to cover the accumulations of past wear and tear and to prevent the necessity for so many repairs and so much loss of time in the future. While the expense of replacing engines is a recurring one in the sense that it recurs in respect to each tug once in five, eight, or ten years, I do not think the expenditure can be classed as one made to meet a continuous demand. There may be more or less continuous demand for repairs to the tug and to the engine in it, but there is no continuous demand for replacement of the engine any more than there is continuous demand for replacement of the hull as a whole. Moreover, in my opinion, the respondent's trade has gained an advantage by the expenditure, in that the expenditure has provided an engine which makes the tug more reliable, keeps it more constantly in service, and enables it to earn greater revenue and at the same time avoids the abnormal repairs formerly required. And such advantage is of an enduring nature in that the anticipated life of the new engine is ten years. No doubt there will be wear and tear each year beyond what is restored by repairs in the year and the advantage will ultimately be exhausted, but in my opinion that does not affect the nature of such advantage as capital. If any deduction from income is to be allowed in respect of such exhaustion, in my view, it must be by way of an allowance of the kind permitted under the exception to s. 12(1)(*b*).

In arriving at my conclusion, I attribute little, if any, importance to the fact that the expenditure to replace the engine exceeds the undepreciated capital cost of the tug and is almost equal to the whole original capital cost of the tug to the respondent. The price at which the respondent bought the LaVerne was, no doubt, affected by many factors other than the cost of replacement, and I do not regard the price paid as any indication of the replacement value of the ship at that time. But I am somewhat influenced by the size of the expenditure in question in relation to what were described as abnormally high repairs to the tug in the years 1949, 1950, and 1951, amounting to $15,833, $12,849, and $10,899.59 respectively.

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These amounts were for repairs to the tug as a whole, not to its engine alone. In the light of this evidence and the evidence that a normal year's repairs should run to somewhat less than $10,000, I think it is apparent that the expenditure of a sum of $42,068.71 to replace a single part of the tug is one to replace a substantial portion of the capital asset rather than to renew some minor item in the course of carrying out the ordinary run of repairs.

I find that the outlay in question was an outlay or replacement of capital within the meaning of s. 12(1)(*b*) of *The Income Tax Act* and, accordingly, was not deductible from income. The appeal will, therefore, be allowed and the assessment restored. The appellant is entitled to his costs.

Judgment accordingly.

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Jan. 9, 10
Feb. 25

Apr. 10

GILLIES BROTHERS & CO., LIMITED ..APPELLANT;

AND

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

Revenue—Income tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 3—Excess Profits Tax Act, S. of C. 1940, c. 32—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 127(1)(e)—Income or capital—Profits on sale of timber limits—"Trade"—"Business"—"Trade or commercial or other business"—"Adventure or concern in the nature of trade"—Appeals dismissed.

Appellant, incorporated in 1944, purchased all the assets and undertaking of Gillies Brothers Ltd., hereinafter referred to as the Company, a firm which had been engaged for many years in the manufacture and sale of timber and lumber in Ontario and Quebec. Included in the assets acquired by appellant were thirty-eight timber licenses held by Gillies Brothers Ltd. authorizing the holder to cut and remove timber from timber lands in the Province of British Columbia. Some of these licences were exercised by loggers under *pay as cut* contracts and appellant acquired the benefit of these contracts as well as the licences, and in subsequent years appellant entered into further similar contracts. Three of the licences acquired by appellant were under contract of sale, the purchase price being payable in instalments and not entirely accrued due, such sales were known as *en bloc* sales. In 1946, 1947, 1948, 1949 and 1950 appellant also made a number of *en bloc* sales of licences for lump sum prices not dependent on the market price of the timber on the tract or the cutting of any of it; in some cases under the terms of the contract of sale the price was

payable immediately, and in others it was payable over periods of several years. The respondent assessed the profit on the sales of the British Columbia licences as income and from such assessment an appeal was taken to this Court. The appellant contends that such profits are capital gains.

Held: That at the time when the Company ceased operations and transferred its assets and undertaking to appellant at or about the end of 1943 the business of that company included that of trading or dealing in British Columbia timber licences since it had acquired licences in considerable volume with a view to turning them to account by methods which included sale of them, it had sold some of them, it had an agent engaged to seek purchasers and arrange sales on a commission based on the selling price of either timber or licence, and it advertised for purchasers and though sales were infrequent when they occurred they were part of the trade rather than realization of investments.

2. That the appellant acquired the remaining British Columbia licences for the purpose of making profit from them either by selling the timber or by selling the licences and it carried out this purpose by using the same methods the Company had used until it had disposed of all of them in one or the other of these ways and in so doing appellant engaged in the business of trading or dealing in British Columbia timber or licences as part of its scheme for turning the licences to account for profit in either of the two ways which it in fact used; the disposals of the British Columbia timber and licences were carried on through the same British Columbia agent, in the same way, on the same commission arrangement, and with the same oversight and direction from the directors as had been followed by the Company in earlier years, and they were disposed of at such times and by such methods as appeared to the directors to be advantageous: such disposals were the final sales in what was in fact the carrying on of a trade with a view to making profit therefrom.

3. That the profit realized from the *en bloc* sales of licences made by the appellant were profits from a trade or other business within the meaning of s. 3 of the *Income War Tax Act* and within the definition of business in s. 127(1)(*e*) of the *Income Tax Act,* and were properly assessed as income.

4. That the contracts of sale made prior to the incorporation of appellant and later transferred to it were not made in the course of the trading or business of appellant nor were the receipts by appellant of the moneys payable under such contracts receipts from its trading or profit-earning operations since what appellant acquired from the Company was a debt plus a licence to hold as security until the debt was paid and sums received by appellant in payment of such debts were realizations of what was assigned to appellant by the Company and if profit were realized by appellant therefrom it was not income but capital gain.

APPEALS under the *Income War Tax Act,* the *Excess Profits Tax Act* and *The Income Tax Act.*

The appeals were heard before the Honourable Mr. Justice Thurlow at Ottawa.

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

K. E. Eaton and *G. W. Ainslie* for respondent.

THURLOW J.:—These are appeals from reassessments of income tax and excess profits tax for the years 1944 and 1945 and of income tax for the years 1949, 1950, 1951, and 1952, all of which reassessments were made by the Minister of National Revenue in respect of the appellant's income for the years in question on or about May 31, 1955, and all of which were confirmed by him on March 9, 1956. The appeals were heard together.

The question raised is whether profits realized by the appellant on sales of its British Columbia timber licences, in the circumstances hereinafter set out, are income or capital gains.

Upon its incorporation in 1944 the appellant purchased (with certain immaterial exceptions) all the assets and undertaking of Gillies Brothers Ltd., a firm which had been engaged for many years in the manufacture and sale of timber and lumber in Ontario and Quebec. Included in the assets which the appellant then acquired were some thirty-eight timber licences held by Gillies Brothers Ltd., authorizing the holder to cut and remove timber from about thirty-eight square miles of timber lands in British Columbia. At the time of the transfer some of the licences were being exercised by loggers under contractual arrangements with Gillies Brothers Ltd., whereby the logger was required to cut the whole of the merchantable timber on the tract upon which he was authorized to operate, to pay the licensee certain fixed stumpage fees based on the quantity of merchantable timber cut from the tract, and also to pay the licensee a percentage of the sale price of the logs. These contracts have been known as *pay as cut* contracts. The appellant acquired both the licences and the benefit of these contracts. In 1944 and subsequent years the appellant entered into further similar contracts. Three of the licences transferred to the appellant were under contract of sale, the purchase price being payable in instalments and not entirely accrued due. These sales have been known as *en bloc* sales. In 1946, 1947, 1948, 1949, and 1950 the appellant also made a number of *en bloc* sales of licences for lump sum prices not dependent

on the market price of the timber on the tract or the cutting of any of it. In some cases, under the terms of the contract of sale the price was payable immediately, and in others it was payable over periods of several years. It is the assessments of profits on these sales that have given rise to the appeals.

The appeal in respect of the reassessment for the year 1951 also involved the question whether profit realized by the appellant in that year on the sale of certain Ontario timber limits, known as the McConnell and Mackelcan limits, was income or a capital gain, but the appellant's contention in respect of this transaction was conceded at the opening of the trial by an admission which has been incorporated by an amendment in the respondent's reply. The correctness of the figures set forth in the reassessment notices was admitted at the opening of the trial and accordingly the only remaining issue is whether or not the appellant is liable to be taxed in respect of the whole or any part of the profits made on *en bloc* sales of British Columbia timber licences.

The appellant contends that the profits realized on these sales are capital gains and are not subject to income tax or excess profits tax. The respondent takes the position that these profits are income, those realized in 1944 and 1945 being income from a trade or business as defined in s. 3 of the *Income War Tax Act*, R.S.C. 1927, c. 97, which definition is also applicable under the *Excess Profits Tax Act*, S. of C., 1940, c. 32, and those realized in 1949 and later years being income from a business within the meaning of ss. 3 and 4 of *The Income Tax Act*, S. of C., 1948, c. 52.

Section 3 of the *Income War Tax Act* is as follows:

> 3. For the purposes of this Act, "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be whether derived from sources within Canada or elsewhere; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source including . . .

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Sections 3 and 4 of *The Income Tax Act*, applicable to the years 1949, 1950, 1951, and 1952, are as follows:

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

By s. 127(1)(*e*) of the same Act, it is further provided:

127. (1) In this Act,

* * *

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

The problem is to determine whether or not the profits in question fall within the description of profits in these definitions. In these appeals the burden of proving facts showing that the profits in question are not profits of the kind mentioned in these sections rests on the appellant.

In *Johnston v. Minister of National Revenue* (1), Rand J. puts the matter thus at p. 489:

Notwithstanding that it is spoken of in section 63(2) as an action ready for trial or hearing, the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant. If the taxpayer here intended to contest the fact that he supported his wife within the meaning of the Rules mentioned he should have raised that issue in his pleading, and the burden would have rested on him as on any appellant to show that the conclusion below was not warranted. For that purpose he might bring evidence before the Court notwithstanding that it had not been placed before the assessor or the Minister, but the onus was his to demolish the basic fact on which the taxation rested.

What, then, is the basic fact on which these assessments rest? In my opinion, the assessments rest on the factual assumptions that the trade or business—that is to say, the profit-earning activities—carried on by the appellant company included the process or practice of trading or

(1) [1948] S.C.R. 486.

dealing in timber licences with a view to making profit from them by selling them, and that the profits in question arose in carrying out that process or practice.

If these assumptions are true, I think it follows that the profits in question are income within the definitions contained in both statutes. If either of the assumptions is not true, it may be that the profits in question are not income as defined in the *Income War Tax Act*, applicable to the reassessments for 1944 and 1945, but, in theory at least, the profits may still be income from a business as defined in *The Income Tax Act*, applicable to the reassessments for 1949, 1950, 1951, and 1952. The meaning of "business" as defined in s. 127(1)(*e*) of *The Income Tax Act* is not co-extensive with that of the expression "trade or commercial or other business" in s. 3 of the *Income War Tax Act*. The former includes the expression "adventure or concern in the nature of trade", which gives a wider import to the meaning of "business" and brings within the definition transactions which, while for one reason or another not falling within the ordinary meaning of *trade*, nevertheless partake of the qualities of trade to a sufficient extent to be classified as being ventures in the nature of trade. *Minister of National Revenue v. James A. Taylor* (1). However, in view of the conclusion to which I have come on the facts, it will not be necessary to consider whether or not any of the profits in question arose from a venture in the nature of trade outside or beyond the scope of trade itself. Nor, for the same reason, is it necessary to consider how much wider is the meaning of the word "business" than the meaning of the word "trade" for, if the transactions in question formed part of the appellant's trade, I think it follows that they also formed part of its business.

In determining whether or not the process or practice which gave rise to the profits in question was a part of the appellant's trade or business, it is clear that neither the number of transactions involved, nor the fact that profit was made on the sales, nor the combination of both these features is sufficient alone to make the transactions part of the appellant's trade or business. Nor do the facts

(1) [1956] C.T.C. 189.

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that the profit was made by a trading company whose sole purpose is to make profits for its shareholders or that the company invested in the property in the expectation of realizing profit from it by selling it at a higher price conclude the matter. These features are all matters to be taken into account and some of them are of the utmost importance, but none of them is, by itself, sufficient to answer the question. The test for answering the question, as expressed by the Lord Justice Clerk in *Californian Copper Syndicate v. Harris* (1) and subsequently quoted and approved in Canada as well as elsewhere, is as follows:

> It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for Income Tax.
>
> What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

The way in which the Lord Justice Clerk applied the test is also of interest. After discussing the objects contained in the company's memorandum of association, he said at p. 166:

> These are shortly some of the main purposes of the Company, and they certainly point distinctly to a highly speculative business, and the mode of their actual procedure was in the same direction. Of the £28,332 realised by shares which were subscribed for, £24,000 was invested in a copper-bearing field in the United States, and the balance was spent in development of the field, and in preliminary and head office expenses.
>
> The Company then were successful in selling the property to the Fresno Company—£300,000 in fully paid up shares being given by the Fresno Company for the property. Although that was a sale, the price to be paid in shares, I feel compelled to hold that this Company was in its inception a Company endeavouring to make profit by a trade or

(1) (1904) 5 T.C. 159.

business, and that the profitable sale of its property was not truly a substitution of one form of investment for another. It is manifest that it never did intend to work this mineral field with the capital at its disposal. Such a thing was quite impossible. Its purpose was to exploit the field, and obtain gain by inducing others to take it up on such terms as would bring substantial gain to themselves. This was that the turning of investment to account was not to be merely incidental, but was, as the Lord President put it in the case of the Scottish Investment Company, the essential feature of the business, speculation being among the appointed means of the Company's gains.

It will be observed that, in that case, the sale of the property in question was the main operation carried out by the company and, as the company was formed to make profit by trading and the sale in question was the main way in which it had, in fact, carried out its object, the inference was readily drawn that making profit by selling the property was, in fact, the company's trade.

A more complicated situation in which to apply the test arose in *Atlantic Sugar Refineries Ltd. v. Minister of National Revenue* (1), where the company's profit-making procedure was to buy raw sugar, refine it, and sell the finished product. Because of unusual developments which threatened the company with a loss in its usual operations, the company undertook a somewhat different operation of buying and selling raw sugar futures and earned profits thereby. These profits were assessed as income under the *Income War Tax Act*, and the assessment was upheld in this Court and in the Supreme Court of Canada. There Kerwin J. (as he then was) delivered the judgment of the majority of the Court and at p. 709, in applying the test, said:

> The company finding itself in an abnormal situation because of the various factors mentioned, Mr. Seidensticker decided to protect the appellant's financial interests by the operations on the Exchange. The company was not investing idle capital funds nor was it disposing of a capital asset. In no sense may it be said that the operations were unconnected with the appellant's business and it is at least an added circumstance that the speculation was made in raw sugar. Even if it were the only transaction of that character, it should be held, in the light of all the evidence, that it was part of the appellant's business or calling and therefore a profit from its business within section 3 of the Act.

From this, it appears that if a trading company has an established type of operation and engages in transactions of a different nature, which transactions on their own do not afford a clear answer to the question whether or not

(1) [1949] S.C.R. 706.

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they are a part of the company's trade, points of connection or relationship between the transactions in question and the company's established trade may serve to show that transactions of the kind in question are part of the company's trade.

Another and wider approach for determining the question is set out by Duff J. in *Anderson Logging Co. v. The King* (1) at pp. 49 and 55, where he said:

> . . . It is difficult to discover any reason derived from the history of the operations of the company for thinking that in buying these timber limits the company did not envisage the course it actually pursued for turning these limits to account for its profit as at least a possible contingency; and, assuming that the correct inference from the true facts is that the limits were purchased with the intention of turning them to account for profit in any way which might present itself as the most convenient, including the sale of them, the proper conclusion seems to be that the assessor was right in treating this profit as income.
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> * * *
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> . . . The essential conditions of assessability (where a profit proposed to be assessed is the profit derived from a sale of part of the company's property) appear to be that the company is dealing with its property in a manner contemplated by the memorandum of association as a class of operation in which the company was to engage, and, moreover, that the governing purpose in acquiring the property had been to turn it to account for the profit of the shareholders, by sale if necessary.

The same approach is evident in the judgment of the House of Lords in *Ducker v. Rees Roturbo Development Syndicate* (2), but with the added fact that the method used to make profit from property of the company was not the line on which the directors would have preferred their business to develop. It was held that this additional feature did not prevent the transaction from being one entered into in the course of the company's trade.

Lord Buckmaster says at p. 140:

> My Lords, I think it is undesirable in these cases to attempt to repeat in different words a rule or principle which has already been found applicable and has received judicial approval, and I find that in the case of the *Californian Copper Syndicate v. Harris*, 5 Tax Cas. 159, it is declared that in considering a matter similar to the present the test to be applied is whether the amount in dispute was "a gain made in an operation of business in carrying out a scheme for profit-making". That principle was approved in a judgment of the Privy Council in the case of *Commissioner of Taxes v. Melbourne Trust*, [1914] A.C. 1001, and it is, I think, the right principle to apply.

(1) [1925] S.C.R. 45. (2) [1928] A.C. 132.

At p. 141 Lord Buckmaster applies the test as follows:

> Turning to the findings of the Commissioners, I find that they set out in detail the circumstances connected with the working of this company, and, in particular, the reports, which begin in 1907 and continue down to 1918. These reports show that the directors were contemplating from the beginning the possibility of the sale of some of these patents. It is quite true that they preferred not to sell them if a sale could be avoided, but the statement in para. 11 of the case is quite plain, that "the possibility of the sale of the foreign patents or rights has always been contemplated by the appellant company in respect of such interest as it possessed in the foreign patents". It is one of the foreign patents with which this appeal has to do, and the agreements, which are set out, showing the way in which the foreign patents in the case of France and of Canada have also been dealt with, show that that statement was not a statement of a mere accidental dealing with a particular class of property, but that it was part of their business which, though not of necessity the line on which they desired their business most extensively to develop, was one which they were prepared to undertake.

I think it is clear that, in each of these cases, the Court treated the transactions in question on the basis of their being part of the trade or business of the company within the ordinary meaning of the word "trade" rather than as being beyond the ordinary meaning of the word but within the meaning as extended by the expression "adventure or concern in the nature of trade" or any similar expression contained in the particular statute to be applied. In the *Atlantic Sugar Refineries* case, the expression "adventure or concern in the nature of trade" was, of course, not in the statute under consideration.

With these considerations in mind, I propose to deal first with the nature of the licences in question and thereafter to consider the objects with which the appellant acquired them and what it was that the appellant did with them.

The licences are known as timber licences. They are in standard form and are issued pursuant to the *Land Act,* Statutes of British Columbia, 1908, c. 30, as amended by 1910, c. 28, and pursuant to the *Forest Act,* Statutes of British Columbia, 1912, c. 17. In each case, the licence covers an area of approximately one square mile and, by it, in consideration of an annual renewal fee and a royalty on the timber taken, the holder is authorized *to cut, fell, and carry away timber* upon all the particular tract of

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land described in the licence. The authority is for one year only but is renewable from year to year, as provided by the statutes upon payment of annual renewal fees.

By virtue of the statutes above mentioned and of the licence issued pursuant to it, the holder becomes entitled to the timber on the limit when it is cut and by whomsoever it may be cut. Until the timber is cut, it remains part of the realty which still belongs to the Crown. If timber has not been cut when the licence expires, the title to it never vests in the licensee. The licensee does not own the timber unless it is cut within the year and, of course, in any case he owns not all the trees but only the trees that are cut.

The owner of a licence may make use of it in several ways. He himself may cut the trees, in which case they become his property and he can sell, manufacture, or otherwise deal with them as he sees fit. Or he may authorize some other party to cut and remove the whole or part of the timber under any of a variety of contractual arrangements between himself and the logger. Upon the cutting, the property in the timber becomes that of the licensee, and through such contractual arrangements it may immediately or later become the property of the logger or other persons. But whether the licensee himself cuts the timber or authorizes some other party to do so, the nature of the process is that the licensee's rights under the licence are exercised; the licence itself is used. To my mind, it makes little difference, for the purposes of this appeal, whether, after cutting the timber or having it cut, the licensee intends to saw the timber himself or to have it sawed or simply to sell the logs, or whether the licensee sells the timber on a stumpage basis. In any of these cases, what the licensee is doing, insofar as the licence is concerned, is making use of it in his business to earn profits. While the trees, when cut, may be used or dealt with in many different ways, the only way the licence itself can be used is by cutting the trees. When being so used, it will, in most cases, have the character of a capital asset. In this process the licence itself may become valueless, and ultimately it may be allowed to lapse. But it is not sold. What is sold is the timber which is the fruit or product of the licence.

There is, in my opinion, a distinction between making profit by use of a licence in any of the ways above mentioned and making profit by selling the licence itself. Profit can, of course, be made in both ways; by cutting the timber either personally or through another, or by trading in the licences—buying them and selling them at a profit. Moreover, the same person may make profit in both ways and from the same licence. But the two profit-earning processes are quite different. One is a making use of the licence to earn profit, the other is the treatment of the licence itself as stock-in-trade in an ordinary process of buying and selling for profit.

It will be seen that the appellant made use of some of its licences and made profit thereby. This was done, in general, through contracts of the kind previously mentioned with loggers who undertook to cut timber from the tracts and to pay the appellant certain stumpage payments and a percentage of the sale price of the logs cut. These are the contracts which have been known as pay as cut contracts, and the profits realized by the appellant through them were treated as income and assessed accordingly. No question as to such profits arises on these appeals.

But the appellant also sold a number of its licences and thereby made profits which are involved in these appeals. Of the licences so sold, some had been or were being used in pay as cut contracts and some had not been so used. It accordingly becomes necessary to examine the facts closely to determine whether or not the appellant's trade or business in the years in question included the acquiring of timber licences with a view to making profit from them in ways which included that of selling them.

The appellant was incorporated in 1944 under the *Dominion Companies Act* with objects and powers wide enough to embrace all the activities to be mentioned and many other kinds of activities which have never been pursued. As previously mentioned, upon incorporation the appellant acquired the assets and undertaking of Gillies Brothers Ltd., and it has proceeded to carry on that undertaking. In the discussion of the facts which follows, Gillies Brothers Ltd. is referred to as "the company". The purpose of the new incorporation, transfer of assets, and

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winding up of the company was to provide a method of withdrawing capital from the company. In the transaction, the appellant simply took the place of the company so far as the business and undertaking were concerned, with the same shareholders each holding in the same proportions, with the same directors and officers, and with the same policies and designs.

In my view, the question to be determined must be resolved on the basis of what the business and undertaking of the appellant was and included in 1944 and subsequent years, rather than what the business and undertaking of the company may have been at any earlier time, but the history of the business and undertaking of the company, its acquisition of the licences, and its policies and conduct in regard to them afford evidence of what the business and undertaking included in 1944 when the appellant acquired them.

The company was incorporated in 1893 and at that time acquired a timber and lumber manufacturing business which had been started many years earlier and had been operated and built up in the meantime in the provinces of Ontario and Quebec. Its principal place of business was at Braeside in Ontario. For the purposes of its operations from time to time it acquired timber limits in those two provinces and on occasion, though rarely, it disposed of limits by selling them, in most, if not in all cases, after the timber required by the company had been removed. Between 1902 and 1919 it made four sales of limits, all of which had been purchased prior to 1900. In 1927 it transferred a tract to the Ontario government as part of a transaction by which it acquired another tract, and in 1951 the appellant sold two limits which had been purchased by the company in 1922 with a view to supplying a new mill which the company was then planning to set up and operate. These were the only sales or disposals of timber lands in Ontario and Quebec by the company and the appellant since 1900. In the meantime, between 1904 and 1956, the company and the appellant made purchases of twelve additional limits. In my opinion, it is clear on the evidence that the acquiring of timber limits by both companies in Ontario and Quebec was for the sole purpose of making use of them in its manufacturing operations,

and at no time was either the company or the appellant engaged in the practice of acquiring limits in those provinces with a view to making profits from them by selling them. It may be added that throughout the existence of the company and of the appellant, from 1944 to the present time, the business and undertakings in these provinces have been by far the main business and undertakings of the respective companies. In comparison with the eastern operations, the activities in British Columbia have been of minor importance and extent.

However, in 1910 and later years the company, with an eye to the future, became interested in the prospects of expansion and development of the lumbering industry in British Columbia.

In 1913, following correspondence between the company and Messrs. Clark and Lyford, a firm of forest engineers operating in British Columbia, the company invested approximately $17,000 in acquiring an interest in 13 British Columbia timber licences. The remaining interest was held by Messrs. Clark and Lyford, and the terms on which the venture was undertaken appear fully from the correspondence and contracts relating to them which are in evidence. To my mind, it is clear beyond doubt that the method, and the only method, then contemplated of deriving profit from this venture was through the sale of the licences. One of them was, in fact, sold in 1916 at a profit. No further sale of any of this group of licences was made until 1941, when the company made an agreement to sell one of them. This sale resulted in a loss. The only other sale of any of the group made by the company was on December 31, 1943, shortly before the transfer to the appellant. One additional licence, referred to as the Seabird licence, had been acquired outright by the company in 1914 and sold in 1917, whether or not at a profit does not appear. Between 1920 and 1940 the market for timber fell and during most of the period continued so low that no profit could be made from sales of the licences, if indeed sales of them could be made

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at all. The carrying charges, however, mounted annually during the period. In each of the years 1924, 1925, 1927, 1928, 1930, 1931, and 1932 some money was derived from the limits under pay as cut contracts, but the company found the contracts very unsatisfactory as they afforded insufficient protection against cutting only the best of the timber on the limits and for the recovery of the money payable to the licensees. Early in 1933 the profit-sharing feature of the arrangements between the company and Messrs. Clark and Lyford was abrogated by mutual agreement, it being the opinion of the parties that no profit was likely to accrue to Messrs. Clark and Lyford. The licences then became the sole property of the company. It may be noted that at that time the company was still contemplating sale of the licences as, before taking over the Clark and Lyford interest, it inquired as to the prospects of selling them and, upon the transfer, made an arrangement with Clark and Lyford for payment to them of a commission on sales of timber or licences which they might make. At the same time the company expressed its preference for sale of these *limits* on a lump sum basis. In each of the years 1933 to 1940 inclusive, and in 1943, the company derived money from pay as cut contracts relating to these licences.

Three of the licences were allowed to lapse, one in 1939, one in 1941, and one in 1942, in each case following pay as cut contracts relating to them. In the case of one of these three licences, the company realized a profit; on the other two, it sustained losses. As previously mentioned, by the end of 1943 three of the 13 licences had been sold.

The remaining seven were transferred to the appellant, and the appellant disposed of all seven of them by selling them, three in 1946, one in 1950, one in 1951, and two in 1956. Prior to sale, it entered into a pay as cut contract in regard to one of them.

So much for the history of what are known as the Clark and Lyford and Seabird licences. I come now to another group of licences acquired, held, and disposed of over

approximately the same period but with at least a partially different object in mind. These are the Drury Inlet licences.

In the years following the first venture of the company in acquiring British Columbia timber licences, other offers were made to it which, for one reason or another, it did not accept. In particular, it did not accept any further offers to purchase on a profit-sharing basis, as the directors objected to this arrangement. It will be apparent that acquiring licences for sale on a profit-sharing basis would not fit into a design which the directors later had in mind to acquire timber for the ultimate purpose of supporting a lumber manufacturing operation to be undertaken by the company in British Columbia. They considered, but did not accept, offers of timber licences covering tracts in Smith Inlet and Rivers Inlet. The correspondence shows that they were aware that the timber was inaccessible in that it would either have to be towed in open water, which involved extra risk, or it would have to be manufactured in the inlet, and they directed inquiries as to the quantity of timber available and the milling opportunity. I regard these inquiries as being related to ascertaining the value of the licences, rather than as indicative of any intention on the part of the directors to undertake a milling operation. There is, however, other evidence that they, in fact, had such an intention, but that intention was developed somewhat later. The company also rejected several offerings of large groups of licences (one of which included a mill) for several reasons, the lack of sufficient available capital to finance purchases of half a million dollars or more being one reason, the state of the markets for lumber being another, and the uncertainty of prospects for the future being a third. In correspondence with Clark and Lyford in September, 1917, the company expressed itself as not interested in a working property at that time but only in timber at low price which could be held *for investment*, and as late as October 28, 1918

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the company, in making an offer of half of what it shortly afterwards paid for a block of 40 licences, in another letter to Clark and Lyford said:

> You can appreciate our difficulty in being at this distance and not in touch with local conditions but this may give us a better view in that we look at lumber conditions as a whole and not from the B.C. viewpoint only, and consequently that only offerings which are unquestionably cheap would be advisable for us as a holding proposition.

Later in 1918 the company accepted an offer and purchased 40 licences on Drury Inlet for $200,000. These licences, according to the evidence of Mr. D. A. Gillies, who was a director of the company from 1909 onward and president of it from 1938 and subsequently of the appellant were purchased as the nucleus of timber holdings to be acquired whenever it was possible to do so on favourable terms, to build up a sufficient supply to support a manufacturing operation which the company had a long term policy to undertake, if and when markets and future prospects became bright enough to justify that course. According to Mr. Gillies' evidence, this purchase was the initial step in carrying out the new policy in regard to British Columbia timber. He said:

> ... It was a very definite and a very big decision on our part and the idea was and my idea was at that time we changed from the idea of the small lot to formulate a policy in the back of our mind—and this group formed the main background of it—that we would gradually build up a quantity of timber through purchase on the British Columbia coast sufficient to justify our entering into the manufacture of lumber on the Pacific coast as we had done in the east over several generations.

The 40 limits were all in one block and bordering on tide water and within towing distance of mills. The quantity exceeded five hundred millions of feet but, in the opinion of the directors, it was by itself insufficient to sustain an undertaking of the kind the directors had in mind for a sufficient number of years. In December, 1918, shortly after the purchase, upon receiving an inquiry as to a price for 25 or all these licences the directors set a price of $10,000 per licence, but no sale was made.

The wording of the directors' minute regarding this incident is as follows:

Clark and Lyford writing *re* 40 cedar limits recently purchased and stating they had a prospective buyer for 25 or all of them and asking bottom price we would accept. *As these were bought* under war conditions and *for rise in value after times became normal,* decided to name $10,000 per limit as minimum price exclusive of 5% commission to Clark and Lyford with possibility of dropping later to not less than $8,000 at lowest. These limits were under option at $10,000 each by the same parties before we bought them and two limits were sold to loggers on terms of $17,500 each.

When asked to explain how the figure of $10,000 per limit was arrived at, Mr. Gillies replied:

I don't recall it except that it shows that we evidently were scotch enough that we are not going to sell any less than what we paid for it and I might also add that it was in a special case if you got 100 per cent on your purchase price anyone who was willing and open to make a deal would be willing to accept it, you would get the new money and you would be in a position to go out and buy further timber at probably less and lower prices again and that does not in any way shape or form change the general idea that we were still trying to build up a block of timber behind the possible mill. The fact that we were willing to sell some of the 40 licences we bought does not mean we had given up or changed our general policy of buying a block of timber which would justify the construction of a plant later.

About a year after the purchase of the 40 limits, the company in a letter to Clark and Lyford said:

Re Southern Timber Limits. We are not anxious to sell the Drury Inlet lot immediately but bought it rather for holding.

We would, however, be willing to sell any or all of the original lot of limits in which you have a joint interest, provided these can be sold at a profit. Some of these carry considerable cedar and at the present time pulpwood should be in good demand.

In 1925 the company purchased one additional licence on Drury Inlet.

The purchase of timber licences as an investment to hold is, in my opinion, consistent with a number of different designs as to what is to be done with them. So long as they are simply held, they are burdensome in that there are annual expenses to be paid and they produce no revenue. The intention to hold them is, I think, quite consistent with an intent to use them in the future in any way in which they can be used, that is, by cutting the timber or having it cut, or to sell them at a profit or with no other intent than to turn them to account for profit in any way which might present itself.

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While I do not doubt the evidence that the company had long-range intentions of undertaking lumber manufacturing in British Columbia, if and when conditions made it an attractive undertaking, and bought these limits with these intentions in mind as a source of supply for the operation, I think this was but one of the company's ideas as to what might be done with these limits to turn them to account for profit. The company's plan for manufacturing lumber in British Columbia being of an indefinite character and still in its earliest stages, I cannot but think that in purchasing these 40 limits *for rise in value after times became normal* the directors also had in view the other course for making profit from them by selling them. And this, to my mind, is borne out by their setting a price on them and contemplating a lower price to achieve a sale of them very shortly after they had been purchased. Even though they may not have been anxious to dispose of them and even though selling them may not have been the way in which they may have preferred their best opportunity in respect to them to arise, they were quite prepared to sell them to make profit. However, none of them were, in fact, sold until 1940, and by that time the decision to abandon all ideas and plans for a manufacturing operation in British Columbia had been made. The company was then in the process of disposing of its British Columbia holdings as rapidly as possible, consistently with disposing of them at a profit, and in concentrating its resources for an expansion of its eastern operations. Moreover, until this decision had been made, that is to say, prior to 1939, cutting under these licences under pay as cut contracts had been done on only five of the 41 limits and the returns indicate that it was not very extensive. They are:

1919	$ 211.87
1921	87.50
1929	653.68
1933	1,905.40
1934	575.26
1935	1,191.07
1936	1,680.53
1937	3,589.54
1938	1,814.37
	$10,709.22

This, with certain very small sums for trespasses, was all the company recovered in twenty years from an investment of $200,000, and it would not approach the amount of expenses incurred in connection with holding the licences.

The attitude of the company towards these licences in the meantime is shown in several minutes of the directors in 1928, 1929, 1936, and 1937 and in a letter to Mr. P. L. Lyford dated February 15, 1933. The minutes are:

December 11, 1928—

Regarding B.C. limits.

. . . Nothing definite from J. D. Lacey & Company. It looks as if immediate prospects of sale was only on the stumpage basis which has serious drawbacks.

January 14, 1929—

B.C. Limits discussed.

The President stated nothing further to report as to possibility of selling them to advantage. The only enquiries to date for the Drury Inlet limits being on a pay as you cut basis which as stated at previous meetings carried serious disadvantages with it . . . though on the other hand if successfully and amicably operated on such basis greater returns could be obtained than on a cash basis . . .

December 15, 1936—

Some offers to cut some limits in Drury Inlet on pay as cut basis had been received but not considered as our experience in this method of selling timber was not satisfactory.

February 8, 1937—

Clark and Lyford has two prospects for buying cedar timber on Drury Inlet on pay as cut basis, no deposit, or guaranty of quantity to be taken out. As our experience in this type of timber sale was far from satisfactory, it was decided not to consider offers of this kind for Drury timber.

The letter of February 15, 1933 (Ex. 25), the first three paragraphs of which refer to the Clark and Lyford licences, is as follows:

Dear Sir:

Re: Profit Sharing Limits.

We have your letter of the 4th inst. suggesting a fee or commission of 5% net to you for sales of timber on these limits including general over-sight of these profit-sharing limits, negotiating of sales and administration of the contracts and collection of stumpage, and we are agreeable to this.

We have already written you that our experience with selling timber on a pay as cut basis has not been satisfactory and suggesting improved methods of accounting to which you refer in your letter.

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We would prefer to sell these *limits* on a lump sum basis and this would be to your advantage also as you would get the same return and we would both be saved the difficulties of collecting on logs as cut.

It may not be possible to sell in this way at the present time but under present conditions and price we will let the Drury Inlet timber stand rather than accept the prices you mention, where there is no guarantee as to the quantity the buyer would take off the limit. Eventually we feel that stumpage will return to a more or less profitable basis, particularly if B.C. can improve their export trade in the future as much as they have been doing this year.

We feel that in spite of Mr. Bennett's stand that the Canadian Exchange is likely to get nearer in line with Sterling and further away from the United States in view of the deficit both in the Dominion, Provincial and Municipal budgets, and that in view of these deficits it will be difficult to keep our exchange in line with the United States and this will make it still easier for B.C. export trade both in Britain and Asia.

Unless you can get something worth while on the Drury Inlet timber, either on a lump sum or with a worth while deposit held so that it cannot be manipulated like the McNaughton one, we will let this timber stand hoping that prices will pick up in a reasonable period.

Yours truly,

GILLIES BROS. Limited,
J. S. Gillies.

It is, of course, possible to sell timber on a lump sum basis, as well as to sell licences on that basis, and it is also possible to sell licences on terms of payment extended over the period of cutting. But I think that the references in the minutes and letter to lump sum sales at least include lump sum sales of licences, if indeed they do not mean such sales alone, rather than lump sum sales of timber. The third paragraph of the letter states that the company prefers to sell the *limits*. And, as far as the evidence discloses, any lump sum sales made were lump sum sales of licences, rather than of timber, except in one case (Ex. 40) where the sale purported to be one of timber but the contract also provided for transfer of the licence to the purchaser upon payment of the purchase price.

My estimate of what the minutes and letter above quoted show is that in this period, with its vision of a milling operation of its own fading, the company was left with *en bloc* sales of licences and stumpage sales of timber as its remaining methods of realizing profits from the licences. Because of its unsatisfactory experience with

pay as cut contracts, the company favoured *en bloc* sales of the licences and would hold the licences for disposal on a lump sum basis except when a substantial deposit could be obtained from one wishing to contract on a pay as cut basis. In any event, I think it is obvious that at this stage these licences were for sale if a profit could be made and the company preferred that course to using the licences in pay as cut arrangements. Preference for one type of contract over another was, however, based only on the desire to secure the best possible return, rather than on any desire to retain the subject matter, that is, the licences, for future use. The intent, as far as the licences were concerned, was thus to turn them to account for profit in the best way that might present itself.

From 1939 onward prices for all types of lumber improved, and commencing in that year and continuing through 1940, 1941, 1942, and 1943 the company entered into pay as cut contracts on 20 of the Drury Inlet limits and derived substantial sums from them. By the end of 1943, 14 of them had been allowed to lapse, some without anything being recovered from the investment, and some after all merchantable timber had been removed. Two had been sold in a single transaction in 1940. The remainder, some twenty-five of them, were transferred to the appellant, but of those transferred about twelve were under pay as cut contracts. The appellant also entered into pay as cut contracts in respect of four or more of the licences. Most of the licences under pay as cut contracts were ultimately allowed to lapse, but some were sold. In all, the appellant sold 13 of this group of licences, five in a single transaction in 1947, five more in a single transaction in 1948, one in another transaction in 1948, and two in separate transactions in 1950.

Besides the Clark and Lyford, Seabird, and Drury Inlet licences, the company in 1921 purchased eight licences on Seymour Inlet. These were situate only twelve

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miles or thereabouts to the northward of Drury Inlet, but the timber on them was commercially more inaccessible in that it would have to be sawn in the inlet, which involved setting up a mill there, or the logs would have to be towed in open waters of the Pacific Ocean to take them to other mills, and this involved greater risks and higher towing charges than towing from Drury Inlet. The timber on these limits, when cruised, fell far short of the rough estimate on which the company had made the purchase, and in a letter to Clark and Lyford dated January 24, 1922 (Ex. H), adverting to this the company, among other things, said:

> This timber, owing to its inaccessibility was bought only as a long term speculation and at a nominal price, and the matter of four or five year's carrying charges is a serious item.
>
> We note your suggestion to take over limit #8810 at an additional cost of $1,182.34, say 20¢ per M, but before putting any more money into this lot we should be glad to hear from you as to what would be the prospect of selling the timber on some of the lighter timbered berths such as 6608 and 6642 containing say 14,000,000 feet and what price could be obtained for these two licenses for immediate cutting. If the Cedar market is now in shape these could be sold to advantage at say $1.50 per M or over, to be cut now, it would reduce the investment and enable us to hold the more desirable licenses.

Two of these licences, 6608 and 6609, were in fact sold in 1922 at a small profit and 6610 was acquired in the same year. The remaining seven were disposed of under pay as cut contracts in 1940 and 1942, and no question as to the proceeds of them arises on this appeal.

One other purchase in British Columbia made by Gillies Brothers Ltd. should be mentioned, that of the Tyee Crown grant in 1924. As to this, it is obvious from the correspondence in evidence that, whether or not it may have also figured in the contemplated manufacturing operation as a source of supply, it was purchased as a speculation and in the hope of realizing profit by selling it or the timber on it in a short time. In a lettter to Clark and Lyford, dated June 13, 1924, the company quoted the following wire it had sent the previous day:

> Your wire twelfth. Trade quiet. No sales. Money tight and directors averse to new commitments. But willing to take on if price named is lowest price obtainable. Willing to give you ten per cent commission on any reduction from purchase price. Purchase contingent on resale com-

mission of ten per cent applying only on profit or difference between cost including carrying charge to date of resale, and the resale price as conceivably on a long hold the commission might equal the profit. Wire amount needed and when.

Later in the letter, the following paragraph appears:

We note your suggestion to make the resale price a minimum of $80,000 and for prompt sale we would be agreeable to this. You of course to get as much higher a price as can be had. Prices should advance with the time the timber is held.

Another letter, dated October 27, 1925 (Ex. K) shows the same intention both with respect to the Tyee Crown grant and one of the Clark and Lyford licences. When asked if the correspondence did not indicate that Gillies Brothers Ltd. had in mind a quick re-sale of the Tyee Crown grant, Mr. Gillies replied:

A. It wasn't too quick. They were already held a good many years. Cutter Creek was purchased in 1913. The Cutter Creek was one of the 14 licences. I know that. I cruised and traveled that myself.

Q. 2. Could we leave Cutter Creek out of this discussion?

A. If you wish to reduce it to the one with Tyee Crown grant probably you might say that it was with a possible sale. We hope and continue to hope that we are traders and if you can get a big and quick profit on anything you buy you are foolish not to accept it. That is my idea of doing business. Then as far as timber goes you could sell it tomorrow and get a profit and go out of it after and buy an additional quantity probably at a lower price for a hold.

The surface rights in the Tyee grant were sold for a small sum in 1927, and the timber was disposed of to a number of loggers over the period from 1933-1943. The receipts from it are not involved in these appeals.

To sum up, the acquisitions by the company in British Columbia from 1913 to the end of 1943 consisted of six purchases between 1913 and 1925 and the transfer to the company in 1933 of the Clark and Lyford interest in the first group of licences. Its sales of licences consisted of one transaction in 1916, one in 1917, one in 1922, none in the next eighteen years, one in 1940, one in 1941, and one in 1943. The remainder of its transactions consisted of sales not of licences but of timber under pay as cut contracts, and these, too, were of only minor importance and extent until 1939. From 1939 onward, extensive sales of timber from these licensed tracts were made.

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To make the sales, the company had an agent in British Columbia whose remuneration was a commission based on the selling price, whether it was the selling price of timber or the selling price of the licence. The agent's work included the promotion of sales, and for this purpose advertisements were also published from time to time.

In my opinion, the Clark and Lyford group of licences was purchased to be sold at a profit and, while other intentions as to their use may have arisen under the pressure of economic circumstances, the scheme to make profit from them by selling them was never lost or abandoned.

The Drury Inlet group was purchased to hold for the purposes of the contemplated mill, this being the favoured purpose, but with the secondary purpose (and this whether the possible mill materialized or not) of deriving profit in any way in which they might be turned to account at a profit, including sale of them. The Seymour Inlet group was purchased with the same purposes in mind as applied to the Drury Inlet licences, but with the knowledge that there was less possibility of using them in the contemplated milling operation. The Tyee Crown grant was purchased to be turned to account for profit by sale of the grant or the timber on it. These original purposes were substantially frustrated by the moribund condition of the timber market in the late 20's and 30's and the general economic depression, and when the markets revived the company's plans for a mill in British Columbia were given up in favour of expansion in eastern Canada. At that stage the residual purpose was to sell either the timber or the licences as expeditiously as this could be done at a profit, and this is what was, in fact, being done with them when the appellant took over the assets and undertaking of the company.

Pausing here, I am of the opinion, notwithstanding the very small number of sales of licences, six in all, made over the years from 1913 to 1943, that at the time when

it ceased operations and transferred its assets and undertaking to the appellant at or about the end of 1943 the business of the company included that of trading or dealing in British Columbia timber licences. It had acquired licences in considerable volume with a view to turning them to account by methods which included sale of them, it had sold some of them, it had an agent engaged to seek purchasers and arrange sales on a commission based on the selling price of either timber or licence, and it advertised for purchasers. No doubt sales of licences were infrequent, but when they occurred I think they were part of the trade rather than mere realizations of investments.

This, then, was the situation when the appellant assumed the undertaking and acquired the remaining British Columbia licences. In my opinion, the appellant acquired them for the purpose of making profit from them either by selling the timber or by selling the licences, and it carried out this purpose using the same methods as the company had used until it had disposed of all of them in one or the other of these ways. In so doing, I think it too engaged in the business of trading or dealing in British Columbia timber licences as part of its scheme for turning the licences to account for profit in either of the two ways which it, in fact, used. When the appellant acquired the licences, there was no thought of using them in connection with a milling operation of its own. No doubt, having abandoned the vision of a mill in British Columbia and having made definite plans for an expansion of the Ontario and Quebec operations, the directors intended from the outset of the appellant's activities to wind up the British Columbia part of the undertaking. There was need for capital to finance the expansion. But the disposals of the British Columbia timber and licences were carried out through the same British Columbia agent, in the same way, on the same commission arrangement, and with the same oversight and direction from the directors as had been followed by the company in earlier years. And they were not all disposed of at once or all

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in the same way but at such times and by such methods as for one reason or another appeared to the directors to be advantageous. I can see nothing in the evidence which would classify such disposals as other than the final sales in what was in fact the carrying on of a trade with a view to making profit therefrom.

A passage in the judgment of the Privy Council in *Commissioners of Inland Revenue v. Melbourne Trust* (1) at p. 1010 seems not inappropriate to express the situation. There the question was whether or not the company was a trading company, and Lord Dunedin, after stating and approving the test expressed in *Californian Copper Syndicate v. Harris* (*supra*) said:

> In the present case the whole object of the company was to hold and nurse the securities it held and to sell them at a profit when convenient occasion presented itself.
>
> Their Lordships therefore come to the conclusion that there is ample evidence here that the company is a trading company and that the surplus realized by it by selling the assets at enhanced prices is a surplus which is taxable as a profit.

As I interpret this quotation, the company referred to was held to be a trading company because what it was doing as set out in the first quoted paragraph was trading. Paraphrasing the paragraph for the present case, it might read:

> In the present case, the whole object of the appellant with respect to its British Columbia timber licences was to hold and nurse them and to sell them or the timber from them at a profit whenever convenient occasion presented itself.

In this view, the appellant's business included the process of trading in British Columbia timber licences and the profits in question, insofar as they arose from sales of licences made by the appellant, were profits arising from such trading. With respect to them, the basis of the assessments has thus not been demolished. This feature distinguishes the case, so far as the profits from such sales are concerned, from *Sutton Lumber and Trad-*

(1) [1914] A.C. 1001.

ing Company v. Minister of National Revenue (1), where at p. 94 Locke J., in delivering the judgment of the Court, said:

> In the present case, the Nootka limits which were sold in 1946 were assets in which the company had invested with a view to cutting the merchantable timber into lumber in a mill to be erected by it in the Clayoquot District and the sale merely a realization upon one of its capital assets which was not required and did not fit in to the company's plans for the operation of its main property and one which was not made in the course of carrying on the business of buying, selling or dealing in timber limits or leases.

I find that the profits realized from the *en bloc* sales of licences made by the appellant were profits from a trade or other business within the meaning of s. 3 of the *Income War Tax Act* and within the definition of business contained in s. 127(1)(*e*) of *The Income Tax Act*. Such profits were accordingly income and were properly assessed.

On the other hand, I do not think the same can be said of contracts of sale made by the company prior to the incorporation of the appellant and later transferred to the appellant as such sales were not made in the course of the trading or business of the appellant. Nor do I think that receipts by the appellant of the moneys payable under such contracts were receipts from its trading or profit-earning operations. What the appellant acquired from the company in these cases was a debt plus a licence to hold as security until the debt was paid. Sums received by the appellant in payment of such debts were, in my opinion, mere realizations of what was assigned to the appellant by the company, and if profit was realized by the appellant therefrom it was not income but a capital gain. Two of such contracts (Exs. 40 and 46) were put in evidence as being involved in the appeals, and one or both of them may have affected the assessments for 1944 and 1945. However, the extent of such affection, if any, is not clear on the evidence. If the parties cannot agree on this, I will hear them as to it on the application

(1) [1953] 2 S.C.R. 77.

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of either party, and in the meantime final disposition of the appeals from the 1944 and 1945 reassessments will be reserved.

The appeal from the reassessment for the year 1951, so far as it is based on profits realized on sale of the McConnell and Mackelcan timber limits, will be allowed with costs up to the time of the amendment above mentioned, and the reassessment will be referred back to the Minister for revision accordingly. The appeals from the reassessments in respect of the years 1949, 1950, and 1952 will be dismissed with costs.

Judgment accordingly.

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

1956
May 29
1957
Feb. 20

AND

ALBERT MARTIN ..... RESPONDENT.

Revenue—Income—Income tax—Refusal by principal to repurchase land bought by agent—Land subdivided, house built and sold—Taxpayer's whole course of conduct determining factor as to whether ensuing profit taxable as income—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4 and 127(1)(e).

The respondent, a tavern keeper and also a church warden of a newly-created parish near Montreal, attended a parish meeting at which it was decided to buy a property up for sale by auction as a site for a church, school and cemetery. In the belief that an individual could bid in the property at a lower price, the meeting requested the respondent to bid it in his own name and resell it to the parish for the amount of such bid. The respondent agreed to do so and at a subsequent meeting reported he had made the purchase and was ready to convey title on the agreed terms. He was then told that the building project had been abandoned and that the parish would not repurchase the land from him. In the dilemma the respondent subdivided the land, built houses on some of the lots, and sold them. The Minister added to the respondent's declared income for 1949 the profit made on the sales. The respondent appealed from the assessment to the Income Tax Appeal Board which allowed the appeal. The Minister appealed to this Court on the ground that it was for the taxpayer to prove that the profits from his real estate transactions were not profits from a business within the meaning of s. 3 of the *Income Tax Act*. In reply the respondent submitted that he had bought the land with no intention of dealing in real estate to make a profit but solely to aid his co-parishioners and that unforeseen complications had forced him to take the subsequent steps in an attempt to recoup the capital disbursements to which he had been committed.

Held: That from a consideration of the evidence and of the respondent's whole course of conduct viewed in the light of all the circumstances the profit in question was not a commercial or speculative profit but an increase in value of an immovable property. *Californian Copper Syndicate v. Harris* 5 T.C. 159 at 165; *Cragg v. Minister of National Revenue* [1952] Ex. C.R. 40; *McGuire v. Minister of National Revenue* [1956] Ex. C.R. 264, referred to.

APPEAL from a decision of the Income Tax Appeal Board (1).

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

I. J. Deslauriers, Q.C. and *Maurice Paquin, Q.C.* for appellant.

H. P. Lemay for respondent.

(1) (1954) 10 T.A.B.C. 330; 8 D.T.C. 233.

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DUMOULIN J.:—Cette cause fut entendue à Montréal le 29 mai 1956.

Le ministre du Revenu national se pourvoit en appel à l'encontre d'une décision de la Commission d'Appel de l'impôt sur le revenu (1), datée le 8 avril 1954, qui, accueillant la contestation, enjoignait au ministère de déduire du revenu de l'intimé, pour l'année 1949, la somme de $1,836, et d'émettre une cotisation revisée.

Les incidents qui ont occasionné ce différend sont, pour le moins, insolites, et la suite le fera voir, d'une portée morale très restreinte.

En 1946, Albert Martin, l'intimé, tavernier de son état, résidait depuis quelques années à Plage Laval, dans la banlieue de Montréal. Simple desserte paroissiale auparavant, Plage Laval, dans le cours de l'an 1946, fut régulièrement érigée en paroisse, avec désignation d'un curé et le choix corollaire de trois marguilliers, dont l'intimé Martin. Cette nouvelle paroisse reçut le vocable de St-Théophile de Laval-ouest. Peu après, une assemblée des marguilliers de l'Œuvre et Fabrique, et des deux syndics, fut tenue. L'on décida d'acquérir un terrain assez vaste pour satisfaire aux besoins paroissiaux: l'église, l'école, le lotissement d'un cimetière.

Une terre de vingt arpents carrés environ, dont la mise à l'enchère, en licitation, était annoncée, paraissant convenir, l'achat en fut résolu. Avec l'espoir, du reste irréalisé, qu'un enchérisseur individuel l'obtiendrait à meilleur compte que la Fabrique, le curé et les marguilliers engagèrent Albert Martin à se porter personnellement acquéreur de cette propriété pour la revendre à la Paroisse au prix par lui payé.

L'intimé, qui avait des économies, crut ne pouvoir se soustraire à pareil appel et accepta le mandat. Aucune limitation du prix ne fut imposée, l'entente étant que Martin achèterait aux meilleures conditions du moment.

Lors de la vente, tenue le 17 décembre 1946, comme les surenchères atteignaient l'indice de $17,000, il semble bien que l'intimé ait hésité à passer outre. Mais le marguillier en charge, Arthur Labelle, lui conseillant de persister jusqu'à concurrence de $20,000, il dut relancer une sur-

(1) (1954) 10 T.A.B.C. 330; 8 D.T.C. 233.

enchère de $19,900 (témoignage d'Arthur Labelle) pour se voir enfin adjuger cet immeuble au prix de $20,000 (voir pièce 1).

Après cette transaction une autre assemblée de l'Œuvre et Fabrique eut lieu; l'intimé fit rapport de sa mission accomplie et se déclara prêt à donner titre à la paroisse sur remboursement de $20,000.

