CASES

DETERMINED BY THE

EXCHEQUER COURT OF CANADA

AT FIRST INSTANCE

AND

IN THE EXERCISE OF ITS APPELLATE JURISDICTION

BETWEEN:

THE MINISTER OF NATIONAL REVENUE .... APPELLANT;

1957
Apr. 12
Dec. 12

AND

WESTERN CANADA STEAMSHIP COMPANY LIMITED .... RESPONDENT.

Revenue—Income tax—The Income Tax Act, 1948, S. of C. 1948, c. 52, s. 12(1)(a)—"An outlay or expense . . . made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer"—Expenses incurred for surveys and repairs to ships sold before completion of voyage and made after the sale—Expenses incurred in accordance with good business practice—Deductions allowed—Appeal dismissed.

Respondent operates a fleet of sea-going tramp steamers out of Vancouver, B.C. Two of these ships were chartered for trips to the Orient and were sold during the final voyage and before they were returned to their home port. In accordance with certain sale conditions the respondent expended large sums of money for surveys and repairs to both ships. The survey and repairs of one ship were initiated in Canada and concluded in Japan; the survey and repairs of the other ship were carried out entirely in Japan. Respondent deducted the costs of these surveys and repairs from its taxable income for the taxation year in which they were incurred. The Minister of National Revenue appealed to this Court from a decision of the Income Tax Appeal Board allowing the deductions.

Held: That the expenses of the surveys and consequent repairs to the ships were properly deductible from taxable income as being expenses properly incurred for the purpose of earning the income.

2. That it was in accordance with good business practice and proper navigation that the owner should ensure by all possible means the staunchness of the vessels in all respects.

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APPEAL from a decision of the Income Tax Appeal Board.

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

F. J. Cross for appellant.

William Murphy, Q.C. and *H. W. Thompson* for respondent.

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

DUMOULIN J. now (December 12, 1957) delivered the following judgment:

This appeal was heard at Vancouver, B.C., April 12, 1957.

The instant case is an appeal from a decision of the Income Tax Appeal Board, dated June 14, 1956[1], allowing the respondent's appeal from an assessment to income tax in respect of the taxation year 1953.

Western Canada Steamship Co. Ltd., a body corporate, has its head office in the City of Vancouver, Province of British Columbia, and operates a fleet of sea-going tramp steamers.

In its income tax return for 1953, respondent deducted from its gross income a sum of $45,524.76 as an operation expense.

An amount of $36,283.53 was spent by respondent for a survey of and repairs to one of its several vessels, viz., the S.S. *Lake Sicamous*.

The further sum of $9,241.23 was also alleged to have been expended for the survey of and repairs to a second ship the S.S. *Lake Winnipeg*.

Both these vessels were, at the material time, owned and operated by Western Canada Steamship Co. Ltd.

For the factual reasons, an outline of which will be given shortly, respondent, in para. 14 of its reply to appellant's statement of facts "submits that amounts set forth in paragraph A 8. of this Reply were expended by the Respondent in the normal and ordinary course of its business and for the maintenance and up-keep of the said vessels and for the purpose of earning income for the Respondent."

[1] 15 Tax A.B.C. 228

It might be appropriate to set out at once the appellant's adverse contention expressed in paras. B. 2 and 3 of its Notice of Appeal:

2. The Appellant says that the costs of the survey and repairs to the said vessels together with the cost of returning the said vessels to the City of Vancouver, were not expenses made or incurred for the purpose of producing income.

3. The Appellant says that such expenses were made or incurred for the purpose of or pursuant to the sale of the said vessels.

Both parties rely upon the self-same provision, i.e. s. 12(1)(*a*) of the 1948 *Income Tax Act,* 11-12 Geo. VI, c. 52, reading:

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.

The undisputed facts are as follows:

In the case under consideration, two units of this fleet, namely S.S. *Lake Winnipeg* and S.S. *Lake Sicamous* were chartered for trips to the Orient with port callings, amongst others, at Pusan, Korea, and Osaka, Japan.

During the final voyage, both vessels were sold, as attested by Exhibits 2 and 5.

The agreement of sale, filed as Exhibit 2, is dated "the 26th day of March, 1953" and deals with the sale of the vessel *Lake Winnipeg,* for the price of $710,000, U.S. currency, with Vancouver as port of delivery, said delivery to be effected "not later than fifteenth (15th) June, 1953", (art. 4).

Exhibit 5 consists in a like agreement, dated "the 31st day of March, 1953", between the same parties implementing the sale of the *Lake Sicamous* for a price of $730,000, U.S. dollars, with obligation to deliver this vessel also at Vancouver, B.C. "not later than 30th June, 1953".

