1951

Sept. 27

1952

Jan. 4

BETWEEN:

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

AND

THE L. D. CAULK CO. OF CANADA LTD. ..... RESPONDENT.

Revenue—Income Tax—Income War Tax Act R.S.C. 1927, c. 97, s. 6—1—"Disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income"—Deductibility of legal expenses incurred in defending a charge prosecuted under the Criminal Code and of making representations to the Commissioner under the Combines Investigation Act—No difference in tests to be applied to determine deductibility of legal expenses and any other expenses or disbursements—Appeal dismissed.

Respondent, a manufacturer of dental supplies, in 1947 at the invitation of the Commissioner under the Combines Investigation Act, who was conducting an investigation into an alleged combine in the manufacture and sale of dental supplies in Canada, made representations before him, employing for that purpose solicitors to whom in 1947 a fee was paid for their services.

Later respondent with others was prosecuted upon a charge laid under the Criminal Code of Canada that they did in fact constitute a combine in the manufacture and sale of dental supplies in Canada. At the trial of such charge respondent was acquitted and an appeal from such acquittal taken by the Crown was dismissed. Respondent in 1948 paid fees to its solicitors and also to counsel who acted for it at the trial and appeal.

In its income tax returns for the taxation years 1947 and 1948 respondent deducted from its income the amounts so paid by it to its solicitors and counsel for their services at the hearing before the Commissioner and at the trial and appeal. These deductions were disallowed by the Minister of National Revenue and an appeal taken by respondent to the Income Tax Appeal Board was allowed. The matter was referred back to the Minister to re-assess the respondent and allow the deductions in full. The Minister appealed to this Court.

Held: That the payments to its solicitors and counsel by respondent were made in the usual course of business and were made with reference to a particular difficulty which arose in the course of the year, namely, the investigation by the Commissioner, the charge laid against the respondent and the unfavourable and damaging publicity which resulted therefrom, and which would have been greatly enhanced had the charge been sustained: the disbursements had nothing to do with the assets or capital of the company but were made in an effort to establish that its trading practices were not illegal, and to enable it to carry on as it had in the past, unimperilled by charges that such practices were illegal.

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2. That the disbursements were wholly, exclusively and necessarily laid out for the purposes of its trade and for the purpose of earning the income.

3. That the tests to be applied to determine the deductibility of legal expenses from income are the same as those applicable to any other disbursements or expenses.

4. That there is no essential difference between expenses incurred in defending a right of a trader to describe his goods in a certain manner (in common with all other members of the public) and expenses incurred in successfully defending a right to the use of certain trade practices which were equally available to all members of the public.

5. That there is no distinction between the legal expenses incurred in the proceedings before the Commissioner and those expenses incurred in defending the criminal charge laid against the respondent, the same matters were in issue throughout and arose out of precisely the same circumstances.

6. That in view of the fact that respondent was acquitted the mere fact that the charge against respondent was made under the Criminal Code has no bearing on the deductibility or otherwise of the expenses incurred in defence of that charge.

APPEAL from a judgment of the Income Tax Appeal Board.

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

Jos. Singer, K.C. and *J. S. Forsyth* for appellant.

J. W. Pickup, K.C. and *J. D. Pickup* for respondent.

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

CAMERON J. now (January 4, 1952) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board, dated December 4, 1950. By consent I heard this appeal and similar appeals in four other cases at the same time. In the other cases the Minister of National Revenue had also appealed from decisions of the Income Tax Appeal Board, the respondents being the *Dominion Dental Co. Ltd.* (No. 43983), *Goldsmith Brothers Smelting and Refining Co. Ltd.* (No. 43981), *The Dental Co. of Canada Ltd.* (No. 46470) and *S.S. White Co. of Canada, Ltd.* (No. 43982).

The principles involved in each case are precisely the same and it was therefore agreed that a formal judgment should be rendered in one case and that that judgment should be applicable to all. I have selected this particular case inasmuch as it applies to two taxation years and involves payments made in respect of two different matters.

The main facts in this case (as well as in the other cases) are not in dispute. The respondent herein carries on the business of manufacturing of dental filling materials and dental specialties at Toronto. In 1947, the Commissioner under the Combines Investigation Act, R.S.C. 1927, c. 26, had been conducting an investigation into an alleged combine in the manufacture and sale of dental supplies in Canada. Prior to making his report thereunder, the Commissioner had invited the respondent along with other companies, to make representations before him. The respondent for that purpose employed solicitors to represent it before the Commissioner and in the year 1947 paid such solicitors the sum of $625 for their legal services.