Si invraisemblable que cela paraisse, une preuve précise, concordante, formelle, m'oblige à tenir pour avéré ce qui suit. Le curé—son nom ne fut pas divulgué—apprit à Martin l'abandon du projet initial de construire une église, ajoutant qu'il suffirait d'agrandir la chapelle actuelle, et qu'il ne saurait être question de racheter la terre dont il venait de se porter acquéreur en qualité de prête-nom.

Ce personnage, il est vrai, suggérait une solution, que je rapporterai selon les termes mêmes du marguillier en charge, Arthur Labelle, et de son collègue du banc-d'œuvre, Omer Brière; je cite (Notes du témoignage d'Arthur Labelle):

> Quelque temps après, au cours d'une autre assemblée des marguilliers, le curé du temps dit à Martin: "Tu as acheté la terre, eh bien! donne-la à la Paroisse, on ne te l'achètera pas".

Notes du témoignage d'Omer Brière:

> Le curé lui a dit: "Martin, maintenant que tu as acheté la terre, donne-la à la Paroisse".

Il n'est pas jusqu'au nouveau curé de St-Théophile, M. l'abbé Roger Raymond, totalement étranger à cette volte-face, qui n'en atteste toutefois la réalité, disant:

> Quand je suis arrivé sur place, je fus confronté par un état de fait: je sais qu'il avait été représenté à M. Martin que la Fabrique lui achèterait cette terre.

Il est permissible de conjecturer ce qui s'était passé et charitable de le taire.

Quant à l'intimé, propriétaire foncier malgré lui, il s'inspire, inconsciemment sans doute, du dicton à l'effet que "qui tombe dans un trou doit essayer d'en sortir par tous les moyens". Fort de cette persuasion, Martin, selon l'avis de l'abbé Raymond, subdivisa la propriété en lots à bâtir, y construisant huit maisons, de 1947 à 1950. L'intimé déclara que, de ces huit demeures, trois étaient vendues et cinq louées. Le secrétaire-trésorier de la ville de Laval-ouest, M. Jean Galarneau, témoignera que le

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rôle d'évaluation de cette municipalité fait mention de dix-sept (17) maisons bâties sur des terrains appartenant, ou ayant appartenu, à l'ancienne terre Nadon, celle dont il s'agit. Enfin, M. Galarneau précise que le prix des terrains, en 1956, à Laval-ouest, est de 0.10¢ le pied carré sur les rues commerciales, et de 0.07¢ sur les rues résidentielles.

Ce fut dans ces circonstances que l'appelant ajouta $1,836 au revenu imposable de l'intimé, pour l'année 1949, comme étant les bénéfices provenus de spéculations immobilières et non pas la plus-value afférente à la réalisation d'un capital.

L'appelant soutient (art. 9) comme unique motif: ". . . qu'il appartient à l'intimé d'établir devant cette honorable cour que les profits provenant des transactions immobilières en question ne sont pas des profits résultant d'un commerce au sens de l'article 3 de la Loi de l'impôt sur le revenu."

L'intimé répond (arts. 8, 9 et 10 fusionnés) qu'il acquit "cette parcelle de terre sans aucune intention de faire un profit et dans le seul but de rendre service à ses coparoissiens; qu'il s'efforce de récupérer par le lotissement de terrains et la vente de maisons, sa mise originale de fonds; qu'il n'a jamais prétendu faire le commerce d'immeubles en achetant le terrain, et que seule une complication imprévisible l'induisit à morceler cette propriété afin de sauvegarder ses capitaux engagés.

En bref, les ventes effectuées par Albert Martin, durant l'année 1949, d'où vient l'excédent de $1,836. étaient-elles de nature commerciale, ou d'inspiration spéculative, ou, au contraire, le gain réalisé ne constitue-t-il que la plus-value inhérente à la revente d'un patrimoine?

Revenus d'initiatives commerciales, d'un métier, ou rentrée de capitaux déboursés, telle est la question soulevée en regard des articles 3, 4 et 127(1)(*e*) de la Loi de l'impôt sur le revenu de 1948 (11-12 Geo. VI, c. 52), dont les deux phrases précédentes résument suffisamment la teneur.

En pareil cas, l'on se réfère volontiers aux directives simples et très lucides, énoncées, dès 1904, dans *Californian Copper Syndicate v. Harris* (1) par le Lord Justice Clerk:

> . . . the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

A quoi il convient de joindre ces principes connexes, d'application concrète, formulée par le Président de cette Cour dans la cause de *Cragg v. Minister of National Revenue* (2). M. le juge Thorson disait que:

> 2. That the Court must be careful before it decides that a series of profits, each one of which would by itself have been a capital gain, has become profit or gain from a business. Such a decision cannot depend solely on the number of transactions in the series, or the period of time in which they occurred, or the amount of profit made, or the kind of property involved. Nor can it rest on statements of intention on the part of the taxpayer. The question in each case is what is the proper deduction to be drawn from the taxpayer's whole course of conduct viewed in the light of all the circumstances. The conclusion in each case must be one of fact.

Donc, question de faits dans chaque cas, informée au regard de la loi par les circonstances ambiantes, non par la seule conjoncture d'un profit et moins encore, ce serait trop simpliste, par l'intention alléguée du contribuable. Cette revente parcellaire et à profit de la propriété n'est qu'un moyen incident, qui ne saurait imprimer à la transaction son caractère spécifique.

La narration du cas comportait aussi l'analyse de la preuve reçue; il serait superflu d'y revenir, sinon à dessein de souligner que le ministère, suspectant les explications de l'intimé et de ses témoins, aurait dû citer en contrepreuve le curé du temps, présumé vivant.

Quant à la conduite des deux autres marguilliers, et davantage celle du curé "fondateur", je laisse à l'indulgence des parties intéressées le soin de l'apprécier.

Avant de conclure, je rapporterai une récente décision (29 mars 1956), rendue par M. le juge adjoint Hyndman dans un cas dont l'analogie au nôtre est assez grande. Il

(1) (1904) 5 T.C. 159 at 165. (2) [1952] Ex. C.R. 40.

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s'agissait de l'affaire *McGuire v. Minister of National Revenue* (1) où il fut jugé que l'appalant (McGuire) ne faisait pas commerce mais disposait tout simplement de son bien et sans spéculation, dans les conditions que voici:

> Appellant in 1940 purchased a farm for a home intending to live on it and at time of hearing of the appeal was living on it. In 1949 he subdivided part of it into 52 lots of which 20 were sold in the years 1949, 1950, 1951 and 1952. Appellant was assessed for income tax on the profits from the sale of these lots . . .
>
> *Held,* that the decision . . . must be reversed as appellant did not purchase the land as a venture or for speculation and there is no distinction between selling the land in whole or in parts.

Je ne puis déceler aucune raison grave de révoquer en doute les assertions catégoriques des marguilliers Labelle et Brière, du maire Laframboise, de M. l'abbé Raymond, celles enfin d'Albert Martin.

Par ces motifs, je tiens pour justifiée, quant à ses conclusions, la réponse de l'intimé à l'avis d'appel. Le gain de $1,836, ajouté au revenu déclaré de Martin pour l'année 1949, par suite des transactions immobilières précitées, n'est point un revenu spéculatif ou commercial mais l'accroissement de valeur d'un patrimoine immobilier.

En conséquence, l'appel est rejeté; l'intimé aura droit de recouvrer tous ses frais taxables.

Jugement en conséquence.

1957

Apr. 11

May 15

W. T. HAWKINS LIMITED ..... APPLICANT;

AND

DEPUTY MINISTER OF NATIONAL REVENUE FOR CUSTOMS AND EXCISE ..... RESPONDENT.

Revenue—Excise Tax Act, R.S.C. 1952, c. 102, 30, 32(1), 58(1)—Magic Pop —Schedule III of the Excise Tax Act—Application for leave to appeal from decision of Tariff Board—Decision of Tariff Board based on construction of provisions of Excise Tax Act—Leave to appeal granted.

The applicant applied for leave to appeal from a decision of the Tariff Board under s. 58(1) of the *Excise Tax Act*, R.S.C. 1952, c. 102 as amended, to the effect that a product called *Magic Pop* consisting of popping corn placed in a block of solidified shortening wrapped and

(1) [1956] Ex. C.R. 264.

packaged for the retail trade is not "grains or seeds in their natural state" within the meaning of Schedule III of the *Excise Tax Act* and consequently taxable under section 30 of the Act.

Held: That leave to appeal should be granted since the decision of the Tariff Board was based on an interpretation of the Act and the Schedules and the construction of a statutory enactment is a matter of law only and the applicant has a fairly arguable case to submit to the Court.

APPLICATION for leave to appeal under section 58(1) of the Excise Tax Act.

The application was heard before the Honourable Mr. Justice Cameron at Ottawa.

G. F. Henderson, Q.C. for applicant.

R. W. McKimm for respondent.

CAMERON J.:—This is an application for an Order, (a) extending the time for applying for leave to appeal to this Court from a decision of the Tariff Board dated February 27, 1957 (Appeal 395); and (b) granting leave to appeal to this Court from a decision of the Board. By consent of the parties, the time for applying for leave to appeal was extended to April 11, 1957, on which date the motion was heard.

The application for leave to appeal is made under the provisions of section 58(1) of the *Excise Tax Act,* R.S.C. 1952, c. 102, as amended. By that section the person who applied to the Tariff Board for a declaration may, upon leave being obtained from the Exchequer Court or a Judge thereof, appeal to the Exchequer Court upon any question that, in the opinion of the Court or Judge, is a question of law.

The applicant packages a product called "Magic Pop" which consists of popping corn placed in a block of solidified shortening wrapped and packaged for the retail trade. The Assistant Deputy Minister for Excise ruled that the popping corn in the package is not "grains or seeds in their natural state" within the meaning of Schedule III of the *Excise Tax Act* and consequently that the product was taxable under section 30 of the Act. The applicant appealed that ruling to the Tariff Board.

Under section 32(1) of the Act, the tax imposed by section 30 does not apply to the sale or importation of the articles mentioned in Schedule III. Items appearing in

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Schedule III which are applicable to the issue are as follows: salt; shortening; grains and seeds in their natural state.

The decision of the Tariff Board, which contains a brief summary of the essential facts, is as follows:

The Appellant, in the words of his counsel, "packages a *product* called 'Magic Pop' which consists of popping corn placed in a block of solidified shortening wrapped and packaged for the retail trade." (Our italic.)

The question at issue is whether this product falls within Schedule III to the *Excise Tax Act*.

The case for the Appellant amounted to a denial that "Magic Pop" is a product in the ordinary sense at all. It was contended that "Magic Pop" ought to be regarded simply as salt, shortening, and grains or seeds in their natural state. Since each of these products (or constituents) is exempt, it was argued that "Magic Pop" therefore is exempt.

However, is the mixture of these ingredients, as sold by the producer, three products or one product? Is the vendor selling shortening, salt, and corn, or is he selling a new product, in effect, a carefully prepared recipe? We think the answer to these questions is clear.

The exemption for shortening, salt, and grains or seeds in their natural state applies to these materials when sold as such, but does not apply to them when they are simply components or ingredients of another product, even though this product is capable of being separated into its original constituents.

Accordingly, the Appeal is dismissed.

The question of law on which the applicant now requests leave to appeal is stated as follows:

Did the Tariff Board err as a matter of law in deciding that a product called "Magic Pop" sold by W. T. Hawkins Limited of Tweed, Ontario, is not exempt from sales tax imposed by the Excise Tax Act.

Counsel for the respondent opposed the application on the ground (1) that no question of law was involved; and (2) that the applicant did not have a fairly arguable case to submit to the Court.

In *Canadian Horticultural Council, et al. v. Freedman & Son Limited* (1), a case decided by the President of this Court, it was held:

Held: That in an application under section 45 of the Customs Act the Court or judge before whom the application is made must not only form an opinion on whether there is a question of law involved in the order, finding or declaration of the Tariff Board but also, if in its or his opinion there is such a question, exercise judicial discretion in determining whether, in the circumstances of the case, leave to appeal on such question should be granted or refused.

(1) [1954] Ex. C.R. 541.

2. That if it appears to the Court or judge hearing an application for leave to appeal under section 45 of the Customs Act that the order, finding or declaration of the Tariff Board from which leave to appeal is sought was plainly right or sound or that there was no reason to doubt its correctness or that the applicant would not have a fairly arguable case to submit to the Court leave to appeal should be refused.

While the decision in that case was made under the provisions of the Customs Act, the principles so stated are of equal application to applications for leave to appeal under the Excise Tax Act.

It seems clear to me that the decision of the Tariff Board was based on an interpretation of the Act and the Schedules. As stated in the final paragraph of its decision, the Board came to the conclusion that while the ingredients of "Magic Pop" were entitled to exemption when sold as such, the exemptions did not apply to them when they are simply components or ingredients of another product, even though the product is capable of being separated into its original constituents.

They decided that exempting provisions of section 32(1) did not apply to the articles mentioned in Schedule III where they were not sold *as such*, although the words which I have underlined are not found in the Act or the Schedule. I do not suggest that they were wrong. I am of the opinion, however, that in so doing they were construing the provisions of the Excise Tax Act.

In the case of *The Deputy Minister of National Revenue for Customs and Excise v. Rediffusion Inc.* (1), I came to the conclusion that the construction of a statutory enactment is a matter of law only. Reference may be made to the cases therein referred to and also to *General Supply Co. Ltd. v. Deputy Minister of National Revenue (Customs and Excise) et al.* (2).

I am of the opinion, also, that the applicant has a fairly arguable case to submit to the Court and that leave to appeal should be granted. Moreover, the precise point in issue—which is one of considerable importance to the public—has not previously been before the Court so far as I am aware.

(1) [1953] Ex. C.R. 221. (2) [1953] Ex. C.R. 185.

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Cameron J.

The application for leave to appeal will therefore be granted and as no question was raised as to the form in which it is proposed that the point of law should be presented to the Court, it will be as proposed in the Notice of Motion for leave to appeal. Costs of the application will be costs in the cause.

Judgment accordingly.

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HER MAJESTY THE QUEEN .....PLAINTIFF;

AND

DOUGLAS SANDFORD, EDWIN J. KELLOCK AND ROY C. HILKER } DEFENDANTS.

Crown—Information—Liability of police officer for damages resulting from shooting of passenger in a car—Shooting done in attempt to stop driver of car fleeing from arrest—Criminal Code, R.S.C. 1927, c. 36, ss. 35, 41, 648—Police officer negligent in acting without due care for passengers.

Action by the Crown to recover damages resulting from injuries caused a member of the Royal Canadian Air Force when he was wounded by a pistol bullet which the Court found had been fired by the defendant Hilker. The firing of the pistol was done by Hilker in attempting to arrest one McDonald, the driver of a car in which the wounded man was a passenger. Hilker sought to justify the shooting under sections 35, 41 and 648 of the Criminal Code, R.S.C. 1927, c. 36, in effect when the incident occurred, and the Court found that the preliminary conditions provided by section 41 to justify the use of force were satisfied with respect to McDonald but not with respect to the passengers in the car. The Court found that the defendant Hilker was a peace officer acting in his own right or assisting a senior police officer in endeavouring to effect the arrest of McDonald without a warrant for dangerous driving when he was in flight to escape arrest.

Held: That the onus lies on the defendant Hilker to establish that the shooting was done without intention to injure and without negligence and though he had a right to use force to stop the driver of the car it was his duty to have due regard for the safety of the passengers and other people and not to use force in such a way as to be likely to injure them.

2. That the course pursued by the defendant Hilker was not a reasonable means of stopping the car nor did it offer any but a very remote chance of accomplishing its purpose.

3. That defendant Hilker was negligent towards the passengers in the car in firing under the conditions then existing and the defence of justification fails and he is liable for the consequences of his action.

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INFORMATION exhibited by the Deputy Attorney General of Canada.

The action was tried before the Honourable Mr. Justice Thurlow at Vancouver.

J. M. Streight and *H. C. MacKay* for plaintiff.

A. Gordon MacKinnon for defendants.

THURLOW J.:—This is an information by which the Crown seeks to recover damages resulting from injuries caused to Ronald G. Byers, a member of the Royal Canadian Air Force, when he was wounded by a pistol bullet at New Westminster, British Columbia on July 27, 1954. The claim is for medical and hospital expenses incurred by the Crown in treating Byers and for loss of his services from the date above mentioned until August 12, 1954, when he died. The defendants are constables of the Police Department of the city of New Westminster, and in the statement of claim it is alleged that they, or one of them, wrongfully and negligently fired the bullet which injured Byers. On their part, the defendants deny the allegations of the statement of claim and say that, in the circumstances, the use of pistols to stop the vehicle in which Byers was a passenger when he was injured was justified.

When the shooting occurred, Byers was in a 1950 Chevrolet coach, sitting on the right-hand side of the back seat. On his left, and directly behind the driver, was another passenger, Charles Calbick. The driver was Ronald McDonald, and with him on the front seat were Herbert LaSalle in the middle and Jack Delaney on the right.

At about 3 a.m. on the morning in question, Constable Charles Keary of the New Westminster Police Department was on patrol duty near the corner of London and Eighth Streets in New Westminster and was driving police car No. 41. With him and also on duty was the defendant Kellock. Constable Keary was the senior and was in charge of the patrol. The constables observed the Chevrolet car driven by McDonald proceed southwardly along Eighth Avenue and stop near the gasoline pumps of a service station at the corner above mentioned. The service station was not open at the time. Suspecting some illegal purpose in the presence of the car on the service station

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grounds, Constable Keary drove onto the grounds and drew up beside the Chev car to investigate. Constable Kellock shone a flashlight on the driver of it, but neither he nor Constable Keary recognized the driver or any of the passengers. Kellock, however, did observe that there were a number of persons in the car besides the driver. At this point someone in the car made an uncouth remark which might be regarded as insulting to and indicating contempt for the policemen, and thereupon the lights of the Chev car were turned off and the car was driven away. The constables gave chase. The Chev car proceeded southwardly on Eighth Street for one block, turned westwardly and proceeded along Dublin Street for two blocks at high speed, turned southwardly and proceeded on Henry Street for two blocks, and then turned westwardly again on Eighth Avenue for twelve blocks. In the distance last mentioned, its speed at times exceeded 60 miles an hour. The police car driven by Constable Keary was close behind throughout this distance and, indeed, throughout the whole of the chase. At no time was it more than a block behind the Chevrolet car, and throughout most of the chase the distance between the cars was a matter of three or four car-lengths. The police car was equipped with a flashing red light on the roof, which was operating, and with a siren which was also operated almost continuously throughout the chase. While proceeding westwardly along Eighth Street, Kellock fired one or two pistol shots in the air, but the Chev car did not stop. On reaching the intersection of Eighth Street and Twenty-Third Street, it turned southwardly on Twenty-Third Street and proceeded for three blocks to Marine Drive. In following the car over this distance, Kellock fired several more shots, aiming at the rear tires of the Chev car. On reaching Marine Drive, the Chev car turned eastwardly and proceeded at high speed along it and its extension known as Sixth Avenue. In doing so, it passed Twentieth Street, crossed the B.C. Electric Railway line, and continued along Sixth Avenue to its intersection with Tenth Street. The whole distance travelled along Marine Drive and Sixth Avenue is about one and one-third miles. The first portion—that is, from Twenty-Third Street to Twentieth Street—is about a third of a mile. The B.C. Electric Railway crossing is one block east

of Twentieth Street, and Sixteenth Street (which is of importance in the events which occurred) crosses Sixth Avenue about a third of a mile east of the railway crossing. In the distance between Twenty-Third Street and the railway crossing, Kellock fired his last round. His pistol had been loaded with five or six cartridges at the outset. He had emptied the pistol, reloaded a single round, and fired it. He did not fire after crossing the railway crossing and probably not after crossing Twentieth Street.

Police car 41 was also equipped with a radio transmitter and receiver, and in the meantime Kellock had been in communication with the other two defendants, Douglas Sandford and Roy C. Hilker, who were on duty in police car No. 40. On receiving word by radio that Constables Keary and Kellock were pursuing the Chev car Sandford, with Hilker, proceeded to the intersection of Sixth Avenue with Sixteenth Street, where, observing the approach of a car without lights and of another car with a flashing red light following it, Sandford hastily parked police car No. 40 in the northern lane of Sixth Avenue, facing westwardly, with its right rear wheel close to the north curb and with the front of the car some three feet from the curb. The headlights were left burning and shone at an angle across Sixth Avenue. Both constables got out of the car, Sandford taking up a position in line with the front of the car and three or four feet to the southward of the centre line of the pavement, and Hilker taking up a position fifteen to twenty feet in front of the car and about three feet to the northward of the centre line of the pavement. The lights of the car were playing on Hilker. Both officers had flashlights and, by waving them, endeavoured to halt the approaching Chev car. The car approached them at high speed, veered for a moment or two to the north of the centre line of the street and then to the southward again, and narrowly missed colliding with police car 40. As the Chev car approached, Constable Sandford shouted to Constable Hilker, who jumped to the north side of the road. Constable Sandford moved to the south side of the road, and the Chev car passed between them. Both constables, Hilker and Sandford, drew their pistols and fired at the car, each of them firing two shots.

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The Chev car continued further along Sixth Avenue for approximately half a mile, passing through an intersection against a red traffic light, turned northwardly on Tenth Street for one block and thence westwardly on Nanaimo Street for one block, when it stopped. By this time, having been informed by radio of the course the car was taking, Constables Sandford and Hilker had proceeded to and reached the intersection of Twelfth and Nanaimo Streets and were blocking the Chev car's passage into it. At about the same moment, an R.C.M.P. car drove up, completing the road block at that intersection. The total distance covered from the service station to the intersection last mentioned was 3.7 miles.

During the chase Byers had been wounded by one of the bullets, and when it ended he was taken to Royal Columbian Hospital at New Westminster, where he was treated until he died. There is no evidence that any charge was laid against him or that he had committed any offence whatever. Nor does the evidence show any reasonable or probable grounds for believing that he had committed or was about to commit any indictable offence.

McDonald, the driver, was arrested and subsequently was convicted of and fined for dangerous driving contrary to the *Criminal Code* and for driving without a licence. LaSalle, Delaney, and Calbick were detained overnight and released without any charge being laid against any of them. There is no evidence as to whether or not any of them was taken before a magistrate, and the only ground for their detention suggested in the evidence is that they were material witnesses in respect of the offence of dangerous driving committed by McDonald.

The first problem is to determine whose bullet injured Byers, as in the circumstances I am of the opinion that no case has been made out for holding any one of the three defendants liable for the consequences of firing by any other of them. Each of them was a constable acting in the discharge of his duty. If anyone was their superior, it was Constable Keary, who is not a defendant. At the time when Byers was injured, all four constables were engaged in a lawful common purpose of stopping the driver of the Chev car, who was committing the offence of dangerous driving. In so doing they were acting in concert. But neither Sand-

ford nor Hilker had any connection whatever with the shooting done by Kellock. And while Constable Keary knew that Kellock was going to fire and apparently acquiesced in his so doing, there is no evidence that either he or Kellock directed or counselled Sandford or Hilker to fire or had any reason to anticipate that either of them would do so. Moreover, neither Sandford nor Hilker had anything to do with the firing by the other. Neither counselled or directed the other to fire. While Sandford was senior to Hilker and in a position to exercise control over him to some extent, he had no reason to anticipate that Hilker would act unlawfully, nor had he any opportunity to restrain him when the occasion arose. On getting out of police car 40, both Sandford and Hilker used flashlights in their effort to flag down the Chev car. When it did not slow down, each of them independently drew his pistol and fired. Each made his own decision to do so, without direction or urging from the other. In my opinion, in these circumstances the defendants cannot be treated as joint tort feasors and, as it is clear and indeed undisputed that one of them wounded Byers, it becomes necessary to determine which of them did so.

On reviewing the evidence, in my opinion it is possible to determine on a balance of probabilities whose bullet struck Byers. It will be recalled that the defendant Kellock fired his last round after coming onto Marine Drive, but somewhere in the distance between Twenty-Third Street and the B.C. Electric Railway crossing, a matter of at least one-third of a mile from the point from which the defendants Sandford and Hilker fired. Neither Sandford nor Hilker speaks of hearing or seeing any firing from the pursuing car. Moreover, on examination next day no bullet holes were found in the back of the Chev car. With these and the facts to be mentioned, it is in my opinion improbable that it could have been any of Kellock's bullets which struck Byers. It will also be recalled that the defendant Sandford was on the south side of the road when the Chev car passed him going eastwardly. The right side of the car was thus nearest to him. Byers was struck on his left side. Two of the witnesses spoke of a bullet striking the right portion of the hood but, whether it did so or not, the windshield was not broken, and none of the three per-

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sons occupying the front seat was struck. It is, therefore, almost inconceivable that that bullet, even assuming it to have been fired by Sandford as the car approached him, could have found its way to the back of the car and struck Byers. Nor was there any bullet hole on the right side of the car through which the bullet which struck Byers might have entered the car. Consequently I think it is also improbable that it could have been any bullet from Sandford's pistol which struck Byers.

On the other hand, it is, in my opinion, highly probable that the fatal bullet was one of those fired by the defendant Hilker. Adverting to the time when Byers was injured, the witness LaSalle gave the following evidence:

Q. You turned left and carried on on Marine Drive or Sixth Avenue back to New Westminster?
A. Yes.
Q. Then what happened?
A. There must have been three or four blocks from where we turned on to Marine Drive, a partial road block.
Q. What do you mean?
A. We seen a car partially blocked across the road.
Q. What kind of car?
A. A police car.
Q. Did you see any policemen?
A. Yes.
Q. Where were the policemen?
A. Standing by the car.
Q. They were by the car?
A. Yes.
Q. Can you say anything about the policemen, what were they doing?
A. I am not too clear on that point.
Q. Did they have lights?
A. I don't remember.
Q. Then what happened?
A. When we passed them there were shots fired.
Q. How many shots?
A. I couldn't say.
Q. One, two, ten?
A. Two—I couldn't say for sure.
Q. Do you know who fired the shots?
A. No.
Q. Was the other police car still following you at this time?
A. Yes.
Q. These shots that were fired at that point by the policemen following you or the policemen standing there?
A. I believe by the policemen standing there.
Q. Did anything else happen at that time?
A. I got down under the dash board.
Q. What caused you to duck?

A. The gunfire I suppose, and when I looked up the back window caved in, the side lefthand rear window and that is when Byers said, "I'm hit, stop the car".
Q. Were there any other bullets hit the car?
A. I believe so, I am not sure.

* * *

Q. Did you examine the vehicle after the accident?
A. Yes.
Q. Did you see any marks on it at all?
A. I believe there was three or four.
Q. Where were they?
A. The one window was shot out and there was a bullet hole in the side of the door and one on the hood of the car.
Q. Where on the hood?
A. The right front of the hood.

Speaking of the condition of the Chev car, the defendant Sandford said:

Q. You didn't observe that; did you examine the McDonald car after the incident?
A. I did.
Q. What did you notice?
A. I noticed the left rear window was smashed out, shattered.
Q. Was there any glass there?
A. There was glass on the rear seat, fragments of glass, a quantity of it on the sill, shatterproof type windows, and also there was a mark on the left rear fender.
Q. The left rear fender?
A. Yes.
Q. Did it indicate to you that it was a bullet mark?
A. It could have been, it was a groove mark.
Q. Did you check anything else on the car?
A. I examined the rest of the vehicle and found the gas meter showed approximately a quarter of a tank of gas; I observed no other marks.
Q. Did you look at the hood?
A. I looked at the hood.
Q. Did you not see any markings?
A. I didn't see any markings.

THE COURT: Q. Constable, was there what appeared to be a bullet hole in the window?
A. No, I couldn't tell that, sir, it was just shattered out, there was nothing to suggest any one particular area of glass, that there was a direct hole, in other words the whole of the window itself was shattered, just small pieces, nothing on the sills themselves to show any indentation that I noticed.

There is no evidence of any bullets having been found inside the Chev car or of any holes by which bullets which entered might have passed out of the car. Nor is there evidence as to which of the windows of the car were up and which were down.

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As the Chev car approached him, the defendant Hilker was standing fifteen to twenty feet in front of police car 40, which, as previously mentioned, was parked at an angle in the north lane of the road and was occupying most of that lane. Hilker says that when the Chev car veered to the north side of the centre line he jumped to the north curb and that he fired from a kneeling position at the Chev car after it had passed police car No. 40. This would mean that he fired either over or through the police car or behind it. And in the latter case the Chev car would necessarily have to be a considerable distance beyond the police car before Hilker would be able to see it from his position. Constable Keary's evidence is as follows:

> Q. Will you continue, what happened to the car that you were following as it approached the road block?
>
> A. It didn't slacken speed and as it went through this police car and the two officers standing there, the officers fired two or three shots each at the car, you could see the flash from their pistols; the car still speeded on four blocks where there is a traffic light showing red for eastbound traffic; . . .
>
> * * *
>
> Mr. McKINNON: Q. Constable, possibly you can clarify or give a definition of when the shots were fired by the police constables on the road, you stated "as it went through"; did you see any fire arms being shot while the car was approaching that road block and the police constables?
>
> A. No, sir.
>
> Q. Where was the pursuing car in relation to the road block when you first noticed the use of fire arms by the peace officers there?
>
> A. Were about five car lengths back, were approaching the road block and the chased vehicle was just going through it.
>
> Q. Had it got by the road block?
>
> A. It had just gone through, I imagine the officers were firing at the rear tires, I am not sure, sir.
>
> * * *
>
> Mr. STREIGHT: Q. . . . Do you know which way the police officers jumped at the time these boys passed?
>
> A. I saw one jump toward the police vehicle, which way the other officer jumped, I don't know.
>
> Q. And as far as you know the shots came from the north side of 6th Avenue at the time of the partial block?
>
> A. I know *the flashes came from between the two vehicles,* whether there were any other flashes on the other side or not, I couldn't say, sir.

I think it is obvious that the Chev car could not have actually passed police car 40 when the flashes occurred. They must have occurred just as the Chev car was passing

the police car or a fraction of a second earlier, for from the time police car No. 40 was passed it would obscure the Chev car from Hilker's view.

The bullet which wounded Byers struck him on the left side of the chest under the left arm but somewhat to the front. It passed between the third and fourth ribs, through the left lung, on a course slightly upward and somewhat towards the back. It ruptured a blood vessel leading from the heart and apparently also penetrated the left wall, but not the right wall, of the oesophagus. Obviously, it was a spent bullet. Byers was operated on at the hospital, but the bullet was not found. This could be explained on the theory that it had been expelled by Byers in vomiting but there is no evidence establishing what became of it.

In my opinion, it was one of Hilker's bullets which smashed the rear window as the Chev car was approaching and passing police car 40, and it was very probably the same bullet which, spent from smashing the window, struck Byers. In my view, it is infinitely more probable that this, rather than any other, was the fatal bullet. To have come from Sandford's gun, the bullet, whether fired before or after the Chev passed him, would have to be travelling on a widely different course from its initial one. Coming from Hilker's gun at the time the car passed Hilker, it would take but minor deflections to direct it to Byers' left side. Accordingly, I find that it was the defendant Hilker who shot Byers.

The next question is whether or not the firing by the defendant Hilker was justified in the circumstances. All of the defendants sought to justify under ss. 35, 41, and 648 of the *Criminal Code*, R.S.C. 1927, c. 36, which was in effect when the incident occurred. These sections are as follows:

35. Every Peace officer is justified in arresting without warrant any person whom he finds committing any offence.

41. Every peace officer proceeding lawfully to arrest, with or without warrant, any person for any offence for which the offender may be arrested without warrant, and every one lawfully assisting in such arrest, is justified, if the person to be arrested takes to flight to avoid arrest, in using such force as may be necessary to prevent his escape by such flight, unless such escape can be prevented by reasonable means in a less violent manner.

648. (1) A peace officer may arrest, without warrant, any one whom he finds committing any criminal offence.

(2) Any person may arrest, without warrant, any one whom he finds committing any criminal offence by night.

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The contention advanced by counsel on behalf of all the defendants is that McDonald, the driver of the Chev car, was committing a criminal offence, namely dangerous driving contrary to s. 285(6) of the *Criminal Code*, that the offence was being committed in their presence, and that accordingly each of them was entitled to arrest the driver without warrant, that as the driver was in flight to escape arrest each of them was entitled to use force to prevent his escape, that firing at the car was no more force than was necessary to prevent the escape, and that the escape could not be prevented by reasonable means in any less violent manner. Counsel for the plaintiff submits that there was no justification for arresting anyone but the driver, that there were other less violent means of preventing the escape, and that no justification for the firing was established.

In *Robertson v. Joyce* (1) Laidlaw J.A., in delivering the judgment of the Ontario Court of Appeal, said at p. 701:

> I turn now to s. 41 of the *Code*. That section is the same in substance as s. 43 of the draft *Code* submitted with the report of the Royal Commission appointed in England in 1878 to consider the law relating to indictable offences. It is founded in part on the principle of the common law that what the law requires it justifies *Quando aliquid mandatur, mandatur et omne per quod pervenitur ad illud.* The provisions of the section are applicable whenever the following conditions exist, namely: where a peace officer is proceeding lawfully to arrest a person; where the offence for which a person is to be arrested is one for which the offender may be arrested without warrant; and where the person to be arrested takes to flight to avoid arrest. Those requisites to the applicability of the section are unquestionably satisfied in the present case. The principal question in issue and to be determined by the Court is whether the defendant was justified in what he did under the particular circumstances of this case.
>
> A peace officer is not empowered to employ whatever means in whatever manner he pleases to prevent the escape of an offender who takes to flight to avoid arrest. He is not free to use force of whatever kind or extent he may think fitting to the circumstances. A statutory defence against liability of a peace officer for what he has done is not available to him under s. 41 if he has used an excess of force to prevent the escape by flight of a person to be arrested by him or if such escape could have been prevented by reasonable means in a less violent manner. The question whether he used an excess of force and the question whether the escape could have been prevented by reasonable means in a less violent manner are questions of fact for determination upon the evidence and in the circumstances of each particular case under review.

(1) [1948] O.R. 696.

In my opinion, the defendant Hilker may be regarded as acting either in his own right as a peace officer or as a person assisting Constable Keary in endeavoring to effect the arrest of McDonald for dangerous driving. In either case, the arrest by Hilker of McDonald for that offence without a warrant could be justified. The first two conditions for the application of s. 41 may thus be taken as satisfied.

And I think, too, that the third of the conditions, namely that McDonald was in flight to escape arrest, sufficiently appears from the evidence. McDonald says that his reason for leaving the service station as he did was that, as he had no driver's licence and as he was to some extent under the influence of liquor, he wanted to get far enough ahead of the police to change drivers and that, when the firing began, he became scared and would not stop. Whether the reasons so given are the correct ones or not, when the chase began McDonald was not fleeing from arrest for dangerous driving, but I think he must have realized, when committing that offence with the police in close pursuit, that he would be arrested for it, and by the time the defendant Hilker came into the situation I think McDonald was fleeing from arrest for that offence as well as for any other reasons he may have had in his mind. The preliminary conditions for the application of s. 41 are thus satisfied with respect to McDonald.

They are not, however, satisfied with respect to any of the other occupants of the car, and in my opinion the matter must be dealt with on the basis of the other occupants being innocent parties. There is no evidence that any of the constables had reasonable or probable grounds for believing that any of the passengers had committed an offence for which he could be arrested without warrant. Nor were the passengers in flight to escape arrest. While it was their duty to endeavor to get McDonald to stop and they, or some of them, asked him to do so, I do not think their failure to take further steps to stop the car is sufficient to make them parties to McDonald's offence. The use of force to arrest them cannot be justified under s. 41, and the injuring of any of them by force used for the purpose of arresting McDonald can be justified, if at all, only by showing not merely circumstances justifying the use of

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such force upon McDonald but also that such force was exercised reasonably and with due regard for the safety of the passengers.

The evidence, in my judgment, falls far short of establishing such a defence. Under s. 41 the force used can be justified as against McDonald only if his escape could not be prevented by reasonable means in a less violent manner. In *The King v. Smith* (1) Perdue J.A., directed the jury as follows:

". . . The grave question here is, what is the degree of force which Smith should have used, and the first thing for you to consider is, could Smith have apprehended the man by any other means than by shooting him. If you find he could have apprehended him by any other means then Smith was not justified in shooting him. Shooting is the very last resort. Only in the last extremity should a peace officer resort to such a dangerous weapon as a revolver in order to prevent the escape of an accused person who is attempting to escape by flight.

"A man who is fleeing from lawful arrest may be tripped up, thrown down, struck with a cudgel and knocked over if it is necessary to do so to prevent his escape, and if he strikes his head on a stone and is killed the police officer is absolved because the man was fleeing to escape lawful arrest and the means taken to stop him were not dangerous and not likely in themselves to cause his death. But firing at a man with a revolver may result in the death of the man, as it did in this case, although the intention was only to wound and so prevent his escape." (His lordship then reviewed the evidence of the chase, and proceeded.) "It is the duty of every citizen to assist in the pursuit and capture of a criminal who is fleeing from arrest, when such citizen is called upon to do so by a peace officer". (His lordship described what was meant by a hue and cry, which the Crown counsel said should have been raised.)

Passing on he said: "You will have to consider whether Smith, if he had not had that revolver or had kept it in his pocket, might not have called to his assistance persons on the street, who would have joined him in the pursuit and have prevented Gans' escape. You will consider whether firing with the revolver did or did not deter them from rendering assistance. You will also have to consider whether Smith should have abandoned the pursuit of Gans at that time. He says his breath failed, his wind was gone; but should he have called upon some of the other persons who were running behind him, and have asked them to follow Gans and keep him in sight until another policeman came up? You will have to consider if the escape of Gans could have been prevented by such means".

His lordship further said they would have to consider whether the men who said they went round to Frances Street to head off the pursuit, and arrived there only to see the man lying on the ground dead, could not have overtaken him if called upon to do so. These were questions strictly for the jury. They would also bear in mind that the accused heard the clatter of a horse and buggy following him and also that there were several other persons running behind, including Wootton and the young man Ludwig.

(1) 13 C.C.C. 326.

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On the facts in evidence, I am not satisfied that the escape of McDonald could not have been prevented without firing at him or at the Chev car. Constable Keary's evidence makes it clear that he had not exhausted all other means at his command to prevent the escape. He thought he could apprehend McDonald without calling upon the R.C.M.P. for assistance, and he did not ask the third New Westminster police patrol to help him. Moreover, it is apparent that McDonald was not succeeding in eluding him. Nor am I satisfied, viewing the matter solely from the point of view of the defendant Hilker, that all other means of preventing McDonald's escape had been exhausted. He and Sandford had a police patrol car in working order, with which they could give chase. It was equipped with a radio with which they could keep in contact with Constable Keary. Hilker knew that the chase had been going on for some time and that Constable Keary had been and still was in close pursuit; he knew that Constable Keary had radio communication at hand with which he might summon further assistance; he must have known that police car 41 was equipped with a siren which could be used to warn the drivers of other vehicles and thus minimize the danger at intersections. He does not suggest in his evidence that his firing was the only means left of stopping the Chev car but says he felt the possibility of hitting a tire and thus stopping the car was very good. In my opinion, his firing was done without regard to the question whether or not there were other less violent means available for preventing McDonald's escape and when there were, in fact, other means for accomplishing that purpose in a less violent manner.

Moreover, assuming that there were no other reasonable means of preventing the escape of McDonald and that the defendant Hilker could have justified shooting and injuring or killing him in the attempt to hit one of the tires, in my view the defendant Hilker was negligent in shooting as he did without due regard for the safety of the passengers in the car.

In *Cook v. Lewis* (1), Cartwright J., in delivering the judgment of the majority of the court, said at p. 839:

> . . . While it is true that the plaintiff expressly pleaded negligence on the part of the defendants he also pleaded that he was shot by them and in

(1) [1951] S.C.R. 830.

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my opinion the action under the old form of pleading would properly have been one of trespass and not of case. In my view, the cases collected and discussed by Denman J. in *Stanley v. Powell,* [1891] 1 Q.B.D. 86, establish the rule (which is subject to an exception in the case of highway accidents with which we are not concerned in the case at bar) that where a plaintiff is injured by force applied directly to him by the defendant his case is made by proving this fact and the onus falls upon the defendant to prove "that such trespass was utterly without his fault". In my opinion *Stanley v. Powell* rightly decides that the defendant in such an action is entitled to judgment if he satisfies the onus of establishing the absence of both intention and negligence on his part.

In my opinion, the position in this case is that, it being established that Byers was shot by the defendant Hilker, the burden lay upon him to establish the absence of both intention and negligence on his part. Assuming Hilker's right to use force to stop McDonald, it was still his duty to have due regard for the safety of the passengers and other people and not to use force in such a way as to be likely to injure them.

The standard of care to be expected of persons using firearms for lawful purposes is stated as follows in *Charlesworth on Negligence,* 3rd Ed., p. 329:

> Loaded firearms must be used with the greatest caution. "The law of England, in its care for human life, requires consummate caution in the person who deals with dangerous weapons". [*Per* Erle C. J. in *Potter v. Faulkner* (1861) 1 B. & S. 800, 805.]

There is evidence suggesting that the defendant Hilker knew that there were persons in the Chev car besides the driver, but whether he knew or not the evidence does not show that he had any reason to assume that the driver was alone in the car. To fire at the Chev car involved the risk that the bullet might strike the driver or a tire and thus put the vehicle out of control when it was moving at high speed. It also involved the risk that the bullet might strike a passenger. In any of these events, injury to a passenger was a likely consequence. Yet in the brief time that elapsed from the time the Chev car veered to the north of the centre line until it passed police car 40 Hilker jumped to the north curb, stumbled, recovered, drew his gun, which was in a holster under his jacket, and fired twice in quick succession at a fast-moving target. It is, of course, easy after the event to criticize a decision made and an act done pursuant to it on the spur of the moment by an officer engaged in the discharge of his duty, but making all due allowance for the difficulties of the situation I do not think

that the course taken by Hilker was a reasonable means of stopping the car or that it offered any but a very remote chance of accomplishing his purpose. Even more remote was the chance that his purpose could be achieved without injuring passengers in the car. He had no exceptional skill at pistol-shooting, yet he attempted from his position to hit the tire of a car moving past him at a speed of fifty miles an hour or more. And he made this attempt by firing twice in quick succession when he had insufficient time or opportunity to take a proper aim.

I find that the defendant Hilker was negligent towards the passengers in firing when the conditions involved so great a risk of injury to them. I also find that he was negligent in firing when he had insufficient opportunity to take a proper aim and in so firing when there was little likelihood of bringing the car to a stop by that means, either with or without injury to the passengers. The defence of justification accordingly fails, and the defendant Hilker must be held liable for the consequences of his act.

On the evidence and admissions, the damages sustained by the Crown as a result of the shooting of Byers amounted to $1,097.12, made up of $690 for physicians' and surgeons' fees, $330 for nursing services, $17.05 for hospital expenses, and $60.07 for loss of Byers' services, calculated by reference to his pay for the period from July 27, 1954 to August 12, 1954.

The plaintiff's claim against the defendants Douglas Sandford and Edwin J. Kellock will be dismissed but, as these defendants were represented by the same counsel as the unsuccessful defendant and made common cause with the unsuccessful defendant both in defending the action and in seeking to justify the shooting by all of them, and as the unsuccessful defendant would, in the circumstances, be ordered to pay any costs the successful defendants may recover, the dismissal of the claim against them will be without costs. The plaintiff will have judgment against the defendant Roy C. Hilker for $1,097.12 damages and costs.

Judgment accordingly.

1957
Feb. 1
May 22

JOHN F. SCHWELLA .....SUPPLIANT;

AND

HER MAJESTY THE QUEEN .....RESPONDENT;

AND

THE HYDRO-ELECTRIC POWER COMMISSION OF ONTARIO, LAMBERT JOHN ROGERS AND RALPH EDWARD TORGALSON } THIRD PARTIES.

Practice—Third party notice—Exchequer Court Act, R.S.C. 1952, c. 98, s. 29(d)—Negligence Act, R.S.O. 1950, c. 252, ss. 2, 3, 4, 5 and 6—Crown Liability Act, S. of C. 1952-53, c. 30, s. 3—Right of Crown to claim contribution and indemnity from third parties pursuant to the Negligence Act—Application to strike out third party notice dismissed —"Actions and suits of a civil nature at common law or equity".

Suppliant by his Petition of Right seeks damages from respondent for personal injuries sustained by him when an aeroplane owned by the Hydro-Electric Power Commission of Ontario, in which he was a passenger, crashed, it being alleged that such crash was caused by the negligence of the Department of Transport. Respondent pleads contributory negligence on part of suppliant and invokes the provisions of the *Negligence Act*, R.S.O. 1950, c. 252. Respondent also issued, pursuant to Rule 234 of the General Rules and Orders of the Exchequer Court, a third party notice directed to the Hydro-Electric Power Commission of Ontario and to two of the persons alleged to have operated the aircraft as servants of the Hydro-Electric Power Commission of Ontario. The Crown claimed contribution and indemnity from these third parties pursuant to the *Negligence Act*. The third parties now apply to the Court to strike out the third party notice on the ground, *inter alia*, that this Court has no jurisdiction to entertain the third party proceedings.

Held: That the right of the Crown to take advantage of the provisions of the *Negligence Act* does not depend on a statute of the Parliament of Canada but on a recognized right of the Crown to take advantage of a provincial enactment and if the *Negligence Act* by its terms is applicable in a certain situation the Crown may take advantage of it to recover the contribution or indemnity which it provides.

2. That the expression "actions and suits of a civil nature at common law or equity" as contained in s. 29(*d*) of the *Exchequer Court Act*, R.S.C. 1952, c. 98 is wide enough to embrace any civil action for contribution or indemnity regardless of how such right to contribution or indemnity arose, and this Court has jurisdiction under s. 29(*d*) of the *Exchequer Court Act* to entertain and determine the claim asserted by the Crown.

3. That s. 6 of the *Negligence Act* couples with the right to indemnity or contribution under s. 2 of the Act a further right to have the other tort feasor made a party in the same action in which the first party is sued for damages and the right given by s. 6 may be pursued by the

Crown in the Exchequer Court when action is brought against the Crown and the Crown makes out an appropriate case for the application of s. 2(1) of the *Negligence Act*.

MOTION to have third party notice struck out.

The motions were argued before the Honourable Mr. Justice Thurlow at Toronto.

E. B. Jolliffe, Q.C. for suppliant.

W. B. Williston, Q.C. for respondent.

F. A. Brewin, Q.C. for third party Lambert John Rogers.

D. K. Laidlaw for third parties The Hydro-Electric Power Commission of Ontario and Ralph Edward Torgalson.

THURLOW J.:—These are applications on behalf of the third parties to strike out a third party notice by which the Crown asserts against them a claim for contribution and indemnity pursuant to the *Negligence Act,* R.S.O. 1950, c. 252. The proceedings were commenced by the suppliant by a petition of right claiming damages for personal injuries sustained by him when an aeroplane owned by The Hydro-Electric Power Commission of Ontario, in which he was a passenger, crashed near London in the Province of Ontario. In the petition it is alleged that the crash of the aircraft was caused by the negligence of the Department of Transport (Air Service Branch). By its defence the respondent denied the allegations above mentioned and pleaded contributory negligence on the part of the suppliant. In so doing, it referred to and invoked the provisions of the *Negligence Act*. At the same time, it issued pursuant to Rule 234 of the General Rules and Orders of the Exchequer Court a third party notice directed to The Hydro-Electric Power Commission of Ontario and to Lambert John Rogers and Ralph Edward Torgalson. The last two parties are alleged to have operated the aircraft as servants of The Hydro-Electric Power Commission of Ontario. By the third party notice, the Crown alleges that if the suppliant's injuries were caused by facts for which Her Majesty must respond said damages were caused or contributed to by the negligence of the third parties and, as previously mentioned, the Crown claims contribution and indemnity from them pursuant to the *Negligence Act*. The third parties entered appearances, that of Lambert John Rogers purporting to be without prejudice to his submission that this

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Court does not have jurisdiction in respect to the third party proceedings. No leave was obtained to enter a conditional appearance. The Hydro-Electric Power Commission of Ontario and Ralph Edward Torgalson now apply to strike out the third party notice as against them and by a separate motion, though on identical grounds, Lambert John Rogers also applies to have the third party notice struck out as against him. The motions were heard together. At the same time the respondent applied for an order for directions as to the trial of the third party proceedings and for an order joining The Hydro-Electric Power Commission of Ontario, Lambert John Rogers, and Ralph Edward Torgalson as third parties in case the third party notice is held to be improperly issued. It was agreed between counsel that if the applications to strike out the third party proceedings failed and an order for directions was made the particular directions could be agreed between counsel.

The applications to strike out the third party notice are made on three grounds:

(a) that this Court has no jurisdiction to entertain the third party proceedings herein,

(b) that the third party notice is not in accordance with or authorized by the *Exchequer Court Act* or the rules of the Exchequer Court passed in pursuance of the said Act,

(c) that assuming that the Exchequer Court has jurisdiction to grant the relief claimed in the third party notice as against the third parties pursuant to the *Negligence Act,* then no leave to issue the third party notice has been obtained from the Exchequer Court or from any other court if any other court has jurisdiction to grant such leave.

In support of ground (a), it is argued (1) that no right to contribution or indemnity exists between tort feasors at common law and that no such right is conferred on the Crown by the *Negligence Act* or by any other statute; (2) that as the cause of action asserted in the third party notice is a purely statutory right created by provincial law it is not within the matters over which jurisdiction is conferred on this Court, the right of the Parliament of Canada to confer

jurisdiction upon this Court being restricted by s. 101 of the *British North America Act* to the setting up of courts for the administration of "the laws of Canada"; (3) that the right of contribution and indemnity created by the *Negligence Act* is coupled with a procedure for enforcing it, that the procedure so provided is the only method for enforcing the right and that, as such procedural provisions are not applicable in or binding on this Court, this Court is without jurisdiction to entertain the claim.

The argument in support of grounds (b) and (c) is that the provisions of Rule 234 do not apply to third party proceedings to enforce the right of contribution and indemnity arising under the *Negligence Act* and that leave to join a third party is necessary under s. 6 of that Act.

The *Negligence Act* provides as follows:

2. (1) Where damages have been caused or contributed to by the fault or neglect of two or more persons, the court shall determine the degree in which each of such persons is at fault or negligent, and, except as provided by subsections 2 and 3, where two or more persons are found at fault or negligent, they shall be jointly and severally liable to the person suffering loss or damage for such fault or negligence, but as between themselves, in the absence of any contract express or implied, each shall be liable to make contribution and indemnify each other in the degree in which they are respectively found to be at fault or negligent.

[Subsections (2) and (3) are not applicable.]

3. A tort feasor may recover contribution or indemnity from any other tort feasor who is, or would if sued have been, liable in respect of the damage to any person suffering damage as a result of a tort by settling with the person suffering such damage, and thereafter commencing or continuing action against such other tort feasor, in which event the tort feasor settling the damage shall satisfy the court that the amount of the settlement was reasonable, and in the event that the court finds the amount of the settlement was excessive it may fix the amount at which the claim should have been settled.

4. In any action for damages which is founded upon the fault or negligence of the defendant if fault or negligence is found on the part of the plaintiff which contributed to the damages, the court shall apportion the damages in proportion to the degree of fault or negligence found against the parties respectively.

5. If it is not practicable to determine the respective degree of fault or negligence as between any parties to an action, such parties shall be deemed to be equally at fault or negligent.

6. Whenever it appears that any person not already a party to an action is or may be wholly or partly responsible for the damages claimed, such person may be added as a party defendant or may be made a third party to the action upon such terms as may be deemed just.

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The applicants' contention that no right to contribution or indemnity is conferred on the Crown by the *Negligence Act* is that the legislature of a province cannot confer rights or impose obligations on the Crown, that the rights and obligations created by s. 2(1) of the *Negligence Act* are reciprocal, and that, as the Crown is not bound by the obligation, it is not entitled to take the benefit of the right.

The *Crown Liability Act*, S. of C. 1952-53, c. 30, provides as follows:

> 3. (1) The Crown is liable in tort for the damages for which, if it were a private person of full age and capacity, it would be liable
>
> (*a*) in respect of a tort committed by a servant of the Crown, or
>
> (*b*) in respect of a breach of duty attaching to the ownership, occupation, possession or control of property.

Under this section, the law applicable for determining when the Crown is liable in the case of tort committed in the province of Ontario is the law of that province and includes the provisions of the *Negligence Act*, which was in force when the *Crown Liability Act* came into effect. When, pursuant to the *Crown Liability Act*, the Crown is sued in respect of a tort occurring in Ontario, it cannot set up contributory negligence of the suppliant as a complete defence as it was at common law but must raise that defence subject to the provisions of the *Negligence Act* requiring an apportionment. See *The King v. Murphy* (1), a case decided under s. 19(*c*) of the *Exchequer Court Act*. But when the Crown is affected by the provincial statute as above mentioned it is so affected by virtue of the provisions of a statute of the Parliament of Canada, rather than by virtue of the provincial enactment. On the other hand, when the Crown in exercise of the same rights possessed by any individual sues to recover damages caused by negligence, the *Negligence Act* may apply to afford to the Crown a claim where, but for the provisions of the *Negligence Act*, the Crown would have no claim at all. But in such a case the Crown can claim "only on the basis of the law applicable as between subject and subject unless something different in the general law relating to the matter is made applicable to the Crown". *Toronto Transportation Commission v. The King* (2). See the judgment of Kerwin J. as he then was, at p. 515. While it may be that no pro-

(1) [1948] S.C.R. 357. (2) [1949] S.C.R. 510.

vision has been made in the *Crown Liability Act* or any other statute for recovery by a tort feasor of contribution or indemnity from the Crown, the right of the Crown to take advantage of the provisions of the *Negligence Act* does not depend on a statute of the Parliament of Canada but on a recognized right of the Crown to take advantage of a provincial enactment, and if the situation established is one to which the *Negligence Act* by its plain terms is applicable, in my opinion the Crown can take advantage of it to recover the contribution or indemnity which it provides. The right of the Crown to take advantage of s. 4 of the same statute was upheld in *Toronto Transportation Commission v. The King* (*supra*), and it was so upheld quite independently of any provision of any federal statute rendering the same section of the *Negligence Act* applicable to bind the Crown in the opposite situation.