Both agreements of sale contain a similarly worded clause which should be reproduced at length:

5. The vessel shall be delivered safely afloat in a seaworthy condition, tight, staunch and strong, and in Lloyd's 100 A-1 class, without reservation, with Special Survey No. 2 passed, and in every way satisfactory for normal service of a vessel of her type, size and description, and, to ascertain the fulfillment of these requirements, the Seller agrees to have the vessel inspected and examined in a drydock in Vancouver, B.C. for bottom damage, by a surveyor of Lloyd's, and to give notice of such inspection to

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the Purchaser by letter, telegram or cable, at his address at least three (3) days before such inspection takes place, the Seller hereby undertaking to promptly carry out at his expense any repairs ordered to be carried out by Lloyd's surveyor to enable him to issue a classification certificate 100 A-1 without reservation; drydocking and other expenses incidental to the inspection to be paid by the Purchaser if the vessel does not require any repairs or does require repairs the cost of which shall be less than One Thousand Dollars ($1,000), but said expenses to be paid by the Seller if the vessel requires repairs, other than painting, the cost of which will be in excess of the sum of One Thousand Dollars ($1,000); the cost of painting to be borne by the Purchaser except for the painting of those parts which needed repairs.

Again two other stipulations, identical in wording, appear in both covenants of sale, viz., arts. 10 of Exhibits 2 and 5 respectively, extending, until actual delivery, the seller's title in and to the vessels, and saddling him with the owner's legal risks.

Appellant did not call any witnesses, relying upon the exhibits filed and more so upon the interpretation which, at law, they should warrant.

Mr. F. J. Cross, for appellant, declared his complete agreement with Mr. Justice Cameron's decision, in re *Montship Lines Ltd. v. The Minister of National Revenue*[1] which met with the approval of the Supreme Court of Canada in an oral pronouncement, and his intention to refrain from quoting other precedents.

Such concurrence means that, in the actual issue as in the former, appellant would have found no fault with the deductions claimed, if the ships, pending their return to Vancouver, had remained unsold.

It also signifies that this sale and its several obligations provide the litigious factors.

The ensuing details had better be reported from the evidence adduced by respondent's two witnesses, the first of which was Mr. John Sinclair Clarke, President and General Manager of Western Canada Steamship Co. Ltd.

Mr. Clarke testified that a special survey is carried out by duly qualified marine surveyors, at least every four years, as a necessary requisite, amongst other precautionary ends, to classify ships in Lloyd's 100 A-1 class.

Regarding S.S. *Lake Winnipeg,* its initial special survey, given as Survey No. 1 or A, dated back to July 1948, and the next one fell due in July 1952. It was begun only in

[1] [1954] Ex. C.R. 376.

August 1952, at Fort Moody, continued in 1953, at Osaka, Japan, resumed in Vancouver in March 1953, and completed on May 2, again at Osaka.

The cost of this survey and consequent repairs amounts to $7,771.73, according to Exhibits 3 and 4.

As for S.S. *Lake Sicamous,* the preceding survey was performed in May 1949, with the result that it should be renewed in 1953. Since labour costs and other requisites were much cheaper in Japan than in America, the *Sicamous* underwent its survey and necessary repairs entirely at Osaka, from May 6 to May 18, 1953.

Capt. Clarke who, by the way, is the holder of a master mariner's degree, says that, prior to the ships' departure for the Orient, respondent company was approached by agents of Lloyds on the matter of its intention regarding the carrying out or completion of the special surveys which, as already stated, are essential to the retention of the 100 A-1 classification. The Company replied that these requirements would surely be fulfilled in the very near future.

Apparently, permission was obtained by Western Canada Steamship Co. Ltd. to carry out the survey and repairs in some Far Eastern port for economy's sake.

The survey and reconditioning of *Lake Sicamous* cost $32,013.03, although Exhibits 6, 7 and 8 tend to show higher figures.

Capt. Clarke positively declares that each and every one of these surveys and repair jobs would have been accomplished in the same way and to the same extent had the ships remained the Company's property. As instances of respondent company's firm intention in this respect, witness quotes inspection and repairs of two other unsold ships, and also that, between March 11 and 16, 1953, when the *Sicamous* rode at anchor in San Francisco harbour, arrangements were concluded for a painting job to be done some weeks later at Pusan, Korea.

Capt. Clarke, cross-examined, declared that by special permission from Lloyds, pursuant to an inspection in dry dock by the marine insurer's own surveyors, if a ship is found in good condition, a twelve-month delay may be granted.

Clarke goes on to say that the proximity of the quadrennial survey did not, in any way, influence the selling prices.

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A significant part of Mr. Clarke's testimony deals with a trade complication particular to ventures in freight transportation to the Orient. The witness explains that tramp steamers meet with considerable hardship in obtaining worthwhile cargoes for the return trip, known, in marine parlance, as the second leg. Whenever a fortunate result of this nature is achieved, the extra profit derived therefrom bears the savoury epithet of "gravy".

Clarke, whose opinion on these points is shared by the other witness, Mr. Francis C. Garde, testifies that only regular shipping lines, operating pre-ordained schedules between West and East are assured of return cargoes. For this reason, says the witness, *our shipping rates must be computed and spread over the through trips, that is outgoing and incoming voyages or "legs", with the consequence that a profit is nonetheless derived even though one of our steamers returns in ballast.* "It was a constant practice and policy with Western Canada Steamship Co. Ltd." concludes Mr. Clarke, "to keep its fleet in the 100 A-1 class and in good standing with Lloyds."