Later in 1947, the Commissioner made a report to the Minister of Justice and therein he expressed the opinion that a combine existed in the distribution and sale of dental supplies in Canada within the meaning of the Combines Investigation Act, and that the respondent, along with others, was a party and privy to that combine. That report was circulated and widely publicized throughout Canada. Subsequently, a charge was laid against the respondent—and other companies—under section 498 of the Criminal Code, and at the trial of that charge the respondent and the other companies were acquitted. Later, an appeal from such acquittal was taken by the Crown and that appeal was dismissed.

In the taxation year 1948, the respondent paid its solicitors a total of $701.41, representing their charges for preparation for trial of the charge so laid against the respondent. As those solicitors were unable to represent it at the trial, the respondent secured counsel and for his services paid the sum of $12,000 in 1948. The respondent claimed to be entitled to deduct from its taxable income the said sum of $625 for the taxation year 1947, and the said sums totalling $12,701.41 in the taxation year 1948. By Notices of Assessment dated respectively December 3, 1949, and May 18, 1950, the Minister totally disallowed the

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said deductions. An appeal was taken by the respondent to the Income Tax Appeal Board which board by its decision dated December 4, 1950 (3 T.A.B.C. 160) allowed the said appeals and referred the matter back to the Minister with a direction that the said deductions should be allowed in full, and to re-assess the respondent accordingly. From that decision an appeal is now taken to this Court.

In his Notice of Appeal the Minister relied on the provisions of paragraphs (*a*) and (*b*) of section 6(1) of the Income War Tax Act, R.S.C. 1927, c. 97, as amended, as follows:

> Sec. 6.—1. 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;
>
> (*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.

At the hearing, however, counsel for the Minister abandoned all reliance upon paragraph (*b*).

At the hearing, no oral evidence was given and the argument proceeded on the basis of the record before me, namely, the documents forwarded by the Registrar of the Income Tax Appeal Board (pursuant to the provisions of the Act) which, of course, included the judgment of the Board and the exhibits filed at the hearing before it.

In each case it is essential to ascertain the true nature of the expenditure in order to determine whether it has been "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income." Ex. A-9 in this case is the indictment preferred against the respondent and others. It shows that they were charged that "during all the years from 1930 to 1947, both inclusive, they did within the jurisdiction of this Honourable Court unlawfully conspire, combine, agree or arrange together and with one another and with certain others (named persons or corporations) to unduly prevent or lessen competition in the production, manufacture, purchase, barter, sale, transportation or supply in the cities of Toronto and Montreal and other places throughout Canada, of articles or commodities which may be a subject of trade or commerce, namely, new, used, and refinished dental equipment,

artificial teeth, precious metals used in dentistry and dental treatment, dental sundries, and other articles or commodities used in dentistry and dental treatment and did thereby commit an indictable offence contrary to the provisions of the Criminal Code, Section 498, subsection 1(*d*)."

I think I may safely assume that the investigation in 1947 by the Commissioner under the Combines Investigation Act, at which time the respondent incurred expenses in having its solicitors appear before him, was an investigation into precisely these same matters.

No question is raised as to the reasonableness of the amounts so paid so that I am not concerned at all with the amount of the deductions.

It is to be noted particularly that the investigation before the Commissioner and the subsequent criminal proceedings taken against the respondent had to do with the day to day practice of the respondent in conducting the manufacturing and selling of its products; that the legal expenses so incurred were incurred directly by and on behalf of the respondent itself, and not on behalf of its individual directors; that the proceedings instituted against it were of a criminal nature and that the respondent was wholly successful throughout. The deductions claimed, therefore, are not in respect of a penalty or fine imposed as a result of a breach of the law or for legal expenses incurred in a criminal proceeding in which the taxpayer was convicted. They do not, therefore, fall within the principles laid down in such cases as *Commissioners of Inland Revenue* v. *E. C. Warnes & Co. Ltd.* (1) and *Commissioners of Inland Revenue* v. *Alexander Von Glehn & Co. Ltd.* (2).

Throughout the whole of the proceedings which occasioned the expenditures in question, the trade practices of the respondent were challenged and defended. It was alleged that such practices were illegal and that the respondent was guilty of a crime. The adverse publicity incidental to the Commissioner's report and the subsequent criminal charge was of such a nature that the company's future prospects were placed in jeopardy. Quite naturally, therefore, they took steps to see that their interests were protected by employing solicitors to represent them before

(1) (1919) 12 T.C. 227. (2) (1919) 12 T.C. 232.