Moreover, while, apart from statute, the Crown is not liable at all in tort, when Parliament enacted that the Crown should be liable in tort under the law of the province the Crown, in my opinion, became entitled to exercise any right which an ordinary person so liable might exert under the general law of the province. By the terms of the *Negligence Act* a person *found* liable becomes entitled to the contribution and indemnity provided by the Act and when, pursuant to the *Crown Liability Act,* the Crown is *found* liable, I see no reason why it should not have the same right as any other person in the like situation.

The second contention involves the interpretation of s. 29(*d*) of the *Exchequer Court Act,* and one of the objections taken is similar to that taken in *Consolidated Distilleries Ltd. v. The King* (1). In that case the right sought to be enforced arose on certain bonds given to secure the payment of excise taxes, and in delivering the judgment of the Judicial Committee Lord Russell of Killowen said at p. 520:

> The question of jurisdiction depends upon a consideration of the British North America Act, 1867, and the Exchequer Court Act (R.S. Can., 1927, c. 34). The matters in regard to which the Provincial legislatures have exclusive power to make laws include, under the British North America Act, s. 92, head 13—"Property and civil rights in the province"—and s. 92, head 14—"The administration of justice in the province, including the constitution, maintenance and organisation of provincial courts,

(1) [1933] A.C. 508.

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both of civil and of criminal jurisdiction, and including procedure in civil matters in those courts". Sect. 101, however, provides that: "The Parliament of Canada may, notwithstanding anything in this Act, from time to time provide for the . . . establishment of any additional courts for the better administration of the laws of Canada".

The Exchequer Court of Canada was constituted in the year 1875 in exercise of this power. It was conceded by the appellants (and rightly, as their Lordships think) in the argument before the Board, that the Parliament of Canada could, in exercising the power conferred by s. 101, properly confer upon the Exchequer Court jurisdiction to hear and determine actions to enforce the liability on bonds executed in favour of the Crown in pursuance of a revenue law enacted by the Parliament of Canada. The point as to jurisdiction accordingly resolves itself into the question whether the language of the Exchequer Court Act upon its true interpretation purports to confer the necessary jurisdiction. The relevant section is s. 30, which is in the following terms: "30. The Exchequer Court shall have and possess concurrent original jurisdiction in Canada (*a*) in all cases relating to the revenue in which it is sought to enforce any law of Canada, including actions, suits and proceedings by way of information to enforce penalties and proceedings by way of information *in rem*, and as well in *qui tam* suits for penalties or forfeiture as where the suit is on behalf of the Crown alone; (*b*) in all cases in which it is sought at the instance of the Attorney-General of Canada, to impeach or annul any patent of invention, or any patent, lease or other instrument respecting lands; (*c*) in all cases in which demand is made or relief sought against any officer of the Crown for anything done or omitted to be done in the performance of his duty as such officer; and (*d*) in all other actions and suits of a civil nature at common law or equity in which the Crown is plaintiff or petitioner. R.S., c. 140, s. 31." By virtue of s. 2(*a*) the Crown means the Crown in right or interest of the Dominion of Canada.

The learned President held that the Exchequer Court had jurisdiction, inasmuch as the bonds were required to be given by a law enacted by the Parliament of Canada in respect of a matter in which it had undoubted jurisdiction. The subject-matter of the actions directly arose from legislation of Parliament in respect of excise.

The Chief Justice thought that the cases fell clearly within s. 30(*d*), and probably also within s. 30(*a*). Duff J., while suggesting a possible doubt as to the application of sub-s. (*a*), held that the cases were plainly within sub-s. (*d*).

Their Lordships are anxious to avoid expressing any general views upon the extent of the jurisdiction conferred by s. 30, beyond what is necessary for the decision of this particular case. Each case as it arises must be determined in relation to its own facts and circumstances. In regard to the present case their Lordships appreciate that a difficulty may exist in regard to sub-s. (*a*). While these actions are no doubt "cases relating to the revenue", it might perhaps be said that no law of Canada is sought to be enforced in them. Their Lordships, however, have come to the conclusion that these actions do fall within sub-s. (*d*). It was suggested that if read literally, and without any limitation, that subsection would entitle the Crown to sue in the Exchequer Court and subject defendants to the jurisdiction of that Court, in respect of any cause of action whatever, and that such a provision would be *ultra vires* the Parliament of Canada as one not covered by the power conferred by s. 101 of the British North America Act. Their Lordships, however, do not think that sub-s. (*d*), in the context in which it is found, can properly be read as

free from all limitations. They think that in view of the provisions of the three preceding sub-sections the actions and suits in sub-s. (*d*) must be confined to actions and suits in relation to some subject-matter, legislation in regard to which is within the legislative competence of the Dominion. So read, the sub-section could not be said to be *ultra vires*, and the present actions appear to their Lordships to fall within its scope. The Exchequer Court accordingly had jurisdiction in the matter of these actions.

The present s. 29 was s. 30 when the above case arose.

The contention of the third parties is that the right asserted in the third party proceedings is a statutory one and not an action or suit either at common law or equity and further that Parliament could not confer and, therefore, has not conferred upon the Exchequer Court jurisdiction to enforce a right arising under a provincial statute.

The right asserted is, both in its nature and by the name given to it by the *Negligence Act*, a right to contribution or indemnity, and in my opinion the expression "actions and suits of a civil nature at common law or equity" is wide enough to embrace any civil action for contribution or indemnity, regardless of how such right to contribution or indemnity arose.

On the constitutional point, the test is whether or not the subject matter of the action is within the legislative competence of Parliament. The point is not free from difficulty, but I have come to the conclusion that, whether or not there is any other right or power exercisable by Parliament to legislate generally in relation to rights of the Crown arising as this one does under a provincial statute (as to which I express no opinion), it lies well within the legislative competence of Parliament in relation to aeronautics to enact laws respecting liability in tort in connection with or arising from aeronautical operations and to provide as well in such cases for both apportionment of fault and liability of one tort feasor to another. It would also be open to Parliament, if it saw fit, to change or abolish in such cases the right of contribution or indemnity between tort feasors which, but for such legislation, would attach in such situations under the general law of the province. Accordingly, I think this Court has jurisdiction under s. 29(*d*) of the *Exchequer Court Act* to entertain and determine the claim asserted by the Crown.

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Thurlow J.

The third point is that this Court does not have jurisdiction because the procedure enacted by s. 6 of the *Negligence Act* is inapplicable in this Court and such procedure is the only means of enforcing the right in cases to which s. 6 applies. I think this argument errs in treating s. 6 as legislation relating exclusively to courts and procedure in them rather than as legislation relating as well to the civil right created by s. 2(1). It may be noted that by s. 4 it is enacted that in certain circumstances "the court" shall apportion damages. In *Toronto Transportation Commission v. The King* (*supra*) this Court made such an apportionment apart from any statute of Parliament making s. 4 applicable in this Court, and the judgment on appeal was based on the apportionment so made. While s. 4 is couched in language appropriate to procedure, I do not think that the power of this Court to make an apportionment as mentioned in s. 4 is derived from s. 4. On the contrary, I think that, besides prescribing procedure, s. 4 also creates a substantive right to recover a portion of the damages, and when making such an apportionment this Court is not carrying out any function imposed on it by the provincial statute but is simply carrying out its ordinary jurisdiction to give effect to the substantive rights of the parties.

The situation is similar under s. 6. While that section may limit the mode by which, in certain circumstances, the substantive right created by s. 2(1) may be enforced, it couples with the right to indemnity or contribution under s. 2 a further right to have the other tort feasor made a party in the same action in which the first party is sued for the damages. In this view, I see no reason why the right given by s. 6 cannot be pursued by the Crown in the Exchequer Court when action is brought against the Crown and the Crown makes out an appropriate case for the application of s. 2(1).

The remaining point is that Rule 234 is inapplicable to proceedings of this kind. No doubt, rights of contribution or indemnity between tort feasors were non-existent when Rule 234 was first enacted, but that Rule by its terms provides a method for obtaining relief against a third party "where a defendant claims to be entitled to contribution or indemnity or to relief over against any person not a party to the action". As already mentioned, the right here sought

to be enforced is a right to *contribution or indemnity*. It is neither contractual nor delictual in its nature but is simply a right created by statute. It arises when two parties have been *found* at fault, a condition which can be satisfied only in a proceeding in which both are parties and are found at fault by an adjudication binding on both of them. While in this Court the third parties cannot be *found* at fault as between themselves and the suppliant, they may, as between themselves and the Crown, be found at fault for the purpose, if it becomes necessary, of determining the degrees of fault and the condition for giving the relief sought will thus be satisfied. I think that procedure by third party notice is appropriate procedure for this purpose, as well as to recover the contribution or indemnity provided by s. 2(1).

Under Rule 234 no leave is required for the issue of a third party notice. But under s. 6 of the *Negligence Act* it is provided that a person may be added as a defendant or may be made a third party "whenever it appears" that such person, not a party, is or may be wholly or partly responsible for the damages claimed. The words "whenever it appears" and "upon such terms as may be deemed just" would seem to make it necessary to apply for leave before issuing a third party notice in cases to which s. 6 applies. However, the view which I take on this point is that, if leave was necessary, the right to raise the objection was waived by The Hydro-Electric Power Commission and Ralph Edward Torgalson by entering an unconditional appearance and by Lambert John Rogers by entering an appearance reserving only the right to object to the jurisdiction of the Court in respect to the third party proceedings.

The applications to strike out the third party notice will be dismissed with costs and an order will be made for directions for the trial of the third party proceedings pursuant to the respondent's application therefor.

Judgment accordingly.

1956
Sept. 24
1957
June 3

ARTHUR COHEN ..... APPELLANT;

AND

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

Revenue—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 127(1)(e)—Income or capital—Profits realized on mortgages purchased at a discount—Appellant not engaged in an adventure or concern in the nature of trade—Capital accretions not taxable gains—Appeal allowed.

Appellant in 1948 and subsequent years purchased existing mortgages at a discount and held them to maturity. In so doing he acted on the advice of his solicitor accepting or rejecting such offers as were made to him from time to time by the solicitor. All mortgages purchased bore interest at the current and normal rate for investments of that type. In 1945 appellant in one transaction purchased at a discount a one-third interest in a block of 57 mortgages known as the Scarborough Mortgages. Appellant paid income tax on the interest received by him from these investments but did not declare as income the profit resulting from the purchase of the mortgages. He was assessed for the years 1949 to 1952 inclusive for income tax on the profit realized thereby. An appeal to the Income Tax Appeal Board was dismissed and from that decision he appealed to this Court.

Held: That the appellant was not engaged in an adventure or concern in the nature of trade and the profits realized were made on ordinary investments by an enhancement in value at maturity and are not taxable gains but capital accretions.

APPEAL from a decision of the Income Tax Appeal Board.

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

J. J. Robinette, Q.C. for appellant.

W. R. Jackett, Q.C. and *J. D. C. Boland* for respondent.

CAMERON J.:—This is an appeal from a decision of the Income Tax Appeal Board dated March 23, 1955, which dismissed the appellant's appeals from assessments made upon him for the years 1949 to 1952, both inclusive. It raises a question as to the liability of the appellant to pay income tax on the profits realized in those years on certain mortgages (including therein a small number of agreements for sale) which he had purchased at a discount. In each of the years, several of the mortgages were paid off, the appellant receiving the principal amount thereof in full. In the several years the respondent, in assessing the appellant, added to his declared income (which had included the

interest received on these and on all other mortgages owned by the appellant) amounts corresponding to the discount, namely, the difference between the amount paid for the said mortgages and the amounts received for principal upon payment of the mortgages. In the forms attached to the assessments, it was stated:

> You are deemed to be in the business of lending money and purchasing mortgages at a profit, and under section 3(*a*) and section 4 of The Income Tax Act, to be taxable on the profits therefrom.

It appears that the full amount of the tax levied by the assessments in dispute has been paid under protest.

It was agreed that the evidence adduced before the Income Tax Appeal Board should constitute the evidence in this appeal. It was further agreed that the amounts added in each year were accurate and therefore the sole question for determination is whether such amounts are taxable income of the appellant under *The Income Tax Act*.

There is no dispute as to the facts. The appellant, now about 76 years of age, resides in Toronto where for many years he had been active in the motion picture business, building and operating theatres, and as a senior executive of Famous Players Corporation and Regal Films. He had accumulated considerable wealth, a substantial portion of which up to 1947 was invested in stocks. In those investments he was advised by a well-known investment counsel. In that year, being fearful of a depression similar to that experienced in 1929, he decided to convert practically all his stocks into cash, the proceeds amounting to approximately $300,000. He had other assets of substantial value.

In the years in question he was semi-retired, his only active interests being in connection with the Casino Theatre (which he built) and with Allco Amusements Limited, which operated the Casino Theatre and in which he was the largest shareholder. He was in receipt of a salary from Allco and occupied a small office (the rent of which was paid by Casino Theatre) in which he transacted his business relating to those two companies.

In 1948 and in subsequent years, acting on the advice of his friend and solicitor, Mr. Henry Rosenberg, he purchased a number of mortgages or parts of mortgages from the mortgagees at a discount. About 16 of these mortgages were paid in full either at or before maturity during the

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Cameron J.

four years in question; there were a few others purchased during these years which were not paid off until later. There is no evidence which establishes the length of time for which the mortgages were originally drawn. None were held by the appellant for a period longer than two years and some were paid in full within a few months after he had purchased them. There was no attempt to sell any of the mortgages, all being held until they were paid. Not all of the funds realized from the sale of stocks was invested in mortgages, the appellant at all times retaining substantial amounts in bank savings accounts. The profits realized on these 16 mortgages—*i.e.*, the difference between the price paid and the amounts realized (after allowing for legal expenses)—aggregated about $46,500 for the four years in question. That amount, plus certain other profits realized in these years from a one-third interest in a block of 57 mortgages purchased at a discount in 1945 from Principal Investments (and hereinafter referred to as the Scarborough mortgages), was added to the appellant's declared income.

It is established that all mortgages purchased by the appellant bore interest at the current and normal rate for such mortgages. The interest received therefrom, as well as interest on other mortgages where no discount was involved, was duly included in the appellant's tax returns. It is also proven that there was a substantial element of risk in all the mortgages purchased at a discount and that they were of such a nature that lending corporations would not be interested in acquiring them. Some were first mortgages and others second and third. Some were on hotels and others were building loans. The amount of the discount was that usual for securities of this type.

In the transactions Mr. Cohen appears to have relied to a very great extent on the advice of his solicitor, Mr. Rosenberg. The appellant did not advertise that he had money to loan or that he was in the market to purchase mortgages. When Mr. Rosenberg knew that a mortgage was for sale, he would personally investigate the security offered and if the terms, discount and security appeared suitable, he would advise the appellant of the offer he had received. In some cases, Mr. Cohen refused to purchase; in some cases, when the amount involved was substantial and he wished

to lessen his personal risk, he would join with one or two others in making the purchase; in other cases he accepted the offer as made. He knew none of the parties to the original mortgages and, except on one or two occasions when he drove with Mr. Rosenberg to see the property, had no personal knowledge of the security. He either accepted or rejected the offer as made, not attempting to secure a discount other than the mortgagee had offered. Mr. Rosenberg handled all legal matters, collected the interest and principal and remitted the proceeds, or a proper proportion thereof, to the appellant, less his fees for services rendered.

During the four years in question, the appellant suffered no losses on any of these mortgages, all being paid in full at or before maturity. He says that he deliberately chose mortgages with early maturity—"I am an elderly man and I have been doubtful as to whether I should go into long-term securities. I want to keep myself as liquid as possible".

For the years in question, the applicable provisions of *The Income Tax Act* were as follows:

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

127.(1) In this Act,

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

The real question in this case, therefore, is whether the amounts of principal received by the appellant in these taxation years in excess of the cost to him (equivalent to the amount of the several discounts) constitute income from a business either in the natural sense of that English word or in its statutory sense as defined in section 127(1)(*e*). The main submission of Mr. Jackett, counsel for the Minister, is that they are profits from "an adventure or concern in the nature of trade"; and, alternatively, that they are profits from "property" or "from a source" (section 3). If they are of that nature, the assessments were

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properly made, there being no dispute as to the amounts involved. If on the other hand, as submitted by Mr. Robinette, counsel for the appellant, they are to be regarded as accretions of capital on ordinary investments, they would not be taxable.

The transactions in question do not suggest that the appellant was engaged in the business of money lending. What he did was to purchase existing mortgages and hold them to maturity.

Mr. Robinette submitted that as the mortgages were bought to keep and not to sell, the transactions could not be considered as trading or as an adventure in the nature of trade. A similar submission was made and rejected in the case of *Barry v. Cordy (Inspector of Taxes)* (1). As that case is of importance on another point also and is much relied on by Mr. Jackett, I shall set out the essential facts. In that case Barry, a skilled mathematician, formulated a scheme whereby out of £100,000 available for investment he could ensure about £7,000 a year to spend for the rest of his anticipated life of twenty-three years. Over a period of eighteen months he bought on the open market endowment policies taken out by other people on their lives. From his outlay of £100,000, he calculated he would receive over the twenty-three years his required figure of £161,000, his purchases thus yielding a means of livelihood of £7,000 a year. These sums contained accretions on the sum originally invested. After holding the policies for some five years, during which time some of them matured, Barry contemplated an entire change in his mode of life and disposed of the policies remaining in his possession. He was assessed to tax from the profits made while he retained possession of the policies and also on the profits made upon the disposition of the remaining policies.

It was contended on behalf of Barry that all the receipts, actual or contemplated, were capital and not income, that the whole operation was pure investment and involved no trade either in the natural sense of that word or in its statutory sense as including "trade, manufacture, adventure or concern in the nature of trade". The Commissioners of Inland Revenue held that the respondent was engaged in "a concern in the nature of trade" resulting in profits which

(1) 28 T.C. 250.

were assessable to tax. Macnaghten J., on appeal, held that it was not an operation within the meaning of "trade" because there was no "dealing" in the policies in the sense of their being bought and sold again, since they were bought to keep and not to sell. In the Court of Appeal it was held that there was abundant evidence to support the finding of the Commissioners, which therefore was final; and that, in any event, their decision, for the reasons stated, was right. It was further held that the trial Judge's interpretation was too narrow and that the taxpayer's operations came within the meaning of both "adventure" and "trade" in the definition of trade.

That case indicates that in certain circumstances there may be an adventure in the nature of trade merely by purchasing securities and retaining them to maturity. But it was emphasized there, as in many other cases, that to be "in the nature of trade", the transaction must bear the *indicia* of trade. Counsel for the Minister submits that there are to be found in the instant case much the same *indicia* of trade as in *Barry's* case. There, Scott L.J., in delivering the judgment of the Court, said in part at page 259:

> The finding of the Commissioners in the present case is that Mr. Barry was "engaged in a concern in the nature of trade, resulting in profits—the fruit of the capital laid out—which are assessable to Income Tax under Case I of Schedule D." In our view there was evidence upon which they could so find; indeed, we doubt whether any other inference of fact was open to them. Having regard to the elaborate way in which Mr. Barry calculated out the annual yield of all his purchases, and the very large number of policies bought, and the fact that these were not ordinary investments, Case I appears to us the appropriate case under which to charge him.

And at page 260 he said:

> In the present case the finding that the present Respondent was engaged in a concern in the nature of trade is final unless it be shown that there was no evidence to support it. There appears to us to be abundant evidence to support this finding. The case is conclusive that he made up his mind to utilise the commercial market in endowment life policies for the express purpose of getting a means of livelihood at the average rate of £7,000 a year over a long period of years. He showed great mathematical skill—an element in the business of an average adjuster, an underwriter, a banker or a financier. He continued to make his purchases in the commercial market over a period of eighteen months, *i.e.*, until he had planted enough trees to yield him the fruit he wanted over the series of seasons for which he was making his purchases. To use an expression of Rowlatt, J., in *Graham v. Green*, 9 T.C., at page 313: "A person . . . can organize himself to do that (namely, to buy) in a commercial and mer-

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cantile way, and the profits which emerge are taxable profits, not of the transaction, but of the trade." In our opinion what Mr. Barry was doing comes within the dictionary definition of both words "adventure" and "trade", which we have quoted.

In my opinion, that case is distinguishable on its facts. There Barry, using great mathematical skill, worked out a very involved plan to provide himself with a means of livelihood for the balance of his anticipated life; the plan involved entering into the commercial market where, at auction sales, carefully selected endowment policies of certain amounts, and maturing at certain required dates, were purchased. Then, as stated in the judgment, such endowment policies were not ordinary investments. These were the *indicia* of trade, or the manner in which Barry "organized himself in a commercial and mercantile way" which resulted in the finding that he was engaged in a concern in the nature of trade. In the present case, nothing of that sort was done by the appellant. There was no scheme to provide himself with a means of livelihood over a period of years; there was no involved scheme worked out in an elaborate way or anything that involved great mathematical skill. Each mortgage purchased was made on its own merits and not with reference to any of the others. He did not commit any definite portion of his idle capital funds to the purchase of mortgages at a discount. In fact, all that he did was to accept or reject such offers as were made to him from time to time by his solicitor.

The most important distinction, however, is that in the present case all the mortgages purchased bore interest at the current and normal rate for investments of that type. In *Barry's* case the policies purchased were not interest-bearing securities and the only possible profit from such investments was the difference between the maturity value of the policies and their cost to him. In such a case the only reasonable inference would be that in purchasing the endowment policies, the gains made at maturity represented interest and nothing else. (Reference may be made to the cases of *Lord Howard de Walden v. Beck* (1) and to *Commissioners of Inland Revenue v. Thomas Nelson and Sons, Ltd.* (2).)

(1) 23 T.C. 384.

(2) 22 T.C. 175.

The distinction between profits that are assessable to tax and those which are not is best stated in the principle laid down in the oft-cited case of *Californian Copper Syndicate v. Harris* (1), where the Lord Justice Clerk said at page 165:

> It is quite a well settled principle in dealing with questions of assessment of income tax, that, where the owner of an ordinary investment chooses to realize it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to income tax. But it is equally well established that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies, which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realization, the gain they make is liable to be assessed for income tax.
>
> What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts, the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

In this case, I am unable to find that the appellant so "organized himself" (to buy mortgages at a discount) in a commercial and mercantile way "or that the capital accretions represented gain *made in an operation of business* in carrying out a scheme for profit-making". I can find neither organization in a commercial way nor an operation of business. If either of these necessary elements were present, the capital accretions would be taxable for it is a part of such a business to take capital risks. The appellant had disposed of some of his prior investments and had kept the proceeds in bank savings accounts where they would produce a relatively low return of interest. He was looking for investments which would yield a fair return. The mortgages in question bore what he considered a fair return on his investments. There was another feature, namely, the risk involved in this particular type of investment—a risk of capital loss if some or all of the mortgages were not paid in full. There was also the possibility that if there were no loss, or but little loss, he would make a gain on some or most of the capital invested. Balancing the risk of loss against

(1) 5 T.C. 159 at 165.

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the possibility of such gain, he decided that it was worth while to risk his capital. It is submitted on behalf of the Minister that because he embarked on such a scheme, bought short-term mortgages at a discount, extended his purchases over a period of some four years and, in fact, suffered no losses, skill, care and good business judgment were brought to bear on the operations and that his primary purpose was to secure a profit on the operations equivalent to the discounts received, and not the fixed interest on the mortgages. It is clear that if he suffered no losses, his accretions to capital would substantially exceed the annual interest he might receive from the mortgages, but it does not follow that his primary purpose was to secure the discounts. It was doubtless one of his motives, but so was his desire to secure the interest. The skill and care which he exercised were precisely that of a prudent investor who desires to spread his investments among a number of carefully chosen securities. He had very substantial assets and in this case the fact that he diversified his investments is of relatively little importance. The fact that the mortgages would mature in a relatively short time may suggest that he was looking for a quick return rather than for investments; but in his case and because of his advanced age, it was reasonable and proper for him to secure investments which would mature at an early date, particularly as they are proven to have borne a substantial degree of risk.

The possibility that a profit might be made in the event that the mortgages were paid at maturity was undoubtedly one of the motives which prompted the appellant to make his purchases.

It was made clear, however, in *Jones v. Leeming* (1), that a mere profit motive is not sufficient to make the profits taxable. There, Lord Warrington stated at page 425:

> The fact that the parties intended from the first to make a profit does not in my opinion affect the question we have to determine.

In the same case, Lord Buckmaster said at page 420:

> An accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value if it does so rise, its realization does not make it income.

(1) [1930] A.C. 415.

In the case of *Minister of National Revenue v. Taylor* (1), the President of this Court said:

> The intention to sell the property at a profit is not of itself a test whether the profit is subject to tax for the intention to make a profit may be just as much the purpose of an investment transaction as of a trading one.

It seems to me that the discounts here realized are not of such a nature as to be considered as additional interest or as taxable profits, but rather as a gain made by a mere enhancement in value by realizing a security—a capital accretion. So far as I have been able to ascertain, this is the first case in which our courts have been asked to find that the profits realized as a result of purchasing securities at a discount constitute taxable profits. There is no provision in our Income Tax Act similar to that found in Case III of Schedule D of the United Kingdom Income Tax Act which brings into tax "all discounts" which are annual profits or gains. However, as pointed out in Simon's Income Tax, Volume II, at page 450, not all sums described as discounts fall within the charge under Case III; they may on analysis turn out to be capital funds. Under our Act, discounts which are realized are not taxed *per se*; but under section 6(*g*) amounts received by a taxpayer *as premium,* paid by a corporation on the redemption or acquisition of any of its shares, are to be included in completing the taxpayer's income. Further, it provides for taxing portions of those payments which may be reasonably regarded as being in part payment of interest or other payment of an income nature and in part in payment of a capital nature (section 7).

In the case of *Lomax (Inspector of Taxes) v. Peter Dixon & Son, Ltd.* (2), the Court of Appeal considered the nature of discounts and premiums received by the taxpayer from a subsidiary company which it had established in Finland. By an agreement for the funding of a debt of £319,600, the Finnish company issued to its creditor 680 notes of £500 each; this was a discount of 6 per cent. The notes were to bear interest at 1 per cent. above the lowest discount rate of the Bank of Finland, the maximum interest to be 10 per cent. One hundred notes were redeemable within a few days after the date of the agreement and 29 in each

(1) [1956] C.T.C. 189. (2) 25 T.C. 353.

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of the next 20 years. It was provided that each note redeemed was to bear a premium of 20 per cent. if, in the year preceding the redemption, the profits of the Finnish Company reached a specified level. It was held (Court of Appeal) that the discount at which the notes were issued and any premiums payable on redemption, were capital sums and that the appellants were not assessable to income tax thereon.

In delivering a judgment with which the other members of the Court concurred, Lord Greene, M.R. analysed the nature of many classes of transactions relating to payment or recompense to lenders of money. He pointed out that in some cases the question whether a receipt is to be regarded as capital or as income may sometimes be answered by the terms of the contract itself; in others it is to be arrived at by the terms of the contract as properly interpreted in the light of all admissible extrinsic evidence. After considering the case of an ordinary issue of debentures by a company with good credit rating and ample security, he said at page 364:

> Now let me take the opposite case where the credit of the company and the security which it offers are not such as to enable it to offer its debentures at par at a normal rate of interest applicable to sound securities. The object of the company is to make its issue attractive and various alternatives are open to it. It may make the issue at par but give a high rate of interest. Here the defect in the security is expressed in terms of interest. The whole of the interest is unquestionably income and is taxable as such although the high rate of interest is, in part, attributable to the capital risk. Another course which the company may take, and for commercial reasons probably will take, is to fix the rate of interest at a more normal level and make the issue at a discount; or it may make the issue at par and offer a premium on redemption; or it may combine both methods. Here the defect in the security is expressed in terms of capital. I venture to think that no business man would regard the discount or the premium as anything but capital matters. In each case the result is the same—the subscriber is paying for a more or less hazardous investment less than the figure at which it is to be redeemed, and in exchange has to be content with a lower rate of interest. Another way of making good the defect in the security would be for the company to take out a guarantee policy—a practice which was common in the days of the Law Guarantee Trust & Accident Society of unhappy memory. In such a case the issue might be at par. The subscriber would be paying more for a safer investment than he would have paid if the guarantee policy had not been taken out. No one would suggest that the premiums paid by the company were part of the subscriber's income. Yet the policy would be playing exactly the same part as would have been played by a reduction in the issue price, or the offer of a premium on redemption, or a combination of the two.

The amount by which the issue price falls short of par or the redemption price exceeds par can, of course, as has been done in the present case, be reduced to terms of income if any one chooses to make the calculation; and this is often done by a stockbroker advising a client, particularly when the redemption date is drawing near. But this does not mean that these amounts are income. If they were income and taxable as such when received on redemption, it would appear to follow that in the case of a debenture issued at a premium and redeemable at par, the amount of the premium ought to be treated as an income loss. A premium on redemption and a premium on issue are in their nature precisely the same and come into existence for the same reason, viz., the desire to express in the former case the greatness, in the latter, the smallness, of the risk in terms of capital rather than in terms of interest.

And at page 365 he said:

The Inland Revenue authorities have never sought to tax the amount by which the redemption price of debentures exceeds the issue price. We were informed by the Solicitor-General that these amounts are regarded, not as income but as capital sums which the company bears in consideration of the risk attaching to the investment which is borne by the investor. In my opinion this view is undoubtedly correct. In passing, I may point out that the reason given by the then Solicitor-General in *Wilson v. Mannooch,* 21 T.C. 178, for not claiming tax on discounts or premiums in the case of debentures, was quite different to that given by the present Solicitor-General in the present case.

I can find no ground for distinguishing the present case from that of an ordinary issue of debentures by a trading company. If at the date of the agreement the Appellants had lent to the Finnish company a sum of £319,600 to be secured by an issue of notes at 94 repayable over 20 years at 120 and bearing interest at a rate fixed by reference to bank rate in the usual way, the Revenue authorities would not have claimed tax on the discount or the premium. The element of capital risk was quite obviously a serious one, and the parties were entitled to express it in the form of capital rather than in the form of interest if they bona fide so chose. It is said, however, that there is a difference between the case of a security issued for a present loan and that of a security issued to cover an existing loan. This argument found favour with Macnaghten, J., but, with all respect to him, I cannot follow it. The parties to the transaction, faced with an existing debt which the Finnish company was obviously not in a position to repay there and then, did what in effect amounted to writing down the capital value of the debt which by the terms of the agreement was now to be repaid over a long period of years, bearing interest in the meantime at a normal commercial rate. I can see no difference between writing down the capital value of an existing debt and writing down the capital value of a new debt which is what is done where a company makes an ordinary issue of debentures at a discount or repayable at a premium. Moreover, it is quite common for a company to issue debentures as security for an existing loan. This is often done in the case of a company's bankers who call for security, and also not infrequently under schemes of arrangement when debentures are issued to existing creditors of the company. In such cases circumstances may well call for a writing down of the value of the debts.

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Then, at page 367 he summarized his conclusions as follows:

> It may be convenient to sum up my conclusions in a few propositions. (1) Where a loan is made at or above such a reasonable commercial rate of interest as is applicable to a reasonably sound security, there is no presumption that a "discount" at which the loan is made or a premium at which it is payable is in the nature of interest. (2) The true nature of the "discount" or the premium, as the case may be, is to be ascertained from all the circumstances of the case and, apart from any matter of law which may bear upon the question (such as the interpretation of the contract), will fall to be determined as a matter of fact by Commissioners. (3) In deciding the true nature of the "discount" or premium, in so far as it is not conclusively determined by the contract, the following matters together with any other relevant circumstances are important to be considered, viz., the term of the loan, the rate of interest expressly stipulated for, the nature of the capital risk, the extent to which, if at all, the parties expressly took or may reasonably be supposed to have taken the capital risk into account in fixing the terms of the contract.

On page 362, after referring to the case of *Lord Howard de Walden v. Beck* (1) (in which certain promissory notes bore no interest rate but were repayable at a premium equivalent to a reasonable commercial rate of interest) and after stating that those facts led as a matter of common sense to the inference that the 4 per cent. was interest, he stated:

> A rather different case is that of a moneylender who stipulates for payment by instalments of a sum very much larger than that which he lends. From a business point of view, the excess, one would have thought, is referable largely, if not mainly, to the capital risk. So long as the moneylender is carrying on his business this is immaterial since he will be assessed under Case 1 of Schedule D. It is part of his business to take capital risks.

That case, of course, is not precisely the same as the present one. In fact, there are many obvious differences. But it does lay down principles which are of use in determining the true nature of a discount or a premium. If a moneylender who is not carrying on a business stipulates for a larger sum than that which he advances (when the security bears a normal commercial rate of interest), the premium is referable mainly to the capital risk involved. I think the same principle must apply when, as here, Cohen did not lend money on mortgages but bought existing mortgages at a discount.

In my opinion, the principles laid down by the Master of the Rolls in summarizing his conclusions are of equal if not of greater application when considering the position of one

(1) 23 T.C. 384.

who purchased securities at a discount but did not advance funds to a borrower. Since in the instant case the mortgages all bore a reasonable commercial rate of interest, there is no presumption that the discounts received were in the nature of interest. As I have stated above, there were very special reasons in this case for preferring mortgages of early maturity, namely, the advanced age of the taxpayer and his natural desire in the circumstances to keep his affairs reasonably liquid. The main feature is that in every case the discounts represented a very real capital risk in all the mortgages. Some were on hotels where the loss of a license would seriously affect the security; others were on building loans where there was a risk of being involved in litigation with lien holders and the possibility that tenants might not be found; others were second and third mortgages, some of which were collaterally secured by chattel mortgages. The evidence that in every case there was a high degree of risk was not challenged by the respondent. I am satisfied on the evidence that the taxpayer took this capital risk into account in purchasing the mortgages at a discount.

In my opinion, the profits realized by the appellant cannot be distinguished from those made by another investor, who, instead of purchasing mortgages at a discount, purchases a number of bonds or debentures in various companies at a discount. The Act does not tax such gains where they are not realized in an operation of business. In my view, the profits here realized were made on ordinary investments by an enhancement in value at maturity and are not taxable gains, but rather capital accretions.

Having found that the appellant was not engaged in an adventure or concern in the nature of trade and that the profits made were capital accretions, it is not necessary to consider the further submissions of counsel for the Minister that they were profits from property or from a source.

I stated above that in 1945 the appellant in one transaction had purchased at a discount a one-third interest in a block of 57 mortgages known as the Scarborough Mortgages. As the evidence in regard to that purchase is of the same nature as that regarding the other mortgages, my finding in regard thereto must be the same.

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In the course of the argument it was stated that in assessing the appellant for the year in question, the assessor had included the interest on all the mortgages as earned income (presumably because in the opinion of the assessor the appellant was engaged in the business of money lending), thereby excluding them from the surtax applicable to investment income. Because of my finding, it becomes necessary to refer the assessments back to the Minister, not only for the purpose of reducing the assessments to the extent of the mortgage discounts realized in the respective years, but also for the purpose of adding to the investment income the amount of interest received in each year on the mortgages and adjusting the surtax accordingly.

For these reasons, the appeal will be allowed, the decision of the Income Tax Appeal Board will be set aside and the matter referred back to the Minister for the purpose of re-assessing the appellant in each of the years in question in accordance with my finding.

Judgment accordingly.

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Mar. 20

Apr. 15

QUEBEC ADMIRALTY DISTRICT

CLEMENT TREMBLAY .....PLAINTIFF;

AND

HENRY C. DRUCE .....DEFENDANT.

Shipping—Admiralty jurisdiction—Arbitration—Charterparty breached outside limits of registry—The Admiralty Act, 1934, S. of C. 1934, c. 31, s. 18(1).

Defendant moved for dismissal of an action to recover demurrage on the ground that the Court lacked jurisdiction because a clause in the charterparty provided that all disputes should be settled by arbitration and further, because the alleged breach took place outside the territorial limits of the registry.

Held: That the Court had jurisdiction *ratione materiae* and, since the cause of action and the defendant were personally within the limits of the registry, it also had territorial jurisdiction. *Johnson v. Taylor Bros. & Co. Ltd.* [1920] A.C. 144 at 154; *In re Smith et al.*, 1 P.D. 300 at 301. *Held,* also, that since the defendant at no time had offered or declared his readiness to submit plaintiff's claim for arbitration, he could not now be heard to do so.

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MOTION to dismiss the action for want of jurisdiction.

The motion was heard before the Honourable Mr. Justice Arthur I. Smith, District Judge in Admiralty for the Quebec Admiralty District, at Montreal.

William Tetley for the motion.

Maurice Jacques contra.

SMITH D.J.A.:—The undersigned seized of the defendant's motion for the dismissal of plaintiff's action for lack of jurisdiction, having heard the parties, examined the proceedings and documents of record and having duly deliberated:

The defendant moves for the dismissal of the plaintiff's action on the ground that this Court is without jurisdiction for two reasons:

(i) because of a clause in the charterparties which form the basis of the action by which the parties agree to submit all disputes to arbitration;

(ii) because the breach of contract which gave rise to the present action took place outside of the limits of this registry;

The undersigned is convinced that the defendant's motion is unfounded.

The arbitration clause contained in the charterparties reads as follows:

14. Any dispute that may arise under this charter shall be settled at Montreal by arbitration. In case of arbitration, one arbitrator shall be appointed by the master, owners, or agents, one arbitrator shall be appointed by the charterers, and a third arbitrator shall be appointed by the two arbitrators so chosen. The decision of a majority of the arbitrators shall be final.

There is no doubt that when such a clause clearly and expressly stipulates that there must be arbitration before any resort to recourse before the Court may be had the effect may be to postpone the right of such recourse and in certain special cases even to deprive the claimant of his right to sue. The arbitration clause however contained in the charterparties upon which the present action is based is not in such terms and merely amounts to an agreement between the parties to arbitrate disputes which may arise.

The undersigned was referred to a number of reported cases all of which however are clearly distinguishable from the present case, since they deal with arbitration clauses drawn in terms very different from those in which the clause now under consideration is expressed.

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Smith D.J.A.

The authorities appear to be clear to the effect that in order to deprive the Court of jurisdiction such a clause must express the intention to do so clearly and equivocally.

Russell on Arbitration, 14th Edit. p. 61:

> It would seem that even in a case where it is provided in the contract that no action shall be brought until an award is made or except upon the award of the arbitrator, a party still has a right to bring an action and the jurisdiction of the Court is not ousted. The Court may stay the action either under section 4 of the Arbitration Act, 1889, or on the ground that it is frivolous and vexatious. If the action proceeds, the Court may even then exercise the discretionary power given it by section 3(4) of the Arbitration Act, 1934, of ordering that the provision making the award a condition precedent cease to have effect.

Halsbury Laws of England, Vol. 8, (2d. Ed.) p. 532, para. 1177:

> An agreement purporting to oust the jurisdiction of the courts is illegal and void on grounds of public policy, but an agreement that no right of action shall arise unless and until the difference of the parties have been settled in some way, *e.g.* by arbitration, is valid and enforceable. The right of the subject to have access to the courts may be taken away or restricted by statute but the language of any such statute will be jealously watched by the courts and will not be extended beyond its least onerous meaning unless clear words are used to justify such extension.

The second ground upon which the defendant's motion is based is that the Court of this registry has no jurisdiction because the breach of contract upon which the action is based occurred beyond the territorial limits of this registry.

In the first place, it should be noted that the plaintiff's action is not based upon any alleged breach of contract. It is rather a claim for demurrage alleged to be due and owing under the said charterparties, both of which were entered into by the parties within the territorial limits of this registry where the defendant was personally served with the present action.

That the plaintiff's claim *ratione materiae* falls within the jurisdiction of the Admiralty Court is not and cannot be questioned having regard to s. 18, s-s. 3 of the *Admiralty Act.*

The question of whether or not the plaintiff's action is within the territorial jurisdiction of the court of this registry must be determined in accordance with the laws of England governing such matters. (S. 18, s-s. 1 of the Admiralty Act) and under that law it has long been recognized that personal service of the Writ of Summons is the basis for the territorial jurisdiction of the Admiralty jurisdiction of the High Court.

Halsbury Laws of England, Vol. 8, p. 536, para. 1187:

Personal actions of a transitory nature, on the other hand, whether in contract or in tort, are within the jurisdiction of the English Courts, even though the cause of action arose abroad, and even an action in respect of an assault committed by a foreigner on a foreigner abroad may be tried by the Courts of this country if process can be properly served.

Johnson v. Taylor Bros. & Co. Ltd. (1), Lord Dunedin, at p. 154:

I understand that jurisdiction according to English law is based on the act of personal service and that if this is effected the English law does not feel bound by the Roman maxim *Actor sequitur forum rei.* It is far otherwise in other systems where service is in no sense a foundation of jurisdiction . . .

In Re: Smith et al. (2), Sir Robert Phillimore:

In this case the Court would, if the *Insulana* could have been arrested within the territorial jurisdiction have had jurisdiction, so far as the res was concerned; but it would, under the old law, have possessed no jurisdiction in personam over the owners of the res unless they could have been served with a citation within the territorial jurisdiction. I do not think that the legislature, in enacting the 1st Rule of Order XI, in the 1st Schedule to the Judicature Act, 1875, contemplated any alteration of the law in cases similar to the present . . .

In the present case, the Court of this registry has jurisdiction *ratione materiae* and since the cause of action arose, and the defendant was personally served within the limits of this registry, it has also territorial jurisdiction.

The defendant's demand therefore that the plaintiff's action be dismissed for lack of jurisdiction is unfounded.

It was suggested by counsel for defendant that even if the Court should decide that the demand for the dismissal of plaintiff's action ought not to be granted, it should nevertheless order said action stayed until the dispute had been arbitrated. This is a proposition to which the undersigned is unable to accede in the circumstances of the present case. At no time, either in his present motion or otherwise, has the defendant offered, or declared his readiness, to submit the plaintiff's claim to arbitration and the only conclusion of his motion is that the action should be dismissed with costs.

The Court finds therefore that the defendant's motion is unfounded and accordingly it is dismissed with costs.

Motion dismissed with costs.

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(1) [1920] A.C. 144.

(2) (1876) 1 P.D. 300 at 301.

1957
Jan. 30 & 31
Mar. 14

QUEBEC ADMIRALTY DISTRICT

CANADA STEAMSHIP LINES LTD. .....PLAINTIFF;

AND

THE SHIP *WALDEMAR PETER* AND HER OWNERS ..... DEFENDANTS.

Shipping—Action for damages sustained by grounding of vessel caused by alleged negligent operation of defendant vessel—Both vessels to blame —Apportionment of damages—Rule 31 Great Lakes Rules—Courses to be pursued by upbound and downbound vessels in St. Clair River.

The action is brought by the plaintiff company to recover damages sustained as the result of the grounding of its vessel the *Goderich* on the United States shore of the St. Clair River allegedly caused by the negligent navigation of the defendant vessel *Waldemar Peter.*

The Court found that the grounding of the *Goderich* was brought about by the joint and concurrent fault of those in charge of both vessels but that the fault of the *Waldemar Peter* was the greater and more serious and the responsibility should be apportioned between them on the basis of seventy per cent against the defendants and thirty per cent against the plaintiff.

Held: That the *Goderich,* upbound, was at all times to her right of mid-channel and that this should have been seen and appreciated from the outset by those in charge of the downbound *Waldemar Peter* who were negligent and at fault in attempting under such conditions to proceed downstream on the port side of the channel, that fault being all the greater since the *Waldemar Peter* was without means of giving normal and adequate warning of her intentions due to the fact that her whistle and her radio telephone were not operating.

2. That the effect of the fault and negligence on the part of those on board the *Waldemar Peter* was to put the *Goderich* in a position of imminent danger from which it was not possible to extricate herself although all reasonable means were taken in an attempt to do so.

3. That having regard to the currents and the circumstances generally the speed maintained by the *Goderich* was normal and necessary for a vessel of her length in order for her to maintain proper steerageway and even if the *Goderich* committed a technical fault in maintaining her speed, this did not constitute fault or negligence which caused or contributed to the disaster.

4. That those in charge of the *Goderich* were at fault and negligent in not maintaining a proper lookout forward and in failing to comply with Rule 31 of the Great Lakes Rules which required the *Goderich* to sound a danger signal as soon as she had occasion to doubt the intentions of the *Waldemar Peter* to keep to the channel normally reserved for downbound vessels.

5. That in departing from the general rule and practice requiring downbound vessels to navigate the United States channel of the St. Clair River, a downbound vessel is obliged, as a matter of ordinary prudence, to exercise particular care not to follow such a course unless every reasonable means has been taken to ascertain that the Canadian channel is free of upbound traffic which may present danger of collision.

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CANADA S.S. LINES LTD. v. THE SHIP *Waldemar Peter* AND HER OWNERS

ACTION for damages to plaintiff's vessel.

The action was tried before the Honourable Mr. Justice Smith, District Judge in Admiralty for the Quebec Admiralty District at Montreal.

F. O. Gerity for the plaintiff.

R. C. Holden, Q.C. and *A. S. Hyndman* for the defendant.

SMITH D.J.A.:—The plaintiff, owner of the steamship *Goderich,* sues to recover damages alleged to have been sustained as the result of the grounding of the said vessel on the United States shore of the St. Clair River on the evening of November 21st, 1955, which grounding is claimed to have been a consequence of the negligent navigation of those in charge of the defendant vessel *Waldemar Peter.*

The steamship *Goderich,* whose length is 500 feet and breadth 54 feet, is a steel screw vessel propelled by one set of triple expansion engines. Her full speed is 10 knots per hour and her port of registry is Midland, Ontario.

At about 9.08 p.m. on the 21st day of November, 1955, the *Goderich* fully laden with a cargo of coal and drawing 19 feet three inches forward and 19 feet 9½ inches aft, was proceeding up the St. Clair River on a voyage from the Port of Toledo to the Port of Sault Ste. Marie. She was being navigated at her full speed at about 10 miles per hour and it is alleged that she was holding to the usual upbound course and was at a point in the river approximately off the more southerly of the two red lights lying just north of Bay Point Light on the Canadian shore. It is alleged that at that time the weather was clear, though partially cloudy and that there was little wind. The plaintiff alleges that the *Goderich* was in charge of a competent master, was fully manned and fit for the voyage being undertaken.

The case for the plaintiff is as follows:—In the circumstances abovementioned, those in charge of *Goderich* sighted the lights of a vessel—later known to be *Waldemar Peter,* downbound—that vessel being just north of the Blue Water Bridge and somewhat to the American side of the international line. A one-whistle signal was sounded and, not being replied to, was repeated. On first sighting, the navigation lights of *Waldemar Peter* were not visible owing to the brightness of working lights in and about her decks.

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Smith D.J.A.

Almost immediately upon sounding of the second whistle signal a green side light on *Waldemar Peter* was sighted—at this time the vessels were some three ship lengths apart and *Goderich* was headed over to the Canadian side of the river. Upon sighting of the green side light aforesaid, it was apparent that *Waldemar Peter* was being so headed as to cross the course of *Goderich*; on sighting of the green side light referred to in the next preceding paragraph, which side light was dim and not readily visible, it was apparent from the course of the approaching ship *Waldemar Peter* that collision between the vessels must ensue if prompt action was not taken. Being thus in a position of danger, the wheel of *Goderich* was put hard to starboard in order to avoid the oncoming vessel, which manœuvre was successful, the vessels clearing each other by some 30 feet. This manoeuvre placed *Goderich* off and a little to the north of wharf premises situated at Point Edward on the Canadian shore and in such a position of danger that she must strike the shore or take the ground unless action by helm or engines was undertaken. The vessel was put hard over to port, since action by use of engines could not avail in these circumstances; as the result of the manoeuvre recited in the next preceding paragraph, the bow of the ship *Goderich* swung out into the river and, being seized by the force of the down current, her master was unable to bring her head up. The vessel was thus set bodily toward the American shore and, being unable to extricate herself by the use of helm or engines or any seamanlike manoeuvre, took the ground on the American shore approximately opposite the premises of Peerless Cement Corporation, about 9.10 p.m. On this day and date and time aforesaid the current running down under the Blue Water Bridge was estimated at some four miles per hour. Subsequently, by the use of engines and with the assistance of a small local vessel owned by Purdy Fisheries, *Goderich* was freed from the ground and proceeded to her destination.

It is the plaintiff's contention that the grounding and resultant damages to *Goderich* were brought about by the negligent navigation and improper management of the ship *Waldemar Peter* and that those in charge of the navigation of that vessel were negligent, in that; they failed to keep a good lookout; proceeded at an excessive speed; failed to

observe the Rules of the Road for the Great Lakes and more particularly Rules 2, 24, 27, 30 and 31 thereof; failed to take any precautions as dictated by the practice of seamen navigating the Great Lakes and having regard to the circumstances; failed to make use of radio-telephone equipment to give timely warning of her intention, or alternatively, failed to keep such radio-telephone equipment in full and efficient operation as is required by the ordinary practice of seamen navigating in these waters; permitting excessively bright lights to be borne on and about their decks in such a manner as to obscure or render less visible the prescribed navigation lights; failed to answer whistle signals, or alternatively, failed to have a whistle or sound signal in efficient and proper working order; failed to sound a danger signal; so navigated their vessel as to cross upbound traffic without timely warning by whistle, radio-telephone or otherwise and without regard to existing circumstances and conditions; failed to slacken speed, reverse or take timely action to avoid placing *Goderich* in a position of difficulty or danger from which she could not extricate herself and, under reserve of the foregoing, it is alleged that those in charge of the navigation of *Goderich* were placed in a position of difficulty and danger by reason of the negligent navigation or management of *Waldemar Peter*, which made it impossible for those in charge of *Goderich* to avoid the subsequent grounding and the damage resultant therefrom which was brought about and occasioned by the negligent navigation or management of *Waldemar Peter*.

The *Waldemar Peter* is a steel screw motor-vessel of the Port of Cologne, West Germany, 77.13 metres in length and 12.82 metres in breadth, of 2,322.07 tons gross and 1,606.61 tons register, fitted with two 8 Cylinder Diesel Motors of 1,000 h.p., each working on a single shaft. At the time of the accident *Waldemar Peter* was manned by a crew of 26 all told, including a British shipmaster as super-cargo.

The case for the defendants is that: On the evening of the 21st November 1955, *Waldemar Peter*, laden with 654 tons of general cargo, was downbound from Milwaukee, Wisconsin, to Sarnia, Ontario, where she was to load additional cargo at the Government dock. She was carrying regulation navigating lights, which were burning brightly, and a good lookout was being kept on board her. The

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weather was dark and clear and there was little or no wind. After passing the Port Huron Light vessel off the entrance to the St. Clair River *Waldemar Peter* while coming down on the Point Edward Range met and passed an upbound vessel after sounding a signal of one blast on her whistle. This upbound vessel answered *Waldemar Peter's* one blast whistle signal with one flash on her foremast signal light, as is customary on many upper lake vessels, and the ships passed safely port to port in the usual manner. When *Waldemar Peter* altered to starboard on the Fort Gratiot Range to proceed down towards the Blue Water Bridge her engines were reduced to half speed, and then to slow, and subsequently as she reached the bridge were reduced to dead slow. As is customary for downbound vessels intending to berth at the Government dock at Sarnia *Waldemar Peter* when approaching and after passing through the Blue Water Bridge kept close to the Canadian shore in order to keep in the upstream eddy along that shore and to be able to proceed sufficiently slowly to turn in to her berth at the said Government dock. When in the vicinity of the Blue Water Bridge *Waldemar Peter* met and passed another upbound vessel starboard to starboard. When meeting this vessel *Waldemar Peter,* which vessel had the right of way and the right to choose on which side she intended to pass, attempted to give a signal of two blasts on her whistle to indicate that she intended to keep to port on the Canadian side of the river and to pass green to green, but it was then found that her whistle would not operate. *Waldemar Peter* therefore gave a signal of two flashes on her Morse signal lamp, which signal was answered with two blasts by the upbound vessel, and the ships passed safely green to green in the usual manner. After she arrived at Sarnia it was discovered that a rubber diaphragm or washer in *Waldemar Peter's* tyfon whistle had broken, making it impossible for the whistle to be sounded until the said diaphragm or washer had been removed. It is customary on Canadian and American upper lake vessels to have a signal light on the foremast which lights up when the whistle is sounded, and it is a recognized practice to give passing signals by means of such signal light if the ship's whistle will not function or for some reason cannot be heard. After passing the upbound vessel (hereinabove referred to) green to green,

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and while proceeding down close to the Canadian shore those on *Waldemar Peter* observed at a considerable distance ahead the green side light and range lights of another upbound vessel, which turned out to be the *Goderich*. The *Goderich* was coming up the river about in mid-channel or a little on the United States side of the International boundary, and the bearing of her green light was well on the starboard bow of *Waldemar Peter* and her range lights were well open. *Waldemar Peter* was proceeding down close to the Canadian shore and the ships were green to green, and it was clear that if both maintained their respective courses they would pass safely starboard to starboard. As her whistle was temporarily out of commission *Waldemar Peter* gave a signal to the *Goderich* of two distinct flashes on her Morse signal lamp. *Goderich* did not respond to this signal with two blasts or two flashes on her masthead signal light, or sound a danger signal, but gave a cross signal of one blast. *Waldemar Peter* thereupon gave a second signal of two distinct flashes on her Morse signal lamp, but *Goderich* was then observed to be turning to starboard and heading to cross the course of *Waldemar Peter* from starboard to port. To avoid a collision the engines of *Waldemar Peter* were at once rung up to full speed ahead and her wheel was put hard to starboard, and she gave a signal of one flash on her Morse signal lamp. The ships then passed each other safely port to port at a distance of about 100 feet. After passing *Goderich* the engines of *Waldemar Peter* were again reduced to slow, but being then out in the current it was not possible for her to turn in directly to her intended berth at the Government dock at Sarnia and after proceeding past that dock she turned about and proceeded back upstream and turned in to her intended berth. The defendants allege that if the *Goderich* grounded on the American side of the St. Clair River a substantial distance after she passed *Waldemar Peter* on the Canadian side her said grounding and any damage thereby caused were due solely to the improper and negligent manner in which *Goderich* was navigated and to the fault and negligence of those in charge of her, in that: they navigated her at an excessive and improper speed under the circumstances; negligently failed to keep a proper lookout; failed to respect *Waldemar Peter's* right of way; improperly

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turned to starboard across the course of *Waldemar Peter*; failed to sound a cross signal or cross signals of one blast; failed to sound any danger signal; failed to slow to a speed barely sufficient for steerageway; failed to slacken speed or reverse the speed of *Goderich* in due time or at all; after passing *Waldemar Peter* safely port to port on the Canadian side of the river, they negligently failed to keep *Goderich* under proper control; failed to make proper use of their helm or engines; negligently directed and continued to direct the course of *Goderich* across the river towards the United States shore until she finally ran aground; failed to exercise the precautions required by ordinary practice of seamen or by the special circumstances of the case; failed to take in due time or at all proper steps to avoid running aground on the United States shore; in contravening Rules 27, 31, 32, 35 and 36 of the Rules of the Road for the Great Lakes and not having sufficient officers or watch on duty. It is alleged that if those on the *Goderich* had navigated her in a proper seamanlike manner she would not have gone aground or sustained damage and that the proximate cause of the grounding was the negligent and improper manner in which she was navigated both before and after she passed *Waldemar Peter;* the grounding of *Goderich* was not due to any fault or negligence on the part of *Waldemar Peter* or those on board her.