Each vessel carried a crew of thirty-six men. Under normal conditions, the homeward journey of 4,200 miles would take seventeen days and require a proper state of seaworthiness to affront the risks of the Pacific Ocean.

Mr. Francis C. Garde, president of a Vancouver shipping agency succeeded Capt. Clarke.

According to this witness, in 1953, prior to the departure of respondent's ships and during their trip, he strove to obtain cargoes of any description whatever for the in-bound voyage, but without avail.

Mr. Garde's endeavours in this connection covered a period of three months previously to the return sailings; he unhesitatingly stresses the real difficulty of procuring cargoes on West bound voyages, save for regular liners.

The issue under consideration is a repetition, I would be tempted to say a replica, of the *Montship Lines Ltd.* case, (*supra*), with the sole exception, and this a decisive one, that here surveys and repairs occurred *during the voyage, before the return* trip, instead of, as in *Montship Lines, after completion of the expedition.*

In the latter case, two vessels were disposed of while on cruise. The agreements of sale also stipulated that both vessels should classify in Lloyd's 100 A-1 class.

Upon their reaching the home port, the ships went into dry docks and certain repairs were made before their delivery. The Court held:

That s. 12(1)(*a*) of the Income Tax Act being a positive enactment and excluding deductions which were not made or incurred by the taxpayer *for the purpose* of gaining or producing income from his property or business, it is not enough to establish that the dilapidations which occasioned the expenditures arose out of or in the course of the business, but that the *purpose* of the taxpayer in making the outlays was that of gaining or producing income from the business. Here that was not the purpose of the taxpayer. The outlays were incurred at the time each vessel entered the drydock, and it was then known that they would no longer be operated by appellant, but, following the inspection by Lloyds' surveyor would be delivered to the purchasers. The sole purpose of appellant in incurring the expenses was to comply with the requirements of the agreements of sale.

However, at p. 380, the learned judge emphasizes that:

It is of particular importance to note that neither of the vessels, following completion of the repairs, was used in the business of the appellant, and that at the time the expenses were incurred the appellant had entered into agreements to dispose of the vessels and knew that *thereafter they would not be used to earn income for the appellant.*

It then becomes apparent that, should any distinguishable difference creep through between the latter and the instant case, it can only proceed from the fact that the *Lake Winnipeg* and *Lake Sicamous,* in the course of their in-bound crossing *would still be operated in the business of respondent upon an income earning venture.* Such a distinction may seem somewhat thin and subtle, which, assuredly, is not a novel contingency in litigations of this nature.

Two witnesses, of unchallenged veracity, Capt. Clarke and Mr. Garde, reported the customary complication for tramp freighters to sail home in ballast from Far Eastern ports, so that cargo rates are tariffed accordingly and overcome this disadvantage. Whenever in-bound ships secure freight consignments, this is looked upon in the light of an additional or super profit nicknamed "gravy".

Had they continued on respondent's register, both these vessels would nonetheless have sailed back to Vancouver, their port of registry, earning, while so engaged, a proportionate share of an income spread over the whole venture.

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The quadrennial surveys evidenced no undue haste nor extraordinary delay regarding their renewals. In the case of S.S. *Lake Winnipeg,* the major portion of the repair jobs, begun in August 1952, continued in January or February 1953 and early March, was over well before the date of sale.

The most recent case in line, viz., *Seagull Steamship Company Limited v. The Minister of National Revenue*[1], a decision rendered by Fournier J. of this Court, on August 30, 1957, dealt with an appellant company which made extensive improvements on two ships that it had agreed to sell. The appellant company deducted the amount spent on repairs for both ships which the Minister then disallowed on the grounds that they were capital.

On pp. 10 and 11 of Mr. Justice Fournier's reasons for judgment, we read:

> I would distinguish this case from that of the *Montship Lines Limited v. The Minister of National Revenue* [*supra*] wherein Cameron J. found that the outlays were not made for the purpose of gaining income but to comply with agreements of sale. . . .
> . . . 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 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 they 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.

The evidence reasonably satisfied the Court that imperative considerations of maintenance and navigation, nowise related with the contractual terms, necessitated the expenditures incurred for surveys and repairs, and also that, owing to conditions inherent to similar undertakings, the ships *persisted during the home crossing,* as related above, *in the income earning business of the respondent.*

Mr. Justice Thorson, in the *Royal Trust Company v. The Minister of National Revenue*[2], pointed out that:

> in considering whether or not an expense was deductible *the first step was to determine whether or not it was in accordance with good business practice.* The second step was to determine whether or not it (the expense) was prohibited by the express terms of section 12(1)(*a*) of the Act.

Before attempting a trans-Pacific voyage of no less than 4,200 miles, was it not then primarily a humane and proper practice of navigation entailing a consequent legal obliga-

[1] [1957] Ex. C.R. 324.

[2] (1957) 11 D.T.C. 1055.

tion for the owners to ensure, by all possible means, the staunchness in all respects of vessels manned by an aggregate crew of seventy-two seamen?

For the preceding reasons the appeal will be dismissed and the record referred to and correspondingly amended by the Minister of National Revenue.

Respondent is entitled to the taxable costs.

Judgment accordingly.