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the Commissioner and to prepare for the trial and the criminal charge, and later by employing counsel to represent them at the trial and the appeal which followed. In the result, their efforts were successful and the respondent was acquitted, the Crown having failed to prove that the trade practices complained of were in any way illegal. I have said that their business was placed in jeopardy by the charges so laid. In the judgment rendered by the Tax Appeal Board it was stated that "the adverse publicity had already contributed to a substantial decrease in the company's business," and under the circumstances of this appeal I think I am entitled to rely on that finding of fact. The respondent's business reputation—and therefore its capacity to earn profits—was at stake and consequently it secured legal assistance in defending its position and its practices. It was forced to incur these expenses or possibly suffer the consequences of a serious loss in business.

Under the circumstances, then, were the disbursements made "wholly, exclusively and necessarily for the purpose of earning the income?"

As stated by the President of this Court in *Siscoe Gold Mines Ltd.* v. *Minister of National Revenue* (1):

> 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.

Counsel for the respondent submitted that the disbursements here in question were incurred by the respondent not in its capacity as a trader, but as a citizen amenable to the law like all other citizens. His argument was put in this way.

> That the legal costs of successfully defending the criminal charge and of resisting the investigation by the Commissioner preceding those charges, were not "business expenses" but "personal expenses" and, therefore, should be disallowed as "not expended for the purpose of earning the income." Although the acts which gave rise to the investigation before the Commissioner, and the charge, were done in the course of "business", the criminal charge and the previous investigation by the Commissioner were taken against the company as "citizens amenable like all other citizens, individual and corporate, to the law," and expenses of clearing themselves were expended upon themselves in their character of citizens and not in their character of traders.

(1) (1945) Ex. C.R. 257 at 261.

He relied on the well-known case of *Strong & Co. Ltd.* v. *Woodifield* (1). The headnote in that case is as follows:

A brewery company owned an inn which was carried on by a manager as part of their business. A customer sleeping in the inn was injured by the fall of a chimney, and recovered damages and costs against the company for the injury, which was owing to the negligence of the company's servants:—

Held, that the damages and costs could not be deducted in estimating the balance of profits for the purpose of the income tax, the loss not being connected with or arising out of the trade, and not being money wholly and exclusively laid out or expended for the purposes of the trade.

Lord Loreburn, L.C., said at p. 452:

In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade, or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation or fall on the trader in some character other than that of trader. The nature of the trade is to be considered. To give an illustration, losses sustained by a railway company in compensating passengers for accidents in travelling might be deducted. On the other hand, if a man kept a grocer's shop, for keeping which a house is necessary, and one of the window shutters fell upon and injured a man walking in the street, the loss arising thereby to the grocer ought not to be deducted. Many cases might be put near the line, and no degree of ingenuity can frame a formula so precise and comprehensive as to solve at sight all the cases that may arise. In the present case I think that the loss sustained by the appellants was not really incidental to their trade as innkeepers, and fell upon them in their character not of traders, but of householders. Accordingly I think that this appeal must be dismissed.

He also referred to *Fairrie* v. *Hall* (2), in which the taxpayer, a sugar broker, claimed the right to deduct from his assessment £550 damages and £3025 legal expenses which he had been obliged to pay as the result of a malicious libel published by him against the chairman of a rival company. In that case MacNaghten, J., following the *Strong* v. *Woodifield* case, disallowed the deductions, finding that the said sums were not losses connected with or arising out of the taxpayer's trade, but fell upon him in the character of a calumniator of a rival sugar broker.

It seems to me that in the matter now before me these cases can have no application on the point under discussion. The business of the respondent was that of manufacturing, distributing and selling dental supplies and it was in

(1) (1906) A.C. 448. (2) (1947) 2 A.E.R. 141.

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relation to its trading practices in manufacturing, distributing and selling that the Commissioner caused an investigation to be held and that later the Crown laid the criminal charge. If the respondent had not been engaged in the manufacture and sale of dental supplies and if it had not followed certain trade practices in connection with its business, no investigation would have been held, no charge would have been laid and no such expenses would have been incurred. I am quite unable to find that such expenses were incurred as "personal" expenses or that they were incurred in any manner or capacity other than that of trader.

In the Supreme Court of Canada the deductibility of legal expenses has been considered on a number of occasions. In the case of *The Minister of National Revenue* v. *The Dominion Natural Gas Co. Ltd.* (1), the decision was concerned with a deduction claimed by the respondents in respect of the costs of litigation, which, in its results, affirmed the right of the respondent under certain bylaws of the Township of Barton to sell gas in certain localities in the City of Hamilton. In that case the decision in this Court (2) was reversed and the deductions disallowed. In the case of *The Minister of National Revenue* v. *The Kellogg Co. of Canada, Ltd.* (3), Duff, C.J. summarized the Court's finding in the *Dominion Natural Gas* case as follows:

> It was held by this Court that the payment of these costs was not an expenditure "laid out as part of the process of profit earning," but was an expenditure made "with a view of preserving an asset or advantage for the enduring benefit of the trade," and, therefore, capital expenditure.