The proof is that those in charge of the *Goderich* first sighted *Waldemar Peter* at about 9.08 o'clock near the Blue Water Bridge, the *Goderich* at that time being in the vicinity of Bay Point, approximately 3,000 feet down river from the said bridge and on the Canadian side of the river.

The testimony of those on board the *Goderich* is that they were not in a position to distinguish the navigation lights of the *Waldemar Peter* when she was first sighted, owing to the brightness of working lights on and about her deck, but a one blast signal was sounded by *Goderich* and when no reply was received this signal was repeated. The proof indicates that at the time the second one blast signal was sounded the vessels were about 500 feet apart and almost immediately thereafter those in charge of *Goderich* sighted a green side light on the *Waldemar Peter* and realizing that the vessels were on crossing courses and in

imminent danger of collision, the *Goderich* put her helm hard to starboard with the result that the vessels passed one another port to port at a distance which those on board the *Goderich* estimated at 35 feet while those in charge of the *Waldemar Peter* placed the distance of 100 feet.

The testimony of those on board the *Goderich* is that after clearing the *Waldemar Peter* their vessel was in great danger of collision with the wharf or bank on the Canadian side and that in order to avert this danger and combat the current which runs about 4 knots per hour at this point, the helm of the *Goderich* was first put hard to port and then, as the vessel came out into the channel, it was put hard to starboard in an effort to bring her around to head into the current. This attempt, however, was unsuccessful because of the weight of the current on the vessel's starboard bow and the ship, while proceeding towards the American shore, was also being carried downstream. When her bow reached a point 200 to 300 feet from the United States shore, the engines of the *Goderich* were put full astern and this order was almost immediately followed by the signal for double full astern and the vessel then grounded slightly below the Blue Water Bridge.

The evidence is that the river in the vicinity of and below the Blue Water Bridge presents navigational hazards due to the narrowness of the channel which at the bridge is only approximately 800 feet wide, the configuration of the river and the nature of the currents, cross-currents and eddies which are to be encountered.

The Great Lakes Pilot, Lake Ontario, Lake Erie and Lake St. Clair, 3 Edit. 1953 contains the following directions, page 186:

> Regulations. The west channel shall be known as the American Channel and the east channel as the Canadian Channel, and the following traffic rules shall govern on and after July 5, 1921:
>
> *Rule 1.* All downbound vessels shall navigate the American Channel. All upbound vessels shall navigate the Canadian Channel. Vessels under 100 gross tons and vessels making local stops along these routes are exempt from this rule.
>
> *Rule 2.* The speed of vessels navigating these channels shall not exceed 9 miles per hour.

Similar directions are to be found in the Great Lakes Pilot (1955) (United States Lakes Survey) p. 281.

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Although it was suggested that it was the common practice for vessels, particularly small ones, to proceed downstream close to the Canadian shore if it was the intention to put in at Sarnia, the weight of the evidence is that such is not the general or approved course, although it appears that it is resorted to on occasion.

While small vessels making local stops are exempted from the obligation imposed by the Rule that downbound vessels are to take the American side of the channel, the Court is satisfied that in departing from the general rule and practice a downbound vessel is obliged as a matter of ordinary prudence to exercise particular care not to follow such a course unless every reasonable means has been taken to ascertain that the Canadian channel is free of upbound traffic which may present danger of collision.

In the circumstances prevailing just prior to and at the time of the occurrences which gave rise to the present action, the burden of care imposed upon *Waldemar Peter* was particularly heavy inasmuch as: (a) it was dark; (b) those in charge of the *Waldemar Peter* stated that they became aware when their vessel was at the Blue Water Bridge and in a position to elect which channel to take that the *Goderich* was upbound; (c) the *Waldemar Peter* was aware at that time she was without the usual means of communicating her intentions to the *Goderich,* since neither her whistle nor her radio-telephone was functioning.

The Court is convinced that it was negligent and poor seamanship for the *Waldemar Peter* in such circumstances to proceed down the Canadian side of the channel. Although an attempt was made on behalf of the *Waldemar Peter* to establish that when the *Goderich* was first sighted she was well towards the United States shore, the weight of the evidence does not support such a proposition. While Captain Crisp, heard as a witness for the defendant, testified that when the *Goderich* was sighted she was about three points on the starboard bow of the *Waldemar Peter* and near the American Reporting Station on the Port Huron side (and although the testimony of Captain Messing was to similar effect) the evidence of Captain Somers, who was navigating the *Waldemar Peter,* is that when he first sighted the *Goderich* she was near the centre of the channel.

On the other hand the testimony of Captain Hall and others is that the *Goderich* passed Bay Point Light well to the Canadian side of the river and was on the course prescribed by the rules for upbound vessels. (See Great Lakes Pilot (Canadian) 1953, page 189.) It is possible that the explanation of the testimony of Captains Crisp and Messing to the effect that when first sighted the *Goderich* was seen over the *Waldemar Peter's* starboard bow and apparently near the American side of the river, is that the river takes a bend about midway between Bay Point and Blue Water Bridge, so that the starboard navigation light of the *Goderich* would, in all likelihood, at a certain time have been open to the *Waldemar Peter* and the *Goderich* would have appeared to be on the American side of the channel.

I am satisfied that the weight of the evidence establishes that when the *Goderich* was first sighted by the *Waldemar Peter* she was to her right of mid-channel and that at no time did she cross to the United States side.

The Court is convinced that when those on board the *Waldemar Peter* testified that when the vessels were 1,500 feet apart the *Goderich* swung suddenly to starboard and came across the bow of the *Waldemar Peter* they were in error, the explanation being that what appeared to these witnesses to be a change of course to starboard on the part of the *Goderich* was nothing more than the change of position of the two vessels in relation to the bend in the river and such was the opinion of the Assessors.

The Court finds therefore that the *Goderich* was at all times to her right of mid-channel and that this should have been seen and appreciated from the outset by those in charge of the *Waldemar Peter* who were negligent and at fault in attempting under such conditions to proceed downstream on the port side of the channel, and the fault of the *Waldemar Peter* was all the greater having regard to the fact that she was without means of giving normal and adequate warning of her intentions.

In my opinion the effect of this fault and negligence on the part of those on board the *Waldemar Peter* was to put the *Goderich* in a position of imminent danger from which it was not possible for her to extricate herself although all reasonable measures were taken in an attempt to do so.

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It was argued strongly that the *Goderich* was at fault particularly in that she was proceeding at full speed right up to the time of the grounding, and failed to maintain a proper lookout or sound danger warnings when she first became uncertain as the intentions of the *Waldemar Peter*.

I have sought the advice of the Assessors with regard to the matter of speed and I am advised that having regard to the currents and the circumstances generally the speed maintained by the *Goderich* was normal and necessary for a vessel of her length in order for her to maintain proper steerageway. I am advised, moreover, that even if the engines of the *Goderich* had been put at slow ahead as soon as those in charge of her became doubtful as to whether the *Waldemar Peter* intended to keep to the American side of the channel, it would have made little, if any, difference in the result, and that moreover it is problematical what effect such action would have had upon the ability of those in charge of the *Goderich* to control her. The advice of the Assessors on this aspect of the case accords completely with my own views and the conclusion I reach is that even if the *Goderich* committed a technical fault in maintaining her speed, this did not constitute fault and negligence which caused, or contributed to, the disaster.

On the other hand, I am persuaded that there was fault and negligence on the part of those in charge of the *Goderich* in that they failed to maintain the lookout forward which should have been kept, and particularly in that they failed to comply with Rule 31 of the Great Lakes Rules, which required the *Goderich* to sound a danger signal as soon as she had occasion to doubt the intentions of the *Waldemar Peter* to keep to the channel normally reserved for downbound vessels. This rule reads as follows:

> 31. If, when steam vessels are approaching each other, the pilot of either vessel fails to understand the course or intention of the other, whether from signals being given or answered erroneously, or from other causes, the pilot so in doubt shall immediately signify the same by giving the danger signal of several short and rapid blasts of the whistle, not less than five, and if both vessels shall have approached within half a mile of each other, both shall immediately be slowed to a speed barely sufficient for steerageway and, when necessary stopped and reversed, until the proper signals are given, answered and understood, or until the vessels shall have passed each other.

I have considered with the Assessors the argument advanced on behalf of the defendants to the effect that in any event the proximate cause of the grounding was, not what occurred prior to or at the time of the meeting of the vessels but was rather the faulty and unseamanlike handling of the *Goderich* after the vessels had met and cleared in safety port to port. In particular it was argued that the grounding might have been avoided if the *Goderich*, as she should have done, had gone full astern when confronted with the danger of striking the dock or bank on the Canadian side.

I am convinced however by the evidence and having regard to the advice of the Assessors that the *Goderich* was faced suddenly with an emergency resulting from the action taken by her to avoid collision with the *Waldemar Peter*, and that having regard to the circumstances Captain Hall acted without negligence and exercised reasonable competence in the manner in which he handled his ship.

The Assessors advise me that in the circumstances to have gone astern would have been merely to invite disaster, having regard to the current and nature of the channel, and this is a conclusion which appears to me to be altogether reasonable.

On the whole therefore the Court finds that the grounding of the *Goderich* was brought about by the joint and concurrent fault of those in charge of both vessels, but that since the fault of the *Waldemar Peter* was the greater and more serious responsibility should be apportioned between them on the basis of 70% against the defendants and 30% against the plaintiff.

There will be judgment accordingly; the costs to be borne by the parties in the same proportion, namely, 70% by the defendants and 30% by the plaintiff; and in the event that the parties fail to agree as to the amount of damages, there will be a reference to the Registrar for the assessment of same.

Judgment accordingly.

1956
May 23, 24, 25, 28 & 29
1957
July 19

COMPOSERS, AUTHORS AND PUBLISHERS ASSOCIATION OF CANADA, LIMITED ..... PLAINTIFF;

AND

SIEGEL DISTRIBUTING COMPANY LIMITED, VASIL C. LEKSOVSKY, PANDO C. PERELOFF AND BORIS C. LEKSOVSKY, administrators of the estate of VASIL PENCHOFF, deceased, PANDALIS CHRIS, TRAIKOS ALEXOPOLUS AND WILLIAM MICHAIL ..... DEFENDANTS.

Copyright—Infringement action—The Copyright Act R.S.C. 1952, c. 55, s. 50, s-s. 7—Copyright in musical composition—"Gramophone"—"Hideaway Phonograph"—"Owner or user" of a gramophone giving public performances.

The action is for infringement of copyright owned by the plaintiff, a Performing Rights Society, in certain musical works and which consists of the sole right to perform the same or any substantial part thereof in public throughout Canada. Permission to perform such musical works was never received from the plaintiff by any of the defendants, nor have they at any time paid or tendered any sum on account of fees for the right to perform such works in public in Canada.

S. 50, ss. 7 of the *Copyright Act* R.S.C. 1952, c. 55 states: "In respect of public performances by means of any radio receiving set or gramophone in any place other than a theatre that is ordinarily and regularly used for entertainment to which an admission charge is made, no fees, charges or royalties shall be collectable from the owner or user of the radio receiving set or gramophone . . ."

The musical works referred to were performed in public over loudspeakers at the Superior Tea Room, a restaurant in the City of Toronto, Ontario, operated by the individual defendants, such loudspeakers being installed, maintained, actuated and supplied with music by the defendant company with the authorization of the individual defendants and without the consent of the plaintiff.

Defendant company installed what is known as a Wurlitzer Hideaway phonograph in the basement of the restaurant premises. This consisted of a ventilated cabinet made by Wurlitzer of about the same dimensions as the Wurlitzer 1800 which is placed where it is on view to patrons of restaurants and other places. It contained a chassis on which were mounted operating parts of the phonograph, except the selectors and loudspeakers which were placed in the booths in the restaurant above and which were connected to the Hideaway by means of a cable and a number of wires leading therefrom. By placing a suitable coin in the coin receptacle a restaurant patron, by pressing the proper selector buttons could place a "call" for the playing of such record or records as he had chosen. Each selector is provided with a soundbox containing two loudspeakers and in the restaurant also there is a remote volume control situated behind the counter which enables any member of the staff to increase or decrease the level of the sound heard at the various soundboxes but not to cut it off completely.

Plaintiff contends that Hideaway and the totality of the equipment placed in Superior Tea Room do not constitute a gramophone but are really a loudspeaker or sound system.

Held: That the public performance of the musical works mentioned was by means of a gramophone and the defendant company is the owner of the gramophone and as such is entitled to the benefit of the exempting provision of ss. 7 of s. 50 of the *Copyright Act.*

2. That the other defendants, the partners who own the restaurant, neither gave nor authorized the public performance of the musical works mentioned and consequently have not infringed the plaintiff's rights; had they been proved to be the "users" of the gramophone they would have been entitled to the benefit of the exempting provision of ss. 7 of s. 50 of the *Copyright Act.*

ACTION by plaintiff praying for an injunction restraining defendants from infringing plaintiff's copyright in certain musical compositions.

The action was tried before the Honourable Mr. Justice Cameron at Toronto.

H. E. Manning, Q.C. for plaintiff.

Gordon W. Ford, Q.C. for defendants.

CAMERON J.:—This is an action for infringement of copyright. The plaintiff is a company incorporated under *The Companies Act* of Canada, having its head office at Toronto. It carries on in Canada the business of acquiring copyrights of musical works or of performing rights therein and deals with or in the issue or grant of licences for the performance in Canada of such works in which copyright subsists. It is therefore a Performing Rights Society and as such is subject to the provisions of sections 48 to 51 of *The Copyright Act,* R.S.C. 1952, c. 55.

The defendant, Siegel Distributing Company Limited, is an incorporated company having its head office at Toronto and will be referred to hereinafter as "the defendant company". The defendants Leksovsky and Pereloff reside in Toronto and are the administrators of the estate of Vasil Penchoff, deceased; the defendants Chris, Alexopolus and Michail also reside in Toronto. The defendants Leksovsky, Pereloff, Chris, Alexopolus and Michail carry on business as partners in the business of operating a restaurant at 253 and 255 Yonge Street, Toronto, under the name of "Superior Tea Room". The said defendants are hereinafter collectively referred to as "the Partners".

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It is established that at all material times the plaintiff was the owner of that part of the copyright in the musical works "Beer Barrel Polka", "Papa Loves Mambo", "As Time Goes By", and "Nobody's Sweetheart", which consists of the sole right to perform the same or any substantial part thereof in public throughout Canada. It is alleged that on the 12th of March, 1955, the defendants and each of them infringed the plaintiff's copyright by performing or causing or authorizing to be performed in public at the Superior Tea Room by loudspeakers installed, maintained, actuated and supplied with music by the defendant company, with the authorization of the defendant partners, each of the specified musical works or a substantial part thereof, without the consent of the plaintiff.

It is established that none of the defendants has ever received permission from the plaintiff to perform any musical works, the sole right to perform which in public in Canada is the property of the plaintiff; and that none of the defendants has at any time paid or tendered any sum on account of fees for the right to perform such works in public in Canada.

The evidence also establishes that the above-named musical works were performed over loudspeakers at the Superior Tea Room on March 12, 1955. It is not now disputed by any of the defendants that in the circumstances disclosed such a performance was a performance in public. Counsel for the defendants formally admitted at the trial that on the facts disclosed the defendant company had authorized the performances in question. The defendant partners, however, allege that they had no control over and did not perform or authorize the performance in public of any of the named works.

The main defence of all the defendants, however, is that the public performance of the musical works was by means of a gramophone and that as a result the owners or users of such gramophone are not liable, in the circumstances, to the payment of any fees, charges, or royalties in respect thereof. They rely on subsection (7) of section 50 of *The Copyright Act*, which is as follows:

(7) In respect of public performances by means of any radio receiving set or gramophone in any place other than a theatre that is ordinarily and regularly used for entertainments to which an admission charge is made, no fees, charges or royalties shall be collectable from the owner or user of

the radio receiving set or gramophone, but the Copyright Appeal Board shall, so far as possible, provide for the collection in advance from radio broadcasting stations or gramophone manufacturers, as the case may be, of fees, charges, and royalties appropriate to the new conditions produced by the provisions of this subsection and shall fix the amount of the same; in so doing the Board shall take into account all expenses of collection and other outlays, if any, saved or savable by, for or on behalf of the owner of the copyright or performing right concerned or his agents, in consequence of the provisions of this subsection.

The Superior Tea Room is a public restaurant and is a place "other than a theatre that is ordinarily and regularly used for entertainments to which an admission charge is made". It is clear, also, that the public performances in question were not performances by means of any radio receiving set. It is in evidence, also, that neither for the year in question, nor for any year since 1938, when the provisions of section 50(7) were first enacted, has the Copyright Appeal Board provided for "the collection in advance from gramophone manufacturers of fees, charges and royalties appropriate to the new conditions produced by the provisions of this subsection" or fixed the amount of the same. It may be noted, however, that in the case of *Vigneux et al. v. Canadian Performing Rights Society, Ltd.* (the predecessor of the plaintiff company) (1), the Judicial Committee of the Privy Council expressed its agreement with the view of Sir Lyman Duff, C.J.C., in the same case in the Supreme Court of Canada (2) that what he termed the statutory licence (or, in other words, the statutory right to perform) which the subsection confers, is in no way conditional on payment of the charges which the subsection enacts are to be payable by broadcasting stations or gramophone manufacturers.

The primary question for determination, therefore, is whether or not the performances in question were by means of a "gramophone". Counsel for both parties agreed that no distinction can be drawn between the words "gramophone" and "phonograph" and that they are used interchangeably, the latter word being now more commonly in use. It becomes necessary at once to consider in detail the nature of the device by means of which the performances were given and the respective roles of the defendant company and the defendant partners therein. It is to be noted particularly that in this part of my judgment, where the

(1) [1945] A.C. 108. (2) [1943] S.C.R. 348.

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words "gramophone" or "phonograph" are used, such user does not involve a conclusion on my part that the devices referred to were in fact a "gramophone" or a "phonograph"; in such user I am merely employing the language of the witnesses unless otherwise stated.

Albert Siegel, the president and chief shareholder of the defendant company, stated that his company was the distributor for the Rudolph Wurlitzer Company (an American manufacturer) of phonographs and auxiliary equipment; that as such distributors it imports and sells the Wurlitzer floor model phonograph, of which the "Wurlitzer 1800", shown on pages 1 and 3 of Exhibit 2, is an example. As will be there seen, that device is a coin-operated phonograph with the selector device attached to the face of the instrument. It is electrically operated and is entirely self-contained. The company also imports and sells the "Wurlitzer Hideaway", which is the device here in question and which will be described later in detail.

By a contract dated November 19, 1954 (Exhibit 1), and called a Lease Agreement, between Milton's Automatic Phonographs (admittedly one of the trade names under which the defendant company carried on business) as lessee and Superior Tea Rooms as lessor, it was agreed in part as follows:

> WITNESSETH that in consideration of the rents, covenants and agreements hereinafter respectively reserved and contained, the Lessor does hereby lease unto the Lessee for such a period as the Lessor, or his successor, shall be operating the hereinafter described premises, not exceeding five years from and after this date; such space or spaces (as shall be designated by the Lessee) in the main room of Lessor's Restaurant located at 253 Yonge St., sufficient for the purpose of installing, maintaining and operating Commercial Music & Equipment for hire by the public during such times as said place is open to the public at the rental payable by the lessee to the Lessor weekly of 50% per cent of all monies paid by the public for the use of said Commercial Music & Equipment.
>
> IT IS FURTHER AGREED that the Lessor will not during this lease permit any similar competing device to be installed in said premises; that the Lessee or its agents may enter said premises at any and all reasonable times to service and change said device. All expenses of installing, maintaining and operating said device, except the electricity consumed in the operation thereof shall be paid by the Lessee.

It is stipulated in writing (Exhibit 17) that that agreement, entered into by the defendant partners as owners and operators of the Superior Tea Room, was at all material times in full force and effect and binding on the defendant partners.

Pursuant to its contract, the defendant company installed "the Commercial Music and Equipment" in the premises of the Superior Tea Room. Instead of placing a Wurlitzer 1800 in the restaurant proper, it was decided to install a Wurlitzer Hideaway phonograph in the basement in order to conserve space in the restaurant; not being there exposed to the public view, it did not require the eye appeal of the Wurlitzer 1800. It consisted of a "ventilated" cabinet made by Wurlitzer, having about the same dimensions as the Wurlitzer 1800; it contained a chassis on which were mounted the operating parts of the phonograph, except the selectors and loudspeakers which were placed in the booths in the restaurant above and which were connected to the Hideaway by means of a cable and a number of wires leading therefrom. The cabinet is shown as a black rectangle on Exhibit 3—a cross-section of the basement and restaurant. In each of the 30 booths in the restaurant, there was placed a "selector" (sometimes referred to as a callbox or a wallbox) similar to that illustrated at the top of the last page of Exhibit 2, a number of such selectors being shown as black squares on Exhibit 4, a floor plan of the restaurant. As will be seen, the selector includes a number of title strips giving the names of the 104 musical works available. After placing a suitable coin in the coin receptacle a restaurant patron, by pressing the proper selector buttons, could place a "call" for the playing of such record or records as he had chosen. In each booth there is a soundbox beneath the table containing two loudspeakers—a total of 60 in all. In the restaurant also, there is a remote volume control situated behind the counter; this enables any member of the staff to increase or decrease the level of the sound heard at the various soundboxes, but not to cut it off completely.

Unfortunately, no illustration of the Hideaway phonograph was produced at the trial. In view of the uncontradicted evidence that the main operative parts of the Hideaway were similar to (and indeed interchangeable with) those of the Wurlitzer 1800 phonograph, my task in describing the Hideaway device will be simplified by describing the mechanism of the Wurlitzer 1800 and thereafter pointing out the differences stressed by counsel for the plaintiff.

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As I have said, the Wurlitzer 1800 phonograph is illustrated and to some extent described in the manufacturer's literature, Exhibit 2. It is shown on page 3 in colour and as it would appear in a restaurant. The selector panel with the title strips, selector buttons and coin receptacle, is located at the front and forms part of the phonograph itself; it is connected by electric wires to the record changer.

Inside the cabinet, mounted on a chassis, are the following:

(a) A Carousel record changer (shown on page 6) operated by an electric motor. It contains a record carrier capable of holding 52 double-sided gramophone records, each with a playmeter which indicates how frequently the record has been played. The changer is so equipped as to store "calls" from the selectors and thereafter to place the record so chosen on the turntable in the numerical order in which the records are held in the record carrier.

(b) An electrically operated turntable on which the gramophone record is placed for playing.

(c) A stylus or needle which when placed in position follows the groove in the record and is held by

(d) A playing head which has a magnetic pickup, i.e. a coil within a magnetic field;

(e) Electrical connecting wires from the coil in the playing head to

(f) A number of audio-amplifiers, with electric wires leading to

(g) A number of loudspeakers.

As described in Exhibit 2, the Wurlitzer 1800 is a coin-operated automatic phonograph, the power being supplied by electricity. In the form shown on page 3, it is entirely self-contained. It may, however, be operated with remote control equipment as shown on page 8. In such a case the selector and the loudspeakers (placed either in the corners or on the wall) are external to the cabinet and connected by electric wiring to the operating parts.

The Wurlitzer 1800 so shown and which is self-contained in one unit, operates as follows: The patron deposits a coin; then, after making his selection of the musical work which he wishes to hear, he presses the appropriate selector button. That call activates the record changer and, if no other

record is being played, his chosen record is carried to the turntable. The stylus or needle then engages the grooves of the record and the pickup converts the resulting vibrations into electrical impulses which by wires are carried to the audio amplifiers and thence to the loudspeakers where they are converted into sound.

In the Shorter Oxford English Dictionary, 2nd Edition 1936, the word "gramophone" is defined as "An instrument for recording and reproducing vocal, instrumental and other sounds; esp. a reproducing instrument consisting essentially of a revolving turn-table capable of carrying disks on which are impressed, in a spiral track, wave-forms corresp. to sound vibrations, to reproduce which a stylus, attached to an acoustic device or electric system, travels along the track".

The Encyclopaedia Britannica, 14th Ed., vol. 10, at p. 616, contains the following definition of "gramophone": "An instrument for reproducing sound . . . by transmitting to the air the mechanical vibrations of a stylus in contact with a sinuous groove in a moving record. In a wider sense the term might be applied to any instrument for the recording or subsequent reproduction of sound."

Now I have no hesitation whatever in reaching the conclusion that the self-contained Wurlitzer 1800, as shown on page 3 of Exhibit 2, is a "gramophone" within the meaning of that word as found in subsection (7) of section 50 of *The Copyright Act* (*supra*). It clearly falls within the definitions just referred to. Counsel for the plaintiff was somewhat unwilling to concede the point but made no submission that it was not. I accept the evidence of Mr. Siegel, president of the defendant company, that since 1934 coin-operated automatic phonographs similar to, if not identical with the Wurlitzer 1800, have been on the market and in general use in Canada and that they were referred to in the trade as "phonographs" although youngsters referred to them as "juke boxes". The Wurlitzer 1800 no doubt contains modifications of and improvements on the original models but the operations are essentially the same. Boyd, a witness for the plaintiff, admitted that he had seen "the electrically coin-operated phonograph or gramophone in restaurants" for seven or eight years. Mr. Kerridge, a witness for the plaintiff and a teacher in the Electronics

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Department of Ryerson Institute of Technology, agreed that the Wurlitzer 1800 came within his definition of a "phonograph".

Moreover, it is clear that in the *Vigneux* case, to which I have referred above, the device in question was an electrically operated gramophone operated by the insertion of a coin and that the same type of device as in that case continued to be available with its modifications in design and a larger number of selections. Mr. Matheson, an officer of the plaintiff company, agreed that such was the case (p. 40 ff.).

Mr. Ford, counsel for the defendants, submits that it was decided in the *Vigneux* case that a coin-operated automatic phonograph is a "gramophone" within the meaning of that word in subsection (7) of section 50. It becomes necessary, therefore, to refer briefly to that case. The plaintiff, Canadian Performing Rights Society (the predecessor of the plaintiff in the instant case) sought an injunction to restrain the defendants, Vigneux Brothers and Rae Restaurants, Ltd., from performing the musical work "Stardust" in which it had the sole performing rights in Canada. The case was heard by Maclean J., the late president of this Court. In his judgment (1), he stated that the business of Vigneux Brothers consisted in the installation and servicing of electrically operated devices, adapted, upon the insertion of a coin therein, to make audible a series of sounds corresponding to markings on one or other of a number of discs or records with which the device was equipped. Such a device was installed by them in the restaurant of the defendant, Rae Brothers, pursuant to an agreement by which the latter paid Vigneux Brothers a fixed weekly payment of $10.00, retaining for their own use the balance of receipts from the use of the device by the restaurant patrons. Maclean J. held that the defendants did not fall within the class of persons protected by subsection 6(*a*) of section 10B of *The Copyright Act* as enacted by 2 George VI, c. 27, s. 4, which is identical with subsection (7) of section 50 of *The Copyright Act,* R.S.C. 1952, c. 55. He held that the defendants were not the "owners or users" of a gramophone giving public performances in the sense contemplated by the Act, and excluded them from the pro-

(1) [1942] Ex. C.R. 129.

tected class of "owner or user" of a gramophone on the ground that they were virtually "partners in a venture of publicly performing musical works primarily for profit". He also stated that "Section 10B does not purport to take from the owner of a musical work the right to restrain infringement of his copyright when no license has been granted or when no definite provision has been made for compensation to the owner for the right to perform his musical work". That statement seems to refer to the fact that the Copyright Appeal Board had made no provision for the collection of fees from gramophone manufacturers.

In numerous places throughout his judgment, Maclean J. referred to the device there in question as a gramophone. I have read that judgment in full as well as those of the Supreme Court of Canada (1) and of the Judicial Committee of the Privy Council (2), and it seems to have been conceded throughout that the device used was in fact a gramophone. The sole question was whether or not the defendants, as "owners or users" of the gramophone, were in the circumstances entitled to the benefit of the exempting subsection.

Mr. C. R. Matheson, an official of and a witness for the plaintiff in the instant case and who was also a witness for the plaintiff in the *Vigneux* case, was asked by Mr. Ford, counsel for the defendants, if he had not stated in the *Vigneux* case that the device there was "a gramophone which operated by inserting a coin in a slot; an automatic gramophone". In reply he said that he could not remember. I have read the Case on Appeal in the Supreme Court of Canada, handed to me by counsel for the plaintiff, and it shows on page 14 thereof that he had so stated. In any event, he admits that in Exhibit 7—a letter written by him to the defendant company on March 14, 1955—his reference to a "gramophone" in the *Vigneux* case was to an electrically operated gramophone operated by the insertion of a coin and manufactured by Wurlitzer. Further, he admitted in cross-examination that the same type of machine as in the *Vigneux* case continued to be and is still available, subject to modifications as to design and having a larger number of selections.

(1) [1943] S.C.R. 348. (2) [1945] A.C. 108.

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It is significant, I think, that none of the plaintiff's witnesses attempted to draw any distinction between the essential parts of the gramophone referred to in the *Vigneux* case and the Wurlitzer 1800.

For these reasons, I am of the opinion that the self-contained Wurlitzer 1800 was a gramophone within the meaning of that word in subsection (7) of section 50.

It remains to be stated that an appeal in *Vigneux's* case to the Supreme Court of Canada was dismissed (1). The defendant's appeal to the Judicial Committee of the Privy council was allowed (2) and it was

Held, that the effect of sub-s. 6(*a*) of s. 10B is to enact that a person who gives a public performance by means of any radio receiving set or gramophone in any place (other than a theatre as defined) need not pay anything for the right to do so. The exoneration of such owners or users in the specified circumstances is absolute, unqualified and unconditional, and such a public performance is a lawful act and no infringement of copyright. Further, the statutory right to perform conferred by the subsection is in no way conditional on payment of the charges which the sub-section enacts are to be payable by broadcasting stations or gramophone manufacturers.

Accordingly, where an electrically operated gramophone, owned by the first appellants and rented to the second appellants, in whose restaurant it was placed, performed, on the insertion of a coin by a customer, a musical selection the copyright in which was owned by the respondent performing right society, the second appellants, as users of the gramophone, came within the provisions of the sub-section, while the first appellants had no need to claim to be protected by it, since they neither gave nor authorized the public performance of the record, having no control over the use of the machine in the restaurant.

Mr. Manning, counsel for the plaintiff, submits that even if the Wurlitzer 1800 is found to be a gramophone, the Hideaway and the totality of the equipment placed in Superior Tea Rooms are so different that they do not constitute a gramophone. He refers to it as a loudspeaker or sound system. There are five things which he submits distinguish the instrumentalities here from an ordinary gramophone.

(1) His first point is the appearance of the Hideaway cabinet and its location in the basement. He says that the "housing" or cabinet of the Hideaway differs in appearance from that of an ordinary gramophone in that it is "ventilated" so that the working parts are more open to inspection. The evidence is that it was a standard Hide-

(1) [1943] S.C.R. 348. (2) [1945] A.C. 108.

away manufactured by Wurlitzer and installed in the same form as it was received. In my opinion, these distinctions are of no importance in deciding the question. A gramophone does not cease to be a gramophone merely because of the appearance of the cabinet, which is a non-essential part; it is intended only for the purpose of housing the operating mechanism in a more or less attractive manner. Similarly, its location in the basement where it would not be seen by the public does not change its nature. An old gramophone placed out of sight in an attic or in a cupboard does not thereby cease to be a gramophone.

(2) The second point is that the Hideaway was equipped with a small test speaker which enabled the serviceman of the defendant corporation to test the operation of the instrument in the basement without the necessity of going to the restaurant above. It is operated by a switch and produces a low tone just sufficient for the serviceman to hear. It is placed there purely for his convenience. There is no such test speaker in the Wurlitzer 1800; it is apparent that it would not there be required as the serviceman in checking that gramophone would be able to hear the music through the ordinary loudspeakers. The evidence is that the number of loudspeakers in a gramophone varies greatly. I am quite unable to see how the addition of another loudspeaker within the cabinet, although designed for a special purpose and operated by a switch, can be said to change the nature of the device into something that is not a gramophone.

(3) The third matter referred to is the remote volume control placed behind the cashier's desk in the restaurant and by means of which an employee of the restaurant may raise or lower the tone volume. The evidence is that there was a remote volume control in the Hideaway itself when purchased, but for the sake of convenience another one, also purchased from Wurlitzer, was installed in the restaurant. I think it may be assumed that in most cases gramophones are equipped with a volume control. On page 7 of Exhibit 2 the Wurlitzer 1800 specifications include volume, dual tone and fade control. This alleged point of difference is therefore based mainly on the fact that the control is "remote"

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and not contained within the cabinet itself. This point can therefore be considered at the same time as the remaining points.

(4) and (5) Points 4 and 5, which I will consider together, are based on the submission that a gramophone is a self-contained unit with all its parts contained within one framework or cabinet. It is submitted, therefore, that the instrumentalities here used could not be considered a "gramophone" inasmuch as (a) the selector boxes and the loudspeakers, as well as the remote volume control, and (b) the electrical wiring leading from the Hideaway to the selectors and loudspeakers and from the remote volume control to the speakers, were not contained within the gramophone itself. It is on this submission that the plaintiff mainly relies.

It is submitted that the word "gramophone" when it is used by itself in subsection (7) of section 50, must be given the same meaning as when it is used in the expression "gramophone manufacturers". Counsel refers to the case of *Composers, Authors and Publishers Association of Canada, Ltd. v. Associated Broadcasting Co. Ltd., et al.* (1) where in the Court of Appeal of Ontario, Roach J.A., in delivering the judgment of the Court, said at page 343:

> It is obvious, therefore, that the word "gramophone" as it appears in s. 10B(6)(*a*) must mean the same kind of gramophone as was contemplated in the expression "gramophone manufacturer". When we speak of gramophone manufacturers, we think of persons engaged in the business of manufacturing gramophones as completed units for sale to the public. No manufacturer ever manufactured the totality of devices that are here in question. As counsel for the appellant said, no factory in the world could hold the totality of those instrumentalities in their completed form. No manufacturer of gramophones ever manufactured, as a completed unit, a gramophone that had 600 to 700 loud-speakers, more than 190 amplifiers and switches that would enable 190 different persons to shut off the sound as each of them might choose without interfering with the user thereof by the others.

Now I am unable to find in that judgment any statement which suggests that in order to be a gramophone the instrumentalities must be self-contained; the judgment speaks of "completed units". The evidence is that the Wurlitzer Company does manufacture and sell the entirety of the devices here used. The Siegel Company purchased the Hideaway, the selector boxes and the remote volume control

(1) [1952] O.R. 322.

from that company and could have purchased from it the loudspeakers and electrical wiring but, for reasons of its own, bought them in Canada.

Several definitions of gramophone have been cited above and I can find nothing therein to suggest that a gramophone must be entirely self-contained. Moreover, there is a substantial body of evidence that record playing devices operated by remote control have been known for many years as phonographs. Mr. Kerridge, whom I have mentioned above, stated that he had been aware for some years that the Wurlitzer Company manufactured the Wurlitzer 1800 but that it and other companies also "manufactured and sold a phonograph mechanism for operation by remote control such as the unit with which we are dealing in this action"; by that he meant that such manufacturers were also advertising and selling "phonographs operated by coin selectors" in which parts such as selectors and speakers were separate from the machine itself. Further he agreed that this device is popularly known and sold as a "phonograph". While endeavouring throughout to adhere to his original opinion that a phonograph must be self-contained, he admitted that the purpose, operation and end result of the remote control devices, namely, the loudspeakers and the selector boxes, were the same as in the Wurlitzer 1800. He agreed, also, that while the length of electrical wire used was greater by reason of the remote control devices being at some distance from the Hideaway, it was a matter of degree only as there were similar but shorter electrical wires in the Wurlitzer 1800. Finally, he agreed that the unit as so installed could popularly be called a phonograph and that "the public interpretation of the apparatus, or whatever you call it, could be considered a phonograph".

The evidence of the witnesses Lowe and Evans was of little assistance to the plaintiff. Mr. Lowe since 1947 has been the general manager of the plaintiff company and prior to that date was engaged in business in various parts of Canada in selling at retail sheet music, records and "small goods" such as mouth organs, violins, record playing devices and radios. While he was aware that prior to 1938 coin-operated phonographs somewhat similar to the Wurlitzer 1800 (or an earlier model thereof) were in the market and in public use, his business did not include the selling of such

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articles. He stated, however, that his own experience indicated that they were not sold as gramophones but as juke boxes. However, as he had not seen any literature relating to them and had not dealt with them in his business, he finally admitted that he could not say how they were sold and that he "could not help from the trade standpoint". He did add, however, that he had known of "juke boxes" in which the loudspeakers were separate from the cabinet and attached to the wall or ceiling, as early as 1940 or 1941.

Mr. G. L. Evans had been in the radio department of Robert Simpson and Company from 1922 to 1940 and since that time had had experience in buying and selling radios and phonographs, but none in buying or selling coin-operated gramophones. He said that when a gramophone was sold it was sold as a complete unit and packaged in one parcel. If a customer required a separate loudspeaker for remote control, it was purchased separately and shipped in a separate parcel, together with the necessary electric wiring. He agreed that from some time prior to 1938 there had been "juke boxes" similar in style and appearance to that of the Wurlitzer 1800 shown on page 3 of Exhibit 2, in popular use. I think that as he had no experience in buying and selling coin-operated devices, his opinion as to the name given to them in the trade is of no assistance.

Mr. Siegel, the president and principal shareholder of the defendant company, stated that since 1944 his company has been distributor for the Wurlitzer Company of phonographs and auxiliary equipment. It sells the floor model phonographs and sells Hideaway phonographs as well as installing them in restaurants under arrangements similar to that made with the Superior Tea Room. From about 1938 to 1944, Mr. Siegel was in the same type of business, operating on his own account. Prior to 1938 he was engaged in the business of selling sheet music. He has therefore had a lengthy and intimate experience with coin-operated phonographs. He states that such phonographs with selector devices have been on the market in Canada continually since 1934 with later models becoming more elaborate. He says that one such phonograph operated by remote control was in use as early as 1934 or 1935 and that by 1938 the use

of selector boxes, or wall boxes, was quite popular in Canada. He says they were called phonographs although children referred to them as juke boxes.

J. R. Hrdlicka, service manager of the phonograph department of the Rudolph Wurlitzer Company of North Tonawanda, New York Division, gave evidence on behalf of the defendants. He has been employed by that company for 28 years in various capacities, but mainly as service manager of radios and phonographs in various plants and stores. He says that his company first manufactured the coin-operated commercial phonograph in 1934 and that by 1936 or 1937 they manufactured them with remote selector wall boxes, although their competitors had introduced this device at an earlier date. They were made for domestic sales in the United States, as well as for export. This witness, however, had no personal knowledge as to their use in Canada; and while they were made by the phonograph department of his company and he called them "phonographs", he did not know the name used for them in Canada.

I am unable to discover any real or essential difference between the totality of the devices installed in the Superior Tea Room and those which would have been in use had the Wurlitzer 1800 been placed in the restaurant with its selector boxes and loudspeakers in the various stalls. As I have stated above, the self-contained Wurlitzer 1800 is, in my opinion, a phonograph or gramophone. In my view, it is still a gramophone when the single selector panel is replaced by a number of panels throughout the restaurant for more convenient use by the patrons or by adding further loudspeakers in the booths or on the walls so as to provide a better and more complete reception throughout the restaurant. It seems to me that if the owner of an ordinary coin-operated phonograph, situated in his living-room, desired to have recorded music in his dining-room and for that purpose placed a loudspeaker therein and connected it by means of electric wiring to the gramophone itself, the performance which he would hear in the dining-room would be a performance "by means of a gramophone". How else could it be described? The same result would follow if he proceeded still further and for his own convenience moved the selector panel into the dining-room. The witness Ker-

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ridge in cross-examination said that "In the light of my definition I would have to consider it (i.e., the installation just referred to) a 'phonograph' ". His definition of a phonograph was "a complete device for producing sounds from records or discs through amplifiers so that they can be audibly heard by whoever was there". Finally, he agreed that the installation in the Superior Tea Room could technically be called a "phonograph" within that definition.

Reference must again be made to the case of the *Composers, Authors and Publishers Association of Canada, Ltd. v. Associated Broadcasting Co. Ltd. et al. (supra)* on which counsel for the plaintiff relies. For the sake of brevity, I will hereinafter refer to it as the *A.B.C.* case. The facts are set out in the judgment of the Court of Appeal of Ontario to which I have referred above, and need not be restated in full. It is sufficient to summarize them as follows: The defendant A.B.C. supplied music to its subscribers (of whom there were about 180 in all, including the other defendants) by means of records played in a central control-room of the company, whence the impulses were transmitted by wires owned and operated by the Bell Telephone Company, to the premises of the subscribers, and reproduced there by means of amplifiers and loudspeakers, installed in the premises. The individual subscriber by the operation of a switch could shut off the sound without interfering with the use thereof by the others. By the contract between A.B.C. and the subscribers, A.B.C. agreed to supply to the subscriber "Music by Muzak Program Service" to the localities therein described, between the opening and closing of the subscribers' establishments. As part of the Muzak Service, A.B.C. agreed to install and keep in operating condition for the reception of Muzak programs in the subscriber's premises, certain equipment specified in the contract, presumably the amplifiers and loudspeakers.

At the trial, Schroeder J. (now J.A.) held that notwithstanding the separation of the instrumentalities by which the performance was effected, the performance of the music was a "performance by means of a gramophone", and the plaintiff's action was dismissed. In the Court of Appeal,

that judgment was reversed and it was held that such performance by the equipment referred to was not "a performance by means of a gramophone". Roach J.A., speaking for the Court, said (1):

I cannot conceive of any person *using* a gramophone unless he has control of not only the gramophone, the whole of it, but also the record on which it is operating. Neither A.B.C., on the one hand, nor its co-defendants, on the other, have that degree of control over the equipment that is inherent in the user of a gramophone. A.B.C. has no control over the equipment in the premises of its subscribers. A.B.C., through its servants or agents, could set in operation the equipment on its premises, but unless and until a subscriber connected up the equipment on his premises with the balance of the system there would be no reproduction of any sound, except perhaps a reproduction in the studio of A.B.C., and that would not be a public performance. The subscribers have no physical control over the records and no say in their selection.

Here we have equipment, part of which is independently controlled by one party, another part of which is independently controlled by another, and in between is still a third part, namely, the Bell Telephone wires, which is in the control of neither (although A.B.C. is entitled to the use of it), but is actually in the control of the Bell Telephone Company. To call the sum-total of that equipment a gramophone, to my mind, is to distort the meaning of the word.

To my mind it is inconceivable that Parliament, by this legislation, intended that it should apply to equipment of which one end might stand on the shore of the Atlantic and be under the control of one person, and the other stand on the Pacific coast and be under the control of a second person, and the wires by which they are connected spread across the whole width of the Dominion and be in the control of still a third person, and, in addition to that, to have it apply to that sum total of equipment plus an offshoot that might lead as far north and as far south as there are telephone wires.

It will be seen at once that the facts in the *A.B.C.* case differ greatly from those in the instant case. Here the equipment was entirely controlled by one party, namely, the corporate defendant, save for the possible user of the volume control. That defendant owned all the equipment and exercised complete control thereover. The Hideaway in the basement was kept locked at all times and only the serviceman of the defendant corporation had access thereto. The records were owned, installed and from time to time changed by the serviceman and any necessary repairs or adjustments to the equipment were made by him. The other defendants had nothing to do with any of these matters. No use was made of telephone wires; the equipment was all in one location, namely, that leased by the partners to the corporate defendant.

(1) [1952] O.R. 322 at 340.

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In view of the special facts in the *A.B.C.* case and which differ so materially from those in the instant case, I am unable to reach the conclusion that it is in any way applicable to the case at bar. It remains to be stated that an appeal in that case to the Judicial Committee of the Privy Council was dismissed (1) and it was held:

> The popular or commercial meaning of "gramophone" did not embrace a mechanism which included an undefined length of electrical wiring laid by an independent authority under powers given by Parliament; accordingly, a public performance by means of the equipment or mechanism used was not a public performance by means of a gramophone within the meaning of s. 10B(6)(*a*).

For the reasons which I have endeavoured to state, I have reached the conclusion that the performance here in question was by means of a gramophone.

It remains to consider whether the defendants, or any of them, come within the provisions of subsection (7). In regard to the defendant company, there seems no doubt in law that it is the owner of the gramophone and as such can claim to be protected by the subsection, as it has done.

What is the position of the partners? At the trial much was said on the question as to whether or not in the named circumstances they had "authorized" the performance. That question would doubtless be of greater importance had I found that the performance was not by means of a gramophone. If, in fact, the partners "authorized" the performance *by means of a gramophone,* they were doing that which they were entitled to do without in any way infringing the rights of the plaintiff and without rendering themselves liable to pay to the plaintiff any fees, charges or royalties.

In the *A.B.C.* case, Roach J.A. considered the words "owners or users" of gramophones and at page 339 he said:

> Now, it surely is perfectly plain that the Legislature had in mind, and was legislating to protect, by exonerating from the payment of fees, the persons who, without such legislation, would be liable for the payment of fees to the Performing Rights Societies.

I am in full agreement with the opinion so expressed. It is clear, I think, that if the partners performed or authorized to be performed in public the musical works in question, they would be liable to payment of fees or royalties to the plaintiff were it not for the exempting provisions of the subsection.

(1) [1954] 3 All E.R. 708.

Then he continued:

> Who were those persons? They were not those who merely owned a gramophone. Possession of a gramophone without any records would mean nothing. They were the persons who had control, either as owners or otherwise, of records, and also a gramophone over which they also had control either as owners or otherwise, and who might use the gramophone and thereby use the records ofr the public performance of musical works contained in the records. Those persons would be "the owners or users" of a gramophone.

It follows that if the partners had, as owners or otherwise, the control over records and a gramophone therein referred to, they would be the "owners or users" of a gramophone and therefore entitled to the benefit of the exempting provisions of the subsection on the facts established.

In *Vigneux's* case, the following statement appears at page 122 of the judgment of the Judicial Committee of the Privy Council:

> It remains to consider whether Raes and Vigneux, or either and which of them, come within the provisions of the sub-section. In their Lordships' opinion Raes do, as being the users of the gramophone by means of which a public performance of "Star Dust" was given in a place other than a theatre as defined. From another point of view it may be said that the customer, who is no party to these proceedings, was the user. But the point is immaterial, since their Lordships feel no doubt that Raes, who hired the instrument and had it placed in their restaurant in order to attract customers, who enjoyed a combination of food and music, used the instrument as a means whereby public performances of "Star Dust" and other musical compositions were given. In regard to Vigneux, no doubt in law they are the owners of the gramophone. As such they might if necessary, claim to be protected by the sub-section, but in their case no such claim is necessary, because, as their Lordships think, they neither gave the public performance of "Star Dust," nor did they authorize it. They had no control over the use of the machine; they had no voice as to whether at any particular time it was to be available to the restaurant customers or not. The only part which they played in the matter was, in the ordinary course of their business, to hire out to Raes one of their machines and supply it with records, at a weekly rental of ten dollars.

It will be noticed that in that case Raes had hired the instrument from Vigneux and that presumably, as Vigneux was found to have no control over the use of the machine, such control must have been in Raes. In the instant case the partners, in my opinion, are in practically the same position as was Vigneux. They had not hired the equipment but had leased a portion of their property to the defendant company, with full knowledge, of course, that the equipment in question would be placed there. They neither had nor exercised any control whatever over the

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use of the machine or the choice of records available for use. There is no evidence that any of them performed the musical works in question by placing a coin in the selector boxes. It cannot therefore be found that they either performed or authorized the performance of the musical works.

For the reasons given, my conclusion must be that the public performance of the musical works mentioned was by means of a gramophone; that the defendant company which admittedly authorized the performance, was, as "owner" of the gramophone, entitled to the benefit of the exempting provisions of subsection (7) of section 50 of the Act. I further find that the partners—the other defendants—neither gave nor authorized the public performance of the musical works and that consequently they have not infringed the plaintiff's rights. It is clear, however, that if the partners had been found to be "users" of the gramophone, they too would have been entitled to the benefit of the exempting provisions of subsection (7).

In the result, the plaintiff's action, as against all defendants, will be dismissed with costs.

Judgment accordingly.

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May 22 & 23

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Aug. 22

THE KVP COMPANY LIMITED .....APPELLANT;

AND

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

Revenue—Income—Income Tax—The Income Tax Act, S. of C. 1948, c. 52, s. 12(1)(a) and (b)—The Forest Management Act, Statutes of Ontario 1947, c. 38, ss. 2, 3, 4, 5, 6, 7—Expenses incurred in preparation of a Forest Management Plan not "an outlay or expense incurred by the taxpayer for the purpose of gaining or producing income from the property or business of the taxpayer"—Appeal dismissed.

Held: That expenses incurred by appellant company in the preparation of a Forest Management Plan in compliance with The Forest Management Act, c. 38 of the Statutes of Ontario 1947 and the licensing agreements with the Province of Ontario are, to the extent that they exceed the annual cost of cruises and surveys in the appellant's normal operations, capital expenditures and part of the capital cost of the timber limit or the right to cut timber from a limit and were not made for the purpose of gaining or producing income from the property

or business of the appellant, having been made by appellant in its capacity as owner rather than as trader or operator and not for the purpose of producing profits in the conduct of the business.

APPEAL under *The Income Tax Act*.

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

J. R. Tolmie, Q.C. for appellant.

K. E. Eaton and *T. Z. Boles* for respondent.

CAMERON J.:—This is an appeal from assessments to income tax made upon the appellant company for each of the fiscal years ending December 31, 1950, 1951 and 1952. The appeal raises the question as to the deductibility of certain expenses incurred by the appellant in carrying out a timber survey on properties over which it had cutting rights and the preparation of a Forest Management Plan. Such expenses aggregated $176,904.67 in the period 1950 to 1954, inclusive; in each of these years the appellant, in filing its corporation income tax return, claimed as a deduction the following amounts:

1950	$ 60,863.78
1951	62,478.81
1952	36,717.24
1953	16,121.62
1954	723.22
	$176,904.67

In this appeal I am concerned only with the assessment relating to the years 1950, 1951 and 1952, those relating to the years 1953 and 1954 not having been issued at the date of the trial.

In assessing the appellant for the years in question, the respondent disallowed as expenses the following portions of these costs:

1950	$ 48,363.78
1951	49,655.84
1952	20,854.34

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Paragraphs 8 and 9 of the respondent's Reply to the Notice of Appeal, as amended without objection at the trial, are as follows:

8. That of the amounts of $60,863.78, $62,478.81 and $36,717.24, claimed as deductions by the Appellant in computing its income for the taxation years 1950, 1951 and 1952, the amounts, $48,363.78, $49,655.84 and $20,854.34, respectively, were not allowable deductions because they were:

(a) outlays or expenses not made or incurred by the Appellant for the purpose of gaining or producing income from property or a business of the Appellant, within the meaning of paragraph (a) of subsection (1) of section 12 of the Income Tax Act, and

(b) outlays or payments on account of capital within the meaning of paragraph (b) of subsection (1) of section 12 of the Act.

9. That, alternatively, no part of the said amounts which were claimed as deductions by the Appellant should have been allowed as the whole of each of those amounts was an outlay, expense or payment of the kind referred to in subparagraphs (a) and (b) of paragraph 8 hereof.

It is to be noted that although the alternative claim of the respondent in paragraph 9 denies the deductibility of any portion of the amount so expended (notwithstanding the fact that part thereof had been allowed in each of the years), counsel for the Minister stated his purpose in asking for the amendment which included these paragraphs: "The purpose of this Motion is to enable us to be in a position to argue that no part of the costs should have been allowed. We are not asking for any re-assessment or anything like that. We are merely clearing the way for a legal argument."

