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Nov. 12

BETWEEN:

SISCOE GOLD MINES LIMITED.. APPELLANT;

AND

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

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, chap. 97, secs. 6 (a), 6 (b)—"Disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income"—Legal expenses incurred in defending attacks on title to property or claims connected with financing arrangements not deductible—Expenditures made for purpose of determining whether assets should be acquired not deductible.

The appellant was engaged in the business of gold mining. Appeals from income tax assessments for the years 1929, 1931, 1932, 1933, 1935, 1936, 1937 were brought because certain disbursements and expenses made and incurred by it were disallowed. Some of these consisted of legal expenses incurred by the appellant in defending actions in which attacks were made on its title to its mining property or in which claims were made arising out of transactions connected with its early financing arrangements. Other expenditures that were disallowed related to certain mining claims. The appellant had entered into an agreement under which it had an option to buy such claims and the right to do exploration, development and diamond drilling on them. After making a number of payments under the agreement and doing considerable diamond drilling the appellant decided not to take up the option. Two other disbursements, one to one of its directors and the other in connection with the distribution of gold medals, were also disallowed.

Held: That legal expenses incurred by a taxpayer in maintaining the title to his property or protecting his income when earned, or in connection with the financing of his business are not expenditures directly related to the earning of his income and are not allowed as deductions in computing the gain or profit to be assessed. *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (1941) S.C.R. 19 and *Montreal Coke and Manufacturing Co.* v. *Minister of National Revenue* (1944) A.C. 130 followed. *Southern* v.. *Borax Consolidated, Ltd.* (1940) 4 All E.R. 412 not followed.

2. That an expenditure incurred for the purpose of enabling a taxpayer to decide whether a capital asset should be acquired is an outlay or payment on account of capital and, as such, is excluded as a deduction by section 6 (*b*).

APPEAL under the provisions of the Income War Tax Act.

The appeals were heard before the Honourable Mr. Justice Thorson, President of the Court, at Montreal.

J. G. Ahern, K.C. for appellant.

D. L. Desbois, K.C. and *H. H. Stikeman* for respondent.

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

THE PRESIDENT, now (Nov. 12, 1945) delivered the following judgment:

The appellant carries on the business of gold mining. In the income tax assessments levied against it for the years 1929, 1931, 1932, 1933, 1935, 1936 and 1937 certain disbursements and expenses made and incurred by it were disallowed as deductions from its income. The appeals from these assessments were brought because of such disallowances.

The items disallowed consisted of certain legal expenses; expenditures relating to certain mining claims; and two other disbursements, one to one of its directors and the other for the distribution of gold medals.

The disbursements and expenses were disallowed under section 6 (*a*) of the Income War Tax Act, R.S.C. 1927, chap. 97, which reads as follows:

> 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;

but consideration must also be given to section 6 (*b*) which prohibits the deduction of:

> (*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence, except as otherwise provided in this Act;

It will be convenient to deal with the disallowed items under the heads mentioned. Of these the most important is that of legal expenses paid by the appellant in 1932, 1933, 1935 and 1936 in connection with actual or threatened litigation. The facts relating to the various claims are complicated but only the salient ones need be given. The appellant's mining property was originally staked by a syndicate of 11 persons, called the Siscoe Mining Syndicate, and the letters patent for it were issued in the name of the syndicate. In 1921 the members of the syndicate executed a deed of sale and conveyance to S. E. Melkman. In 1923 a deed to the appellant was executed by Walter Glod, one of the members of the syndicate, acting on his own behalf and also for the other members under power of attorney from them,

and also by S. E. Melkman. Several attacks on the appellant's title to its property followed. In 1933 action was brought by Janiec Estate Corporation Limited, which had acquired the rights of the heirs of Albert Janiec, one of the members of the syndicate, alleging that the appellant had never acquired his interest in the property and claiming an undivided 1/11th interest in the mining property, an accounting of the profits and 1/11th share therein. The action was contested but was settled. The legal expenses of this litigation came to $45,115. The next three actions centred around Stanley Hadish, another member of the syndicate. In 1934 action was brought by the widow of Michael Shultz alleging that Stanley Hadish had assigned his interest in the syndicate to her husband, that Walter Glod had no authority to act for him and that her husband's interest in the mining property had never passed to the appellant, and claiming that she and her children, as the heirs of Michael Shultz, were the undivided owners of the property. This action was not proceeded with. Subsequently in 1935 action was brought by Michael Shultz Estate Corporation Limited, through the heirs of Michael Shultz, claiming that the assignment from Joseph Hadish to Michael Shultz was valid and that the appellant had never acquired Michael Shultz's interest in the property. Later an amended declaration was filed by Michael Shultz Estate Corporation Limited making a similar claim. The claims were essentially the same as in the Janiec litigation, namely for an undivided 1/11th interest in the property. The Hadish claims were settled with $11,397.22 spent in legal expenses. The claim of Joseph Pluto, another member of the syndicate, was somewhat similar. This related to a certain mining claim which the appellant had acquired from H. J. Burkhardt who had acquired it from Joseph Pluto. In 1933 Pluto brought action claiming that the transfer from himself to Burkhardt and from Burkhardt to the appellant be set aside and that he be declared the owner of the claim and subsidiarily for $1,000,000 damages or 666,666 shares of fully paid up capital stock. The action was abandoned but $5,130 was paid out in legal expenses in contesting it. The Janiec, Hadish and Pluto actions were similar in that in each of them an attack was made on the appellant's