The appellant company is a Canadian subsidiary of the Kalamazoo Vegetable Parchment Company of Kalamazoo, Michigan, and is engaged in the business of logging and producing pulp and paper in the vicinity of Espanola, Ontario. In 1943 the parent company acquired certain properties from the Abitibi Company (in receivership) and on May 26, 1944, negotiated a timber concession from the province of Ontario (Appendix 1A to the Notice of Appeal) by which the Crown granted to the parent company the right to cut certain species of timber at the rates and subject to the conditions mentioned therein. These cutting rights were assigned to the appellant by the parent company by an agreement dated March 25, 1946, with the consent of the Minister of Lands and Forests. In 1947 the appellant acquired further licences in the same drainage area from the McFadden Lumber Company. Then by an agreement dated

February 27, 1947 (Appendix 1B to the Notice of Appeal), the Crown, in the right of the province of Ontario, entered into a further agreement with the appellant company by which certain cutting rights were granted to the appellant on the terms and conditions therein set forth. The matter is not at all clear but it would appear that the cutting rights so granted covered the areas formerly under licence to the McFadden Lumber Company as well as certain additional properties in the township of Ermatinger, and possibly also the properties referred to in the original agreement of May 26, 1944.

On March 10, 1947, the Minister of Lands and Forests forwarded a letter to the appellant (Exhibit 3) in these terms:

> For your information I am enclosing a copy of the "Manual of Requirements for Working or Management Plans, Operating Plans, Annual Cutting Applications and Forest Surveys".
>
> This manual should be used by you as a guide in the preparation of reports required under the terms of your agreement with the Crown.
>
> Your working plan is due on May 26, 1949.

Subsequently, the date for filing the Working Plan was extended to March 31, 1952.

Exhibit 4 is the "Manual of Requirements" mentioned in that letter. It includes a copy of the *Forest Management Act,* 1947, and a statement of the data which should be included in (1) a Working or Management Plan; (2) an Operating Plan; (3) the annual cutting applications; and (4) a statement of the minimum requirements for summarizing information on forest surveys conducted for the Department of Lands and Forests.

The *Forest Management Act,* 1947, is chapter 38 of the Statutes of Ontario 1947. Inasmuch as the expenditures here in question were made pursuant to its provisions and the regulations established thereunder, it will be helpful to state the operative sections in full:

> 2. (1) Every person who has cutting rights in a Crown timber area shall, when required by the Minister, furnish to him—
>
> (*a*) an estimated inventory of the timber on the Crown timber area with respect to which he has cutting rights, classifying the timber as to age, species, size and type;
>
> (*b*) A proposed master plan for managing the Crown timber area and utilizing the timber thereon; and
>
> (*c*) a map, which shall form a part of the master plan, dividing the Crown timber area into proposed operational units.

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(2) The Minister may approve a master plan as submitted to him or may approve it with such alterations therein as he may deem advisable.

(3) Subject to section 3, a person who has received a request to furnish a master plan shall manage the Crown timber area covered by it and utilize the timber thereon in accordance with the provisions of the approved master plan.

(4) Where conflict exists between an approved master plan and any agreement made or license granted under The Crown Timber Act, the provisions of the master plan shall govern.

3. (1) Every person who is required to furnish a master plan shall annually during the life of such master plan, furnish to the Minister,—

(a) at least sixty days before cutting operations commence, a plan for cutting operations to be conducted during the twelve-month period commencing on the 1st day of April; and

(b) on or before the 31st day of October, a map indicating the cut-over areas together with a statement showing the amount, species and size of timber cut from each cutting area during the twelve-month period ending March 31st of that year.

(2) The Minister may direct such alteration to be made in an annual plan as he deems advisable and where such alteration involves the alteration of an approved master plan, the master plan shall be deemed to be altered accordingly.

4. The Minister may direct the cessation of cutting operations until a master plan has been approved.

5. Where any person fails to comply with an approved master plan, the Minister may suspend or cancel the agreement, or license, or both, under which he derives his cutting rights.

6. The Lieutenant-Governor in Council may make regulations,

(a) prescribing the manner of preparing and the form of inventories, maps and statements required under this Act and governing the accuracy and verification thereof; and

(b) generally for the better carrying out of the provisions of this Act.

7. This Act shall come into force on the 1st day of June, 1947.

It is common ground that Exhibit 4—the Manual of Requirements—constitutes the regulations provided for in section 6 of the Act.

Pursuant to the request of the Minister of Lands and Forests dated March 10, 1947 (Exhibit 3), and in accordance with the provisions of the Act and its regulations, the witness D. W. Gray—who was the assistant woods manager and the logging engineer of the appellant company—proceeded to secure the information necessary to prepare the Forest Management Plan. Certain data were already on hand, some of which had been taken over from the previous owners and some of which had been acquired in previous years by the cruises and surveys carried out by the appel-

lant company itself. This information, however, was insufficient to meet the requirements of the regulations; it was necessary, therefore, to secure further and up-to-date information as to the inventory of timber before the required "estimated inventory", the master plan for managing the timber area, and the map could be furnished to the Minister. There is no precise statement as to the details of this operation, but in the main they consisted of extensive aerial surveys and ground cruises, involving also to some extent the use of office personnel and the preparation of prints and maps. As I have said, the entire operation took about five years to complete, the total cost being $176,904.67; no exception is taken to that amount or as to the proportion thereof expended in each year.

Exhibit 1 is the Forest Management Plan; it is a summary of findings relative to quantity of timber, their location and condition. Exhibits 2(*a*) to 2(*g*) are the operating plans dealing with individual watersheds set up as operating areas by the company; they constitute a broad outline of operating procedure which should be followed in their development.

The evidence indicates that in the years prior to 1947 (when it was required to prepare the Forest Management Plan) the appellant, for its own purposes and in the operation of its business, had expended annually an amount of about $17,000 for surveys and timber cruises, which amounts had been allowed as operating expenses. While the preparation of the Forest Management Plan was undertaken solely for the purpose of meeting the requirements of the Minister of Lands and Forests, part of the information thereby secured was of direct assistance to the company and resulted in a lessening of the cost of the annual surveys and cruises which would normally have been undertaken. While such expense had averaged $17,000 per annum before the preparation of the Plan, it was reduced to about $4,500 per annum after the Plan was undertaken, and the latter amount of normal expenditures was apparently allowed as a proper deduction. In addition, for each of the years in question the Minister, in assessing the appellant, allowed a further sum of $12,500, being apparently of the opinion that $17,000 was a normal and proper deduction

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for such surveys and cruises. In addition, he allowed $322.97 and $3,362.90 as the cost of maps for the years 1951 and 1952 respectively. From the assessments made on this basis, the appellant now appeals to this Court.

For each of the taxation years in question, the following provisions were contained in *The Income Tax Act*:

> 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.

Briefly, the contention of the appellant is that the whole of the expenditures so incurred was made for the purpose of gaining or producing income from property or a business of the taxpayer and were consequently not barred from deduction by the provisions of s-s. (1)(*a*) of section 12. For the respondent, it is submitted that the outlays were barred from deduction by the provisions of that subsection in that they were not made for the purpose of gaining or producing income from property or a business of the taxpayer; and also that they were barred by the provisions of s-s. (1)(*b*) as being an outlay or payment on account of capital.

Before considering these subsections, it will be convenient to dispose first of one submission made by Mr. Tolmie, counsel for the appellant company. It relates to the evidence of Mr. A. McG. Kennedy, manager of the Toronto office of Ernst and Ernst, accountants and auditors of the appellant company. Mr. Kennedy stated that the outlays in question, under generally accepted accounting principles, would be treated as expenses and charged to operating expenses at the time they were incurred and that he had treated them in that manner. He considered that no portion should be capitalized as he could not find that any capital asset had been created or enhanced in value by the expenditures. In cross-examination, he stated that the absence of any capital asset (as a result of the expenditures) was the sole reason for the opinion at which he had arrived.

It is well settled, however, that an outlay or expense which might be deductible from income on generally accepted accounting principles is not deductible if it be

barred by express provisions of the Act. In the case of *Imperial Oil Ltd. v. Minister of National Revenue* (1), the learned President of this Court stated in reference to the somewhat similar provisions of section 6(*a*) of the *Income War Tax Act*:

> . . . The section directs that such disbursements or expenses are not to be deducted, even although they might be deductible according to ordinary principles of commercial trading or, as it has been suggested "well accepted principles of business and accounting practice". The range of deductibility according to such principles may be wider than that which is inferentially permitted under the section. To that extent they must give way to the express terms of the section, which must, of course, prevail. The result is that the deductibility of disbursements or expenses is to be determined according to the ordinary principles of commercial trading or well accepted principles of business and accounting practice unless their deduction is prohibited by reason of their coming within the express terms of the excluding provisions of the section.

In order to determine whether the outlay was made for the purpose of gaining or producing income from property or a business of the appellant company, it becomes necessary to examine the real nature of the expenses and why they were incurred. It is abundantly clear from the evidence that, had not the appellant been required to prepare the master plan, it would not have embarked on the very extensive woods inventory survey which it actually made; it would merely have continued to make the ordinary annual cruises and surveys necessary for its own logging operations that it had made in previous years. Mr. Gray stated that

> The purpose of this plan was to fulfil the requirements of the Department of Lands and Forests under the Forest Management Act. We already had the information which was sufficient to put our limits on a sustained yield basis . . . The purpose of this plan was to provide the Department of Lands and Forests with information which would enable them to prepare a picture of the forest . . . an inventory of the forest condition in the province as a whole.

This latter view is supported by a statement on page 10 of the Manual of Requirements that

> By following a form such as outlined herewith, basic data from all forest surveys conducted for the Department of Lands and Forests can be amalgamated to form a mosaic of forest conditions over large territories and provide uniform summaries from which to determine the present and future values of the forests of Ontario.

(1) [1947] Ex. C.R. 527 at 530.

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Later Mr. Gray reiterated the point:

> Yet again, if I may repeat, we were under an obligation, and the only reason that this work was undertaken was in order to satisfy the requirements of that manual, which has the effect of being a regulation issued under the Forest Management Act . . . I prepared them (i.e. the cruise regulations) to satisfy the conditions of that manual."

Mr. Avery, president and general manager of the appellant company, was equally emphatic on this point. He stated that the purpose of gathering the data "was to conform with the directions received and the plan was written and submitted in accordance with that." Further, he stated that the company's operations had always been based on a policy of maintaining yields in perpetuity and that the plan which was prepared was not needed to carry out that policy.

> The survey made to secure the data for the plan was merely the carrying out of a duty required under the 1947 legislation. The plan which the company had prepared and used previously, supplemented by necessary annual "current cruising" to ascertain damage by fire and insects and unauthorized cutting, was sufficient to keep the inventory up to date for its own purposes.

In his opinion, the purpose of requiring all licensees in the province to prepare Forest Management Plans was to ensure uniformity of survey throughout the province.

It was undoubtedly necessary for the appellant company to comply with the requirement of the Minister of Lands and Forests that it prepare the Forest Management Plan. If it failed to do so, the Minister under the terms of the Act was empowered to direct the suspension of all its cutting activities. Further, and notwithstanding its general licence from the province, the company was required annually (section 3) to apply for a "cutting permit" over specified areas and in specified quantities, and this cutting permit could also have been withheld had the requirements not been fulfilled. Mr. Avery stated the position of the company as follows:

> As a licensee of the Crown, in order to continue the rights under the licence, we were required to do the work and we had to do it. It would not have been done in this manner had we not been required under the statute to do it.

He admitted that, if the annual cutting permit were denied, the company would be out of business in six months, as its supply of wood would have been cut off.

In these circumstances, it seems to me that the overriding purpose of the appellant company, in incurring these expenses, was not that of gaining or producing income from

its property or business but rather for the purpose of complying with the requirement of the Minister of Lands and Forests, as authorized by the *Forest Management Act* and its regulations, in order to preserve its rights under the licensing agreements which it held. The business operations of the appellant company consisted in acquiring timber, either by cutting on its own limits or by purchase from others, and in processing it into pulp or paper for sale. To the extent that the special surveys made for the purpose of collecting data for the Forest Management Plan exceeded the ordinary annual cruises incidental to the company's normal operations, the sole purpose in undertaking them was to supply data to the provincial authorities for their own use in planning forest management control for the whole of the province and was of benefit only to those authorities. To that extent, the outlays were not made for the purpose of gaining or producing income and were made by the appellant not as trader or operator, but as owner.

While the expenses were incurred in connection with the appellant's business, that is not of itself sufficient to render them deductible. In the case of *Strong & Co. v. Woodifield* (1), Lord Davey said:

> . . . It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits.

In *Minister of National Revenue v. The Dominion Natural Gas Co. Ltd.* (2), Duff C.J.C. stated:

> First, in order to fall within the category "disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning the income", expenses must, I think, be working expenses; that is to say, expenses incurred in the process of earning "the income".

Reference may also be made to *Montreal Coke and Manufacturing Co. v. Minister of National Revenue* (3) where Lord Macmillan, in the Judicial Committee of the Privy Council, said:

> . . . Expenditure, to be deductible, must be directly related to the earning of income. The earnings of a trader are the product of the trading operations which he conducts.

(1) [1906] A.C. 448 at 453. (2) [1941] S.C.R. 19 at 22.
(3) [1944] A.C. 126 at 133.

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Again, in *Tata Hydro-Electric Agencies, Ltd., Bombay v. Commissioner of Income Tax* (1) the facts, as set out in the headnote, are as follows:

The appellants, a private limited company, who carried on the business of managing agents of A. company, receiving for their services a commission of 10 per cent. on the annual net profits of A. company, with a minimum of Rs. 50,000 whether that company should make any profits or not, had acquired that agency from B. company, their predecessors, under an assignment whereby B. company transferred to the appellants their whole rights and interest as agents of A. company, subject, however, to their (B. company's) obligations under two agreements with D. and E. respectively whereby B. company, who while the managing agents of A. company had borrowed money for that company from D. and E., had to pay to both D. and E., in addition to the interest they would receive from A. company on the loan, 12½ per cent. of the commission earned by them (B. company) under their agency agreement with A. company:—

Held, that in computing their income, profits and gains for tax purposes the appellants were not entitled to deduct the 25 per cent. of the commission earned and received from A. company which they paid over to D. and E. under the agreements. That percentage of the commission paid to D. and E. was not expenditure incurred by the appellants "solely for the purpose of earning . . . profits or gains" of their business within the meaning of s. 10, sub-s. 2 (ix.) of the Indian Income-tax Act, 1922. The obligation to make the payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that was, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business.

Lord Macmillan at page 695 said this:

Their Lordships recognize, and the decided cases show, how difficult it is to discriminate between expenditure which is, and expenditure which is not, incurred solely for the purpose of earning profits or gains. In the present case their Lordships have reached the conclusion that the payments in question were not expenditure so incurred by the appellants. They were certainly not made in the process of earning their profits; they were not payments to creditors for goods supplied or services rendered to the appellants in their business; they did not arise out of any transactions in the conduct of their business. That they had to make those payments no doubt affected the ultimate yield in money to them from their business, but that is not the statutory criterion. They must have taken this liability into account when they agreed to take over the business. In short, the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business.

And at page 696 he stated the test to be as follows:

. . . It is necessary, accordingly, to attend to the true nature of the expenditure, and to ask oneself the question, Is it a part of the Company's working expenses; is it expenditure laid out as part of the process of profit earning?

(1) [1937] A.C. 685.

Applying the principles and tests laid down in these cases, I have reached the conclusion that the expenses in question, to the extent that they exceeded the normal annual expenses for cruising and surveys, were, for the reasons stated, not made for the purpose of gaining or producing income from the property or business of the appellant. They were made by the appellant in its capacity as owner, rather than as trader or operator, and were not made for the purpose of producing profits in the conduct of the business.

While the appellant company, during the years in question, did not attempt to segregate its normal annual operating expenses for surveys and cruises from the total amount expended in preparing the data for the Forest Management Plan, the assessments made in the manner indicated above did provide for such segregation on what appears to be a fair and reasonable basis. In any event, there was no evidence led by the appellant company to indicate that the deductions so permitted were less than should have been allowed for the cost of the normal annual operating cruises and surveys.

I am of the opinion also that the expenses to the same extent as mentioned above were barred from deduction by the provisions of s-s. (1)(*b*) of section 12 of *The Income Tax Act* as being an outlay on account of capital. In the original licensing agreement, dated May 26, 1944, between the province and the parent company (page 10 of Appendix A/1 to Exhibit 1), there are the following provisions:

1. In consideration of the covenants and agreements on the part of the Company herein contained, the Crown, with the approval and consent of the Lieutenant-Governor in Council, and subject to the terms and conditions hereof, doth grant to the Company for a period of twenty-one (21) years from the First day of April, 1943 the sole right to cut and remove the timber specified in Clause 2 of this Agreement in and upon the lands described in Schedule "A" hereto and the lands selected from Schedules "B" and "C" hereto, which Schedules form part of this Agreement.

* * *

11. The Company shall operate in accordance with good forestry practice, and within five (5) years from the date hereof shall file with the Department of Lands and Forests a working plan prepared by the Company, which shall be satisfactory to the Minister, providing a general scheme for the operation and management of the area granted, and providing for the placing of its supply of pulpwood on a sustained-yield basis, to the end that the area will be kept productive and in accordance with the provisions of the Pulpwood Conservation Act.

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29. This Agreement shall be subject to all Acts of the Legislature of the Province of Ontario which are now or which may hereafter be in force and all regulations duly made under the provisions of such Acts, so far as they may be of general application to the cutting, measuring, removing and driving of timber on and from Crown lands throughout the Province, and the same shall be binding upon and ensure unto the Company and shall apply to its operations under this Agreement as fully and effectually as if they had been set forth herein.

* * *

34. The Company hereby covenants and agrees to observe, perform and keep all covenants, provisions, agreements and conditions on its part herein contained.

And in the licensing agreement of February 27, 1947 (Appendix 1B to the Notice of Appeal), after reciting that the 1944 agreement had been assigned by the parent company to the appellant company with the approval of the Minister of Lands and Forests there is the following provision:

It is further agreed by and between the parties hereto that all the terms and condiitons of the 1944 agreement shall apply to and be binding upon this Agreement as fully and effectually as if the area in Schedule "A" hereto had been included in and formed part of the 1944 agreement.

It is apparent, therefore, that the appellant company, by the terms and conditions of its licensing agreements with the province, was bound to submit and conform to all acts of the Legislature, including those that thereafter might come into force, and the regulations made under such acts, such as the *Forest Management Act,* 1947 and its regulations. It seems, therefore, that the obligation to prepare and deposit the Forest Management Plan was assumed by the appellant company in part consideration, at least, of the acquisition of the licences and the opportunity to earn profits therefrom.

In this connection, reference may be made to a portion of the judgment in the *Tata* case (*supra*), where at page 695 it is stated:

. . . They must have taken this liability into account when they agreed to take over the business. In short, the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business.

In *The Royal Insurance Co. v. Watson* (1), the headnote is as follows:

Upon the transfer of an insurance business the transferees agreed to take into their service the transferors' manager at a fixed salary, with liberty to commute the same by payment to him of a gross sum to be calculated upon life tables. The transferees retained the manager's services for a short time and then paid him a gross sum in commutation of his salary. They claimed to deduct that sum in estimating their profits for income tax:—

Held, that the agreement to pay the commutation money was in fact part of the consideration for the transfer of the business, that the payment was therefore a "sum employed as capital" and could not be deducted.

At page 8 Lord Herschell said:

. . . The payment was made in pursuance of a bargain entered into between the Royal Insurance Company and the Queen Insurance Company, which bargain contained the terms on which the Royal Insurance Company was to become possessed of the business of the Queen Insurance Company. Of course, it could not be disputed for a moment that the price paid to a company whose concern was bought by another company would not be expenditure which could be set against the gains of the year in which the payment was made. It would obviously be capital expenditure; and although in this case the payment was a payment to be made under that agreement to the former manager of the Queen Insurance Company, when the matter is looked at in its substance and essence, I do not think that payment differs from such a payment as I have alluded to. I think it was equally a payment made in pursuance of the obligation contained in the contract by which the business of the Queen Insurance Company was purchased, and, therefore, is properly capital expenditure.

As in that case, I think that the expenditures here made, in so far as they exceeded the normal cost of the annual surveys and cruises of the appellant company in carrying out its operations, were made in pursuance of its obligations in the licensing agreement and were, therefore, capital expenditures.

Reference may also be made to *Robert Addie and Sons' Collieries Ltd. v. The Commissioner of Inland Revenue* (2).

In assessing the appellant, the respondent had treated the expenses disallowed as relating to property subject to capital cost allowances under section 11(1)(*a*) of *The Income Tax Act*; accordingly, he applied the provisions of section 1100(1)(*e*) of the Regulations, which is as follows:

1100. (1) Under paragraph (*a*) of subsection (1) of section 11 of the Act, there is hereby allowed to a taxpayer, in computing his income from a business or property, as the case may be, deductions for each taxation year equal to

(1) [1897] A.C. 1.

(2) (1924) 8 T.C. 671.

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(e) such amount as he may claim not exceeding the amount calculated in accordance with Schedule C in respect of the capital cost to him of a timber limit or a right to cut timber from a limit.

It was suggested in the Notice of Appeal that, if the expenditures disallowed were found to be of a capital nature, the capital cost allowance should have been computed at a rate of 30 per cent. under the provisions of Class 10(1) of Schedule B, which is as follows:

Property not included in any other class, that is

(1) property that was acquired for the purpose of cutting and removing merchantable timber from a timber limit and will be of no further use to the taxpayer after all merchantable timber has been removed from the limit, unless the taxpayer has elected to include another property of this kind in another class.

The point was not stressed in argument except for the purpose of suggesting that the capital cost allowance provided for in the assessments was inadequate. It is sufficient to say that in my opinion the expenses incurred, to the extent that they exceeded the annual cost of cruises and surveys in the appellant's normal operations, were capital expenditures incurred pursuant to the terms of its licensing agreements and the *Forest Management Act* 1947, and were part of the capital cost of the timber limit or the right to cut timber from a limit, and consequently fell within the provisions of section 1100(1)(*e*) of the Regulations. It is unnecessary to define the properties which would come within class 10(1) of Schedule B, but it is to be noted that they do not affect "property included in any other class".

For these reasons the appeals will be dismissed and the assessments made upon the appellant for the years 1950, 1951 and 1952 will be affirmed. The respondent is entitled to his costs after taxation.

Judgment accordingly.

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Dec. 10

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July 10

PARKE, DAVIS & COMPANY ..... APPELLANT;

AND

FINE CHEMICALS OF CANADA, LIMITED ..... } RESPONDENT.

Patents—Appeal from order of Commissioner of Patents granting a licence to use appellant's patented invention—The Patent Act, R.S.C. 1952, c. 203, ss. 2(d), 28, 35, 36, 41 and 46—Expression "Medicine" in s. 41(3)

of the Patent Act to be interpreted broadly—Right to market patented product is implied when produced under a licence—Infringement of patent prior to application for licence is a matter to be considered by the Commissioner of Patents on hearing application for licence—Order granting licence under s. 41(3) not wrong because applicant infringed patentee's invention.

The Patent Act, R.S.C. 1952, c. 203, s. 41 states:

41(1). In the case of inventions relating to substances prepared or produced by chemical processes and intended for food or medicine, the specification shall not include claims for the substance itself, except when prepared or produced by the methods or processes of manufacture particularly described and claimed or by their obvious chemical equivalents.

(2). .....

(3). In the case of any patent for an invention intended for or capable of being used for the preparation or production of food or medicine, the Commissioner shall, unless he sees good reason to the contrary, grant to any person applying for the same, a licence limited to the use of the invention for the purposes of the preparation or production of food or medicine but not otherwise; and, in settling the terms of such licence and fixing the amount of royalty or other consideration payable the Commissioner shall have regard to the desirability of making the food or medicine available to the public at the lowest possible price consistent with giving to the inventor due reward for the research leading to the invention.

.....

Appellant is the patentee of Canadian Patent number 466573 for an invention relating to a class of chemical compounds alleged in the specification to be new and to have therapeutic value. One of the compounds is known as diphenhydramine hydrochloride and is marketed by appellant under the trade name "Benadryl". The Commissioner of Patents ordered that a licence should be granted to the respondent under the patent "for the ultimate purpose of the preparation or production of medicine only and for no other purpose". The respondent's purpose is to use the patented process to manufacture the product for sale in bulk, rather than to use it in the preparation or production of any other food or medicine, or to reduce it to capsules or tablets or any other dosage form, either with or without the admixture of other substances.

Appellant appealed from the decision of the Commissioner of Patents to this Court.

Held: That the expression "Medicine" in s. 41(1) of the Patent Act should be interpreted broadly and not restricted to opinions as to when a substance having medicinal values in small doses but noxious effects in larger doses, is medicine and when it is not, and the respondent in proposing to produce bulk diphenhydramine hydrochloride proposes to produce a medicine within the meaning of the word in s. 41(1) of the Patent Act.

2. That a right to market the patented product, when produced under a licence under s. 41(3) of the Patent Act to use the patented process, is to be implied from the wording of s. 41(3).

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APPEAL from an order of the Commissioner of Patents granting a licence under s. 41(3) of the Patent Act.

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

J. J. Robinette, Q.C. and *J. M. Godfrey, Q.C.* for appellant.

Gordon Henderson, Q.C. and *David Watson* for respondent.

THURLOW J.:—This is an appeal by Parke, Davis & Co., the patentee of Canadian patent number 466573, from a decision of the Commissioner of Patents dated June 28, 1955, granting an application by Fine Chemicals of Canada, Ltd. for a licence to use the patented invention.

The application was made under s. 40 of the *Patent Act*, S. of C. 1935, c. 32, now s. 41 of the *Patent Act*, R.S.C. 1952, c. 203, which is as follows:

41. (1) In the case of inventions relating to substances prepared or produced by chemical processes and intended for food or medicine, the specification shall not include claims for the substance itself, except when prepared or produced by the methods or processes of manufacture particularly described and claimed or by their obvious chemical equivalents.

(2) In an action for infringement of a patent where the invention relates to the production of a new substance, any substance of the same chemical composition and constitution shall, in the absence of proof to the contrary, be deemed to have been produced by the patented process.

(3) In the case of any patent for an invention intended for or capable of being used for the preparation or production of food or medicine, the Commissioner shall, unless he sees good reason to the contrary, grant to any person applying for the same, a licence limited to the use of the invention for the purposes of the preparation or production of food or medicine but not otherwise; and, in settling the terms of such licence and fixing the amount of royalty or other consideration payable the Commissioner shall have regard to the desirability of making the food or medicine available to the public at the lowest possible price consistent with giving to the inventor due reward for the research leading to the invention.

(4) Any decision of the Commissioner under this section is subject to appeal to the Exchequer Court.

(5) This section applies only to patents granted after the 13th day of June, 1923.

The patent in question was issued to the appellant on July 11, 1950 for an invention relating to a class of chemical compounds alleged in the specification to be new and to have therapeutic value. The specification describes the compounds and processes for their manufacture, as well as

methods for their administration to humans for the alleviation of certain disorders, and it ends with twenty-five claims, of which fourteen are for processes and the other eleven are for the compounds when produced by the claimed processes. One of the compounds is known as diphenhydramine hydrochloride and is marketed by the appellant under the trade name "Benadryl". It is this compound and some of the claimed processes by which it may be made in which the respondent is particularly interested.

On January 14, 1953 the respondent applied in writing to the Commissioner of Patents under s. 40, now s. 41, of the *Patent Act* for the grant of a licence under the patent "for the purpose of the preparation or production of the patented products." In the application, it is stated that the respondent is prepared to make the product for sale in Canada and is fully equipped to do so, and it appears from the evidence that the respondent's purpose is to use the patented process to manufacture the product for sale in bulk, rather than to use it in the preparation or production of any other food or medicine, or to reduce it to capsules or tablets or any other dosage form, either with or without the admixture of other substances. The appellant opposed the application and, after a hearing in which oral evidence was taken and argument heard, the Commissioner gave the decision from which this appeal was taken. The Commissioner's decision is based on his opinion that the patent affords protection for the processes alone, that the product itself is not protected by the patent, and that dealing with the product is free provided it has been produced legally. He concluded that a licence should be granted to the respondent under the patent "for the ultimate purpose of the preparation or production of medicine only and for no other purpose," and set a royalty to be paid by the respondent of ten per cent, based on the net selling price of the bulk product.

Notice of appeal from the Commissioner's decision was given on July 27, 1955. Subsequently, on January 19, 1956 a formal licence was issued which, after reciting the prior

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proceedings and the decision and that the form of the licence comes before the Commissioner to be settled pursuant to the decision, proceeds as follows:

> NOW, THEREFORE, be it known that pursuant to the powers vested in me by the Patent Act and particularly by Sections 4 and 41 of said Act, I do order the grant to the applicant, Fine Chemicals of Canada, of a non-exclusive licence under Canadian Patent No. 466,573 for the unexpired term thereof, and under no other patent, to manufacture in its own establishment only, products according to the patented process with the consequent right to sell the products under the following terms and conditions:

Then follow ten paragraphs, setting out various terms, including provision for the payment of royalty as previously mentioned. The licence is included in the material making up the case on appeal, pursuant to an order of this Court made on June 28, 1956.

At the hearing in this Court, the appellant rested its appeal on four points. First, it was argued that diphenhydramine hydrochloride in bulk is not a medicine and, as the respondent is not a pharmaceutical manufacturer and proposes to make only the bulk product, the purpose for which the licence was asked was not within the provisions of s. 41(3). Secondly, the appellant argued that s. 41(3) is applicable only where the patent is one for a process alone and the subsection cannot be applied where the patent protects not only a process but a product as well, when produced by the process, that, as the patent in question is for both processes and products when produced by the processes, the Commissioner had no authority to grant a licence to use the processes where the result would be to authorize the manufacture of products protected by the patent, and that the Commissioner also exceeded his powers in purporting to license the sale of the products. Thirdly, it was argued that the Commissioner had not considered two matters which should have constituted good reason for refusing the application; that is to say, first, the fact that the Canadian market for diphenhydramine hydrochloride was already fully supplied and, secondly, the fact that the respondent had infringed the patent, both by making diphenhydramine hydrochloride by the patented process and by selling it prior to applying for the licence. Finally, it was argued that the royalty set by the Commissioner at ten per cent on the bulk sale price was inadequate.

At this point it will be convenient to refer to and set out several sections of the *Patent Act,* which bear on the problems raised.

Invention is defined as follows by s. 2(*d*):

> (*d*) "invention" means any new and useful art, process, machine, manufacture or composition of matter, or any new and useful improvement in any art, process, machine, manufacture or composition of matter;

Leaving out inapplicable expressions, an invention may thus consist of a process or of a composition of matter otherwise generally referred to as a substance. Section 28 provides that, within the limits therein mentioned and on compliance with the requirements of the Act, an inventor may obtain a patent granting to him an exclusive property in his invention. By s. 35 it is provided that an application for a patent shall be accompanied by a specification of the invention, and by s. 36 it is further provided as follows:

> 36. (1) The applicant shall in the specification correctly and fully describe the invention and its operation or use as contemplated by the inventor, and set forth clearly the various steps in a process, or the method of constructing, making, compounding or using a machine, manufacture or composition of matter, in such full, clear, concise and exact terms as to enable any person skilled in the art or science to which it appertains, or with which it is mostly closely connected, to make, construct, compound or use it; in the case of a machine he shall explain the principle thereof and the best mode in which he has contemplated the application of that principle; in the case of a process he shall explain the necessary sequence, if any, of the various steps, so as to distinguish the invention from other inventions; he shall particularly indicate and distinctly claim the part, improvement or combination which he claims as his invention.
>
> (2) The specification shall end with a claim or claims stating distinctly and in explicit terms the things or combinations that the applicant regards as new and in which he claims an exclusive property or privilege.

The limits of the exclusive property conferred by the patent on the inventor are found in s. 46, which is as follows:

> 46. Every patent granted under this Act shall contain the title or name of the invention, with a reference to the specification, and shall, subject to the conditions in this Act prescribed, grant to the patentee and his legal representatives for the term therein mentioned, from the granting of the same, the exclusive right, privilege and liberty of making, constructing, using and vending to others to be used the said invention, subject to adjudication in respect thereof before any court of competent jurisdiction.

But in the cases to which s. 41 applies such exclusive property is further limited by and subject to the provisions therein contained.

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In these proceedings, no question arises as to the validity of the patent. The respondent, when applying for a licence to use the invention, cannot be heard to challenge the patent in respect of the processes claimed, nor can a proceeding of this kind be used as a method of challenging the product claims. Consequently, the appeal must be determined on the basis of the patent being valid in its entirety and of the appellant being entitled to exclusive property in the whole of the invention as claimed; that is to say, for both the processes claimed and the products as claimed when produced by any of the claimed processes.

The first ground of appeal urged by the appellant may be put in two ways. The first is that the words "to any person applying for the same" in s. 41(3) refer to and are limited by the words "a licence limited to the use of the invention for the purposes of the preparation or production of food or medicine but not otherwise", that the product of the invention, bulk diphenhydramine hydrochloride, which the respondent proposed to produce is a chemical and not a medicine until certain further formulation processes have been carried out, and accordingly that the respondent's application for a licence to produce the patented product was not an application of the kind contemplated by s. 41(3). The other, and I think the stronger, way of putting the point is that since, under s. 41(3), the Commissioner can license the use of the invention only for the purpose of producing food or medicine, and since the respondent's declared intention is to use the invention to produce bulk diphenhydramine hydrochloride, which is neither food nor medicine, the Commissioner should have regarded it as established that the respondent did not propose to follow the terms of the only licence he could grant and accordingly should have refused the application. But, putting the argument in either way, it becomes necessary to determine whether the bulk diphenhydramine hydrochloride which the respondent proposed to produce could properly be regarded as medicine. It is not suggested that it could be a food.

There is opinion evidence given by Dr. R. Fleming that bulk diphenhydramine hydrochloride is not medicine until it is reduced to dosage form, because it is a dangerous substance if taken in too large a dose. The same witness also gave evidence that, in formulating the bulk chemical (which

may itself meet accepted standards for purity) into medicinals, change or adulteration is likely to occur, making the chemical no longer safe for medicinal use, and he expressed the view that diphenhydramine hydrochloride has therapeutic value when properly formulated but that, when produced in bulk form by the process of the patent, it cannot be used in medicine.

Notwithstanding this opinion, there is evidence that diphenhydramine hydrochloride is used in the treatment of allergies and is also useful in the treatment or the prevention of motion sickness, and it appears as well that the therapeutic value to be derived from its use rests in the diphenhydramine hydrochloride itself. While it may be desirable to use diphenhydramine hydrochloride along with other substances, the therapeutic benefits which it produces are its own and do not result from its reaction with the other substances.

The following is from the specification:

> The invention relates to a new class of chemical compounds of therapeutic value . . . .
>
> * * *
>
> The compounds may be administered to humans as the hydrochloride or other salts or the free bases. They may be given orally, parenterally, rectally or as a vapour or mist. The more active compounds of the invention, such as Compound 1, are indicated for therapeutic use in humans for allergic conditions (asthma, urticaria, histamine cephalgia, anaphylactic shock), smooth muscle spasm (biliary spasm, dysmenorrhea).
>
> Compound 1 may be orally administered in dosage of 5 grains and given intravenously in amount of 150 mg.

In my opinion, the expression "medicine" in s. 41(1) should be interpreted broadly and not restricted by notions as to when a substance having a medicinal value in small doses, but noxious effects in larger doses, is medicine and when it is not. In the popular sense, medicine in bulk is none the less medicine merely because a person taking too much of it at one time or taking it in an undiluted form may expect to suffer from it rather than to be relieved. Nor does the probability that it may, under some conditions or because of certain things being done to it, deteriorate and become useless as a medicine make it any the less a medicine before such deterioration takes place. Moreover, I do not think the appellant can be heard to contradict the claims in its specification which clearly assert that the substance pro-

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duced by the processes described can be administered to humans for what are obviously medicinal purposes. It was not suggested that diphenhydramine hydrochloride has any utility except for such purposes. In my opinion the respondent, in proposing to produce bulk diphenhydramine hydrochloride, proposes to produce medicine, within the meaning of the word in s. 41(1), and the appellant's objection consequently fails.

The second ground of appeal urged by the appellant is that s. 41(3) is applicable only to patents for processes alone, that the Commissioner was without authority to license the use of the processes of the patent in question as the result is to authorize the manufacture of substances which are also protected by the patent, and that the Commissioner exceeded his powers in purporting to license the sale of the substances.

It may be noted that, while s. 41(1) is limited in its application to "inventions relating to substances prepared or produced by chemical processes and intended for food or medicine", the class to which s. 41(3) applies is different, being wider in some respects and narrower in others. Section 41(3) applies to inventions "intended for or capable of being used for the preparation or production of food or medicine." In my opinion, however, the invention in question falls within both classifications, and both ss. 41(1) and 41(3) are applicable.

The result of the applicability of s. 41(1) is that the appellant is entitled to the exclusive rights mentioned in s. 46 both in the processes claimed in the patent and in the substances when produced by such processes, but not in the substances when produced by any other process or processes. This situation is to be distinguished from one wherein the process is patented but the substance produced by it is not patented. In such a case, sale of the substance when produced by the patented process without the patentee's permission is unlawful and constitutes an infringement of the patent for the process. But while the protection so given for the process may in many cases be a *de facto* protection of the product as well, it is not protection for the product itself but protection for the process, which is the only thing patented. The right infringed by

such sale is the right in the process, not a right in the product. It was argued on behalf of the respondent that all that is protected in the present case is the process, but with this I cannot agree, for I think that in this case the substance, being new, is also protected when produced by the patented process. See the judgment of Rand J. in *Hoffman-LaRoche v. Commissioner of Patents* (1) at p. 418, where he says:

> . . . the section prohibits a claim for the new substance alone, but allows one for that substance as produced by the new process.

In such case the patentee has, in respect of the substance itself when so produced, the exclusive rights mentioned in s. 46.

Coming to s. 41(3), it may be doubted that the words "an invention intended for or capable of being used for the preparation or production of food or medicine" are apt to include both the processes claimed in the patent in question and the products or substances produced by the process as well, because the words quoted do not seem applicable to substances. But as this patent is one for an invention which includes a process of the kind referred to in s. 41(3) I can see no reason for holding the subsection inapplicable to it. It follows that, on a proper application, the Commissioner was authorized and, indeed, directed to grant a licence of the kind mentioned in the subsection.

The question of the extent of the licence which the Commissioner can grant is one of some nicety in this appeal, in view of the wording of the licence as above quoted. The words of s. 41(3) are:

> . . . shall grant a licence limited to the use of the invention for the purposes of preparation or production of medicine but not otherwise.

It is argued for the appellant that these words limit the power of the Commissioner to the granting of licences in cases where the patent is for a process alone, the product of which is not itself protected, and that the subsection cannot apply to patents for both process and product, as the Commissioner has no power to authorize sale of the product. Support for this view may be found in s. 46, where the right to sell the invention for use by others is expressly mentioned along with the right of using it, thus indicating that using the invention is not intended to include selling it.

(1) [1955] S.C.R. 414.

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But, whatever may be the limitations of the power of the Commissioner to authorize sale of a patented product, his power and his duty to license the use of the process in a proper case is clear. In purporting to license the sale of patented products, it may be that he would exceed the powers expressly granted to him by s. 41(3), but it does not follow that a right for the licensee of the process to sell the product of it would not exist. Such a right does exist in the case of a licence to use an invention covered by a bare process patent. And it would seem that the subsection has no application at all in the case of an invention of a substance alone. Such a case might occur in respect of a newly invented food or medicine not produced by chemical processes, and in such a case a patent could conceivably issue for the substance alone. But if, as I have held, s. 41(3) does apply to an invention for both process and product, and if the subsection contemplates in such cases the licensing of production only, without any expressed or implied right to sell the product, the policy of making food and medicine available to the public at low cost declared by the latter part of the subsection will obviously be frustrated in situations such as the present one and without any apparent reason why such a distinction should have been made.

Commenting on this subsection in *Commissioner of Patents v. Winthrop Chemical Co. Ltd.* (1), at p. 53 Kellock J., in delivering the judgment of himself and Taschereau J., said:

> Again when one turns to subsection 3, the same consideration appears. It provides that in the case of a patent for an invention intended for or capable of being used "for the preparation or production" of food or medicine, the Commissioner of Patents has power to grant a licence to an applicant therefor limited to the "use of the invention for the preparation or production" of food or medicine (*i.e.* the process) and it is declared that in settling the terms of the licence regard shall be had to the desirability of making the food or medicine (*i.e.* the substance) available to the public at a proper price. Under this provision it is the *invention* which is to be the subject of the licence and it is the *process* which is referred to by the subsection as the invention. If, therefore, subsection 1 is to be interpreted as applying to a substance produced by a process which need not be patentable, no licence could be obtained under subsection 3 for its production. In my opinion no such effect was intended by the legislation.

(1) [1948] S.C.R. 46.

Rand J. appears to carry the matter somewhat further, where he says at p. 56:

> Subsection (2) confirms the plain meaning of the words; it creates a procedural privilege or advantage to the holder of a patented process where the new substance is found produced by someone other than the patentee. The same confirmation arises from ss. (3) where authority to grant licenses to use the patented mode or process is conferred upon the Commissioner of Patents.
>
> I agree that ss. (2) could, as a matter of words, be construed to have only a partial application, limited to those cases in which the process itself is patented; but why, if under ss. (1) the process may be old, in the juxtaposition of the two subsections, the procedural benefit should not have been extended to the patentee of a substance restricted in production to an old process, has not been made apparent. I agree, also, that *under ss. (3) a license for the process may be deemed to imply a license for the substance itself where that likewise is the subject of patent;* but if the substance could be patented along with an old process, it would be a distortion of language to say that a license could issue for the substance alone and the declared purpose of the subsection would be defeated.

In speaking of an implied licence *for the substance itself, where that likewise is the subject of patent,* I think the reference is not to a licence merely to use the substance in any narrow sense but to deal with it in such a way as to accomplish the declared policy of making the food or medicine available to the public at the lowest possible price. Accordingly, I hold that a right to market the patented product, when produced under a licence under s. 41(3) to use the patented process, is to be implied from the wording of s. 41(3).

It follows that the licence granted in this case, in referring to the *consequent right* to sell the product and in fixing the royalty and other terms by reference thereto, does not purport to give to the licensee more than that to which it would be entitled had the wording of the licence followed exactly the wording of s. 41(3). It might have been preferable to follow the wording of the section, but so long as the licence purports to give no more than what the Commissioner is empowered to license I do not think it is open to objection. The objection taken by the appellant accordingly fails.

The third ground taken by the appellant is that the Commissioner did not consider two matters which ought to have afforded good reason for refusing the application; that is to say, first, the fact that the Canadian market for diphen-

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hydramine hydrochloride was already fully supplied and, secondly, the fact that the respondent had infringed the patent before applying for the licence.

In the Commissioner's decision, no mention is made of these two matters, and I think it must be assumed that if they were put forward at the hearing before him he considered them but did not see in them good reason for refusing the licence. Evidence was given indicating that the Canadian market is amply supplied, but it was not established that the product is available at the lowest possible price consistent with giving the inventor due reward for the research leading to the invention. Indeed, such evidence as was given as to the cost of production and the prices at which the products are sold indicates a wide spread between the two as to which no explanation was given. Consequently, I think the Commissioner properly rejected the mere availability of a supply as a ground for refusing a licence.

The other ground urged was that the respondent, having infringed the patent, should not have been granted a licence. An application under s. 41(3) is not a suit for an equitable remedy. It is a statutory proceeding to obtain a licence which the Commissioner is directed to grant in the public interest, unless he sees good reason to the contrary. The statute does not define what is to be regarded as good reason but leaves the matter to the judgment of the Commissioner. Obviously, reasons affecting the public interest would be proper ones to be taken into consideration, and it may be that in some cases conduct of the applicant in connection with the invention may have a bearing on whether or not it is in the public interest that a licence should be refused. But whether the infringement complained of could be regarded as good reason or not, the decision whether or not it should be so regarded in the circumstances of this particular case was one for the Commissioner to make and on what appears in the evidence I do not think it can be said that he was wrong in granting the licence, notwithstanding such infringement.

Finally, the appellant argued that the royalty set by the Commissioner is inadequate. No complaint is made of the use of the bulk sale price as a base on which to calculate the royalty, but it is argued that ten per cent on it is much too

low. The Commissioner gave no reasons for arriving at his figure, and I think it must stand unless it can be said that it is so high or so low that one is forced to the conclusion that it is based on some wrong principle or inadmissible material or on the omission to consider some matter which ought to have been taken into account. The only matter which the Commissioner is expressly directed to take into account is the desirability of making the medicine available to the public at the lowest possible price consistent with giving to the inventor due reward for the research leading to the invention. Mr. George Dyer, the secretary-treasurer of the respondent company, stated that five per cent on the bulk sales price would be a reasonable royalty. On the other hand, John Bradshaw, the assistant general attorney and assistant secretary of the appellant company, expressed the view based on his experience that five per cent on the bulk sales price would be exceedingly unfair, and he cited an example of an agreed licence whereon the royalty was set at thirty-five per cent of the bulk sales price. He also cited another example of a licence granted by the appellant in connection with its diphenhydramine patents, where the licensee was authorized to sell in bulk and whereon the agreed royalty was $7\frac{1}{2}$ per cent on the licensee's bulk sale price plus $3\frac{3}{4}$ per cent on the customer's selling price to the trade. Obviously, these rates total more than ten per cent on the bulk sales price, but how much more does not appear. The cost of the research leading to the invention is said to have been $185,000, but the record does not show the quantum of sales made or likely to be made during the continuance of the patent, either in Canada or any other country, or what profits can be expected from such sales. The evidence, as a whole, on the question of royalty is sketchy, and it is difficult to draw firm conclusions from it as to what would be a reasonable reward to the inventor from the Canadian market. On such evidence as does appear in the record, I am not satisfied that the royalty set is not ample, and in my opinion no sufficient ground has been shown for disturbing the Commissioner's finding.

The appeal will be dismissed with costs.

Judgment accordingly.

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Feb. 22
Sept. 11

ARRCO PLAYING CARD COMPANY (CANADA) LIMITED } APPELLANT;

AND

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

Revenue—Income tax—Deductions—Legal fees paid to secure reduction on import duties—Whether disbursement for purpose of gaining income or payment on account of capital—The Income Tax Act, S. of C. 1948, c. 52, s. 12(1)(a) and (b)—Customs Tariff, R.S.C. 1927, c. 44 as amended, s. 1 and Schedule A, Part III, items 194, 194(a).

The appellant, a manufacturer of playing cards, imported lithographed sheets used in their manufacture which under item 194 of the *Customs Tariff*, R.S.C. 1927, c. 44, as amended (now R.S.C. 1952, c. 60), were subject to an equal amount of duty as that charged on manufactured playing cards. The appellant believed the duty imposed unfair and retained a lawyer to submit its views to the taxing authorities. As a result of the latter's representations, the Act was amended and item 194(*a*) added, resulting in a substantial reduction on the duty on lithographed sheets when imported by manufacturers for the manufacture of playing cards in their own factories. The sum paid the lawyer, deducted by the appellant from its taxable income, was disallowed by the Minister on the grounds that the outlay was not incurred for the purpose of gaining income from the appellant's business within the meaning of s. 12(1)(*a*) but was a payment on account of capital under s. 12(1)(*b*) of the *Income Tax Act*.

Held: That the purpose of the expenditure was to secure by means of a modification of the tariff a long term advantage and such expenditure constituted a payment on account of capital, the deduction of which is prohibited by s. 12(1)(*b*) of the *Income Tax Act*. *Minister of National Revenue v. Dominion Natural Gas Co. Ltd.* [1941] S.C.R. 19; *Montreal Light, Heat & Power Consolidated v. Minister of National Revenue* [1942] S.C.R. 89; *Minister of National Revenue v. Siscoe Gold Mines Ltd.* [1945] Ex. C.R. 257 at 261; *Thompson Construction (Chemong) Ltd. v. Minister of National Revenue* [1957] Ex. C.R. 96 at 102, followed. *Minister of National Revenue v. Kellogg Co. of Canada Ltd.* [1943] S.C.R. 58; *Minister of National Revenue v. L. D. Caulk Co. of Canada Ltd.* [1954] S.C.R. 55, distinguished.

APPEAL from a decision of the Income Tax Appeal Board. (1).

The appeal was heard by the Honourable Mr. Justice Kearney at Montreal.

Leon Crestohl, Q. C. and *Lazarus Tinkoff* for appellant.

K. E. Eaton and *W. R. Latimer* for respondent.

(1) 12 Tax A.B.C. 230; (1955) 55 D.T.C. 135.

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KEARNEY J.:—This is an appeal from a decision of the Income Tax Appeal Board (1), dated February 4, 1955, dismissing an appeal by the taxpayer from a re-assessment applicable to its taxation for the year ending June 30, 1951.

The appellant deducted from its 1950-51 income some $11,000, representing fees and disbursements paid during the said year to its attorney for professional services rendered in procuring favourable modifications in the *Customs Tariff* affecting materials imported by the appellant from the United States.

The deduction was disallowed because, according to the respondent, the outlays in question were not incurred by the taxpayer for the purpose of gaining or producing income, within the meaning of s. 12(1)(*a*) of *The Income Tax Act,* S. of C. 1948, c. 52, but were outlays on account of capital, within the meaning of s. 12(1)(*b*) thereof.

Counsel for the appellant submitted that s. 12(1)(*b*) has no application as the expenditure was in no sense an outlay on account of capital, but clearly one made for the purpose envisaged in the exceptive provision contained in s. 12 (1)(*a*).

Section 12 reads in part 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 appellant company was incorporated in December 1949 and began operations in July 1950, with the result that its first fiscal year ended June 30, 1951. At some time it imported playing cards from the United States in finished form, but during its first year of operations it engaged in the business of manufacturing playing cards in Toronto and found it necessary to import cards in the form of lithographed sheets from the United States. Twenty-seven cards were lithographed on each sheet and two such sheets formed a unit which represented about 35 per cent of the manufactured cost of a finished deck. Manufacture of the sheets into complete ready-for-sale

(1) 12 Tax A.B.C. 230; (1955) D.T.C. 135.

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decks was carried out in the appellant's plant by processes known as punch pressing, sanding, gilting, deck and box wrapping.

The appellant found that the rate of duty applicable was seven cents per deck, whether imported in a complete state of manufacture or in the form of sheets which required the aforesaid finishing processes. Moreover, the duty of seven cents per deck applied, whether the material was of a quality to constitute a high or a low-priced deck.

The appellant considered the existing import duty contained in item 194 of the *Customs Tariff* unfair and authorized its attorney to obtain, if possible, a rectification thereof and a reduction in the existing duty of seven cents per unit. The appellant's attorney succeeded in having a new item, 194a, added to the *Customs Tariff*, which fixed a duty of 20 per cent of the value of the imported unit in the form of sheets. As a result the appellant paid in the fiscal year 1950-51 $29,734 less in customs duties, and on future imports will continue to derive a similar advantage so long as the existing legislation remains in force. Omitting the rate of duty applicable, the two aforesaid tariff items read as follows:

194. Playing cards, in packs or in sheet form, n.o.p.; cards and sheets partly lithographed or printed, for use in the manufacture of such playing cards . . ."

194*a*. Wholly or partially lithographed or printed sheets when imported by manufacturers of playing cards for use exclusively in the manufacture of playing cards in their own factories.

Item 194, as set out above, resulted from an amendment in 1937 (S. of C. 1937, c. 26, s. 2) to *An Act Respecting the Duties of Customs*, or to give it its short title, the *Customs Tariff* (R.S.C. 1927, c. 44 now R.S.C. 1952, c. 60). Owing to parliamentary delays, item 194*a* was not enacted until 1952 (S. of C. 1952, c. 23, s. 1 and Schedule A, Part III), but in the meantime the appellant received the benefits contained in the said item by means of two Orders-in-Council, P.C. 5744 dated November 29, 1950 (Ex. 3) and P.C. 4611 dated September 5, 1951 (Ex. 4). Furthermore, P.C. 5744 was made retroactive to August 1, 1950, and the appellant received a refund of some $13,000, which was included in the amount of $29,734 previously mentioned.

Counsel for the respondent submitted that, first and foremost, the purpose and effect of the services for which appellant's attorney was paid were to secure an enduring benefit in the form of a continuing tariff advantage for the appellant and that, therefore, the cost of those services was a payment on account of capital, the deduction of which is prohibited by s. 12(1)(*b*).

Alternatively, it was submitted that the cost of the said services was an outlay or expense not made or incurred by the appellant for the purpose of gaining or producing income from the appellant's business and therefore its deduction was prohibited by s. 12(1)(*a*).

In support of the alternative statement, it was also submitted that, because the expenditure was made to decrease cost or save expense, it could not be said to have been made for the purpose of gaining or producing income, or to have been directly related to that purpose. Likewise, since it was made to secure from the government a concession in customs duties or taxes, it could not have been made for the purpose of gaining or producing income *from the business* of the appellant. In addition, it was not directly related to the earning of income notwithstanding that incidentally it had the effect of increasing income.

Counsel for the appellant supported his submissions by the following statements. Not only the purpose but the effect of the expenditure was to produce income. The advantage received must be regarded not as an enduring but as a short term benefit. The benefit was not an exclusive one and the appellant had no assurance that it would not be withdrawn. Moreover, even admitting that the expenditure had been made to secure an enduring benefit, it nevertheless should not be regarded as a payment on account of capital as its deduction is permissible under ordinary principles of commercial trading and accepted business practice; and under these same principles it could not properly be set up on the company's books of account as a capital asset and depreciated.

I think it is of first importance to determine if the $11,000 paid to the attorney constituted a payment on account of capital, within the meaning of s. 12(1)(*b*) because, as pointed out by counsel for the respondent, provided the deduction were found to be prohibited by para.

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(*b*), further enquiry into whether it fell outside or within the exceptive provision of para. (*a*) could be dispensed with. On the other hand, such enquiry would be necessary in the event of a finding that the deduction was not excluded by para. (*b*). Authority for this statement is found in the observations of Thorson P. in *Siscoe Gold Mines Ltd. v. Minister of National Revenue* (1) when dealing with the corresponding paragraphs (*a*) and (*b*) of s. 6 of the *Income War Tax Act*. The same reasoning was recently applied to s. 12(1)(*a*) and (*b*) of the *Income Tax Act* by Cameron J. in *Thompson Construction (Chemong) Ltd. v. Minister of National Revenue* (2).

In determining whether or not the deduction was excluded by para. (*b*), I will begin by considering the purpose of the expenditure and the nature of the benefit sought. The General Manager testified (pp. 7 and 12 of the transcript) that the sole purpose of the expenditure was to reduce the duty from seven cents per deck in sheet form to twenty per cent of the value thereof, which made a difference of four cents per pack.

The evidence of the attorney shows that the services performed by him were related to securing a rectification in the tariff, which he considered could not be brought about otherwise than by a statutory amendment, (p. 26 of the transcript). It shows also that, because "the House was not in session," delays occurred in securing the statutory amendment, and it was only as an interim measure that the attorney asked to have an Order-in-Council passed (p. 23). This was done and in fact a second one was required. Even the first Order-in-Council had to be delayed pending the result of an International Tariff Conference in England which the attorney attended (p. 21). Only because of this was it made retroactive and did the appellant receive a refund of some $13,000. Although the General Manager of the appellant made some reference to a rebate, I do not think he contended that it was sought, and the following evidence of the attorney, at p. 24, plainly shows that such was not the case.

> The Tariff Commissioner drew to my attention that to right this wrong he would even recommend that the Order-in-Council be made retroactive, which produced for the company an additional $13,000 profit

(1) [1945] Ex. C.R. 257 at 261. (2) [1957] Ex. C.R. 96 at 102.

for that one year, and we recovered a cheque for some $13,000. I did not even go to seek that, but as a result of my efforts that was a by-product, and to the company a very healthy and desirable by-product.

Thus the evidence does not support the suggestion that the appellant's purpose was to secure a refund or a benefit limited to the duration of an Order-in-Council.

Again, at p. 14, the same witness, speaking of the extent and duration of the benefit, said:

A. If the tariff does not change we actually gain as long as the tariff remains as it is.

Q. And you might expect to get $29,000 each year?

A. Depending on business conditions.

Q. Has the tariff been changed since?

A. The tariff has not been changed, no.

In the light of the foregoing evidence, and also because it was so much in the interest of the appellant to secure a favourable modification in the tariff for as long a period as statutory rights would give it, I find that such was the appellant's purpose.

It is true, of course, that the amendment made to the *Customs Tariff* is not reserved for the sole use of the appellant. Nevertheless it is less general than item 194 and is applicable only to wholly or partially lithographed units "when imported by manufacturers of playing cards for use exclusively *in their own factories.*" This provision was made to fit the appellant's situation at its request and, although someone else who could conform to its requirements might avail himself of it, it still constitutes, in my opinion, and will likely continue to constitute an important benefit or advantage to the appellant.

It is likewise true, as argued by counsel for the appellant, that the company had no assurance that, once the amending Act was passed by Parliament, it would not at some later date be revoked or modified. For example, a change of policy at governmental level on tariff matters could result in a general increase or reduction in customs duties. However, in virtue of R.S.C. 1952, c. 158, s. 8, every federal statute is subject to amendment, alteration or repeal, by a subsequent Act, even if passed at the same session of Parliament during which the original Act was passed. This leads to the legal question of the duration of a statute.

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As pointed out at p. 61 in *Craies on Statute Law,* 5th Ed., Acts are classified by reference to their duration as temporary or perpetual.

(*a*) *Temporary.* Temporary statutes are those on the duration of which some limit is put by Parliament.

(*b*) *Perpetual.* Perpetual Acts are those upon whose continuance no limitation of time is expressly named or necessarily to be understood. They are not perpetual in the sense of being irrevocable.

And again under the title of "Duration of Statutes," at p. 374:

3. *Duration presumably perpetual.* Every statute for which no time is limited is called a perpetual Act, and continues in force until it is repealed.

The same statement appears in *Halsbury's Laws of England,* 2nd Ed.; Vol. 31, Art. 664, "The duration of a statute is *prima facie* perpetual."

In speaking of burden of proof, *Phipson on Evidence,* 9th Ed., p. 35, says:

(1) Where a disputable presumption of law exists, or a *prima facie* case has been proved, in favour of a party, it lies upon his adversary to rebut it.

I am of the opinion that in the present instance at least a *prima facie* case has been established and that we are dealing not with a temporary statute but with one which must be deemed to be perpetual.

There remains the important question of whether the expenditure should be attributed to capital or to revenue.

The appellant caused to be heard two chartered accountants. One of them, Mr. Parkinson, C. A., after saying he considered the expenditure deductible by the ordinary principles of commercial and trading practice and that, as an auditor, he thought he would oppose setting it up as an asset, made the following statement, p. 31 of the transcript, (which I think, in a measure recognizes the continuing nature of the benefit obtained): ". . . certainly we can use hindsight when we know the tariffs have not since been changed. Using hindsight we possibly could have amortized the cost of that charge over future years. On the other hand, trying to use foresight at the beginning where there is no guarantee that the benefit is to last indefinitely, and having regard to the fact that his (its) income was increased $29,000 in the year under review, it would be prudent business practice to deduct it completely."

Counsel for the respondent did not take issue with the concluding words of the opinion above expressed. He submitted that such complete deduction has been held to be prohibited for income tax purposes because the expenditure is regarded as an outlay to secure an enduring benefit, and that such decision must prevail over business practice or good accountancy. He then referred to *Minister of National Revenue v. Dominion Natural Gas Co. Ltd.* (1).

The legal expenses incurred in the case cited resulted from the defence of an action brought against the taxpayer by way of an attack on its franchise rights to continue to supply natural gas to parts of the City of Hamilton by a company which also claimed franchise rights therein. Duff, C. J., while stating that "in the ordinary course, . . ., legal expenses are simply current expenditure and deductible as such; but that is not necessarily so . . .," came to the conclusion that the expenditure should be attributed to capital. *Vide* p. 24.

> It satisfies, I think, the criterion laid down by Lord Cave in *British Insulated v. Atherton* (2). The expenditure was incurred "once and for all" and it was incurred for the purpose and with the effect of procuring for the company "the advantage of an enduring benefit." The settlement of the issue raised by the proceedings attacking the rights of the respondents with the object of excluding them from carrying on their undertakings within the limits of the City of Hamilton was, I think, an enduring benefit within the sense of Lord Cave's language . . .
>
> * * *
>
> The character of the expenditure is for our present purposes, I think, analogous to that of the expenditure in question in *Moore v. Hare* (3), where promotion expenses incurred by coalmasters in connection with two parliamentary bills giving authority to construct a line to serve the coalfield were held to be capital expenditures.

In the case of *Montreal Light, Heat and Power Consolidated v. Minister of National Revenue* (4), wherein the company sought to deduct as a current expense the expenditure made to reduce carrying charges on its bonds, Duff, C. J., at p. 92, again invoked what was said in the *Atherton* case in these terms:

> I think, moreover, that these disbursements were made for a purpose which falls within the principle enunciated by Lord Cave in the *British Insulated and Helsby Cables Ltd. v. Atherton* (5); that is to say, the expenditures were made with a view to securing an enduring benefit, the reduction of the cost of borrowed capital over a period of at least fifteen years.

(1) [1941] S.C.R. 19.
(2) [1926] A.C. 205 at 213.
(3) [1935] A.C. 431 at 440.
(4) [1942] S.C.R. 89.
(5) [1926] A.C. 205 at 212.

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When later heard before the Privy Council (1), the ensuing judgment was based not on the prohibition contained in s. 6(1)(*b*) of the *Income War Tax Act* but on that contained in s. 6(1)(*a*) thereof. Nevertheless Lord Macmillan, at p. 135, stated:

> . . . their Lordships in no way dissent from the view that the second objection (namely, that the expense was a capital one) also applies.

In argument, counsel for the appellant observed that instances are not lacking where legal expenditures have been attributed to revenue rather than to capital and, as no two cases are identical, each must be judged on its own merits. He particularly relied on *Minister of National Revenue v. L. D. Caulk Co. of Canada Ltd.* (2); *Minister of National Revenue v. Kellogg Co. of Canada Ltd.* (3).

In the *Caulk* case which distinguished the *Dominion Natural Gas* case, it was held that expenses incurred by the taxpayer in successfully defending itself against a criminal charge instigated by the government under the *Combines Investigation Act,* and in making representations to the Commissioner administering the said Act, were wholly, exclusively and necessarily laid out for the purpose of earning income. I do not think the principles applied in that case, wherein a branch of the government sought to prevent the taxpayer from carrying on business in its accustomed manner, are applicable in the instant case. Here the appellant is free to import its basic material without interference but seeks a new particular concession by way of diminished duties; and the immediate problem is to determine whether or not the appellant is deemed to have made a capital expenditure because the expenditure was made in order to obtain a continuing benefit or advantage. I do not think that such an issue arose in the *Caulk* case.

The same, in my opinion, is true of the judgment delivered by Duff, C. J., in the *Kellogg* case wherein the appellant had no reasonable alternative but to defend itself against injunction proceedings aimed at preventing it from making use of ordinary descriptive words in connection with the sale of its products. Here the appellant is not faced with the necessity of defending itself against

(1) [1944] A.C. 126. (2) [1954] S.C.R. 55.
(3) [1943] S.C.R. 58.

someone seeking to deprive it of its common law rights, but rather does it seek the enactment of a statute which will procure for it a long term advantage which it did not previously possess.

Although, admittedly, the facts in the *Dominion Natural Gas* and the *Montreal Light, Heat and Power* cases differ from those in the present one, I nevertheless feel bound to follow them because they contain certain criteria which, I believe, *mutatis mutandis*, are apposite herein.

The expenditure under consideration was, in my opinion, made once and for all to secure a benefit or advantage that was expected to be enjoyed over a lengthy though indefinite future period. The purpose which motivated the expenditure was the appellant's desire to pay less customs duties in the future than in the past. The fact that, in the last analysis, an increase in income should accrue to the appellant does not, I consider, affect the validity of the above-mentioned conclusion.

I therefore find that the expenditure in question should be regarded as constituting a payment on account of capital, the deduction of which is prohibited under s. 12(1)(*b*).

Since I find that the deduction sought is so prohibited, I do not think it necessary to discuss the respondent's alternative submission or the reasons advanced by the appellant in support of its contention that the case falls within the exceptive provision of s. 12(1)(*a*).

For the above-mentioned reasons, I consider that the appeal in this case should be dismissed with costs.

Judgment accordingly.

1957

June 20

Aug. 30

SEAGULL STEAMSHIP COMPANY OF CANADA LIMITED ..... APPELLANT;

AND

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

Revenue—Income tax—Deductions—Repairs to ships followed by sale—Outlay for purpose of gaining or producing income or payment on account of capital—The Income Tax Act, S. of C. 1948, c. 52, s. 12(1)(a),(b)—Depreciation and special charge against profits allowed on ships purchased from Crown—Ships subsequently sold—Proceeds of disposition used for replacement under conditions not satisfactory to Canadian Maritime Commission—The Income Tax Act, s. 20(1)—Canadian Vessel Construction Assistance Act, R.S.C. 1952, c. 43, ss. 3, 4.

The appellant steamship company in 1947 purchased three ships from the Crown, *La Grande Hermine, Saint Malo* and *La Petite Hermine,* but as they were under bareboat charter *La Grande Hermine* was not turned over to the appellant until March and the other two ships until May, 1951. Prior to taking delivery, the appellant arranged to have the ships surveyed and repaired in Germany. Repairs to *La Grande Hermine* were completed in May. The repairs to the other two ships, employed as cargo carriers until August, were completed in September. While *La Grande Hermine* was under repair, she was inspected by a prospective purchaser who executed agreements of sale to purchase her and the *Saint Malo,* subject to equivalent repairs being made to the latter, title to pass on delivery. Pursuant to the agreement, *La Grande Hermine* was delivered in June, the *Saint Malo* in September.

In its 1951 income tax return the appellant deducted the expense of the surveys and repairs and a further sum of $5,962.20 as "depreciation recaptured" under s. 4(1) of the *Canadian Vessel Reconstruction Act,* R.S.C. 1952, c. 43. The Minister disallowed the deductions and ruled: (i) that the expense items were not made or incurred for the purpose of gaining or producing income within the meaning of the exception to s. 12(1)(*a*) of the *Income Tax Act* but to comply with the provisions of the agreements for sale and constituted payments on account of capital under s. 12(1)(*b*); (ii) that the amount claimed for "depreciation recaptured" was properly added to the taxpayer's income pursuant to s. 20(1) of the Act.

Before this Court the appellant argued that the payments for the surveys and repairs constituted outlays for the purpose of gaining or producing income from its business within the meaning of s. 12(1)(*a*) of the Act. As to the "depreciation recaptured", it submitted that as the proceeds from the sale were used for replacements under conditions satisfactory to the Canadian Maritime Commission, s. 20 of *The Income Tax Act* pursuant to s. 4(1) of the *Canadian Vessel Construction Assistance Act,* was not applicable.

Held: That the appellant's decision to repair the ships was made prior to its entering into the agreements of sale.

2. That the expenses were incurred for the purpose of producing or gaining income from the taxpayer's business and were of a temporary and recurring nature, and not capital outlays and therefore deductible from its income.

3. That as the appellant failed to establish, as required by s. 4(1) of the *Canadian Vessel Construction Assistance Act,* that the proceeds of disposition arising from the sale of the ships had been used for replacement under conditions satisfactory to the Canadian Maritime Commission, s. 20(1) of the *Income Tax Act* applied and the "depreciation recaptured" was properly added to the appellant's taxable income.

APPEAL from a decision of the Income Tax Appeal Board. (1).

The appeal was heard by the Honourable Mr. Justice Fournier at Montreal.

Roger Letourneau, Q.C. and *Renault St. Laurent, Q.C.* for appellant.

John Ahern, Q.C. and *Paul Boivin, Q.C.* for respondent.

FOURNIER J.:—This is an appeal and a cross-appeal from a decision of the Income Tax Appeal Board (1) dated February 15, 1954, allowing only in part the appellant's appeal against its tax assessment for 1951.

The appellant is a company which owns and operates steamships and also investments in the capital stock of other steamship companies. It derives its income from freight and charter revenue. In its income tax return for the year 1951 the appellant claimed that it was entitled, in computing its taxable income, to deduct as an expense the sums paid for the repairs of two of its ships, S.S. *La Grande Hermine* and S.S. *Saint-Malo,* along with Lloyd's Surveyor's fees and expenses while attending special surveys of the above vessels and legal fees, and it reported an operating loss of $38,533.32.

In assessing the appellant, the Minister, as appears from the notice of re-assessment dated January 23, 1953, considered that for the year 1951 the appellant had a taxable net income of $17,833.56, thus converting the reported net loss of $38,533.32 into a taxable income of $17,833.56 by disallowing as a deduction, in computing the appellant's

(1) 10 Tax A.B.C. 161; (1954) 54 D.T.C. 158.

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income, the following expenses and adding an amount for depreciation recaptured:

Repairs to S.S. *La Grande Hermine*		$ 12,280.51
Repairs to S.S. *Saint-Malo*		50,077.85
Survey expenses re S.S. *La Grande Hermine*		791.93
Survey expenses re S.S. *Saint-Malo*		792.47
Depreciation recaptured		5,962.20
Legal fees		1,505.34
		$ 71,410.30
Less:		
Portion of unabsorbed 1948 loss	$7,803.03	
Unabsorbed 1950 loss	7,240.39	$ 15,043.42
		$ 56,366.88
Less reported loss for 1951		38,533.32
Net taxable income		$ 17,833.56

The appellant objected to the assessment, with the exception of the item of $1,505.34 for legal fees, but the Minister confirmed it. The appellant then appealed to the Income Tax Appeal Board, which allowed the appeal, but only in part. It is from that decision that the appeal and cross-appeal to this Court were brought.

The Minister disallowed the expense items on the ground that they were not made or incurred by the appellant for the purpose of gaining or producing income and added that the amount of $5,962.20 "depreciation recaptured" was properly included in computing the income pursuant to s. 20(1) of the *Income Tax Act*.

So, there are two questions for a decision by the Court. First, are the expenses for the repairs of the two ships and the surveys deductible from income under s. 12(1)(*a*) and (*b*) of the *Income Tax Act*? The second question is the recapture of depreciation. Was it properly added to the appellant's taxable income and in accordance with the provisions of s. 20(1) of the *Income Tax Act* and the provisions of the *Canadian Vessel Construction Assistance Act* (R.S.C. 1952, c. 43)?

The provisions of s. 12(1)(*a*) and (*b*) of the *Income Tax Act* to be considered concerning the first point 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 depreciation, except as expressly permitted by this Part, . . .

The issue is whether the payments made or incurred by the appellant for the repairs and surveys of its two ships constitute an outlay or expense made or incurred by it for the purpose of gaining or producing income from its property or business within the meaning of the exception expressed in s. 12(1)(*a*) of the Act and outside its prohibition.

The appellant argued for the affirmative, but the respondent contended that the payments for repairs and surveys were made for the purpose of complying with the provisions of certain deeds of sale in respect of the two vessels, in which case the expenses would come under s. 12(1)(*b*) as payments on account of capital.

At the hearing it was agreed by the parties that the admissions, testimony and documents which were made and filed before the Income Tax Appeal Board in 1954 form part of the record before the Exchequer Court and would constitute both the evidence of the appellant before the Court and the cross-examination by the respondent. The only oral evidence on record was adduced by the appellant's two witnesses.

Certain facts were established, others not in dispute. I will summarize them. The appellant, a company which owns and operates steamships and derives its income from freight and charter, became the owner of three ships, *La Grande Hermine, Saint-Malo* and *La Petite Hermine,* which it purchased from the Crown on October 16, 1947. At the time of the purchase *La Grande Hermine* and the *Saint-Malo* were under bareboat charter with the Dominion Shipping Co. The bareboat charter agreement had been made and concluded on April 10, 1946, for a period of about five years. The agreement then was to

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end some time in April 1951. In effect, the appellant took delivery of *La Grande Hermine* on March 1, 1951, and of the *Saint-Malo* on May 17, 1951.

When it became apparent—some time about the end of 1950—that the charterers would give back the ships, the appellant prepared a program for the repairs of the two vessels and other ships of their fleet and started negotiations to have them repaired. Having found out that the repairs would be more costly in Canadian shipyards than in European countries, it negotiated and contracted to have them repaired in Germany.

S.S. *La Grande Hermine* was repaired at Hamburg, Germany, from April 14 to May 20, 1951. Before the repairs had been undertaken or completed, she was chartered to carry cargo from Germany to the United States and thereby earned income for the appellant. The *Saint-Malo* was received on May 17, 1951, and from that date up to August 20, 1951, when it went into the shipyards for repairs, it was operated by the appellant to carry cargo, but after the repairs were completed it was immediately delivered to new owners.

After it was agreed that the two vessels would be returned to the appellant and that *La Grande Hermine* had been received and put into shipyards for repairs and that the *Saint-Malo* was waiting its turn to enter the shipyards for repairs, the appellant, on May 11 and 14, 1951, agreed to sell and the Panama Shipping Co. Inc. agreed to purchase the two vessels, title to pass on delivery. It would seem that the purchaser had inspected *La Grande Hermine* at Bremerhaven and had found her condition to be satisfactory. As to the *Saint-Malo,* the buyer had made a preliminary inspection of the vessel and found her condition satisfactory, subject to . . . "making such repairs, replacements and alterations and outfit the vessel, all in the same manner and to the same extent and to effect the same capacities as was done by the seller at Bremerhaven to the S.S. *La Grande Hermine,* which latter vessel, after such similar conversion and outfitting at Bremerhaven, was recently inspected by the buyer and contract made for her purchase (see agreement of May 14, 1951, between appellant and Panama Shipping Co.

Inc.)." *La Grande Hermine* was delivered to the purchaser at Baltimore, U.S.A., on June 22, 1951, and the *Saint-Malo* on September 18, 1951, at Bremerhaven, Germany.

It was established that the payments made for the repairs of the two vessels and disallowed were only part of the amount expended for the repairs and did not comprise the cost of converting the ships from coal burner to oil burner. The amounts spent and paid which were disallowed were made so that the vessels could produce income, avoid losses in their operation and meet the requirements of the *Canada Shipping Act*. The repairs were also necessitated to obtain Lloyd's classification 100 A.1 and to be insurable.

The real difficult question to be answered is whether the repairs to the ships were decided upon and contracted for before negotiations were undertaken or agreement arrived at to dispose of the ships or whether they were made to comply with the agreement of sale. What are the facts?

There is evidence that it became apparent by the end of 1950 that the vessels would be returned to the appellant some time in the spring 1951. The appellant then proceeded to have ships repaired. Necessary steps to that effect were taken. Delivery of S.S. *La Grande Hermine* was made on March 1, 1951; she entered the shipyard on April 14 and the repairs were completed on May 20, 1951. She was chartered on May 5, 1951, to carry cargo and delivered to the new owner on June 22, 1951.

What was the evidence as to the *Saint-Malo?* She was delivered to the appellant on May 17, 1951; she entered the shipyard on August 20, was repaired and delivered to the new owners at the beginning of September.

A third ship, S.S. *La Petite Hermine*, which was not sold in 1951, was delivered about the same time, was repaired and continued to be operated by the appellant. The repair expenses were considered deductible.

Now, as to the evidence in respect of the sale of these vessels. At the hearing the agreement for the sale was filed; it was dated May 11, 1951. *La Grande Hermine* was delivered to the purchasers on June 22, 1951. The agreement for the sale of the *Saint-Malo*, dated May 14, 1951, was filed. She was delivered to the purchasers in September.

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There remains the uncontradicted testimony of Mr. Papachristidis to the effect that long before the sale of the two vessels the repairs had been decided and acted upon for the purpose of having them operated by the appellant and producing income from its business. Maintenance repairs, alterations and conversion changes were made not only to the two vessels in question but also to a third vessel of the same class. However, only the amounts paid or incurred for the maintenance and operating repairs were claimed as deductions. In the case of the two vessels sold they were disallowed, but were allowed in the case of the third vessel because it was not sold.

The above facts and a careful consideration of the evidence have convinced me that the repairs were decided and acted upon before negotiations were undertaken or agreement arrived at to dispose of the two vessels. If this were not so, how explain the repairs, alterations and conversions made at about the same time to the third vessel, which after the execution of these works was operated by the appellant for the purpose of gaining income from its business.

Furthermore, I am of the opnion that the outlays which were claimed as deductions were incurred for repairs of a maintenance character and not of a capital nature.

Would these findings be sufficient to conclude that these outlays are deductible from income for tax purposes within the exception contained in s. 12(1)(*a*) of the *Income Tax Act?*

Let us consider this section with s. 6(1)(*a*) of the *Income War Tax Act.*

The exception contained in s. 12(1)(*a*) applies to outlays made or incurred for the purpose of producing or *gaining income.*

The exception in s. 6(1)(*a*) would apply to disbursements or expenses wholly, exclusively and necessarily expended for the purpose of earning the income.

There is no doubt that the extent of the deductible outlays is far greater in the first instance than in the second. Under s. 6(1)(*a*) the deductibility was based on the test that the disbursements were made necessarily, exclusively and wholly for the purpose of earning income

whilst in this case the purpose of the expenses for earning income made in accordance with the ordinary principles of business and practices of accounting would bring them under the provision of s. 12(1)(*a*) relating to deductibility. This in my opinion would meet the definition of *annual profit or gain* of s. 3 of the Act. This principle for the computation of profits or gains was expressed by Lord Halsbury L. C. in *Gresham Life Assurance Society v. Styles* (1) as follows:

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

In the present instance it would seem that the expenses were incurred by the appellant in a way which would have commended itself to any owner of commercial ships desirous of operating them for gaining or producing income from its property or business. I believe it was good business, because the appellant had decided to use the ships itself for carrying freight or leasing them to others. To my mind it is immaterial that after incurring the expenses to have the repairs made it became more advantageous for the appellant to dispose of the ships rather than operate them. If this reasoning is wrong, s. 12(1)(*a*) would receive application only in cases where outlays were made and income had resulted from such outlays, which would contradict decisions where expenses were deductible in the year although no gain or profit from the business was made during that year and would exclude outlays or expenses incurred.

The test, when expenses are made or incurred for recurring maintenance repairs, is that the outlays or payments were made or incurred *for the purpose*. It is the purpose which is essential, but the purpose must be that of making profit from the taxpayer's business or property.

When the evidence establishes that expenses were incurred for a purpose and that the purpose is to produce or gain income from the taxpayer's property or business and that the expenses were of a temporary and recurring nature, and not capital outlay, such expenses should be deductible from the taxpayer's income. This is what I find in this case on the evidence adduced.

(1) [1892] A.C. 309 at 316.

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I would distinguish this case from that of the *Montship Lines Ltd. v. Minister of National Revenue* (1) wherein Cameron J. found that the outlays were not made for the purpose of gaining income but to comply with agreements of sale. The headnote reads:

> In 1948, the appellant company which operated a number of freight vessels sold two vessels while they were undertaking a voyage on its behalf. Under the agreements of sale both vessels were to be delivered to the purchasers in Lloyd's 100 A-1 class. Upon completion of their respective voyages the vessels went into dry dock and there certain repairs were made before their delivery . . . On the facts the Court found that the repairs were maintenance repairs, . . .

The learned judge held that the sole purpose of the appellant in incurring the expenses was to comply with the requirements of the agreements of sale.

In this case no such agreement existed at the time the appellant decided to have the repairs made. The uncontradicted evidence and a careful perusal of the documents filed would indicate that the appellant had decided to operate the vessels itself and thought it advisable to incur expenses for repairs in order to increase its income from their operation. It was only after putting the first vessel in dry-dock for repairs that it was disposed of. As to the second, it had decided on the repairs and had incurred expenses before agreeing to sell it. On the facts I cannot agree with counsel for the respondent that the repairs were made and paid for to comply with the agreements. The fact is that the appellant had three of its vessels repaired, one of which was sold while it was in dry-dock, another was sold before going into dry-dock and the third was repaired but not sold. The three vessels had been received at about the same time as the bareboat charter lapsed and arrangements had been made for their repairs prior to their being received. No agreements of sale existed when this was taking place. The Minister refused to deduct the outlay for repairs on the first two vessels but allowed as deduction the outlay for the repairs of the third. Why discriminate? Because the first two were sold. I do not believe the sales at the time they were agreed upon could change the fact, which was established, that expenses had been incurred for the purpose of gaining income from its business.

(1) [1954] Ex. C.R. 376.

For these reasons, I find the sums expended for repairs and surveys should be deducted from the appellant's income for taxation purposes and dismiss the cross-appeal.

As to the second point relating to the depreciation recaptured.

The Minister, in his re-assessment of the suppliant's income, added, for the year 1951, the sum of $5,962.20 as depreciation recaptured in accordance with the provisions of s. 20(1) of the *Income Tax Act* which reads as follows:

20. (1) Where depreciable property of a taxpayer of a prescribed class has, in a taxation year, been disposed of and the proceeds of disposition exceed the undepreciated capital cost to him of depreciable property of that class immediately before the disposition, the lesser of

(*a*) the amount of the excess, or

(*b*) the amount that the excess would be if the property had been disposed of for the capital cost thereof to the taxpayer,

shall be included in computing his income for the year.

The appellant contends that the above section does not apply to these vessels. They had been purchased from the Crown, then sold to a third party. The proceeds of the sales had been deposited in escrow and later transferred to other parties which "used them for replacement under conditions satisfactory to the Canadian Maritime Commission." Under these conditions and in view of the provisions of s. 4(1) of the *Canadian Vessel Construction Assistance Act* s. 20(1) of the *Income Tax Act* was not applicable.

This section reads as follows:

4. (1) Where a vessel in respect of which an allowance has been made under section 3, or in respect of which "special depreciation", "extra depreciation" or allowances in lieu of depreciation were allowed for the purposes of the *Income War Tax Act* or the *Income Tax Act,* is disposed of, subsection (1) of section 20 of the *Income Tax Act* does not apply in respect of the proceeds of disposition to the extent that they are used for replacement under conditions satisfactory to the Canadian Maritime Commission.

The appellant submits that s. 3 hereinabove referred to applies to its vessels, because they belong to a class of depreciable property to which s. 20(1) of the *Income Tax Act* refers.

The above amount of $5,962.20, described as depreciation recaptured, is part of a larger sum of $41,448.67 which the appellant had been allowed to deduct from its 1947 profits,

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pursuant to the provisions of a memorandum issued by the Deputy Minister of National Revenue, Inspector of Income Tax, under date of January 10, 1946, and relates to depreciation on ships. Paragraph 3 applies to ships purchased from the War Assets Corporation.

> 3. In addition to the depreciation allowances set out in 1 and 2 above, a special charge may be made against profits on the cost of ships purchased from the War Assets Corporation or other Crown companies at the rate of 13%. This allowance may only be permitted in the first year the ship is acquired.

The last paragraph of the memorandum summarizes the regulations of depreciation, namely:

> The rate applicable to all ships has been increased from 4% to 6%; ships purchased in the period between November 10, 1944, and December 31, 1946, are eligible for depreciation at not more than double the rate normally allowed, i.e. 12%, and a special allowance of 13% is permitted on ships purchased from the War Assets Corporation or other Crown companies in the first year of operation only. Thus, on a ship acquired from the War Assets Corporation, depreciation is permitted to a maximum amount of 12% in subsequent years until 80% of the cost of the ship has been written off, after which the normal rate of 6% will apply.

So in 1947, the first year of operation of the appellant's two vessels, a total depreciation of 25% was allowed on their cost. It is clear, by this last paragraph that the special charge made against profits on the cost of the ship is depreciation calculated on the cost of the vessels. Though the memorandum describes the 13% as a special charge, I believe it is an allowance in lieu of depreciation. The words "a special charge may be made against profits" means that in computing a taxpayer's taxable income an amount equal to 13% of the cost of the ship may be deducted from his profits. The principle of recapturing depreciation applies to allowances in lieu of depreciation, as it does to special, extra or double depreciation.

Depreciation, in computing taxable income in 1947, is dealt with in s. 6(1)(*n*) of the *Income War Tax Act*.

> 6. (1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> * * *
>
> (*n*) depreciation, except such amount as the Minister in his discretion may allow.

The memorandum of regulations relating to depreciation of ships was without doubt issued pursuant to the power and discretion provided for in the above section

of the Act. If not, I do not know of any other section of the Act which deals with this subject. This being the case, the appellant benefited from a charge against its profits on a depreciation based on the cost of its vessels, which depreciation could be recaptured under certain circumstances, unless specifically exempted by some provision of law.

There would be no doubt concerning the appellant's contention if it was established that "the proceeds of the disposition of the two vessels to the extent that they were used for replacement 'were made' under conditions satisfactory to the Canadian Maritime Commission."

What is the evidence on this point? In the preamble of agreement of sale of the vessels by His Majesty the King in the right of Canada to the appellant it is stated.

> Whereas the said ships were sold by His Majesty to the shipowner on a deferred payment basis with the object of creating and developing a privately-owned Canadian ocean-going merchant fleet by Canadians for the benefit of Canada at large; (See Replacement and Escrow Agreement on file).

The vessels were later sold to a foreign corporation and registered under a foreign flag. The proceeds were deposited in escrow under control of the Canadian Maritime Commission. The proceeds were then sold, assigned or transferred to third parties which used them to construct vessels of other types than those mentioned in the above preamble. In other words, the proceeds were not used to fulfil the object which the Crown had in mind at the time of the sale. Nothing in the agreements barred the use of the proceeds in such a way, but it is clear that such a use of the proceeds did not meet the object specified in the agreement of sale.

The approval of the transactions by the Commission was made with the reservation that the question of whether the appellant would qualify under s. 4 of the *Canadian Vessel Construction Assistance Act* would be taken up later. In a letter dated March 7, 1953, the Commission informed the appellant that a certificate stating that the proceeds of disposition of the vessels had been used under conditions satisfactory to the Commission was required by the Income Tax Division before exemption would be allowed from the provisions of s. 20 of the *Income Tax*

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Act. The Commission had decided that it would not issue such certificate in cases where the proceeds of disposition were assigned to be used towards the construction of ships other than ocean-going vessels. I believe that the decision was based on the object described in the preamble of the agreement of sale. This seems to me to be a valid reason for declaring that the funds were not used under satisfactory conditions.

I find that the amount of $5,962.20, depreciation recaptured, was properly added to the appellant's taxable income for the year 1951.

The appeal is allowed in part, the assessment vacated, the sums of $13,072.44 and $50,870.32 directed to be deducted from the appellant's taxable income for the year 1951 and the matter referred to the Minister for re-assessment accordingly, with costs to be taxed in the usual manner. The cross-appeal is dismissed.

Judgment accordingly.

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BETWEEN:

CHESLEY SAMSON .....SUPPLIANT;

AND

HER MAJESTY THE QUEEN .....RESPONDENT;

AND

THE ATTORNEY GENERAL OF NEWFOUNDLAND ..... INTERVENANT.

Crown—Petition of right—Articles 36, 39(1) of the Terms of Union of Newfoundland with Canada—S. 1 British North America (No. 1) Act, 12-13 Geo. VI, c. 22—Prevailing Rate Employees General Regulations, Order in Council, P.C. 6190, December 6, 1949—Treasury Board Minutes 388035-1, April 28, 1950, and 396847, October 19, 1950—Interpretation of Article 39(1) of Terms of Union of Newfoundland with Canada—Remuneration according to prevailing rates—Employee accepting service in one locality not to be paid at rate prevailing in another locality.

Article 39(1) of the Terms of Union of Newfoundland with Canada provides:

"39(1) Employees of the Government of Newfoundland in the services taken over by Canada pursuant to these Terms will be offered employment in these services or in similar Canadian services under the terms and conditions from time to time governing

employment in those services, but without reduction in salary or loss of pension rights acquired by reason of service in Newfoundland."

Suppliant, prior to the date when Newfoundland became a province of Canada, was employed as a carpenter at Gander Airport in Newfoundland. Civil Aviation, including Gander Airport, was one of the Newfoundland services taken over by Canada, pursuant to Article 31 of the Terms of Union, and on its being taken over the suppliant was offered and accepted employment as a carpenter at Gander Airport by the Department of Transport (Air Services Branch).

Suppliant by his petition of right seeks to recover from the respondent the sum of $3,468.10 alleging that the terms and conditions of his employment have not been in accordance with the terms and conditions governing the employment of carpenters at other airports under the jurisdiction of the Department of Transport in that his rate of wages has been less than in the case of carpenters at such other airports and he has not been paid for overtime on the same basis as that for carpenters at such other airports. Suppliant alleges he had been discriminated against and there had been a breach of the obligation imposed by Article 39(1) and he was entitled to compensation accordingly. Suppliant selected the terms and conditions at Dorval Airport as those to which he was entitled because of the large number of prevailing rate employees there and also because both Gander and Dorval were international in character.

Leave was granted to the Attorney General of Newfoundland to intervene in the action and he gave general support to the argument of counsel for the suppliant. The position of carpenter was one excluded from the operation of the Civil Service Act by Order in Council which provided:

"2. That the compensation shall not exceed the salaries provided in the classification schedules, and that where 'Prevailing Rates' are provided as the compensation for a class, or where no class schedule exists, the rates of pay shall be such as are recommended by the Department and approved by the Governor in Council, and that the compensation in these classes shall carry no bonus."

Article 36 of the Terms of Union provides:

"36. Without prejudice to the legislative authority of the Parliament of Canada under the British North America Act, 1867 to 1946, any works, property, or services taken over by Canada pursuant to these Terms shall thereupon be subject to the legislative authority of the Parliament of Canada."

Article 18 of the Terms of Union made the Civil Service Act applicable to Newfoundland as of April 1, 1949. By virtue of an Order in Council of May 18, 1949, the suppliant became as from April 1, 1949, a prevailing rate employee of the Department of Transport at the rate of pay recommended by the Department of Labour. Pursuant to the Prevailing Rate Employee General Regulations enacted by Order in Council and a Treasury Board Minute, a standard work week and the normal working hours were established for prevailing rate staffs of the Air Service Branch employed at Gander Airport.

Held: That by virtue of Article 39(1) of the Terms of Union an employee of the Government of Newfoundland in a service taken over by Canada pursuant to the Terms of Union will be offered employment

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either in the service taken over *or* in a similar Canadian service, his employment to be under the terms and conditions from time to time governing employment in the service in which he was offered employment.

2. That Article 39(1) does not contemplate that after a Newfoundland employee had been offered employment in the service taken over and had accepted such employment he should then become entitled to the terms and conditions governing employment in some other service, even a similar one, in which he had not been offered employment.

3. That remuneration according to prevailing rates does not mean that a prevailing rate employee in one locality is to be paid at the same rate as a prevailing rate employee in another locality.

4. That since the suppliant was offered employment as a carpenter at Gander Airport on its being taken over by Canada and accepted such employment and has been lawfully dealt with under the terms and conditions from time to time governing employment of carpenters at Gander Airport Article 39(1) of the Terms of Union has been complied with in so far as he is concerned and he has no cause of action.

PETITION OF RIGHT to recover wages from the Crown alleged due suppliant.

The action was tried before the President of the Court at Ottawa.

E. B. Jolliffe, Q.C. and *M. W. Wright* for suppliant.

W. R. Jackett, Q.C. and *D. S. Maxwell* for respondent.

P. J. Lewis, Q.C. for intervenant.

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

THE PRESIDENT now (July 31, 1956) delivered the following judgment:

The suppliant claims the sum of $3,468.10 on the ground that this amount is the difference between the wages paid to him while employed as a carpenter at Gander Airport in Newfoundland during the period from April 1, 1949, to June 30, 1952, and the wages that should have been paid to him during the said period.

His claim is based on Article 39 (1) of the Terms of Union of Newfoundland with Canada which provides as follows:

39. (1) Employees of the Government of Newfoundland in the services taken over by Canada pursuant to these Terms will be offered employment in these services or in similar Canadian services under the terms and conditions from time to time governing employment in those services, but without reduction in salary or loss of pension rights acquired by reason of service in Newfoundland.

There was agreement on the facts. Prior to April 1, 1949, the date when Newfoundland became a province of Canada, the suppliant was employed as a carpenter at Gander Airport in Newfoundland. Civil Aviation, including Gander Airport, was one of the Newfoundland services taken over by Canada, pursuant to Article 31 of the Terms of Union. On its being taken over the suppliant was offered employment as a carpenter in the said service and accepted such employment. Since April 1, 1949, he has been continuously employed as a carpenter at Gander Airport by the Department of Transport (Air Services Branch).

His complaint is that the terms and conditions of his employment have not been in accordance with the terms and conditions governing the employment of carpenters at other airports under the jurisdiction of the Department of Transport in that his rate of wages has been less than in the case of carpenters at such other airports and he has not been paid for overtime on the same basis as that for carpenters at such other airports.

The facts relating to his wages are set out in detail in the admissions of the parties and I need merely summarize them. Prior to April 1, 1949, the suppliant was paid at the rate of 82 cents per hour. Then, pursuant to Order in Council P.C. 157/2540, dated May 18, 1949, he was paid at the rate of 86½ cents per hour with effect from April 1, 1949, and continued to be paid at that rate until August 23, 1950. His wages were then raised to $1.16 per hour, pursuant to a Treasury Board minute of August 24, 1950, and he was paid at that rate until June 30, 1951. His wages were then raised to $1.30 per hour, pursuant to a Treasury Board minute of December 31, 1951, and he continued to be paid at that rate from July 1, 1951, to June 30, 1952.

The facts relating to his hours of work are as follows. Prior to April 1, 1949, he worked 10 hours, 60 hours per week, and was paid at the rate of time and one-half for time in excess of 60 hours per week. After April 1, 1949, his hours of work remained the same until August 31, 1950, without any provision for extra pay for overtime. Then, as from September 1, 1950, pursuant to Treasury Board Minute 396847 of October 19, 1950, under section 4 of Order in Council P.C. 6190, dated December 6, 1949, his hours

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of work were reduced to 8 hours per day with a standard work week of 44 hours, but he was permitted to work up to 48 hours per week with time and one-half for any time in excess of 48 hours per week. This continued to be the situation up to June 30, 1952.

The rates of wages for carpenters at other airports under the jurisdiction of the Department of Transport varied. Between April 1, 1949, and June 30, 1950, the rates were $1.25 per hour at Winnipeg, $1.50 at Malton, $1.20 at Dorval, 90 cents at Mont Joli and Seven Islands and $1.15 at Gore Bay. These remained the same until August 23, 1950, except that between July 1, 1950, and August 23, 1950, the rate at Dorval was $1.40 per hour. Between August 24, 1950, and June 30, 1951, the rates at Winnipeg ran from $1.25 per hour to $1.50, at Malton from $1.50 to $1.75, at Dorval $1.40, at Mont Joli and Seven Islands from 90 cents to $1.05 and at Gore Bay $1.15. Between July 1, 1951, and July 31, 1951, the rates at Winnipeg were $1.65 per hour, at Malton $1.75, at Dorval $1.40, at Mont Joli and Seven Islands $1.05 and at Gore Bay from $1.15 to $1.25. Finally, between August 1, 1951, and June 30, 1952, the rates at Winnipeg were from $1.65 per hour to $1.80, at Malton from $1.75 to $2.10, at Dorval $1.55, at Mont Joli and Seven Islands $1.05 and at Gore Bay $1.25.

There was less variation in the hours of work. Between April 1, 1949, and September 30, 1949, carpenters at Winnipeg and Malton worked 8 hours per day, 44 hours per week, whereas those at Dorval, Mont Joli, Seven Islands and Gore Bay worked 48 hours per week and there were no special rates for overtime. Then from October 1, 1949, to June 30, 1952, the normal working hours were 8 per day and the standard work week was established at 44 hours per week pursuant to Treasury Board Minute 388033 of April 28, 1950, under section 4 of Order in Council P.C. 6190, dated December 6, 1949, but carpenters at Dorval, Mont Joli and Seven Islands were permitted to work 48 hours per week. Overtime rates were paid for time in excess of 48 hours per week.

Thus it appears that from April 1, 1949, up to August 23, 1950, a period of almost 17 months, the suppliant's rate of wages was lower than that at any of the airports mentioned and that after the latter date it was lower than the

rates paid at Winnipeg, Malton and Dorval but higher than those paid at Mont Joli, Seven Islands and Gore Bay. It also appears that from October 1, 1949, to September 1, 1950, a period of 11 months, the suppliant was still on a 60 hour week without any provision for extra pay for overtime, whereas at the other airports carpenters had a standard work week of 44 hours with overtime pay for any time in excess of 48 hours.

I should also refer to certain statutory provisions. Section 1 of the British North America (No. 1) Act, 1949, enacted by the Parliament of the United Kingdom, 12-13 Geo. VI, Chapter 22, provided:

> 1. The Agreement containing the Terms of Union between Canada and Newfoundland set out in the Schedule to this Act is hereby confirmed and shall have the force of law notwithstanding anything in the British North America Acts, 1867 to 1946.

This enactment was subsequent to the approval of the Agreement by the Parliament of Canada by an Act to approve the Terms of Union of Newfoundland with Canada, Statutes of Canada 1949, Chapter 1.

It was contended on behalf of the suppliant that on and after April 1, 1949, he had a statutory and constitutional right to the terms and conditions of employment established for him by Article 39 (1) of the Terms of Union and that there was a legal obligation on the part of Canada to accord them to him. It was submitted that the suppliant was entitled to the terms and conditions from time to time governing the employment of carpenters at the other Canadian airports and that, since his rate of wages had been less than the rates paid to carpenters at the other airports and he had not been paid for overtime on the same basis as at such other airports, he had been discriminated against and there had been a breach of the obligation imposed by Article 39(1) and he was entitled to compensation accordingly.

There being no uniformity in the terms and conditions governing the employment of carpenters at Canadian airports counsel for the suppliant selected the terms and conditons at Dorval Airport as those to which the suppliant was entitled. The reason put forward for selecting Dorval Airport was that it was more nearly comparable with Gander Airport than were the other

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airports, particularly because of the large number of prevailing rate employees there and also because both Gander and Dorval were international in character. Consequently, the suppliant claimed that during the period mentioned in his petition he should have been paid at the same rate of wages as that paid to carpenters at Dorval Airport and also that he should have been paid overtime rates for all time in excess of 48 hours per week as at Dorval. The details of how his claim is made up are set out in his petition.

This is a test case. It is of considerable importance in that it involves the interpretation of Article 39(1) of the Terms of Union and the decision may affect other prevailing rate employees at Gander Airport of whom there were 770 on April 1, 1949, which number had been reduced to 651 by June 30, 1952.

The Attorney-General of Newfoundland was granted leave to intervene in the action. Counsel for the intervenant gave general support to the argument of counsel for the suppliant. He urged that the Terms of Union were more than a contract. They had the force of law. He stressed that Article 39 (1) ensured that there should be no reduction in salary in the case of a Newfoundland employee in a service taken over by Canada but his main complaint, as I understood his submission, was that there had been discrimination against the suppliant as compared with carpenters at other Canadian airports in that while a standard work week of 44 hours had been established for them with effect from October 1, 1949, by Treasury Board Minute 388035 of April 28, 1950, enacted under section 4 of the Prevailing Rate Employees General Regulations, a standard work week of the same hours was not established for prevailing rate employees of the Air Services Branch employed at Gander Airport until September 1, 1950, with the result that even if the suppliant's take-home pay were comparable with that of carpenters at other airports he had to work longer hours than they in order to earn it and that this discrimination was a contravention of Article 39 (1).

Before dealing with the suppliant's claim I should refer to the statutory enactments affecting the status of his employment. Section 38B of the Civil Service Act, 1918,

as amended in 1921, Statutes of Canada, Chapter 22, which was carried forward by section 59 of the Civil Service Act, R.S.C. 1927, Chapter 22, empowered the Civil Service Commission, with the approval of the Governor in Council, to exclude certain positions from the operation of the Act and make regulations prescribing how they were to be dealt with. Order in Council P.C. 1053, dated June 29, 1922, enacted under the authority of the said section 38B, excluded several positions, including that of carpenter, from the operation of the Act and section 2 of this Order in Council provided:

> 2. That the compensation shall not exceed the salaries provided in the classification schedules, and that where "Prevailing Rates" are provided as the compensation for a class, or where no class schedule exists, the rates of pay shall be such as are recommended by the Department and approved by the Governor General in Council, and that the compensation in these cases shall carry no bonus.

This general exempting order has been amended from time to time.

This Order in council was continued in effect after the Revised Statutes of Canada of 1927 came into force: *vide* An Act respecting the Revised Statutes of Canada, Statutes of Canada, 1924, Chapter 65, and *vide* also section 20 of the Interpretation Act, R. S. C. 1927, Chapter 1. This was, therefore, the situation of a carpenter in the employment of the Government of Canada when Newfoundland became part of Canada on April 1, 1949.

I next refer to Article 36 of the Terms of Union which provides:

> 36. Without prejudice to the legislative authority of the Parliament of Canada under the British North America Acts, 1867 to 1946, any works, property, or services taken over by Canada pursuant to these Terms shall thereupon be subject to the legislative authority of the Parliament of Canada.

Consequently, when the service of civil aviation, including Gander Airport, was taken over by Canada it became subject to the legislative authority of the Parliament of Canada.

Then, pursuant to Article 18 of the Terms of Union, the Civil Service Act was made applicable to Newfoundland as of April 1, 1949, by a proclamation, dated April 1, 1949: *vide* Canada Gazette, Volume 83, page 1292. This carried with it Order in Council P.C. 1053, dated June 29, 1922, as amended up to that date.

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Then by Order in Council P.C. 157/2540, dated May 18, 1949, approval was given to the Treasury Board's approval, on the recommendation of the Minister of Transport, of the prevailing rates of wages for the classes of employees at Gander listed in the schedule attached to the Treasury Board minute, effective April 1, 1949. This Order in Council was a valid exercise of the power to fix the wages of employees set out in section 2 of Order in Council P.C. 1053, dated June 29, 1922. One of the Classes listed in the schedule was that of carpenter. The suppliant thus became as from April 1, 1949, a prevailing rate employee of the Department of Transport, with his rate of wages lawfully fixed at 86½ cents per hour, that being the rate recommended by the Department of Labour.

I should also refer to the Prevailing Rate Employee General Regulations, enacted by Order in Council P.C. 6190, dated December 6, 1949. Sections 4,5 and 6 of these General Regulations provide:

4. The Treasury Board shall, on the recommendation of the deputy head concerned, determine for employees in each unit in the public service:

(*a*) a work week which shall be each period of a week commencing on such day of the week as the Treasury Board may name;

(*b*) a standard work week which shall be the number of hours that the employees are ordinarily required to work during the work week determined for the employees under paragraph (*a*); and

(*c*) a normal number of working hours for each day in the work week determined for the employees under paragraph (*a*), which shall be the number of hours that the employees are ordinarily required to work on that day.

5. The rate of normal pay and the rate and conditions of extra pay for employees in each unit in the public service shall be fixed by the Treasury Board after consultation with the Department of Labour.

6. Wages shall not be paid to an employee at a rate other than the rate for work performed during normal working hours unless a standard work week for the employee has been determined by the Treasury Board under section four.

And section 32 provided:

32. The Treasury Board may direct the manner in which these regulations apply in any case of doubt or may exclude an employee or class of employees from these regulations.

Finally, I refer to Treasury Board Minute 388035-1 of April 28, 1950, whereby, pursuant to section 32 of the General Regulations, the Board excluded prevailing rate staffs employed by the Air Services Branch of the Department of Transport at Gander Airport from the operations of sections 4 and 6 of the General Regulations for the period from October 1, 1949, to June 1, 1950.

And I have already referred to Treasury Board Minute 396847 of October 19, 1950, whereby a standard work week of 44 working hours was established for prevailing rate staffs of the Air Services Branch employed at Gander Airport and the normal working hours per day were set at 8.

I should say that the validity of the Prevailing Rate Employees General Regulations was questioned by counsel for the suppliant and counsel for the respondent was unable to find any statutory authority for it. In view of the conclusion to which I have come I need not express an opinion on its validity and do no more than suggest the desirability of giving statutory approval of it in view of the extensive use made of it.

In my opinion, there is no support in law for the suppliant's claim. It is based on an erroneous construction of Article 39(1) of the Terms of Union. There is no warrant in it for the assumption that when the suppliant was offered employment as a carpenter in the civil aviation service at Gander Airport he became entitled to employment there under the terms and conditions from time to time governing the employment of carpenters at Dorval Airport or any other Canadian airport. That is the assumption on which the suppliant's claim is based. In my judgment, it is erroneous.

Counsel for the suppliant sought to support it by reading the term "those services" in Article 39(1) as being referable only to the term "similar Canadian services" but that, in my opinion, is not a correct construction. The term is referable both to the services taken over, described in the Article as "these services", and to the "similar Canadian services" and should be read disjunctively.

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The error in construction is partly due to the use of the plural terms "these services" and "those services". If Article 39(1) is looked at from the point of view of an individual in one of the services taken over its meaning is clear, namely, that an employee of the Government of Newfoundland in a service taken over by Canada pursuant to the Terms of Union will be offered employment *either* in the service taken over *or* in a similar Canadian service, his employment to be under the terms and conditions from time to time governing employment in the service in which he was offered employment. Thus, if he is offered employment in the service in which he was previously employed it will be under the terms and conditions from time to time governing employment in that service. On the other hand, if he is offered employment in a Canadian service similar to the one taken over it will be under the terms and conditions from time to time governing employment in such similar Canadian service. There is, of course, the saving provision in each case that he is not to suffer a reduction in salary.

In my judgment, the construction advanced in support of the suppliant's claim is not a reasonable one. It could not have been contemplated that after the Newfoundland employee had been offered employment in the service taken over and had accepted such employment he should then become entitled to the terms and conditions governing employment in some other service, even a similar one, in which he had not been offered employment. It would be unrealistic to read such an intention into the Article, particularly in the case of a prevailing rate employee whose remuneration is based on the rate of pay prevailing in the area of his employment for the class of work he does. The fact that the prevailing rates for carpenters at Canadian airports other than Gander varied, as at April 1, 1949, from $1.50 per hour at Malton to 90c at Mont Joli and Seven Islands points to the unreality of the suppliant's claim. It is implicit in the idea of remuneration according to prevailing rates that a prevailing rate employee in one locality may not be paid at the same rate as a prevailing rate employee in another locality. Thus, in the case of the suppliant, if he had been offered employment at Dorval Airport there is no doubt that he would have been paid

the prevailing rate at Dorval. But he was not offered employment at Dorval and the terms and conditions governing employment at Dorval do not apply to him. His offer of employment was employment at Gander Airport and his only right is to the terms and conditions governing employment there, subject always, of course, to the saving provision that his salary should not be reduced.

There is thus no basis in law for the suppliant's or the intervenant's complaint that there has been discrimination against carpenters employed at Gander Airport. If there is any complaint by reason of the fact that for 17 months their rate of pay was lower than that of carpenters at other Canadian airports and that a standard work week of 44 hours was not established for them until 11 months after such a week had been established for carpenters at other airports, as to which I do not express any opinion, there is no ground for complaint in point of law.

Thus, since the suppliant was offered employment as a carpenter at Gander Airport on its being taken over by Canada and accepted such employment and has been lawfully dealt with under the terms and conditions from time to time governing employment of carpenters at Gander Airport it is apparent that so far as he is concerned Article 39(1) of the Terms of Union has been complied with and he has no cause of action.