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title to its mining property. If they had succeeded the appellant's capital assets would have been substantially impaired. The other claims against the appellant were connected with certain financing arrangements made by it. When Walter Glod transferred the mining property of the Siscoe Mining Syndicate to the appellant approximately one-third of the shares issued in payment were transferred to the Eastern Trust Company to be used in financing the appellant to production. Several years later actions were brought by Mining Assets Realization Limited representing five members of the syndicate alleging that Walter Glod had no authority to transfer any shares to the Eastern Trust Company and claiming that each of the five members of the syndicate was entitled to 1/11th of the shares issued and that the appellant was indebted to them for the shares they had not received or their value. The first and second actions were withdrawn and the third was settled. The legal expenses incurred in this litigation amounted to $1,811.32. Then there was the litigation by Felix Bijakowski, another member of the syndicate. The shares transferred to the Eastern Trust Company were not sufficient to enable the appellant to finance itself to production and several of the shareholders were called upon to transfer some of their shares to the appellant for additional financing purposes. Bijakowski was one of these. Some ten years later he brought action alleging that he and two others, who had transferred their right to him, had lent 30,000 shares to the appellant and claiming the return of the shares or their value. He succeeded in his claim, which was carried as far as the Supreme Court of Canada. This litigation cost the appellant the sum of $11,360.76. The action brought by W. R. Baillie was related to this financing operation. He alleged that he had been promised a commission of cash and shares for finding a person willing to subscribe $75,000 for capital stock of the appellant and claimed 65,000 shares or $65,000. The appellant successfully contested this claim but incurred $13,728.15 of legal expenses in so doing. Finally, the appellant paid $529 as its contribution towards settling an action brought by the Eastern Trust Company, its transfer agent, against Andrew Bowers,

to whom it had made an over-issue of 3,000 shares in error. Bowers refused to return these shares and also threatened action similar to that taken by Bijakowski, since he had been one of the persons who had transferred 10,000 shares to enable the appellant to finance.

From this statement of the facts it will be seen that all the legal expenses under review were incurred by the appellant either for the purpose of maintaining its title to its mining property and protecting its right to the profits already earned or in connection with the arrangements made for financing its property into production; they were not related to the appellant's business of gold mining or the earning of its income therefrom.

There is nothing in the Income War Tax Act to warrant the assumption that legal expenses are a special class of disbursements or expenses or that they are generally deductible and that it is only in exceptional cases that their deduction is disallowed. The tests to be applied in determining their deductibility are the same as those applicable to any other disbursements or expenses.

The determination of whether a disbursement or expense is deductible does not depend solely upon whether it is attributable to capital or to revenue. If it is an outlay or payment on account of capital its deduction is prohibited by section 6 (*b*), but it is not sufficient in order to make it deductible merely to show that it is not excluded by section 6 (*b*); if that were the only section to be considered this would be sufficient, but section 6 (*a*) clearly implies that there may be disbursements or expenses, that are not of a capital nature and, therefore, not covered by section 6 (*b*), that are, nevertheless, not deductible for, otherwise, there would be no need for section 6 (*a*) at all. Section 6 (*a*), in my judgment, prohibits the deduction of all disbursements or expenses, even if they are of a revenue nature, that are "not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income", and the test to be applied in each case is whether the disbursement or expense falls within the exclusions specified.

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The kind of disbursement or expense that is deductible was defined by the House of Lords in *Strong & Co.* v. *Woodifield* (1) in dealing with the corresponding English section. There Lord Davey said, at page 453:

> 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.