In view of this disposition of the suppliant's case I need not express an opinion on the other contentions submitted by counsel for the respondent, namely: that if Article 39(1) imposes a duty on the Canadian Government to offer employment under the terms and conditions of employment suggested on behalf of the suppliant the petition is ill-founded in that it does not ask for a declaration that the suppliant is entitled to such offer of employment but is a petition for the compensation to which he would have been entitled if he had been offered employment in a different service; that since Article 39(1) is an agreement between Newfoundland and Canada it confers no rights on any individual; that if the petition is for failure to offer employment under the terms and conditions suggested the suppliant has renounced his right by accepting employment

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under other terms and conditions; and, finally, that if the petition is for failure to pay wages legal proceedings do not lie against the Crown to enforce payment of arrears of wages in favour of a servant of the Crown.

Under the circumstances, the judgment of the Court is that the suppliant is not entitled to any of the relief sought by him in his petition of right and that the respondent is entitled to costs. There will be no costs for or against the intervenant.

Judgment accordingly.

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Feb. 14

BETWEEN:

MARINE INDUSTRIES LIMITED .....APPELLANT;

AND

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

Revenue—Income tax—The Income Tax Act, 11-12, Geo. VI, c. 52, ss. 3, 4 and 127(1)(e)—Payment made to reduce deficits incurred in performance of a contract—Donation or trading debt—Money received in consequence of regular business operations—Appeal from Income Tax Appeal Board dismissed.

Appellant contracted with another company to perform certain work for a determined price. Later appellant received payment of an additional sum to cover operating deficits incurred in the performance of the contract. Appellant was assessed income tax on such additional sum and now contends that such money was received as a minimization of capital loss and not as income.

Held: That the payment under consideration was made as an acknowledgement of a contractual and trading debt and not as a donation.

2. That the payment was received by appellant in consequence of previous and regular business operations and was rightly assessed for income tax.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

Lazarus Phillips, Q.C. and *Neil F. Phillips* for appellant.

Léon Lalande, Q.C. and *F. J. Dubrule* for respondent.

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

DUMOULIN J. now (February 14, 1957) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board, dated the 27th of January 1955 (1), dismissing an appeal by the taxpayer from an assessment levied for the taxation year 1950.

The facts are undisputed. Appellant company, incorporated under Letters Patent issued by Canada, is engaged mainly in the shipbuilding and dredging business at Sorel, a river port in the Province of Quebec. On March 31, 1939, appellant entered into a principal contract (amended and extended by a subsequent agreement dated March 6, 1943), with Beauharnois Light, Heat & Power Co. (hereinafter referred to as Beauharnois), a company then owned by private shareholders, the said contract having for its main object certain dredging work in the construction of the Beauharnois Canal (Exhibit A-1).

From and after April 15, 1944, all the shares of the capital stock of Beauharnois Light, Heat & Power Co. became the property of the Quebec Hydro-Electric Commission, a Crown corporation (Chapter 22, Statutes of Quebec, 8 George VI, 1944, s. 14). Simultaneously an amendment to the Hydro-Electric Commission Act (9 George VI, c. 30) was enacted, adding in section 33 thereof:

> 18*a*—From and after the 15th of April 1944, Beauharnois Light, Heat & Power Co. has always been and still is an agent of the Crown in the right of the Province, and its property as well as the profits which it realized have belonged and belong to the Province.

From March 31, 1939, to April 15, 1944, appellant was under contract with a private company, but from this latter date on to December 20, 1944, when the undertaking reached completion, it worked for an agent of the Crown in the right of the province.

The principal contract and its amendments provided for the excavation of "between 5,000,000 and 6,000,000 cubic yards of unclassified boulder clay and its disposition outside of the limits of the canal."

Unforeseen technical difficulties, such as a far greater amount of rock than was expected; various complications brought about by the wartime restrictions then obtaining; a shortage of labour with the obviating necessity of an

(1) 12 Tax A.B.C. 161.

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onerous raise in wages, culminated in the overall loss of $1,487,124.35, based "on the difference between the total cost of the contract to the appellant and the total amount received from Beauharnois". Understandably reluctant to shoulder this burden without at least seeking some indemnification, appellant, on February 16, 1945, presented to Beauharnois a demand for compensation of those operating deficits set out at length in an itemized memorandum of costs (Exhibit A-2).

This official request (Ex. A-2, p. 11), signed by appellant's comptroller, Mr. P. A. Lavallée, in its concluding paragraph and in bold type reads:

> Cette réclamation est présentée sur une base d'équité et tous les faits mentionnés dans ce factum justifient la "Compagnie" de payer au "Contracteur" la somme réclamée. Nous sommes convaincus que la compagnie nous accordera cette part de justice qui nous revient. Le tout sans préjudice.

What occurred during the four years following remains untold and would be of no import. Suffice it to say that, on June 17, 1949, Beauharnois Light, Heat & Power Co. paid to Marine Industries Ltd. a sum of $750,000 by cheque to which was attached a stub containing this legend:

> In settlement of your claims against this company, under contract dated March 31, 1939, and amendment thereto dated March 6, 1943. (Ex. A-4).

On receiving this amount, appellant's auditors marked it to income "and immediately deducted therefrom the sum of $650,000 as 'Amounts set up for special contract expense by charge to special revenue'." As a result of the foregoing, appellant included in income on its books the $750,000 received from Beauharnois, claimed as a deduction the contingent reserve (for reconversion of a dredge from electric power to steampower) of $650,000 and continued to include in income on its books the $100,000 difference between the two sums aforesaid." The Minister added the $750,000 to appellant's reported income for the 1950 taxation year. At that time, however, Marine Industries Ltd., reversing its initial interpretation of the deal, had taken the stand that it was not a trading receipt but a minimization of capital loss, outside the scope of regular business affairs.

Consequently, in paragraph 17 of its Notice of Appeal, Marine Industries Ltd. claims it "is not bound by the erroneous entries made in its books of account with respect to the receipt of the $750,000 from Beauharnois." I agree that a real error is not binding: "erreur n'est pas cause"; although one might be interested to know where, in appellant's view, the error lies. Would it be in the so-called reserve fund outlined without any perceptible deprecation in paragraph 13 *supra?*

The fact remains that, upon receiving payment, appellant listed it in its income column, the subsequent change of "name" from income to capital arising as an afterthought. This of course, by itself, is not conclusive, yet, in a limited degree, it could be indicative.

What is the true nature of this payment? Such is the question at stake.

Appellant claims:

(a) That the said sum of $750,000 does not constitute income under ss. 3 and 4 of The Income Tax Act, 1948 (11-12 George VI, c. 52). (N. of A. para. 18).

(b) This sum represents a receipt on capital account. (N. of A. para. 20).

(c) It is not a trading receipt or an ordinary payment, but a gratuitous or extraordinary payment received outside the ordinary course of business. (N. of A. para. 21).

(d) That such gratuitous benefit conferred after the close of a contract, which did not result in a profit but only in the minimization of a loss, does not constitute taxable income. (N. of A. para. 23).

The respondent, relying upon ss. 3, 4 and 139(1)(*e*) of the Act (s. 127(1)(*e*) (1948) R.S. 11-12 Geo. VI, c. 52, would be more appropriate), briefly replies in law that:

(a) The assessment for the taxation year 1950 is correct and made in accordance with the provisions of the Income Tax Act.

(b) The amount of $750,000 received by the appellant in the taxation year 1950 is income.

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I will at once dispose of the so-called "act of grace" or purely benevolent character of the payment made by Beauharnois to appellant.

Ages ago, shrewd observers of human nature, the Romans, had inscribed in the pertinent law a caution which holds good to this day: *Nemo praesumitur donare*—"Gifts are not presumed but proven".

I am at a loss to understand how or why the regular process of the taxing statute could be diverted from its ordinary course, merely because a trade obligation, implemented through payment, happened to be a moral one and not strictly enforceable at law.

In my opinion, there is no doubt but that Beauharnois paid for value received, acknowledging its real, if not strictly legal, obligations. In the English case of *Herbert v. McQuade* (1), it was said:

> . . . the test is whether, from the standpoint of the person who receives it (i.e. the voluntary payment), it accrues to him in virtue of his office; . . . and the liability to income tax is not negatived merely by reason of the fact that there was no legal obligation on the part of the persons who contributed the money to pay it.

In a similar vein, we read in *Cooper v. Blakiston* (2) that:

> The question is not what was the motive of the payment, but what was the character in which the recipient received it. Was it received by him by reason of his office?

Regarding the motive of the "payer", I have stated my conviction; concerning the "character" of the recipient or "payee", it received payment of its contractual enterprise. This also disposes of the time factor which fails to alter the nature of the payment.

Furthermore, should the transaction at issue be anything but a regular acquittance of debt, in the ordinary, though tardy, course of business, the alternative then necessarily points to a gift or donation, something outside the scope of trade between a privately owned concern, and a Crown company.

How could a Crown agent, such as Beauharnois Light, Heat & Power Co. "donate" $750,000 to Marine Industries Ltd. without proper authority so to do, namely a vote of

(1) [1902] 2 K.B. 631 at 649, in fine. (2) [1907] 2 K.B. 688 at 703.

the Legislature as in the *Geo. T. Davie* case (*infra*). And would a "donation" be properly acknowledged by means of a company resolution, such as Exhibit R-1, dated June 17, 1949, recording, *inter alia*, para. 4:

> Que la compagnie donne *une quittance complète, totale et finale* à Beauharnois Light, Heat & Power Company en considération *du paiement* de ladite somme de $750,000, de toute réclamation quelconque au sujet dudit contrat et de toutes choses qui en ont découlé.

If this does not qualify conclusively, and in appellant's own terms, the nature of the act "un payement" and the "character" according to which it was received that of a vendor of services and material, warranting a release or quittance "de toute réclamation quelconque au sujet dudit contrat", I renounce all possibility of showing it in a more revealing light.

A few precedents were referred to during the argument and with special emphasis those of *British Mexican Petroleum Co. Ltd. v. Jackson* (1) and *Geo T. Davie and Sons Ltd. v. Minister of National Revenue* (2).

In the former affair, the pertinent matter was that:

> Under the terms of an agreement dated the 25th November, 1921, the Appellant Company (British Mexican Petroleum) paid to the producing company (The Huasteca Company) the sum of £325,000 and was released by the producing company from its liability to pay the balance remaining due, viz., £945,232. The amount so released was carried direct to the Appellant Company's balance sheet and was shown as a separate item under the head "Reserve" at the 31st December, 1922.
>
> The question in this appeal (wrote Lord Thankerton at page 590) is whether this sum of £945,232 falls to be brought into account for the purpose of computing the profits and gains of the Respondents under Schedule D of the *Income Tax Act,* 1918, either by reducing by that amount the debit item in the trading account to 30th June, 1921, or by crediting it as a trading receipt in the trading account to 31st December, 1922.

Due account taken that respondents never disputed the sum of their contractual liability to the Huasteca Company (p. 592), Lord Thankerton continued thus:

> I am unable to see how the *release* from a liability, which liability has been finally dealt with in the preceding account, can form a *trading receipt* in the account for the year in which it was granted.

That case seems readily distinguishable from ours, in which I perceive no "release" from a liability but the "acquittance" of one.

(1) 16 Tax Cases, 570 ff. (2) [1954] Ex. C.R. 280 ff.

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Marine Industries who, alone, could have forgiven Beauharnois its, let us say, moral and equitable (*lato sensu*) obligations, insisted on obtaining payment.

Admittedly, the receipt by appellant of $750,000 served to abate an eventual loss. But so do all payments when envisaged from that viewpoint.

The distinction alluded to above assumes the proportion of a neat difference as another glance may reveal. At page 593, third paragraph, Lord Macmillan held that:

> If then, the accounts for the year to 30th June, 1921, cannot now be gone back upon, still less in my opinion can the Appellant Company (B.M. Petroleum Co.) be required to enter as a credit item in its accounts for the eighteen months to 31st December, 1922, the sum of £945,232, being the extent to which the Huasteca Company *agreed to release the Appellant Company's debt to it.* I say so for the short and simple reason that the Appellant Company *did not,* in those eighteen months, either *receive payment of that sum* or acquire any right to receive payment of it. I cannot see how the extent to which *a debt is forgiven* can become a credit item in the trading account for the period within which the concession is made.

The essential expressions are, of course, those indicating a "release" of debt and a debt "forgiven".

As already stated, in the case at issue, none, save Marine Industries Ltd. enjoyed the right of "releasing" or "forgiving" any liability owing by Beauharnois. Far from releasing or forgiving any fraction of the latter's indebtedness, appellant, four years pending, strove to obtain $1,487,124.35, of which it was finally *paid* $750,000 on a pro and con settlement basis.

The agreement, in *British Mexican Petroleum v. Huasteca Co.* (*supra*), was to *release* and *forgive* a debt of £945,232; whilst here, in complete contrast, we find an *acknowledgement* of a debt, a contractual and trading one, fully instanced on June 23, 1949, through actual payment. Hence appellant's apparent confusion of a debt *forgiven* with a debt *admitted* and *acquitted.*

Let us now advert to the question raised in the matter of *Geo. T. Davie and Sons Ltd. v. The Minister of National Revenue* (*supra*).

Geo. T. Davie (for short), a shipbuilding enterprise, at Lévis, P.Q., fell into financial difficulties while building five Yangtze River boats, under contract with a Chinese company, which derived its funds mainly from loans guaranteed by the Canadian Government. The Davie Co.

obtained, under a mortgage security covering all its immovables, advances from the Canadian Commercial Corporation, a Crown company, to which it was already indebted in the amount of $450,000 for previous loans. Upon completion of the contract, Geo. T. Davie's total indebtedness to C.C.C. amounted to $914,000.

On November 2, 1949, the Crown, ultimate if not proximate creditor, abated the shipbuilder's debts in respect of two amounts: the first of $248,813.83 "being the amount of a payment received by the Canadian Commercial Corporation from the Chinese company, representing the final increase in the price of the three large vessels"; the second of $450,000 "being a portion of the said advances made by the Canadian Commercial Corporation to the shipbuilder and representing the portion of the loss assumed by the Canadian Government . . . ." The payment of $248,813.83 from the Chinese company *was taken in appellant's accounts* for 1949 *as a trading receipt*, but the sum of $450,000, shown in its tax returns for the same year as an increase in capital surplus, was added by the Minister to appellant's declared revenue, whence the problem. It was held, *inter alia*, that (p. 281):

(3) The mere cancellation or abatement of an undisputed trade debt does not give rise to taxable income in the hands of a taxpayer whose trade debt has been cancelled or abated. The abatement of a capital indebtedness cannot give rise to taxable income.

To this must be joined the following pronouncement:

(4) The benefit conferred on Appellant by the abatement of its *capital liability* was not something received in the course of its normal trading operations. It was outside those operations entirely. *It did not* in 1949 *receive payment of the sum of $450,000* or acquire any right to receive it. The liability was diminished purely as an act of grace. The benefit received was not a profit from Appellant's business.

In the George T. Davie case, the Crown agent, Canadian Commercial Corporation, shows up merely in the guise of a mortgage creditor for moneys advanced and is, otherwise, alien to the shipbuilding contracts, while Marine Industries Ltd. and Beauharnois are linked together in a direct contractual relationship, comparable to that of vendor and purchaser in final analysis.

Another significant factor of the Davie case: the sum of $248,813.83 paid, in 1949, by the Chinese company to Canadian Commercial Corporation and credited to George

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T. Davie's account (an incident of close analogy to the $750,000 paid by Beauharnois to Marine Industries) "was taken into the appellant's accounts for the year 1949 as a trading receipt" and shown as an item of assessable revenue. As Cameron J. put it in the Davie case (p. 287):

> There is no evidence whatever that in paying the additional sum of $248,813.83, Ming Sung (the Chinese firm) *was contributing to the losses* of the Appellant. The letter of the Deputy Minister dated November 2, 1949, states that that sum "was received by the C.C.C. from Ming Sung *as the final increase of contract price* in respect of the three large vessels."

A wording, very similar, was resorted to in our Exhibit A-4 *supra* and *infra*. Lastly, the abatement of $450,000 consented to by the Canadian Government, in reduction of advances to George T. Davie, never took the form or shape of a *payment* but that of a mere *entry* in the lender's books. On the other hand, in sharp contrast, Beauharnois Light, Heat & Power, *by its cheque* of June 17, 1949, went through the positive act of paying $750,000 to appellant, "attaching to the above mentioned cheque a stub with the following legend (Exhibit A-4):

> In settlement of *your claim* against this company *under the contract* dated March 31, 1939, and amendment thereto dated March 6, 1943.

Finally, how could one trace the faintest outline of a *capital liability* throughout the entire unfolding of this transaction?

The inescapable result is to classify the $750,000 paid in the category of operational trading obligations as contemplated by ss. 3 and 4 and as further defined by s. 127(1)(*e*) of the Act. Appellant received, in 1949, this amount in consequence of previous and regular business operations.

The consequent assessment by the Minister was correct and made conformably to the relevant provisions of *The Income Tax Act*, 1948.

Therefore, appellant's appeal should be dismissed, with costs taxed in the usual way.

Judgment accordingly.

BETWEEN:

ERIC FRANCIS STEPHAN .....SUPPLIANT;

AND

HER MAJESTY THE QUEEN .....RESPONDENT.

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Crown—Petition of right—Damage to suppliant's vehicle through negligent driving of a Crown servant not "acting within the scope of his duties or employment"—Vehicle operated by driver without permission, authority or knowledge of his superior officers—Driver of vehicle not engaged in performance of the duties for which he was employed—Crown vehicle readily accessible to driver—No liability to suppliant.

Suppliant's truck was damaged through the admitted negligent driving of a Crown vehicle by one Maher. Maher was a recruiting sergeant and not a driver of any vehicle. The regular all-time driver of the Army vehicle was one Private Casey. On the occasion on which the suppliant's truck was damaged Maher was driving the Army vehicle involved in the accident for purposes of his own and contrary to orders which prohibited him driving an Army vehicle. Suppliant seeks to recover from the Crown the damages caused to his truck.

Held: That Maher in disobeying orders and assuming to drive the car was not acting within the scope of his duties or employment.

2. That the fact that Maher had ready though forbidden access to the Crown vehicle does not render the Crown liable to the suppliant.

PETITION OF RIGHT to recover damages from the Crown.

The action was tried before the Honourable Mr. Justice Dumoulin at Montreal.

Harold B. Lande, Q.C. and *Pierre A. Badeaux, Q.C.* for suppliant.

J. W. Long, Q.C. for respondent.

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

DUMOULIN J. now (January 25, 1957) delivered the following judgment:

This petition was tried at Montreal on the 30th of May 1956.

Suppliant, carrying on business in the city and district of Montreal, and elsewhere, under the registered name of Drummond Transit Company, prays for damages in the sum of $3,138.10 from Her Majesty the Queen, through

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the Department of National Defence, the sequel of a smash-up which occurred in the town of Beloeil on November 18, 1954, at about 9.40 that evening.

At this latter time and place, suppliant's regular driver, in charge of one of suppliant's numerous trucks, was directing this particular tractor and trailer unit, a 1949 White motor truck, bearing Quebec license No. L-15330 of 1954, from St. Hyacinthe to Montreal, in the wake of the respondent's station wagon license No. G-9303. This station wagon was driven by one William Harold Maher, a sergeant, then attached to the Army Service Corps and stationed at St. Hyacinthe in the capacity of recruiting sergeant.

Both vehicles were passing through the little town of Beloeil, when, and without any signal or warning, respondent's car left the road to its right hand side, where quite a few shops are located. In the permissible assumption that the road would remain free, the chauffeur of suppliant's truck, one Gaston Lachapelle, sped on. Unfortunately, the army wagon, as the truck came abreast of it—a matter of a very few seconds at the utmost—, left the right border or shoulder of the road, suddenly cut directly across route No. 9, and managed by a hair's breadth to enter a side lane adjoining. Lachapelle slammed on the brakes, but the fourteen to twenty thousand pounds of the loaded trailer pushed it forward in despite of all, thrusting the truck in a jack-knife angle with the front portion or tractor, thereby blocking both tracks of the road.

At the same moment, a local farmer, Adrien Senécal, happened to be driving his own truck eastwards to St. Hyacinthe, at a speed of 20 or 22 miles per hour. The negligible intervening distance separating Senécal's farm truck from respondent's, and a damp(humide) pavement, here again nullified all attempts at braking, with the ultimate result that the former vehicle crashed head on into the latter, inflicting heavy material damages to suppliant's property ($3,138.10).

The Department of National Defence car had come to a stop on St. Charles street, a lateral and secondary thoroughfare, some 70 feet distant from Laurier Boulevard, the point of collision, opposite the house of one Philippe Comtois. Heard as a witness, Comtois says that perceiving

the noise of the collision, he came out to inquire, noticed the army station wagon from which two persons, a man and a woman, were issuing. The darkness precluded any further identification of the couple who unconcernedly walked away. Later that night, Sergeant Maher and a female consort were found by a Provincial Police agent drinking in some nearby grill. Suppliant's chauffeur, Gaston Lachapelle, remained in the vicinity until midnight, but could not find Maher who, in the meantime, with his girl friend, had returned by taxi to St. Hyacinthe, after being refused room accommodation at two Beloeil hotels (*vide*: Cécile Guignard's statement).

The evidence established Maher's culpable negligence to such an overwhelming degree that, on the facts of the accident itself, no proof was tendered in defence and advisedly so. It will therefore suffice to note that this was a repetition of the age worn and classic (in its legal connotation) joy-ride case, giving rise to the corollary legal queries: was the driver of the respondent's car at the time of the accident "in the employ of and on the business of respondent" according to paragraph 16 of the petition, or, negatively, should I decide, in keeping with paragraphs 27 and 29 of the answer to petition, that:

Para. 27— . . . on the said date Sgt. W. H. Maher did appropriate the use of the said vehicle for his own purposes and without permission, without authority and without the knowledge of his superiors.

Para. 29—That on the evening of the said 18th of November, 1954, the said Sgt. Maher was not engaged in the performance of the duties for which he was employed.

Let us now review the evidence on this crucial issue.

William Harold Maher, who appeared especially concerned in hushing the "romantic" tangle of his perilous escapade, and in the course of his endeavours got bogged in a mire of contradictions, had this to declare as to his official status:

He was recruiting sergeant for one of the Army teams, a more or less roving unit, composed of Major Bell, the witness, holding sergeant's rank, Corporal Baker and driver Casey. This small group usually left Montreal on Monday morning for St. Hyacinthe, its recruiting base covering some Eastern Townships sections, returning to Montreal Friday night. The evening of November 18, however, Major Bell was away from St. Hyacinthe, so Corporal Casey, the regular army driver, his day's work done and according to routine orders, handed over the keys of the station wagon to Sergeant Maher, the next in rank during Major Bell's absence. Otherwise, these keys would have been delivered to the commanding officer.

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Around 7.30, that fateful evening, Maher met Cécile Guignard at the Ottawa Hotel, in St. Hyacinthe. This girl told him she intended to meet other girls "de petites amies" at Beloeil, whereupon Maher replied that he would bring her there, since he had work to do in that direction "par là-bas". (The italicized portion is from my notes of Cécile Guignard's evidence).

To continue now with the sergeant's testimony he says:

In 1954, I was engaged in recruiting. *Beloeil village was then in our recruiting area, but not at that time on our visiting curriculum or schedule.* Major Bell, Corporal Baker, Pte. Casey and myself composed our recruiting team.

Casey was the appointed driver of the team's station wagon. On the night of the 18th of November, 1954, I had no right to drive the Government's car. When off duty, I was allowed to wear civilian clothes. That night, at the material time, I was wearing civilian apparel.

Prior to my posting to my particular team, as I learned upon joining it, I was told that the Beloeil area had been dropped off the list as unproductive and another spot substituted instead. I always adhered to the visiting list closely.

Maher repeats *he "had no authority to drive that car on that particular night", although previously acknowledging he had driven, some time before, another military car.* The witness goes on to explain that "to the best of my knowledge, on the night of November 18 Major Bell was in Montreal. *I was not then in command of the team.* I am just a non-commissioned officer and had received particular and definite orders from Major Bell. *Casey, in the absence of the commanding officer, gave me the keys of the car for a receipt. Had Major Bell been present, Casey would have handed the keys to him as commanding officer."*

At this point, attorney for suppliant put the following question to the witness:

Q. That night, were you on recruiting duty?

A. As far as I was concerned, yes Sir.

This man was asked by the Court how it could be so, seeing that, on his own admissions, Beloeil village "was not at that time on the visiting curriculum or schedule"; that "Beloeil area had been dropped off the list as unproductive and another spot substituted instead". Maher replied that he was looking for a Reserve Unit Force in some undivulged section of the Beloeil-McMasterville region, *winding up his long story with this positive statement: "No orders to that effect (viz. for recruiting duties in the Beloeil-McMasterville sector) had been given to me by my commanding officer, Major Bell, nor by any one exercising authority over me."*

Due account had of this man's frequently dubious statements, I must nevertheless retain as probable that:

1—Private Casey, and not he, was the regular army driver.

2—Maher had no authority nor permission to use the car.

3—When using it, in violation of orders, on November 18, he was not "on the business of the respondent" nor on any recruiting duty, but merely engaged on a pursuit of his own.

Other and more trustworthy witnesses were called, among whom was Colonel Alfred Crowe, Assistant Judge Advocate General, also a member of the Quebec Bar.

Colonel Crowe states that in November 1954 Sergeant Maher was on the Army roll, assigned to the Montreal manning depot, recruiting section. He also files exhibits A and B, duly certified under his signature as "true extracts of Canadian Army regulations applicable to drivers of the Canadian Army; these regulations made pursuant to section 13 of the National Defence Act were in force in November 1954 and are still in force".

Exhibit A, an extract from Instructions for R.C.A.S.C. Supplies & Transport, provides for driver testing. From the 3rd paragraph's second line on, I read: *"The driver will be issued with the Manual for Drivers* (Wheeled) *and a D.N.D. Driver's Permit* (C.A.F.B. 1691). The qualifications obtained will also be entered in the driver's Individual Training Record and his Soldier's Service Book, CAB2 (Pt.1)."

Exhibit B, an extract from Canadian Army Manual For Drivers, in its article 4, paragraphs (*a*) and (*b*), is more explicit still:

4. *Qualifications and Authority for Operating Military Vehicles.*

(*a*) *Driver's Tests and Permits.*

All drivers of military vehicles must be tested and qualified in accordance with existing instructions (Part D of the Manual for S. & F. Canada) *and must at all times be in possession of a current Driver's Permit, duly authorized and signed by the issuing officer. You are not permitted to operate vehicles which are not included in your classification.*

(*b*) *Authority for Driving a Vehicle.*

No military vehicle will be operated outside the bounds of the garage, workshop or vehicle compound unless the driver is in

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possession of a Transport Work Ticket, properly completed and signed by the despatching officer or his delegated representative. The Transport Work Ticket is important. In addition to providing a means for recording vehicle operating data, *it is your official authority for operating a military vehicle.*

Private Casey, but not Sgt. Maher, was, at the material time, the holder of the requisite Transport Work Ticket. After a lapse of twelve months such "Work Tickets", testifies Colonel Crowe, are handed in, destroyed, and new ones issued; this procedure gives the explanation for driver Casey's 1954 "Work Ticket" not being available on May 31, 1956.

These written extracts, while falling in the category of *res inter alios acta*, and not binding upon third parties, admissibly corroborate respondent's plea (arts. 26 to 30 inclusive) that at the critical moment Maher *"was not engaged in the performance of the duties for which he was employed"* (Answer to petition, art. 29).

The next witness was Lt. Colonel Joseph-Albert Lefebvre, who, through all of November 1954, served in the capacity of Assistant Adjutant General, Manning and Supplies, Quebec Command, with headquarters in Montreal. Before, on and after November 18, 1954, Sgt. William Harold Maher was a member of Col. Lefebvre's command, subject to his ultimate authority, and under Major Bell's immediate orders at St. Hyacinthe.

This witness positively asserts that:

Maher n'avait absolument pas le droit de conduire les véhicules militaires. Il n'était pas attaché à l'armée en tant que chauffeur, mais en qualité de 'sous-officier recruteur' sur l'équipe de St-Hyacinthe. Le chauffeur de cette équipe, de cette section, était le soldat Casey. L'officier en charge a l'entière responsabilité de son équipe.

Le centre d'attache de cette section de recrutement était à St-Hyacinthe, *mais, les soirs, elle rayonne dans les villages environnants, tels que Belœil,* St-Hilaire, Otterburn Park, se rendant aux manèges locaux.

Il existait une directive écrite envoyée à chaque commandant, dont le Major Bell, interdisant l'utilisation des véhicules militaires pour fins personnelles. Il est à ma connaissance personnelle le Major Bell a reçu ces directives.

Colonel Lefebvre files exhibit C, a circular instructional letter from Headquarters, dated April 18, 1954, for distribution to officers in charge of recruiting teams and entitled "Misuse of D.N.D. vehicles".

In rebuttal, the witness has this to add:

A St-Hyacinthe, les véhicules militaires, si je me souviens bien, *étaient toujours rentrés dans l'Arsenal. Les clés étaient alors données à l'officier et, s'il était absent, au sergent. Le major Bell ne possédait pas le droit de désigner le conducteur du véhicule militaire, ni celui de le conduire lui-même. Le garage principal, en l'espèce celui de Montréal, désignait seul les chauffeurs militaires, les répartissait entre les différentes équipes ou sections; les quartiers généraux leur délivrant alors leurs 'standing orders' qui les autorisaient à conduire. Maher n'avait pas, que je sache, de 'standing orders' de conduire.*

I deem it difficult not to accept so direct an asseveration that: (a) Maher had no right whatever to drive the military vehicle; (b) his army status was not that of driver but of a non-commissioned recruiting officer, and (c) Pte. Casey alone was the duly appointed chauffeur attached to the St. Hyacinthe team.

I had rather expected to hear driver Casey, of whom no further mention was made; and particularly Major Bell, present at the trial and ordered to leave the room while Maher testified. No evidence on their part was forthcoming; no reasons volunteered for such omissions.

At this stage of the case, a significant appraisal, underscoring respondent's view of the problem, appears in the suppliant's factum, dated June 27, 1956. For instance, at page 11 of this written argument, we read the following:

> From the foregoing (to wit, a survey of the evidence) we can arrive at certain general conclusions.
>
> E. The night of the accident Maher was out recruiting, *but was doing so in disobedience of certain of the rules and regulations of his unit.*

Under the circumstances known, it is safe to think that Maher's pursuits at the crucial hour defy all assimilation to "the business of the respondent". So far, there were no "rules and regulations to disobey". Then if any were broken it could only be those concerning an unauthorized, hence an unlawful use of the D.N.D. car by anyone but the regularly appointed driver.

On page 12, we find that (fourth paragraph):

> However, under both systems of law the jurisprudence is uniform *that mere disobedience by an employee of orders given by his master . . .*

Again, it should be borne in mind that, in the present case, "the mere disobedience by an employee of orders given by his master" could only relate to the assumption, on recruiting sergeant Maher's part, of driver Casey's non-transferable duties.

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Any lingering doubt about the exact meaning intended by such expressions as "in disobedience of certain of the rules and regulations of his unit" (p. 11) and ". . . disobedience by an employee of orders given by his master" (p. 12) should be dispelled by the last sentence of page 17 and the first on page 18:

> *Page 17—Although Maher was forbidden to drive the car,* there was no one present to prevent him from doing so or to see that he observed (p. 18) this rule. Even the Major in charge of the unit was away from his duties, in Montreal, leaving in charge *the man who was the first to break the rules.*

Suppliant's interpretation is climaxed in a last quotation, beginning at the ninth line of page 22.

> When Maher drove the truck that night he drove it in a twofold capacity. *He was Sgt. Maher taking it on a personal frolic in disobedience of orders.* He was also the "commanding officer" pro tem whose duty it was to see that the car was driven prudently and carefully and according to law.

Without any attempt at rebutting this Dr. Jekyll and Mr. Hyde theory, I will simply note the suppliant's opinion that Sgt. Maher was taking the car *"on a personal frolic in disobedience of orders"*.

On November 15, 1954, three days before the unfortunate incident, an "Act respecting the Liability of the Crown for Torts and Civil Salvage", 1-2 Elizabeth II, c. 30, came into force (*Canada Gazette* Vol. 88, p. 3796; Extra, November 8, 1954), s. 3, ss. (2) of which reads:

> (2) The Crown is liable for the damage sustained by any person by reason of a motor vehicle, owned by the Crown upon a highway, for which the Crown would be liable if it were a private person of full age and capacity.

Section 7, ss. (1) proceeds to empower the Exchequer Court of Canada with "exclusive original jurisdiction to hear and determine every claim for damages under this Act".

Whether this text is intended to supersede paragraph (*c*) of ss. (1) of s. 18 (R.S.C., 1952, c. 98) in submitting all similar claims to the pertinent provincial laws, I do not feel called upon to decide. Taking the view, as I feel bound to do, that the "culprit" here, though a servant of the Crown (s. 50, c. 98), did not cause the "injury" to property,

"While acting within the scope of his duties or employment" [Exchequer Court Act, 18 (1)(c)], nor "in the performance of the work for which he was employed" [Civil Code, art. 1054 (7)], should s. 3 (2) of c. 30 above refer the matter to the provincial law, in both hypotheses the conclusion is identical: no *lien de droit,* hence no vicarious responsibility was convincingly established between suppliant and respondent.

Of the seventeen decisions or so discussed in the factum, most, if not all, relate to regularly hired and appointed chauffeurs, or to individuals for the time being, duly entrusted with permission to drive (le préposé occasionnel).

The present set of facts points in an opposite direction: Maher was a recruiting sergeant and that only; Pte. Casey, was the "all time" driver and he alone. Should this interpretation prove accurate, Maher, in disobeying orders and assuming to drive the car was no more *"within the scope of his duties or employment"* than would a bank janitor when surreptitiously making use of the bank's automobile.

Lord Dunedin imparted to this distinction a very apt wording in the case of *Plump v. Cobden Flour Mills Company* (1), a wording which met with the former Chief Justice Rinfret's unmitigated approval. I quote (p. 67):

> . . . *there are prohibitions which limit the sphere of employment,* and prohibitions which only deal with conduct within the sphere of employment. A transgression of a prohibition of the latter class leaves the sphere of employment where it was, and consequently will not prevent recovery and compensation. *A transgression of the former class carries with it the result that the man has gone outside the sphere.*

An exhaustive study of the question will be found in the matter of *Curley v. Osmond Latreille* (2) where the late Justices Anglin and Mignault conducted a thorough sifting of vicarious responsibility (l'action oblique) in its many complexities. The relevant facts are given thus on page 131:

> The respondent's chauffeur (a relation Maher was devoid of), while using his master's automobile for purposes of his own in violation of instructions and driving the car at excessive speed, killed the appellant's son. *The negligence of the chauffeur was admitted;* there was no evidence of want of care on the respondent's part in engaging him and some evidence was adduced that the master had exercised reasonable supervision.
>
> *Held,* Brodeur J. dissenting, that the master was not liable, as, *at the time of the accident, the chauffeur was not "in the performance of the work for which he was employed".* (Art. 1054 C.C.).

(1) [1914] A.C. 62.

(2) [1920] S.C.R. 131 *et seq.*

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At page 178, Mr. Justice Mignault, who had devoted to this question great consideration in the 5th volume of his authoritative treatise (published in 1901), is reported as having said:

Il ne s'agit pas ici d'un cas d'abus, par le serviteur, des fonctions que son maître lui a confiées, mais d'un acte accompli entièrement en dehors de ces fonctions, et pendant qu'avec des copains semblables à lui, il se donnait le luxe d'un "joy-ride" . . .

Thirteen years later, this doctrine met with the continued approval of the Supreme Court of Canada, in re *Moreau v. Labelle* (1), holding that:

. . . the appellant was not liable, *for, at the time of the accident, the appellant's nephew was not "in the performance of the work" which had been entrusted to him.* (Art. 1054 C.C.).

In interpreting the meaning of the last paragraph of article 1054 C.C., it would be an error in law to assimilate to an offence committed by a servant or workman "in the performance of the work for which they are employed" *a similar offence committed "during the period"* of that *work.* Plump v. Cobden (op. cit.).

A closing word: I feel in duty bound to remark that we are confronted here with a particularly unfortunate happening, where a party, victimized through the heedless act of a servant of the Crown, having ready (if forbidden) access to the Crown's vehicle, will nevertheless remain uncompensated.

And again, why were not Major Bell (present at the hearing) and Casey summoned as witnesses?

However I must take judicial notice of the evidence adduced before me.

For the reasons stated there will be a declaration that the suppliant is not entitled to the relief sought and that the respondent is entitled to its costs of the action should it deem fit to claim them.

Judgment accordingly.

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(1) [1933] S.C.R. 201 at 202.

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Feb. 18

Oct. 4

BETWEEN:

WILLIAM EWART BANNERMAN .....APPELLANT;

AND

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

Revenue—Income tax—Expenditure for purpose of gaining income from property or business—Reasonably direct relationship required between objective sought, means employed and expenditure made thereon—Winding-up order employed to gain income from shares and rent from real property—The Income Tax Act, 1948, S. of C. 1948, c. 52, ss. 12(1)(a)(b), 81, 82, 105—The Winding-Up Act, R.S.C. 1952, c. 296, s. 10(a).

The appellant deducted from his 1952 taxable income expenditures he claimed to have made for the purpose of gaining income from certain shares of stock and from certain real property. The deductions were disallowed by the Minister whose decision on an appeal to the Income Tax Appeal Board was affirmed. The appellant appealed from the Board's decision.

The shares were in a company formed in 1929 in which the managing director (the president) and the appellant (the vice-president) each held a one-half interest. The real property was owned by the appellant and occupied by the company and the rent to be paid was to be determined on completion of a building then being erected for occupancy by the company. The expenditures were made to end the managing director's control of the company, when following an investigation in 1951 by the income tax authorities the appellant learned that the managing director had diverted to his own use company funds in excess of half a million dollars. Following the inquiry the managing director promised the appellant to make restitution to the company, pay the resultant income tax owing by it, and settle on the amount of rent the company should pay for occupation of appellant's property. The managing director paid the tax but refused to do more and the appellant moved at a shareholder's meeting in April 1952 that the company be voluntarily wound up. The motion was defeated by the president's casting vote. The appellant then applied for an order under s. 10(*a*) of *The Winding-Up Act*, R.S.C. 1952, c. 296. The Court granted the order and appointed a provisional liquidator to manage the company. Pending the managing director's appeal from the order, the liquidator and the two litigants agreed to submit certain contentious matters to arbitration. The arbitrator's finding, signed November 18, 1953, was that as of January 27, 1953, the managing director was indebted to the liquidator for $66,481.37 and that the rent owing the appellant was $15,065.67, based on, but excluding, the annual rent being paid by the liquidator at the time of the award. The managing director refused to abide by the finding and the liquidator brought suit to recover the debt and other sums owing the company and obtained jugdment for $365,114. The expenditures in dispute totalled $13,357.06 of which amount the appellant allocated $10,000 for the purpose of gaining income from the shares and the balance to gaining income in the form of rent from the real property. His contention was that the winding-up proceedings were the only means of forcing restitution to the company and thereby enabling him to gain income from the two sources.

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Held: That the evidence did not support the contention that the rent payments made by the liquidator were the direct result of the winding-up proceedings nor that such proceedings were the only means of collecting rent. Nothing prevented the appellant from having the terms of the lease defined by the usual process of law.

2. That it was the arbitration, not the winding-up, that determined the amount of rent owing and, as the expenditures on the winding-up pre-dated the arbitrator's award, they could have no relation thereto.
3. That in the absence of any definition of the word "purpose" in s. 12(1)(*a*) of *The Income Tax Act,* to conform to its meaning, there should exist at least a reasonably direct relationship between the objective sought, the means employed to obtain it, and the expenditure made thereon and an immediate distinction made between the primary purpose of the expenditure and the indirect and ultimate results therefrom.
4. That it was the moneys expended on the arbitration and not on the winding-up that were directly responsible for the return to the company of all but $66,481.37 of the diverted funds and also fixed at $15,065.67 the rent owing from July 1, 1951 to January 27, 1953 (the date of the liquidator's appointment) and confirmed the rental of $7,314.48 per annum thereafter paid by the latter for reduced space.
5. That to ascertain the appellant's purpose of intent when he applied for the winding-up order, the court must consider his whole course of conduct and other relevant facts on the record and having done so could not credit one so income tax conscious with deliberately seeking a distribution under *The Winding-Up Act* with the heavy incidence of taxation entailed if it could, as it appeared here, be avoided.
6. That to justify the claim that inevitability of distribution under s. 81 of *The Income Tax Act* is a valid substitute for proof of purpose such inevitability must be proven but was not.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Kearney at Montreal.

A. J. Campbell, Q.C. for the appellant.

L. Lalande, Q.C. and *J. M. Poulin* for the respondent.

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

KEARNEY J. now (October 4, 1957) delivered the following judgment:

This is an appeal (heard *in camera*) from a decision of the Income Tax Appeal Board (1), dismissing the appellant's appeal and affirming a re-assessment of his income tax for the year 1952, whereby the sum of $13,357.06, which the appellant had deducted, was added to his taxable income.

(1) [1955] 13 Tax A.B.C. 38; 9 D.T.C. 291.

This amount was expended by the appellant on legal, travelling and telephone expenses, allegedly for the purpose of gaining or producing income from two properties—one a piece of real estate, and the other shares of stock.

The legal point at issue is whether, in the circumstances, the expenditure is a permissible deduction, within the meaning of s. 12(1)(*a*) and not prohibited by s. 12(1)(*b*) of the *Income Tax Act*, S. of C. 1948, c. 52.

The facts are rather involved. In 1929, the appellant, whose main occupation was and still is that of an important executive in a large company, and possessed of a substantial investment income, formed with a business acquaintance since deceased, and hereinafter called "the managing director," "C" company, each acquiring 50% of the issued shares. The new venture was largely carried on by the managing director who, as president, had the casting vote at meetings of the company or its directors.

The appellant was mentally stunned when, in July 1951, he was informed by the Income Tax Branch that an incomplete investigation revealed that the managing director had been diverting company funds for his own use, from 1941 to 1950 inclusive. Later, the amount diverted was found to be over half a million dollars.

The managing director told the appellant that he had made a grave error. He undertook to, first, get the company's tax problem settled, which he did, and then to square accounts with the company and the appellant, but this he failed to do.

At that time the Toronto branch of the company was occupying the yard of the appellant's property in Scarborough Township, while the appellant was erecting a building thereon, which was also to be occupied by the company. Determination of rental and space was left in abeyance pending the building's completion.

At their next meeting in September 1951, although in the meantime the managing director had paid on behalf of the company $318,397.18 income tax arising from his diversions, he changed his attitude, refusing to make further restitution or to cause the company to make an offer to pay rent for the Scarborough property. Further discussions were had but to no avail.

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At the annual meeting of shareholders in April 1952, the appellant, acting on advice of counsel, moved to have a voluntary winding-up of the company. The managing director, by use of his casting vote, defeated the motion. The appellant then applied for a winding-up order under the *Winding-up Act*, R.S.C. 1952, c. 296, s. 10(*e*) which, *inter alia*, provides that a winding-up order may be granted,

> (*e*) when the court is of opinion that for any other reason it is just and equitable that the company should be wound up.

The application was heard by Batshaw J. of the Superior Court of Quebec who, after a hearing lasting 14 days, granted the order on January 27, 1953 (1). A provisional liquidator was appointed, winding-up proceedings suspended, and the liquidator authorized to carry on the company's business, which he has since continued to do. Subsequently the liquidator, the managing director and the appellant agreed to submit certain contentious matters, including the Scarborough property rental, to arbitration and, on June 29 (Ex. C), three chartered accountants were appointed as arbitrators and mediators to make an accounting between (*a*) the liquidators and the managing director and (*b*) the liquidator and the appellant.

Certain other claims by the company against the managing director were specifically excluded by the Deed of Arbitration.

By award signed November 18, 1953 (Ex. A), a majority of the arbitrators found that, as of January 27, 1953, (a) the managing director was indebted to the liquidator for $66,481.37 and (b) the liquidator, for occupancy of the Scarborough property, was indebted to the appellant for $15,065.67, based on an annual rental of $7,314.48 being paid by the liquidator at the time of the award.

Notwithstanding the agreement by the parties to abide by the findings, the managing director refused to pay the $66,481.37, and the liquidator, on behalf of the company, brought suit to enforce payment thereof together with other sums excluded from the arbitration, including penalties for income tax infractions, damages, interest and costs, amounting in all to $2,271,180.63. Judgment was subsequently obtained for $365,114.27 together with interest and costs

(1) [1953] R.C.S. 107.

(Ex. 4). The heirs of the managing director and the liquidator appealed from the judgment, and their appeals are still pending.

I enquired during the hearing if counsel could agree on what portion of the $13,357.06 expended on procuring the winding-up order was allegedly for the purpose of gaining rental and dividend income respectively. Such agreement was not reached but, by consent, the appellant and his counsel subsequently filed affidavits setting out that, of the $3,357.06 for telephone and travelling expenses, $500 was attributable to rental and, of the $10,000 expended on legal expenses, $2,000 was chargeable to the question of rental, leaving a balance of $10,857 attributable to gaining of share income.

As I have reached the same conclusion in respect of expenditure on rental and dividend income, further comment on the merits of apportionment can be dispensed with.

Regarding the alleged $2,500 expenditure *re* rental income, the appellant's notice of appeal states that, upon legal advice, he instituted proceedings under the *Winding-up Act,* there being no other way to force restitution of the amounts diverted and subsequently to obtain payment of rent; and that the expenditure made in the winding-up proceedings did in fact directly result in producing income to the appellant from his property and that he "has received $15,065.67 for occupation rental for his said real property for the period May 1st, 1951 to December 31st, 1952, and is in receipt of subsequent regular rental income therefrom . . .," on which tax has been paid to December 31, 1954.

I do not think that the appellant is justified in his contention that there was no other way to obtain payment of rent except through winding-up proceedings and such proceedings, I consider, were for purposes other than to obtain rental. If the only issue between the appellant and the company were the disagreement concerning rent, this would not, in my opinion, constitute a valid reason to justify the granting of a winding-up order. I believe that recognition of this fact explains why the appellant, in his letter of April 27, 1953 (Ex. B), which accompanied his income tax return and described the purpose of the expenditure claimed as a deduction, failed to mention rental recovery. Nothing

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prevented the appellant, during the period extending from July 1950 to January 1953, from suing the company in either the province of Ontario or Quebec to have the terms of the lease determined. In such proceedings the terms of the lease would have been the only issue, but during the extended hearing for a winding-up order the question of rental never arose.

It might conceivably have been a ground for seeking a winding-up order if the company's failure to pay the rent had been due to the fraud or bad faith of its managing director. There is nothing in the evidence to indicate that such was the case. Neither the space to be occupied nor the price per foot to be paid had been determined prior to the granting of the winding-up order, and five months after it had been granted, the terms being still unsettled, it was thought necessary to have recourse to arbitration proceedings.

I am also of the opinion that the evidence does not bear out the appellant's contention that the $15,065.67 and subsequent rental payments made to him by the liquidator were the direct result of his expenditure on winding-up proceedings.

It was the arbitration award of November 8, 1953, which dealt with "the accountability of the Liquidator to W. Ewart Bannerman for rent of premises owned by the latter and occupied by . . ." "C" company (Ex. A. p. 2(*c*)), that determined the liquidator's indebtedness of $15,065.67 for rent from July 1, 1951 to January 27, 1953. It also confirmed the rental of $7,314.48 the liquidator was then paying for reduced space in the Scarborough property (Ex. A, appendix "B", p. 2—see transcript p. 15), thus dispensing with further accounting.

The expenditure claimed as a deduction covered a period preceding December 12, 1952 (Ex. A-5), but the appellant and his attorney participated in the arbitration proceedings which began only in 1953, and therefore the preceding expenditure could have no relation to the arbitration proceedings or any expenditures made thereon.

Next to be considered is the more important question, namely, the expenditure ($10,857) said to have been made by the appellant for the purpose of gaining income from his shares in "C" company.

In a case such as the present one, where the purpose of the expenditure is allegedly not confined to one property or to one objective but to a succession of results, each objective or result becomes increasingly remote. In the absence of any definition of the word "purpose," as found in s. 12(1)(*a*), I think, to conform to its meaning, there should exist at least a reasonably direct relationship between the objective sought, the means employed to obtain it, and the expenditure made thereon.

The appellant, both in his pleadings and testimony, claimed that, as a result of his own action and the subsequent proceedings taken and to be taken by the liquidator, 50 per cent of the monies recovered by the company would ultimately be received by him as a taxable dividend under s. 81(1) of *The Income Tax Act*.

I think that an immediate distinction must be drawn between the primary purpose of the expenditure and indirect and ultimate results therefrom. In my opinion there is evidence in this case of a primary purpose. The managing director, having promised to make restitution, went back on his word and defiantly declared that he had done nothing wrong and that everything that the company had made was due to him and he "was entitled to all" he "had taken," (p. 3 of transcript). In Ex. B, the appellant refers to the removal of the managing director. At p. 16 of his testimony he spoke of "first of all putting the company into liquidation and having a liquidator appointed that" he "could deal with." Batshaw J., in his judgment removing the managing director and appointing the interim liquidator, said: ". . . the Court is of the opinion that the elementary rules of ordinary business morality would preclude the application of that by-law" (which gave the president a casting vote) "in favour of a president who sought to use same to perpetuate his corrupt administration . . ."

On the evidence, I think the appellant's immediate and most urgent purpose in making the expenditure on winding-up proceedings was to oust a defiant managing director from the control of the company's affairs, thus preventing him from continuing his corrupt practices and using his official position to protect his personal interest to the

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detriment of the shareholders in general, and the appellant in particular. The expenditure claimed as a deduction, I consider, must be attributed essentially to that purpose.

Furthermore, the arbitrators who were also mediators, apart from deciding the rental issue, determined the amount which the managing director had diverted to be $547,934.67. After taking into account payments made by the managing director, to or for the account of the company, the adjustments and transactions between the parties, which took place during the course of the arbitration proceedings, all but $66,481.37 of the diverted funds had been recovered for the company (Ex. A, Appendix "A", p. 1).

It was the monies expended on the above-mentioned proceedings, and not the appellant's expenditure in 1952, which were immediately responsible for recoveries made for the account of the company and which do not constitute income to the appellant.

As regards his receipt of the assets in the manner alleged, the appellant submits, firstly, that it was his intention to bring this about and, secondly, that this in any event would inevitably follow in consequence of his recourse to a winding-up order. This latter claim is important because, if established, it might be sufficient in itself to constitute purpose, and counsel placed the greatest reliance on it.

To ascertain the appellant's intent at the time he retained counsel and on their advice applied for the winding-up order, I consider the court should not rely only on his statement but should weigh it in the light of his conduct, and other relevant facts and circumstances disclosed in the record should also be considered. Cameron J., in *Gairdner Securities Ltd. v. Minister of National Revenue* (1), speaking of proof of intention notwithstanding the taxpayer's evidence, said:

> I am of the opinion that its true nature is to be determined from the taxpayer's whole course of conduct, viewed in the light of all the circumstances.

The appellant made the following statement to counsel at the hearing (p. 24 of transcript):

> Q. In so far as it rests with you, Mr. Bannerman, is it your intention that the business and assets of this company be sold and that the

(1) [1952] Ex. C.R. 448 at 457.

assets (proceeds) be distributed among the shareholders according to law?

A. That is correct.

The arbitrators' report indicates that the appellant was intensely income tax conscious and I cannot credit anyone, particularly the appellant, with deliberately seeking a distribution of the company's assets under the *Winding-up Act* with the heavy incidence of taxation entailed, if it could be avoided. The appellant is in one of the higher brackets of the income tax scale and, if, when all assets were realized upon, the proceeds were distributed, some idea of the appellant's income tax assessment can be judged by the balance sheet of the company for the year 1955 (Ex. 5), which, subject to auditors' remarks, shows fixed assets at cost amounting to over one million and the company's surplus to almost three-quarters of a million dollars.

The appellant has likewise failed to prove that inevitably a distribution under s. 81(1) of the *Income Tax Act* will take place.

81.(1) Where funds or property of a corporation have, at a time when the corporation had undistributed income on hand, been distributed . . . on the winding-up . . . of its business, a dividend shall be deemed to have been received at that time by each shareholder equal to the lesser of

(*a*) the amount or value of the funds or property so distributed or appropriated to him, or

(*b*) his portion of the undistributed income then on hand.

I consider it is likely, for one thing, that the company, under s. 105 of the *Income Tax Act,* will elect to create tax-paid undistributed income. Since such income is defined in s. 82 and is not included in s. 81(*b*), to a large extent at least, it could reach the shareholders as non-taxable capital instead of taxable dividends. (See *Waters v. Toronto General Trusts Corporation* (1) and *In re Hardy* (2).) It would be possible for the liquidator under s. 35 of the *Winding-up Act* to make such election.

It is also probable, I think, that the company will continue as a going concern since, according to the evidence of the liquidator, its business has been carried on at "a very substantial profit" (p. 33 of transcript) and the court, under s. 18 of the *Winding-up Act,* has power to make permanent the suspension order which has been in force since January 1953. True, the liquidator testified that he

(1) [1956] S.C.R. 889. (2) [1956] S.C.R. 906.

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could see no other solution but to offer eventually the company for sale, predicated on the belief that the appellant and the heirs of the managing director were not likely to carry on together in the future. He admitted that, if the personnel of the shareholders should change, there was a possibility of ending the liquidation and that the company could continue "on its prosperous way" (p. 40 of transcript).

The evidence indicates that the said heirs and the appellant have a common interest in avoiding payment of unnecessarily high income taxes, and that it would be to their respective interests to sell the shares of the company rather than to wind it up and distribute its assets.

On behalf of the appellant, it was urged that it was not necessary to show that income resulted from the expenditure made, and it would suffice if the expenditure were made for the purpose of gaining income, although that purpose was not realized. Counsel for the respondent did not take issue with this principle but submitted, correctly I think, that, to justify the claim that inevitability of distribution under s. 81 is a valid substitute for proof of purpose, such inevitability must be proven, and that such proof was not made.