This relation between the disbursement or expense and the earning of the profits is of vital importance in construing the meaning of section 6 (*a*). Some caution must be exercised in applying an English decision in the construction of this section because of the differences between it and the section upon which the decision is based. Section 6 (*a*) contains the word "necessarily" which does not appear in the corresponding English section; moreover, section 6 (*a*) uses the expression "for the purpose of earning the income" while the English section contains the expression "for the purposes of the trade". Without now determining what effect, if any, this difference in language may have, it is, I think, safe to say that the English section is more generous in its allowance of deductions than is the Canadian one, and it may, therefore, be said generally that, while English decisions disallowing deductions may be applicable, those allowing them are not necessarily so. The statement of Lord Davey in *Strong & Co. Ltd.* v. *Woodifield* (*supra*) is in my judgment, clearly applicable in the present case, for section 6 (*a*) prohibits the deduction of disbursements or expenses that are not laid out or expended for the purpose of "earning" the income. This excludes, in my opinion, the legal expenses incurred by the appellant for they were laid out for purposes other than the earning of its income.

Lord Davey's statement was approved by the Lord President (Clyde) of the Scottish Court of Session in *Robert Addie & Sons' Collieries, Limited* v. *Commissioners of Inland Revenue* (2), where the following test was laid down:

> What is 'money wholly and exclusively laid out for the purposes of the trade' is a question which must be determined upon the principles of ordinary commercial trading. It is necessary, accordingly, to attend

(1) (1906) A.C. 448.

(2) (1924) S.C. 231 at 235.

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?

This test was approved by the Judicial Committee of the Privy Council in *Tata Hydro-Electric Agencies, Bombay* v. *Income Tax Commissioner, Bombay Presidency and Aden* (1) and was adopted by the Supreme Court of Canada in *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (2). In that case the respondent company had incurred legal expenses in defending its right to supply gas in the City of Hamilton and sought to deduct such expenses from its income. The Supreme Court of Canada, reversing the judgment of this Court, held that it was not entitled to do so. All the judges were agreed that the expenditure did not meet the test laid down by Lord President Clyde in the *Addie* case (*supra*). Duff C.J., for himself and Davis J., held the legal expenses to be not deductible on two grounds; one, that they were not expenses incurred in the process of earning "the income", and the other, that the expenditure was a capital expenditure incurred "once and for all" for the purpose and with the effect of procuring for the company "the advantage of an enduring benefit". Crocket J. considered the test laid down in the *Addie* case (*supra*) and approved in the *Tata* case (*supra*) binding and held that the expenditure did not fall within the test. Kerwin J., speaking for Hudson J. as well, also held that the test referred to was applicable and that the payment of the costs was not an expenditure laid out as part of the process of profit earning. His view was that it was a "payment on account of capital" made "with a view of preserving an asset or advantage for the enduring benefit of a trade".

In my opinion, the legal expenses incurred by the appellant are not distinguishable in principle from those held to be not deductible in the *Dominion Natural Gas Company* case (*supra*). They do not meet the test laid down in the *Addie* case (*supra*). The business of the appellant was that of gold mining and it earned its income from that business. The legal expenses incurred had nothing to do with the business of gold mining or with the earning of income therefrom. In my opinion,

(1) (1937) A.C. 685 at 696. (2) (1941) S.C.R. 19.

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they fell within the exclusions of section 6 (*a*). There is a further reason for holding them not deductible. If the litigation attacking the appellants's title had succeeded the appellant would have suffered a substantial loss of its capital assets. The legal expenses incurred in the actions relating to the financing arrangements of the appellant may properly be regarded as further costs of the additional capital obtained by such arrangements. The legal expenses may, therefore, be considered as capital outlays or payments on account of capital. As such, they are within the prohibitions of section 6 (*b*).

The matter is, I think, settled beyond dispute by the judgment of the Judicial Committee of the Privy Council in *Montreal Coke and Manufacturing Co.* v. *Minister of National Revenue* (1). In that case the appellant company had redeemed certain bonds prior to their maturity and had issued other bonds at reduced rates of interest, with a resulting increase in its net revenues, and sought to deduct the expenses of these financial operations from its income. The Judicial Committee, affirming the judgment of the Supreme Court of Canada, which in turn by a majority had affirmed the judgment of this Court, held that such expenses were not deductible. At page 133, Lord MacMillan said:

> 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.

and later, on the same page:

> 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. Of course, like other business people, they must have capital to enable them to conduct their enterprises, but their financial arrangements are quite distinct from the activities by which they earn their income. No doubt the way in which they finance their business will, or may, reflect itself favourably or unfavourably in their annual accounts, but expenditures incurred in relation to the financing of their business is not, in their Lordships' opinion, expenditure incurred in the earning of their income within the statutory meaning.

(1) (1944) A.C. 130.

This statement of the law clearly excludes all the legal expenses incurred by the appellant. They were not directly related to the earning of its income from its gold mining business.