Counsel for the appellant stated that, as far as he was aware, this was the first case upon which a deduction based on the admittedly narrow grounds of the applicability of s. 81 had been made. In my view, the appellant is not entitled to succeed in respect to the deduction, because I consider his ultimate receipt of monies "deemed to be a dividend" is too unlikely or, at best, too uncertain and remote to establish a reasonably direct relationship between the object or purpose sought, the means employed, and the expenditure made thereon.

A further reason why the appellant failed to justify the deduction is to be found in s. 12(1)(*b*). Counsel for the appellant admitted that, if a distribution of assets occurred as alleged, it would inevitably follow, because of the appellant's present stock ownership, that some portion of the monies received by him would constitute capital in his hands. If recourse were had to s. 105, the amount thus received would be very much increased. It is for the appellant to establish the extent, if any, of the expenditure made

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for the purpose of gaining or producing income, as contrasted with a return of capital but he failed to do so.

For the above-mentioned reasons, the appeal is dismissed with costs and the re-assessment made for the year 1952 is affirmed.

Judgment accordingly.

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Mar. 28

Nov. 5

BETWEEN:

ROBERT B. CURRAN ..... APPELLANT;

AND

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

Revenue—Income—Income tax—The Income Tax Act, 1948, S. of C. 1948, c. 52, ss. 2(1), 3, 5, 24A, 125(2)(3), 127(1)—Appellant severing connection with his employer on receipt of a payment of money—Loss of pension rights and opportunity for promotion—Income or capital—Appeal dismissed.

Appellant, an employee of Imperial Oil Limited for eighteen years entered into an agreement with R. A. Brown whereby the latter as agent of Calta Assets Limited by making his personal cheque paid appellant the sum of $250,000, in consideration for which the appellant severed his connection with Imperial Oil Limited and entered the service of a company designated by Brown. The appellant was assessed income tax on the said sum of $250,000 which assessment was affirmed by a decision of the Income Tax Appeal Board from which he now appeals to this Court.

Held: That the payment to appellant was a benefit received by him and therefore constituted income within the meaning of the Income Tax Act.

2. That any beneficial gains to Brown eventually resulting from the transaction between him and appellant would enhance the income character of such payment.

3. That the loss of pension rights in Imperial Oil by appellant does not change the character of the payment, it remains income.

APPEAL from a decision of the Income Tax Appeal Board.

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

J. V. H. Milvain, Q.C. and *H. H. Stikeman, Q.C.* for appellant.

H. J. MacDonald, F. J. Cross and *B. R. Cheeseman* for respondent.

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

DUMOULIN J. now (November 5, 1957) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board, dated the 9th day of May, 1956 (1), in respect of the income tax assessment of the appellant for the year 1951.

It was heard at Calgary, Alberta, on March 28, 1957.

At the turn of the year 1948-1949, the appellant, Robert B. Curran, at Calgary, Alberta, assumed the managership of Imperial Oil's Producing Department, Western Division, with a yearly salary of $25,000.

An American by birth, this man, for the preceding eighteen years had continued in the employ of Imperial Oil Limited, affiliated with Standard Oil of New Jersey.

He enjoyed a reputation as a progressive, skilled and efficient executive, or, so the saying goes, a top-notch oil man.

Company assignments of still greater importance and emolument seemed a reasonable expectation such as, for instance, a lucrative directorship in Imperial Oil.

The superannuation age, barring premature invalidity, was sixty-five. On the minimum basis of his $25,000 annual remuneration, appellant would become the recipient of a $12,500 pension, but could legitimately anticipate more, at the rate of one-half the average wages earned during a five-year period prior to retirement from Imperial Oil's staff. In the spring of 1951, Curran and one Robert A. Brown, of Calgary, initiated business talks that culminated in the several agreements of which more will be heard as this case unfolds.

Robert Arthur Brown, Jr., then thirty-seven years of age, had manifold interests in the oil business. He apparently possessed in a high degree, the optimism of youth, which the surrounding mineral wealth nowise abated.

(1) 15 Tax A.B.C. 73.

At the time, Mr. Brown was president, managing director, majority shareholder of Federated Petroleums Limited, and a most substantial albeit not a controlling one in Home Oil Limited. With his brother and sister he also constituted one of three participants "in a small private company", with a capital of $20,000, called Calta Assets Ltd. An interlocking pattern developed through which Calta Assets held a large block of Federated Petroleums shares, this latter concern also merging in a sizable share ownership of Home Oil with the Brown group, i.e., Brown personally, Calta Assets and United Oils Ltd. It is of record that Brown's mind was set upon obtaining full control of Home Oil, in which company he "represented the largest single ownership".

Certain difficulties hampered the attainment of this goal, one being Major Lowery's reluctance to forsake the Home Oil chairmanship, unless assured of a suitable successor, and there is no evidence whether or not Major Lowery looked upon Mr. Brown as an eligible candidate.

This and possibly some ancillary projects, all concerned with oil trade promotion, motivated the ensuing business negotiations between these two parties, which can best be accounted for in Brown's own words.

> A. I had three purposes. [In approaching Curran]
>
> .....
>
> A. Firstly, I had worked out in my mind, and I think, in fact, with Major Lowery, who was then the president and managing-director of Home Oil Company, if I were able to get a suitable individual, a man of reputation in the oil industry, I was quite confident that I would be able to get Major Lowery to resign from the active management of Home Oil, of which company I represented the largest single ownership, although it was not actual control, so that was the first purpose in wanting to get Curran to apply, to have him become identified with the Home Oil Company. The second purpose was that I was negotiating with the bank a loan of some $5,000,000, as I remember, and because of the heavy investment we had in the Home Oil Company they [*i.e.* the Bank] were concerned about the management of the company, and a person of Curran's calibre would have satisfied their worries insofar as they might have affected my bank loan. The third reason was that my opinion was that in making arrangements with a man of Curran's standing in the industry we would definitely be buying a positive asset of experience in the oil industry, so those were the three.
> (Cf. Transcript of Proceedings, at pages 61-62-63)

Previously, throughout his evidence, R. B. Curran repeatedly assigned identical considerations to Brown's overtures that he sever his connections with Imperial Oil

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and enter the service of either Federated Petroleums or Home Oil. A few excerpts from the transcript clearly bear out this point.

On page 33, the appellant says:

A. . . . through my resignation from Imperial Oil thereafter Mr. Brown felt I could be of service to one of his companies.

. . . . . .

. . . For a consideration I leave the service of Imperial Oil, which was number one; number two was my being employed by one of Mr. Brown's companies thereafter.

. . . . . .

Q. [By counsel for Respondent] There was no doubt that Mr. Brown was very interested in acquiring your services for one of these companies? (Vide p. 34)

A. That is correct, sir.

Q. And you knew that Mr. Brown considered that would be of benefit to these companies?

A. Yes, sir.

. . . . . .

Q. It was pretty commonly known that Mr. Brown was interested in obtaining control of Home Oil Company?

A. That was a very much known fact, sir.

Q. Not only you but a good number of other people knew that?

A. Yes.

Q. Mr. Brown made no secret of it?

A. No sir.

Q. And the one problem he had was that Major Lowery was the dominant factor in the company, you knew that?

A. Major Lowery was president of Home Oil at the time you refer to.

Q. And Mr. Brown indicated to you, did he not, that he wanted to persuade Major Lowery to step down?

A. Well, Major Lowery was an elderly man and I think that perhaps Mr. Brown had in mind Major Lowery becoming what he did, chairman of the board.

Q. Yes, and that someone else would take Major Lowery's place as president and general manager who would be, let us say, more sympathetic to Mr. Brown's interests?

A. That is possibly true, sir.

Asking Curran to give up the management of Imperial Oil, an undisputed leader in the industry, was one thing, but quite a different one to have him do so. A twofold obstacle barred the way to compliance. Firstly, the appellant's accruing benefits after eighteen years with Imperial, for instance a retirement pension of no less than $12,500 per annum; secondly, various alluring prospects of preferment which, doubtless, the sanguine Mr. Curran dangled before Mr. Brown's eyes.

Moreover the business importance of Federated Petroleums or Home Oil, their foreseeable range of expansion could not compare with Imperial's bulk and far-reaching spread.

Hence, after some bargaining, Brown finally accepted Curran's demand for $250,000 by way of compensation, should he give up his employ and join forces with one or another of the former's companies.

We have now fingered the sore point, whence the ensuing complications flow.

One all-pervasive care visibly shows through the transactions entered into, that of avoiding the reach of income tax, as will be seen later on.

On August 15, 1951, the negotiations, reaching a concluding phase, materialized in the form of two contracts, the first of which duly recorded R. B. Curran's resignation as an executive officer of Imperial Oil Limited (Exhibit 1), carefully describing the several advantages thereby surrendered against an indemnity of $250,000, purporting to be paid by R. A. Brown Jr.

By the second and simultaneous deed, Federated Petroleums Limited (Exhibit 2) engaged Robert B. Curran as its general manager from October 1, 1951, "for a period of five (5) years (art. 2)", with "a fixed salary at the rate of $25,000 per year (art. 4)", but without any reference to a superannuation fund.

After completion of the deeds, R. A. Brown then and there handed a personal cheque (Exhibit 3), for $250,000, dated "16th August, 1951", drawn on the Canadian Bank of Commerce, Calgary Branch, payable to R. B. Curran, who deposited it on or about August 22.

A better understanding of the matter warrants the insertion, according to their textual wording, of the most revealing stipulations in both contracts.

The heading of Exhibit 1 reads: "R. A. Brown Jr., of Calgary, Alberta (hereinafter called 'the grantor') of the First Part—and—Robert B. Curran (hereinafter called 'the grantee') of the Second Part". It continues thus, after mentioning Curran's connection with Imperial Oil:

And whereas the grantee has acquired the right to a pension on retirement from Imperial Oil Limited or any of its affiliates, which if his present salary scale remains the same until his retirement will yield to

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him the sum of $12,500 per year, and the probabilities are that if he remains with his present employers his salary will increase substantially over the years with corresponding increases in the pension payable to him.

And whereas his pension rights will cease entirely if he voluntarily severs his connection with the said Company and its affiliates.

Page (2) And whereas Federated Petroleums Limited, a comparatively small oil company . . . has recently intimated its willingness to offer the grantee a position as manager at a salary equivalent to that which he draws from Imperial Oil Limited, which proposed offer the grantee has intimated that he would refuse solely by reason of the fact that he would be obliged to give up his chances of advancement with his present employers and their affiliates . . . and would lose all accumulated and future rights to pension.

And whereas the grantor holds a substantial interest in Federated Petroleums Limited, is of the opinion that the grantee's experience, capabilities and connections would be valuable to that Company, and is very desirous of persuading the grantee to resign from his present position in order that he may then be free to accept an offer of employment from Federated Petroleums Limited.

And then, on page 3, the two last paragraphs:

Now Therefore This Indenture Witnesseth

1. The grantor hereby agrees to pay to the grantee the sum of $250,000 in consideration of the loss of pension rights, chances for advancement, and opportunities for re-employment in the oil industry, consequently upon the resignation of the grantee from his present position with Imperial Oil Limited, the said sum to be paid forthwith upon the grantee informing his present employers that he is leaving their employ and whether or not employment has been offered to him by Federated Petroleums Limited or accepted by him, prior to that time.
2. In consideration of the agreement of the grantor to pay the said sum, the grantee hereby agrees to resign his position with Imperial Oil Limited, such resignation to take effect not later than the 15th day of September, A.D. 1951.

The first signature on this contract is that of R. A. Brown Jr. Also dated the 15th day of August, 1951, the other indenture (Exhibit 2) is between: "Federated Petroleums Limited (hereinafter called 'the Company')—and—Robert B. Curran (hereinafter called 'the Manager')". It partially reads:

1. Employment:

The Company shall employ the Manager as General Manager of the Company at and upon and subject to the terms and conditions following.

We are acquainted with the stipulations concerning duration and salary, respectively five years at $25,000 per year.

The only noteworthy provision and which received an immediate application was clause 8:

> The Manager shall as the directors may determine from time to time, serve as Manager of any other company or companies in which the Company has a financial interest, either in addition to or in lieu of serving as Manager of the Company and if he is paid a salary by such other company or companies any such salary when received shall to the extent thereof be deemed satisfaction of the salary which under the terms hereof the Company is obligated to pay.

This covenant bears the signature of Federated Petroleums Limited, per R. A. Brown Jr. (the Company's president), Robert B. Curran and that of J. W. Moyer, an officer of Federated. Pursuant to article 8 of the "employment" contract, appellant, on or about October 1, 1951, became president and general manager of Home Oil Limited, and never held any office whatever with Federated Petroleums. It goes without saying that Home Oil also attended to paying the agreed salary. No written document evidences Curran's period of service with this latter company.

Conflicting opinions soon arose and since the gap kept ever widening, the parties resolved to end their erstwhile convenant (Exhibit 2), and achieved this by means of a "release", on December 1, 1952 (Exhibit "B"). Again the signatories to this parting indenture were identically those who had signed the "employment" covenant (Exhibit 2) some fourteen months previously, namely: "Federated Petroleums Limited, per R. A. Brown" and "R. B. Curran", who remained in undisturbed ownership of the "compensation incentive" paid him a year before.

We already know: why, by whom, to what purpose the $250,000 were paid; it now remains to trace their actual source. To that end reference must be had to the record of proceedings at pages 66, 67 and 68. Mr. Milvain, Q.C., one of appellant's counsel is questioning Mr. Brown.

Page 66—

Q. Were the moneys that were paid to Mr. Curran your own personal moneys?

A. No, sir.

Q. Just what was the arrangement there?

A. Calta Assets had approximately, as I remember it, $100,000 in the bank and in order to have the $250,000 available, it was necessary to borrow an additional $150,000 . . . The Bank of Nova Scotia would not loan Calta $150,000. I was able to borrow $150,000 at the Royal Bank personally. Calta [the Brown family's private

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company] was not able to borrow the money at the Royal Bank as a company so I had to borrow it personally. Subsequently, Calta was responsible for the full payment of $250,000.

Page 67—

Q. And eventually the whole debt was brought over to Calta?

A. No. Calta, as I remember it, loaned [me] from the security which I used as collateral to borrow the money at the Royal Bank. When Calta liquidated enough shares to pay off the $150,000 either they paid the money to me and I paid it out to the Royal Bank or they may have paid it directly . . . but they were responsible for paying the loan off.

.....

Q. . . . So that to summarize the situation, the actual $250,000 represented by a cheque with your signature on it dealt with Calta Assets' moneys?

A. Yes.

Q. And it was Calta Assets that actually paid the $250,000?

A. Through me as their agent.

Page 68—

Q. Now, was the $250,000 paid to Curran by Calta through the medium of your cheque ever repaid to Calta by either Home or Federated?

A. No, sir.

Q. Or by anyone else?

A. By no one.

.....

Q. . . . Now, how was the $250,000 expenditure treated by Calta Assets?

A. As a capital expenditure.

.....

Q. You might tell the Court, Mr. Brown, whether or not Mr. Curran ever became an employee of Calta Assets?

A. No, never. Mr. Curran became employed only by Home Oil Company.

Page 69—

Q. Never by you personally?

A. No, sir.

Q. And you say never by Federated?

A. No, sir.

This last negative reply is, I believe, a misconstruction of the facts, but of no bearing on the issue. Appellant, although chief executive of Home Oil, was detailed to such office by Federated Petroleums, in virtue of the "employment" contract, paragraph 8 (cf. Exhibit 2). When conflicting policies came to a head, the "release" (Exhibit B) originated solely from Federated Petroleums as "Party of the First Part".

The record continues with Mr. Brown's testimony.

Page 71—

Q. . . . did you at any time discuss with the directors of Home or Federated as to whether either of those companies repay that sum of money? [*i.e.* the $250,000]

A. I certainly suggested it to the directors of Federated.
Q. With what result?
A. Negative result, they weren't interested, they wouldn't pay it.

Page 72—

Q. Do you know if any approach was made to Home in order to have them pay it?
A. I am quite sure there wasn't.
Q. So that the decision of paying $250,000 was made by whom?
A. I should think it was made by me.

.....

Q. Was that decision made by you on the basis that you were employing Mr. Curran?
A. No, not at all. The decision, when I said "made by me", that was made by Calta Assets because I consulted both with my brother and sister to get their consent that the deal would be entered into.

Despite an exhaustive cross-examination, Mr. Brown's evidence remained unshaken, and no attempt made at otherwise refuting it.

So then, the basic, recorded, set of facts shows that (a) Calta Assets Limited, "through Brown as its agent" paid the incentive sum of $250,000, which it never recuperated; (b) Curran was at no time employed by Calta Ltd. or Brown personally; (c) the original and paramount employer remained throughout Federated Petroleums which, implementing a mandatory prerogative provided for in article 8 of Exhibit 2, assigned R. B. Curran to Home Oil; (d) the parting release "from all covenants . . . and agreements", dated December 1, 1952, issued from Federated Petroleums on the employers' behalf.

Let us now examine the respective legal interpretations adopted by litigants.

The appellant's submission, concisely stated by Mr. Stikeman, Q.C., in his opening remarks, is as follows:

> We assert that the payment was personally to Mr. Curran, that it was paid to him to terminate an employment which had no relationship to the payer of the cheque, and that the maker of the cheque, Mr. Brown, or his principal, Calta Assets, never were or became the employers of Mr. Curran.

This impresses me as a rather cursory view of the case, one that leaves a great deal unsaid.

Respondent, on the other hand, initially contends that: (cf. Reply to Notice of Appeal, para. 10)

> The payment of $250,000, . . . was a benefit received by the Appellant in the year 1951 in respect of, or by virtue of, his position in the service of an oil company and was therefore income . . . for the purposes of Part I of the Income Tax Act by virtue of sections 3 and 5 of the said Act.

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Recourse is then had to three subsidiary submissions which I quote:

Alternatively, the said $250,000 was paid to the Appellant as part of his remuneration for services to be rendered by him as an employee of an oil company and was therefore income of the Appellant for the taxation year 1951 for the purposes of Part I of the Income Tax Act by virtue of sections 3 and 5 of the said Act.

Alternatively, the said $250,000 was an amount received by the Appellant from a person in satisfaction of an obligation arising out of an agreement made by that person with the Appellant immediately prior to a period that the Appellant was in the employment of such person and it is therefore deemed to be remuneration for the Appellant's services rendered during the period of employment, by virtue of section 24A of the said Act.

Alternatively, the said $250,000 was received by the Appellant as a benefit as a result of a transaction or transactions and as such amounts to a payment of income for the purposes of Part I by virtue of Section 125 of the said Act.

The problem easily enough stated but by no means easy to solve, can be thus set forth: Was the profit or gain under review, truly of an income nature as contemplated by sections 2(1), 3, 5, 24A, 125(2) (3), 127(1) of the 1948 *Income Tax Act*, c. 52, on which both parties rely?

Section 2(1) provides that any resident of Canada will pay income tax upon his taxable income for each taxation year.

Section 3 gives the first general rule, reading:

3. The income of a taxpayer for a taxation year for the purposes of this Part [Computation of Income] is his income for the year from all sources . . . and without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses
(*b*) property, and
(*c*) offices and employments.

Section 5 deals further with "income":

Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year . . .

The specific point of payments by "employer to employee" is disposed of in section 24A.

An amount received by one person from another,

(*a*) during a period while the payee was an officer of, or in the employment of, the payer, or

(*b*) on account or in lieu of payment of, or in satisfaction of, an obligation arising out of an agreement made by the payer with the payee immediately prior to, during or immediately after a period that the payee was an officer of, or in the employment of, the payer,

shall be deemed, for the purpose of section 5, to be remuneration for the payee's services rendered as an officer or during the period of employment, unless it is established that, irrespective of when the agreement, if any, under which the amount was received, was made, or the form or legal effect thereof, it cannot reasonably be regarded as having been received.

(i) as consideration or partial consideration for accepting the office or entering into the contract of employment,

.....

Section 125, the opening one of Part V.—Tax Evasion, in its subsections (2) and (3) rules that:

(2) Where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatsoever is that a person confers a benefit on a taxpayer, that person shall be deemed to have made a payment to the taxpayer equal to the amount of the benefit conferred notwithstanding the form or legal effect of the transactions . . . the payment shall, depending upon the circumstances, be

(*a*) included in computing the taxpayer's income for the purpose of Part 1,

.....

Subsection (3) says that no benefit exists when the parties deal at arm's length, *bona fide,* and not pursuant to any other transaction and are not effecting payment "in whole or in part, of an existing or future obligation,".

According to Exhibit 1, appellant contends that Brown personally paid him $250,000 and was at no time his employer, in an obvious attempt to escape the reach of section 24A, and to forestall respondent's allegation that this payment "was a benefit received by the appellant in the year 1951 in respect of, or by virtue of his position in the service of an oil company . . ."

I would insofar agree with appellant and therefore insofar also disagree with respondent.

This amount never was disbursed by either of the three companies with which Curran had business connections during 1951. Imperial Oil paid him until October 1, when, as an employee of Federated Petroleums, he was assigned to Home Oil, this latter company continuing his annual salary of $25,000 for the last three months. Moreover, Curran's "salary or wages" for 1951 were not $275,000. The answer must be found elsewhere.

What can be the real nature, the most plausible meaning of the bargain entered into by those two businessmen whose names so frequently reappear?

The expressions used in the written document, Exhibit 1, reveal merely one aspect of the bargain.

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In the "resignation contract" Brown adduces a twofold explanation identical with Curran's own views: (a) that he agrees to pay the *grantee* $250,000 in consideration of the loss of pension rights and the chances for advancement; (b) that he, the *grantor* "holds a substantial interest in Federated Petroleums Limited, is of the opinion that the grantee's experience, capabilities and connections would be valuable to that Company, and is very desirous of persuading the grantee to resign from his present position in order that he may then be free to accept an offer of employment from Federated Petroleums Limited." So then two objects are stated for which payment was had.

Both considerations put forward by Curran were of no particular concern to Brown, who would as readily have satisfied any of the latter's demands such as, for instance, purchasing his house in another city and providing him with a residence in Calgary. Brown's only object was the enlistment for his companies of Curran's reputed experience, capabilities and connections. What one wished to obtain exactly corresponded to that which the other delivered: the normal business expectations of experience, capabilities and connections. In his capacity of controlling shareholder of Federated Petroleums and largest single owner of Home Oil shares, Brown stood at the apex of the receiving line if eventually the hoped-for "experience, capabilities and connections" occasioned an increased yield in company gains.

Brown furthermore eagerly sought to achieve paramount influence over Home Oil and, as expected of him, Curran greatly facilitated the fruition of the scheme.

A man's experience, capabilities and connections are intangible assets of a capital nature; but the effects accruing from their fruitful use should be viewed in the light of income.

Regarding those properly called "chances" which the appellant voluntarily surrendered, quite likely some would in time materialize, still they might not, through an unfortunate twist of fortune: sickness, disability, untimely death. At all events, I feel that such a consideration never was the immediate cause or "*causa causans*" of the agreement.

This brings the matter to the pension rights angle; again it must be said that it is completely foreign to our problem, *res inter alios acta,* a matter to be liquidated by the parties concerned, Curran and Imperial Oil.

A glance at page 8 of the transcript reveals that Curran and Imperial Oil effectively settled it between themselves, I quote:

> Q. [by Mr. Milvain, Q.C. to Curran] Now, in the event of the employee voluntarily terminating the employment, what was the position with respect to that superannuation or pension plan?
> A. He would have an option of doing one of two things, either he might take what is termed a deferred annuity [maturing at the age of 65], or he could take entirely cash and he would receive mainly the money that he had put into the plan himself at that time.
> Q. Insofar as the contributions made by the employer, . . . Imperial, would the employee get that part of the contribution?
> A. Not entirely, he would get a small part of that employer's contribution . . .

The appellant predicated his first line of attack on a total lack of employer-employee connection between himself and Brown. It should be borne in mind that pension rights, superannuation funds, especially in cases of a single payment, become taxable in virtue of section 34 of the Act.

Here, a dilemma confronts the appellant with equally unfavourable alternatives.

If Curran obtained payment as a consideration of surrendered pension rights, then section 34 arises with its necessary implications of employer-employee relationships, paving the way, at the minister's option, to section 24A.

On the contrary, objecting to section 34 is tantamount to asserting the nonexistence of a valid or regular pension plan and of all employment dependence between Curran and Brown.

Then, should we conclude that no employment ties, no superannuation fund, can be traced, it irresistibly follows that the pension argument loses its arguable value.

In his written engagements, throughout his examination and Brown's, appellant took a precarious and contradictory position.

In effect, he argued that:

(a) Brown never employed Curran;

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(b) Curran received $250,000 from Brown for two considerations, one of which was the surrender of pension rights with Imperial Oil.

Now, this second claim is admissible only if an assessment under section 34 be equally justified, a consequence giving rise to legal implications destructive of appellant's essential argument (a).

The test seems rather self-evident: Had the respondent assessed appellant in virtue of section 34, hereunder partially reproduced, could he then successfully prosecute a claim for recovery?

> 34. (1) In the case of
>
> (*a*) a single payment
>
> (i) out of or pursuant to *a superannuation or pension fund or plan* upon the death, *withdrawal* or *retirement from employment of an employee or former employee* or upon the winding-up of the fund or plan *in full satisfaction of all rights of the payee in or under the fund or plan,* or
>
> .....
>
> the payment or payments made in a taxation year may, at the option of the taxpayer by whom it is or they are received, be deemed not to be income of the taxpayer for the purpose of this Part, in which case the taxpayer shall pay, in addition to any other tax payable for the year, a tax on the payment or aggregate of the payments equal to the proportion thereof that
>
> .....

The present appellant could, and no doubt would counter, that between Brown and himself as payer and payee no such legal superannuation fund or pension plan existed. He would object, and properly so, that the $250,000 were not granted to him "upon withdrawal or retirement from employment [as an] employee or former employee . . ." Possibly one might concede that the compensation story subjectively envisaged, i.e. in appellant's light is true to a degree but, as a matter of fact in the ruling purview of the Act, i.e. objectively, it is untenable.

The amount paid is closely akin to a tangible appraisal, a material appreciation of the beneficial effects consequent upon "experience, capabilities and connections" as well as a pecuniary recognition for future assistance, outside the employment field, rendered to or anticipated by R. A. Brown personally.

For reasons somewhat differing from those propounded by respondent, I agree that the sum of $250,000 constitutes income.

Audette J. in re *Morrison v. Minister of National Revenue* (1) spoke thus:

> Now the controlling and paramount enactment of sec. 3 defining the income is "the annual net profit or gain or gratuity." Having said so much the statute proceeding by way of illustration, but not by way of limiting the foregoing words, mentions seven different classes of subjects which cannot be taken as exhaustive since it provides, by what has been called the omnibus clause, a very material addition reading "and also the annual profit or gain from any other sources." The words "and also" and "other sources" make the above illustration absolutely refractory to any possibility of applying the doctrine of *ejusdem generis* set up at the hearing. The balance of the paragraph is added only *ex majori cautelâ* . . . The net is thrown with all conceivable wideness to include all *bona fide* profits or gain made by the subject.

Despite a lapse of years, this interpretation of section 3 is still true of the amended text as it read in 1951.

In very wide terms, section 3 renders taxable "income for the year from *all sources* and without restricting the generality of the foregoing . . ."

Therefore, this controversial payment meets, I believe, the statutory meaning of income for the year from a source other than those particularized by subsections (*a*), (*b*) and (*c*) and was properly assessed as such.

Lord Halsbury L.C., in re *Alexander Tennant v. Robert Sinclair Smith,* (2) wrote that:

> . . . This is an Income Tax Act, and what is intended to be taxed is income. And when I say "what is intended to be taxed," I mean what is the intention of the Act as expressed in its provisions, because in a taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes. In various cases the principle of construction of a taxing Act has been referred to in various forms, but I believe they may be all reduced to this, that inasmuch as you have no right to assume that there is any governing object which a taxing Act is intended to attain other than that which it has expressed by making such and such objects the intended subject for taxation, you must see whether a tax is expressly imposed.
>
> Cases, therefore, under the Taxing Acts always resolve themselves into a question whether or not the words of the Act have reached the alleged subject of taxation. Lord Wensleydale said, in *In re Micklethwait* (3), "It is a well-established rule, that the subject is not to be taxed without clear words for that purpose; and also, that every Act of Parliament must be read according to the natural construction of its words."

(1) [1928] Ex. C.R. 75. (2) [1892] A.C. 150 at 154.
(3) 11 Ex. (U.K.) 456.

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As just said above, I would hold that "the words of the Act,—in the appropriate part of section 3, (1948, R.S.C. c. 52),—have reached the alleged subject of taxation".

The assessment claimed from appellant as income for taxation year, 1951, was in accordance with the Act and the appeal must be dismissed with costs.

Judgment accordingly.

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June 13, 14

Oct. 9

TOBY BARNETT ..... APPELLANT;

AND

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

Revenue—Income Tax—Capital Gain—Adventure in the nature of trade—Land purchased by furrier to be turned over at cost to company to be formed—Company not formed—Whether profit realized by forced sale taxable—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 139(1)(e).

The appellant and her brother, partners in a retail furrier business, respectively appealed from a re-assessment of their 1953 taxable incomes when the Minister added thereto gains made by them on a real estate transaction. The facts in each case were identical and the two appeals were heard together. The appellants entered into a parol agreement with New York interests to establish near Toronto a specialized fur-shopping centre. No arrangements were made as to how the expenses were to be shared but the appellants were authorized to select and purchase a suitable site to be transferred at cost to a company to be formed. The site they selected was approved by the New York interests. The land was subject to an offer to purchase executed in favour of the nominee of one S, a building contractor, who permitted the substitution of the appellants in his nominee's stead. Since the latter had nothing in writing to bind the New York interests they obtained, for their own protection, a written offer from S to re-purchase the land at the price they paid for it together with his cheque for $10,000 as a deposit. The understanding was that, if the proposed scheme went through, both would be returned to him. The appellants bought the land for $199,300, paying $58,500 down and giving back a mortgage for the balance payable in three years. They financed the down payment by a bank loan. The New York interests were notified and agreed to come to Toronto to form the company and arrange the financing, and on this assurance appellants returned S's offer and cheque. The New York interests then refused to go on and the appellants, to get rid of the heavy liability they had assumed, sought an immediate buyer. S made the first offer, $328,000. It was accepted and the appellants divided the gain made on the sale between them. The Minister added the profit realized to their declared taxable income, and they appealed from his decision.

Held: That the gain made by the appellants was an entirely fortuitous one and not the result of an operation of business when carrying out a scheme for profit-making but resulted from circumstances over which the appellants had no control, namely, the failure of the New York parties to implement their oral undertaking, and the enhancement of the value of the land.

2. That there was here no adventure or concern in the nature of trade and the profit realized was not from a business, but an accretion to capital, not subject to tax.

APPEAL under the *Income Tax Act.*

The case was heard before the Honourable Mr. Justice Cameron at Toronto.

G. F. Henderson, Q.C. and *R. McKercher* for appellant.

E. D. Hickey and *T. Z. Boles* for respondent.

CAMERON J.:—This is an appeal from a re-assessment dated March 8, 1955, made upon the appellant in respect of her income for the year 1953. In that re-assessment the respondent had added to the declared income of the appellant the sum of $63,353.77, described as "gain re Scarboro property", as well as one for $1,494.25 described as "gain re King Street East". Following the appellant's Notice of Objections, the respondent by his Notification reduced the re-assessment by the sum of $1,494.25 relating to the King Street East property in Hamilton, but confirmed the said re-assessment in all other respects. The present appeal relates, therefore, to the item of $63,353.77 added by the respondent in respect to the "gain re Scarboro property".

For a number of years the appellant has been a partner in a trading firm at Hamilton, Ontario, known as Harte Manufacturing Furriers. Prior to 1947 she had a one-third interest therein with her brother Robert Organ and one Symon Wise. In that year Wise withdrew from the partnership and thereafter the business was conducted by the appellant and Robert Organ, each having an equal interest therein. The business is that of buying furs, manufacturing fur coats therefrom, and selling them at retail; it also operates a fur storage. The business has been very successful and for some years prior to 1953 the partners considered it advisable to move from 55 John Street, Hamilton (where it had been located since 1937) to a better area and into better and larger quarters. They purchased successively

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a number of buildings in Hamilton with the intention of moving the business; but due to inability to get full possession, or inability to make the required structural changes, or the unsuitability of the location, each of these properties was sold. It appears that for the years 1951, 1952 and 1953, the appellant's share of the profits so realized on these sales was added to her declared income, but on objection being taken to such assessments, the amounts so added were dropped from the assessments.

Counsel for all parties consenting, it was agreed that this appeal and that of the appellant's brother, Robert Organ, should be heard together and that all the evidence should be applicable to both appeals, the facts in each case being identical.

In order to purchase furs and observe the styles, the appellant made frequent trips to New York City; her brother went less frequently. Both were acquainted with the witness Abraham Avigdor, a manufacturer of fur garments in New York City. His specialty was that of "China Mink" garments. His business in 1951 and 1952 was seriously affected by the embargo placed on the importation of goods from China into the United States. Some of his competitors had opened branches in Canada where no such embargo was in effect and he discussed with the appellant the possibility of following their example. Mrs. Barnett was of the opinion, however, that a much larger venture, such as she and her brother had considered for some time, would be much more successful. Her opinion was that there should be established near one of the larger cities of Canada a fur-centre in which all branches of the fur-making industry, including its many specialties, would be represented, as well as dyeing, cleaning and storage plants. It would be in the nature of a specialized shopping centre with ample room for various buildings and parking spaces. There was no such area in Canada although it appears that in New York City most of the industry is located in one district. The scheme appealed to Avigdor but it was realized that the venture was a large one and that other capital would have to be brought in. Accordingly, Avigdor introduced Mrs. Barnett to three or four leading New York manufacturers, including one Pestin. All agreed to join in the proposed plan and to

contribute to the expenses involved. Nothing, however, was put in writing and no decision was made as to the amounts to be contributed by the individual members. It was decided, however, that the appellant on her return to Canada should select and acquire a suitable site near Toronto and that such site when purchased should be turned over to the new company to be formed, at cost.

In the summer of 1952 the appellant made inquiries as to a suitable location near Toronto, but for some time nothing of a suitable nature was found. Her husband, Percy Barnett, who was then an employee of Harte Manufacturing Furriers and also engaged in the real estate busines, contacted a school friend, one Harry P. Botnick (a lawyer in Toronto who had contacts with parties buying and selling real estate) and asked to be advised if the latter heard of a property suitable for such a fur-centre. Some time later Botnick advised them of a parcel of land which might be suitable and that, if it were, they could "pick up the offer". The property was on Kennedy Road in Scarboro close to Toronto and comprised about 160 acres in all. It seemed suitable for light industry and in every way satisfactory for the establishment of a fur-centre. Before completing the purchase, it was arranged that the property should be inspected by Pestin, one of the New York manufacturers who were interested in the proposed plan. He came to Toronto and, after inspection, approved of the site.

The purchase was closed out on or about October 22, 1952, at the office of Mr. Schreiber, the Hamilton solicitor for the appellant and her brother. Those present were the appellant, Organ, Mr. Barnett (the appellant's husband), Mr. Schreiber, Samuel L. Shields (a contractor of Toronto), and Mr. Botnick, the latter apparently acting as solicitor for Shields. It was then disclosed for the first time that the "offer" which Botnick had originally advised the appellant might be taken up, was actually two agreements of sale and purchase in which the vendors were respectively J. C. Rutherford and H. B. Rutherford and the purchaser was D. Gilbert; the properties were adjacent to each other. Copies of these agreements are filed as Exhibit 1. It was explained that the real purchaser in these agreements was Samuel L. Shields and that at his

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request, at the time the agreements were negotiated, the purchases were taken in the name of D. Gilbert as his nominee only. These agreements were dated July 2, 1952, and were accepted by the purchaser on July 15 and July 11, 1952, respectively. It was a condition of each that the other offer should also be accepted or the offers would be void. The total purchase price was $199,300, of which amount $58,500 (inclusive of the deposits of $1,000 each) was to be paid on closing and the balance secured by a first mortgage bearing interest at 5 per cent., the principal to be due on October 1, 1955. The conveyances to the appellant and Organ were direct from the Rutherfords (Exhibit 10) and were registered on October 24. In effect, the appellant and Organ were substituted for Shields, the latter withdrawing from the transaction, making no profit in the matter but being content to receive only the deposits he had made.

Organ, who was a careful business man, was greatly concerned about the liability he was undertaking, particularly so as there was nothing in writing with the New York manufacturers who had agreed to take part in the proposed scheme. Prior to closing, therefore, he had intimated to Botnick that he would like to have an escape from his liability if the scheme fell through. Botnick thought that such an arrangement could be made with his client. Accordingly, when the parties met in Hamilton there was produced an "Offer to Purchase" (Exhibit 2) by the terms of which Shields agreed to purchase the entire property from the appellant and Organ at the same price they had paid, namely, $199,300, such sale to be completed by May 19, 1952 (an obvious error for 1953). In the offer so submitted, the down-payment was $1,000, but at the insistence of Organ it was increased to $10,000 and Shields' cheque for that amount, made out in Schreiber's favour, was delivered. There was a verbal understanding the cheque would be held by Schreiber and it never actually came into the hands of the appellant or Organ. There was also a verbal arrangement that at such time as the appellant and Organ were satisfied that the proposed plan would go through, they would so notify Shields, the cheque would be returned to him and his "Offer to Purchase" would then be void and at an end.

This agreement, which was also signed by the appellant and Organ, may be referred to as the "Protective Offer".

Shortly after the purchase was completed, the appellant was again in New York and advised the parties interested that the property had been acquired. All were still interested in the scheme and it was arranged verbally that they would come to Canada in January 1953, incorporate a company to carry out the plan, and agree on the method of financing. Being thus assured that the plan would be proceeded with, the appellant on her return to Canada wrote Shields (Exhibit 6), avising him that she had just returned from New York and that "Robert (i.e., her brother Organ) and I are happy to say that we have decided to go ahead with the deal". Shields acknowledged that letter of September 2 (Exhibit 6) and added, "It is now in order for you to return our cheque for the $10,000 and cancel our offer".

When the interested parties from New York failed to appear in Hamilton in January as arranged, the appellant and her brother were greatly concerned, and in February she went to New York to ascertain the reason for the delay. To her regret she found that due to adverse business conditions in the fur industry, all the parties except one were unwilling to proceed with the plan and that the one still interested would not proceed without the others. It was then obvious that the proposed plan would have to be dropped.

It should be stated here that in October 1952, when the appellant and Organ purchased the Scarboro property, they secured a loan from the Royal Bank of Canada at Hamilton for $65,000, of which amount $58,000 was used to make the down-payment, the balance being used for the general purposes of Harte Manufacturing furriers. That loan was secured by a note payable in one year with collateral security also being provided. Mr. Amy, the manager of that bank, was advised by the appellant of the general scheme of the plan for the proposed fur-centre, that certain New York manufacturers were interested in the plan and that in the main the loan was being arranged for the purpose of making the down-payment on the proposed site. The loan was well secured and while, therefore, Mr. Amy was not greatly concerned whether

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the plan went through or not, he did ask the appellant "What are you going to do if these people don't come through?", to which she replied, "Well I don't think there is any doubt about that because they are extremely anxious".

It was obvious to the appellant and her brother that without the assistance of the New York interests they would themselves be unable to proceed with the plan for a fur centre. Both the appellant and Organ were greatly concerned about their position and the large amounts for which they were liable, both to the bank and the Rutherfords. They had no desire to hold the property as a speculation, although Mr. Amy, the bank manager, advised them not to get "panicky" as the industrial expansion in the area was "very strong". The appellant's husband also advised them to "hold on" in view of advancing prices. Both the appellant and Organ, however—and they alone were under liability in the matter—decided that if possible the property should be sold in order to clear up their liabilities. Word was sent to Mr. Botnick, who had first put them in touch with the property, that they would consider an offer to purchase. On April 20, 1953, Mr. Shields, from whom they had taken over the original purchase or agreement in October 1952, came to their place of business in Hamilton with an offer to purchase (Exhibit 9). After some discussion the offer was accepted and signed by all parties. The purchase price was $328,500, some $128,000 in excess of that paid by the appellant and Organ in the previous October. The terms of purchase were as follows: $1,000 deposit; $190,000 by certified cheque at closing on May 19, 1953; and the balance by assuming the mortgages held by the Rutherfords. The purchase and sale were closed out in the manner provided for by the agreement. It is of interest to note that Shields did not know that the scheme for the proposed fur centre had fallen through until after his purchase was made; otherwise, he said, his offer would have been substantially less. He did know,

however, that prices in the area were increasing rapidly and that while in the previous year he had been advised that he could not proceed with a subdivision for some time, the way was now clear for that purpose. It is also of interest to note that in November of the same year Shields re-sold the property *en bloc* at a gain of $100,000.

The net profit on the sale to Shields, less carrying charges and costs, was divided equally between the appellant and Organ and, as I have said, that is the amount added to their declared incomes and now in dispute.

Both parties rely on the following sections of the *Income Tax Act*, (R.S.C. 1952, c. 148).

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

* * *

139.(1)(*e*) "Business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

For the respondent it is submitted that the purchase and sale of the Scarboro property was an adventure in the nature of trade and that the profit therefrom was profit from a business within the extended meaning of that term as defined in s. 139(1)(*e*). For the appellant—on whom the onus lies—it is submitted that the gain so made did not constitute taxable income but was rather a "capital gain"; that there was here no adventure in the nature of trade; that the sole purpose in acquiring the property was that of securing a suitable site for the proposed fur centre which was to be turned over to the new company, to be formed, at cost; that owing to the change in circumstances

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over which neither the appellant nor her brother had any control, namely, the failure of the New York interests to implement their verbal undertakings, the appellant had no alternative but to sell the property; that the first offer made was accepted and that such gain as was made was purely fortuitous; and that the whole transaction was an isolated one and separate and distinct from that of the appellant's business of manufacturing fur garments.

Before considering the nature of the profit made in this transaction, I should like to refer to one or two submissions put forward—but not stressed too seriously—by counsel for the respondent. They relate to the credibility of the appellant, her brother and certain of her witnesses. It was suggested that the evidence relating to the alleged plan for the establishment of a fur centre is to be viewed with a great deal of scepticism; that no person with any knowledge of business matters would have embarked upon a scheme of this magnitude without definite assurances in written form as to the nature of the company to be formed, the amount of the capital to be advanced by each of the participants and complete details as to the building plans and method of financing the project. It will be remembered that the appellant and Organ took no such precautions but were prepared to proceed on the faith of the oral commitments made by the New York group, probably because of the established position these men held in the fur industry and the repeated assurances that were given. It is suggested, therefore, that the unbusinesslike methods were so extraordinary that I should not accept the evidence as to the proposed plan as credible.

From the evidence as a whole, however, I am quite satisfied that there was such a plan as that described by the appellant and her brother. This evidence is substantially supported by that of the witness Avigdor (who has no interest in this litigation) and also by that of the appellant's brother. Shields also was made aware of the proposed plan when the sale to the appellant and her

brother was completed in Schreiber's office. It was the then uncertainty of Organ as to the completion of the plan that led to the preparation of the "Protective Offer" by Shields. Moreover, Amy, the only witness called by the respondent, was aware of the plan prior to and at the time he arranged for the bank loan. I have reached the conclusion, therefore, notwithstanding that the appellant and her brother may have lacked the usual business acumen in embarking on the plan, that there was such a plan as that described. Further, I am of the opinion that the property so acquired was purchased with the intention of turning it over *en bloc* at cost to the company which those interested had agreed to establish. There is ample evidence which supports this conclusion and nothing of a substantial nature to lead to any other view. Support for this view is found in the evidence relating to the "Protective Offer" by the terms of which Shields was given the right to repurchase the entire property at cost for a period of six months, with the collateral verbal agreement that he would be released from his agreement as and when the appellant and her brother were satisfied that the proposed plan would be carried to completion.

Counsel for the respondent referred to the evidence of the witness Amy who stated that Mrs. Barnett, at the time the bank loan was arranged, said "that it would be repaid for sure within the year". In Amy's view "the application was made on the basis that it was for the purpose of land and repayment within a year one way or the other, either from a sale of all or a part of the land or from the proceeds of the company (by which I think he referred to Harte Manufacturing Furriers) whose profits per year were sufficient under normal conditions to repay that kind of loan". Then in re-examination, when asked whether any explanation was given him as to what might have happened with any excess land that was not used, he said, "Yes, I think it was inferred that they would have no problem in disposing of the excess either in whole

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or in part". It is submitted by counsel for the Minister that this evidence indicates that even if there was a plan to establish a fur centre, such a plan involved turning over only a small portion of the acreage to the new company to be formed and the sale by the appellant and her brother of the balance as soon as a convenient opportunity presented itself. Whatever inference may be drawn from this evidence—and the witness quite naturally was not too clear as to some of the details of the conversation four years prior to the trial—I accept the direct evidence of the appellant and her witnesses that the whole of the acreage acquired was to be turned over to the company to be formed, at cost. This view, I think, is supported by the evidence relating to the "Protective Offer" entered into with Shields, which, coupled with the oral evidence relating thereto, establishes that the appellant and her brother were willing and ready to turn the whole of the property back to Shields at cost in the event of the fur centre scheme falling through. Counsel for the Minister quite properly conceded that Shields' actions throughout were in good faith and his evidence was quite unshaken. In my view, the binding agreement with Shields indicates clearly that the appellant and her brother had no intention of making a profit on the purchase in the event of the fur centre scheme being carried to completion; and also that it was their intention to transfer the whole of the property to the new company at cost without retaining portions of the acreage to be sold by them later. Having secured the protective offer there was no element of speculation, for if the scheme fell through, Shields was bound to re-purchase at cost unless, of course, he was released from his contract—an event which happened when it was thought that the scheme would be carried to completion.

Another submission made by counsel for the Minister was that the amount of the land purchased was so greatly in excess of the amount reasonably required for the purpose of a fur centre, that it must have been the intention of the

appellant and her brother to retain portions for later re-sale at a profit. The execution of the "Protective Offer" with Shields precludes any such inference and the evidence of the appellant and her witnesses shows that such was not the case. Counsel for the appellant admitted that the land purchased was somewhat in excess of what would normally be required for a fur centre. The evidence is clear, however, that to get the site required, it was necesary to purchase the whole of the property. Accepting as I do the evidence led on behalf of the appellant that the entire acreage was to be transferred to the new company, it follows that if and when the plan was fully implemented, any surplus of land not then required would fall to be disposed of by the new company in whatever manner might then be decided upon.

On the facts as I have found them, it is clear that the appellant and her brother had no intention of holding the property as an investment. It is clear, also, that they intended to sell it to the company to be formed or, alternatively, to Shields—but without profit. Being assured that the fur centre scheme would be successfully carried through, they relieved Shields from his contract and shortly after found that the scheme envisaged had fallen through. In the result they accepted the first offer made, that offer, because of increasing land values, being greatly in excess of the cost. While they owned the property, they had done nothing to improve it in any way.

The question for consideration, therefore, is whether in the light of the circumstances as a whole and the findings which I have made, the transaction in question is "an adventure in the nature of trade" and the profit therefrom is income from a business under s. 4 (*supra*).

In the recent case of *Minister of National Revenue v. Taylor* (1), the learned President of this Court considered the effect of the introduction of the phrase "adventure or

(1) 56 D.T.C. 1125; [1956] C.T.C. 189.

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concern in the nature of trade" in the definition of "business" now found in s. 139(1)(*e*) of the Act. After reviewing all the relevant United Kingdom and Canadian cases, he said at page 1136:

> The cases establish that the inclusion of the term "adventure or concern in the nature of trade" in the definition of "trade" in the United Kingdom Act substantially enlarged the ambit of the kind of transactions the profits from which were subject to income tax. In my opinion, the inclusion of the term in the definition of "business" in the Canadian Act, quite apart from any judicial decisions, has had a similar effect in Canada. I am also of the view that it is not possible to determine the limits of the ambit of the term or lay down any single criterion for deciding whether a particular transaction was an adventure of trade, for the answer in each case must depend on the facts and surrounding circumstances of the case. But while that is so it is possible to state with certainty some propositions of a negative nature.

Then, after stating a number of propositions (both of a negative and positive nature) of assistance in determining whether a given transaction is or is not an "adventure or concern in the nature of trade", he referred specifically to the intention of the taxpayer when entering into the transaction. He said at page 1137:

> And a transaction may be an adventure in the nature of trade although the person entering upon it did so without any intention to sell its subject matter at a profit. The intention to sell the purchased property at a profit is not of itself a test of whether the profit is subject to tax, for the intention to make a profit may be just as much the purpose of an investment transaction as of a trading one. Such intention may well be an important factor in determining that a transaction was an adventure in the nature of trade but its presence is not an essential prerequisite to such a determination and its absence does not negative the idea of an adventure in the nature of trade. The considerations prompting the transaction may be of such a business nature as to invest it with the character of an adventure in the nature of trade even without any intention of making a profit on the sale of the purchased commodity. And the taxpayer's declaration that he entered upon the transaction without any intention of making a profit on the sale of the purchased property should be scrutinized with care. It is what he did that must be considered and his declaration that he did not intend to make a profit may be overborne by other considerations of a business or trading nature motivating the transaction.

Findings which I have set out above were arrived at after a most careful scrutiny of the evidence of the appellant and her brother and after fully considering what they actually did, as well as all the surrounding circumstances. It now becomes necessary to consider whether the transaction was "in the nature of trade". If the purchase had been made with the intention of subdividing the property and marketing it at a profit in the same way as would have been done by a speculator or dealer in real estate, there seems no doubt that the resulting gain would have been taxable as income from an adventure in the nature of trade notwithstanding that it was an isolated case. In such a case the transaction would have borne the badges of trade (*see Edwards v. Bairstow et al.* (1)).

In *Taylor's* case, reference was made by the learned President to the first definition of "trade" in the United Kingdom cases, contained in the speech of Lord Davey in *Grainger and Son v. Gough* (2), where he said:

> Trade in the largest sense is the business of selling, with a view to profit, goods which the trader has either manufactured or himself purchased.

Now, in the very special circumstances of this case, I can find none of the usual badges of trade. It is true that a purchase was made followed by a later sale at a profit; but these facts by themselves are insufficient to establish that what was done was "in the nature of trade". The property was acquired solely for the purpose of turning it over to the company to be formed, with a "loophole" by means of which the purchasers could escape without loss or profit by sale to Shields if the original scheme fell through. There was no intention of deriving any profit from the purchase; the established intention was that no profit would be made either on the sale to the company or, alternatively, to Shields.

(1) [1955] 3 All E.R. 48—House of Lords.
(2) (1896) 3 T.C. 462 at 474.

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In *Taylor's* case the learned President referred to the well-known statement of the test to be applied, as stated by the Lord Justice Clerk in *Californian Copper Syndicate Ltd. v. Harris* (1):

> What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

And in *Cooper v. Stubbs* (2), Warrington L.J. in the Court of Appeal said:

> The question therefore is simply this, were these dealings and transactions entered into with a view to producing, in the result, income or revenue for the person who entered into them? If they were, then in my opinion profits arising from them were annual gains or profits within the meaning of para. 1(*b*) of Sc. D.

In the instant case there was no scheme for profitmaking and the original transaction was not entered into with a view to producing, in the result, income or revenue for the purchaser. As I view the transaction in question, the appellant and her brother, as the main promoters of the scheme to establish a fur centre, purchased the land with no intention of speculation or without any hope or expectation of profit to be derived therefrom. To some extent they were acting on behalf of the interested members of the syndicate to whose company when formed the property would be turned over in its entirety at cost. Their ownership was intended to be of a purely temporary nature and was to continue only until such time as the company would be incorporated. That purpose was frustrated through no fault on their part and as a result they found themselves the owners of property for which they had no use. Their agreement with Shields under the "Protective Offer" had been terminated and consequently could not be enforced. In the meantime, the value of the property had increased substantially and upon re-sale a profit was made.

(1) (1904) 5 T.C. 159 at 166. (2) [1925] 2 K.B. 753 at 769.

In my opinion, the profit so made was merely an enhancement of value by realizing a security for which the appellant and her brother no longer had any use. The gain was entirely fortuitous and not the result of an operation of business when carrying out a scheme for profit-making. It resulted entirely from two circumstances over which neither the appellant nor her brother had any control, namely, the failure of the New York parties to implement their oral agreement to come into the scheme, and the enhancement of the value of the land.

I have reached the conclusion, therefore, that there was here no adventure or concern in the nature of trade and that the profit realized on the transaction was not profit from a business but was rather an accretion to capital, not subject to tax.

Counsel for the respondent also suggested that it might be found that the whole transaction was in some way for the benefit of the appellant's husband and he referred to the evidence that on previous occasions the appellant and Organ had financed some of his real estate transactions and that he played a part in the negotiation for the purchase and the later sale of the Scarboro property. I find nothing in the evidence to warrant any such conclusion. As a member of the family his advice was sought but not always followed. The down-payments on the purchase price were paid by monies borrowed by Harte Manufacturing Furriers from the Royal Bank, and when the sale to Shields was made in 1953, the proceeds were deposited to the credit of that firm and on the following day divided equally between the appellant and her brother, who alone at that time had any financial interest in the business.

For these reasons the appeal will be allowed, the assessment set aside and the matter will be referred back to the Minister to re-assess the appellant in accordance with my findings.

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The appellant is entitled to her costs after taxation. Inasmuch, however, as the same counsel appeared for both the appellant and her brother at the trial and as the witness's evidence related to both appeals, I direct that the taxing officer in taxing the costs of the trial shall allow to this appellant only one-half of such taxed costs.

Judgment accordingly.

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