Counsel for the appellant relied strongly upon the decision in *Southern* v. *Borax Consolidated, Ltd.* (1). In that case the respondent company for the purposes of its business had acquired certain property near Los Angeles in California. The City of Los Angeles brought action claiming that the title to this property was invalid. The company defended this action and incurred legal expenses in so doing. It contended that these expenditures were deductible as being wholly and exclusively for the purposes of its trade. The Revenue officers argued that the action concerned the capital assets of the company and was contested to preserve the existence of those assets and were not deductible. The Commissioners for the General Purposes of the Income Tax Acts found on the evidence that the expense was wholly and exclusively laid out by the company for the purposes of its trade and was allowable as a deduction. Lawrence J. held that the decision of the Commissioners was right. In view of the principles laid down in the *Dominion Natural Gas Company* case (*supra*) and the *Montreal Coke Company* case (*supra*), which are binding upon this Court, the decision in *Southern* v. *Borax Consolidated Ltd.* (*supra*), should not, in my opinion, be regarded as an authority to be followed in construing section 6 (*a*) of the Income War Tax Act. In my view, it is established that legal expenses incurred by a taxpayer in maintaining the title to his property or protecting his income when earned, or in connection with the financing of his business are not expenditures directly related to the earning of his income and are not allowed as deductions in computing the gain or profit to be assessed.

The next expenditures to be considered related to the House mining claims. There were twelve of these to the east of the appellant's mining property, two being contiguous to it. There were indications that ore veins in the appellant's property continued eastward into the House

(1) (1940) 4 All E.R. 412.

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claims. On July 23, 1936, the appellant entered into an agreement whereby, on the payment of $10,000, it acquired the sole and exclusive right and option to purchase the claims and during the life of the option to enter upon and take possession of them and do exploration, development and diamond drilling on them. The agreement provided for annual payments to keep the option to purchase and the right to work on the claims alive, up to a certain period, when the appellant could give notice of its intention to purchase the claims and become bound to pay the further price provided. The mining claims were not to vest in the appellant until such price was paid in full and it was provided that if it did not make the annual payments its rights under the agreement would lapse. The appellant made the initial payment of $10,000 in 1936 and a further payment of the same amount in 1937. In these years it did a considerable amount of exploration and diamond drilling work but on the advice of its manager decided to drop the option. It sought to deduct from its income for the year 1936 the sum of $18,069.82 and for the year 1937 the sum of $26,861.40, each of which sums included an option payment, the balance having been spent on exploration and diamond drilling work. I am quite unable to see by what right the appellant can deduct these expenditures. It is quite clear that they were incurred for the purpose of determining whether the claims should be acquired as capital assets. If the option had been taken up, additional capital assets would have been acquired and the expenditures made would clearly have been capital outlays or payments on account of capital and could not have been deducted. The fact that it was decided to abandon the option and not to acquire the claims cannot change the character of the disbursements. They were losses incurred in connection with a capital venture. Counsel argued that they should be regarded as an operating expense for the right to go in and do diamond drilling. Even on this view of the expenditures the judgment of the Supreme Court of Canada in *Roseberry-Surprise Mining Co.* v. *The King* (1) is strongly against the appellant. The expenditures made were not laid out or expended in the process of earning the income

(1) (1924) S.C.R. 445.

within the test laid down in the *Addie* case (*supra*) and were certain not directly related to the production of the appellant's income from its gold mining business within the meaning of the judgment in the *Montreal Coke Company* case (*supra*). Moreover, I think it is clear that an expenditure incurred for the purpose of enabling a taxpayer to decide whether a capital asset should be acquired is an outlay or payment on account of capital and, as such, is excluded as a deduction by section 6 (*b*). The expenditures of the appellant in connection with the House claims were of that character and were, in my opinion, properly disallowed.

In 1933 the appellant paid Mr. T. H. Higginson, one of its directors, the sum of $2,500 pursuant to a resolution passed by the directors by which "it was unanimously resolved the sum of $2,500 be granted to Mr. T. H. Higginson for past services rendered during the early days of the company, and for his untiring efforts during recent years in connection with the company's fire insurance". If this correctly states the basis for the payment, it is obviously not deductible as an expense for there was no obligation to make it—*vide In* re *Salary of Lieutenant-Governors* (1). In reality the expenditure, although put on the basis of payment for past services, was made in repayment for stock loaned to the appellant in connection with its financing under circumstances similar to those in the Bijakowski litigation. That being so, the amount paid to Mr. Higginson was clearly not deductible for the same reasons as apply in connection with the legal expenses.

Finally, in 1931 the appellant distributed gold medals, at a cost of $1,690.85, to its past and present directors and other persons, as a token of appreciation, and sought to deduct this as an operating expense. It is obvious, in my judgment, that this disbursement was not within the tests laid down in the cases referred to. It was not "necessarily" laid out or expended and it had nothing to do with the earning of the appellant's income. It was, in my opinion, properly disallowed.

All the disbursements and expenses in question having been properly disallowed, it follows that these appeals must be dismissed with costs.

Judgment accordingly.

((1) (1931) Ex. C.R. 232.