In the instant case it is not contended that the amounts disbursed were capital expenditures.

In the *Kellogg* case Duff, C.J., speaking for all the members of the Court, after stating that counsel for the appellant rested his case on the decision in the *Dominion Natural Gas Co.* case, and after reviewing that case and the decision thereon, stated:

> The present appeal concerns expenditures made by the respondent company in payment of the costs of litigation between that company and the Canadian Shredded Wheat Company. To quote from the judgment of the Privy Council, delivered by Lord Russell of Killowen in

(1) (1941) S.C.R. 19. (2) (1940) Ex. C.R. 9.
(3) (1943) S.C.R. 58.

Canadian Shredded Wheat Co. Ltd. v. *Kellogg Co. of Canada, Ltd.* (1938) 2 D.L.R. 145, at 149, the Canadian Shredded Wheat Company claimed

"an injunction to restrain (the respondent) from infringing the registered trade marks consisting of the words "Shredded Wheat" by the use of the words "Shredded Wheat", or "Shredded Whole Wheat" or "Shredded Whole Wheat Biscuit", or any words only colourably differing therefrom."

As regards this payment, the question in issue was whether or not the registered trade marks of the plaintiffs in the action were valid trade marks, or, in other words, whether or not the present respondents, The Kellogg Company, and all other members of the public were excluded from the use of the words in respect of which the complaint was made. The right upon which the respondents relied was not a right of property, or an exclusive right of any description, but the right (in common with all other members of the public) to describe their goods in the manner in which they were describing them.

It was pointed out in *The Minister of National Revenue* v. *The Dominion Natural Gas Company, supra,* at p. 25, that in the ordinary course legal expenses are simply current expenditures and deductible as such. The expenditures in question here would appear to fall within this general rule.

It is very clear that the appellant does not succeed in bringing his case within the decision upon which he relies.

The appeal should be dismissed with costs.

The principles applied in that case seem to me to be applicable here. The dispute which arose and which resulted in the payment of legal expenses was occasioned by certain trading practices which in the result were not found to be illegal. The right upon which the respondent relied was the right to conduct its business in a certain manner and was not a right of property or an exclusive right of any description, but the right, in common with all other members of the public, to follow the trade practices which it was following. Insofar as the provisions of section 6(1) (*a*) are concerned, I am unable to perceive any essential difference between expenses incurred in defending a right of a trader to describe his goods in a certain manner (in common with all other members of the public) and expenses incurred in successfully defending a right to the use of certain trade practices which, so far as I am aware, were equally available to all members of the public.

Further, I am unable to find that any distinction can be made between the legal expenses incurred in the proceedings before the Commissioner and those expenses incurred in defending the criminal charge laid against the respondent,

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of which charge it was acquitted. The same matters were in issue throughout and arose out of precisely the same circumstances. In view of the fact that the respondent was acquitted, I do not think that *in this case* the mere fact that the charge against the respondent was made under the Criminal Code has any bearing on the deductibility or otherwise of the expenses incurred in defence of that charge. The result might have been different had the respondent been found guilty of the charge, but as to that I need say nothing.

The decision in *Spofforth & Prince* v. *Golden* (H. M. Inspector of Taxes) (1) is of considerable interest. In that case the appellant was a firm of chartered accountants and Mr. Spofforth, one of the partners, was accused of conspiring with a client to defraud the revenue in setting up a new corporation. No charge was laid against Mr. Prince, the other partner, but in defending the charge before the Magistrate, Mr. Spofforth had his own counsel and Mr. Prince was represented by counsel having a watching brief. The case broke down *in limine* and the Magistrate declined to commit Mr. Spofforth. The costs incurred by both Mr. Spofforth and Mr. Prince were paid by the firm and the firm claimed the right to deduct the legal expenses so incurred from the profits of the partnership for the year.

Wrottesley, J. disallowed these deductions. As I read the judgment, the costs incurred by Spofforth were disallowed on the ground that they were incurred in defending a charge against him personally and not a charge against the partnership; there was also considerable doubt as to whether the costs, while paid by the appellant, were, in fact, incurred by the partnership. The costs of Mr. Prince were also disallowed on the ground that while Mr. Prince was separately advised, both he and Mr. Spofforth were aiming not at the making of profits by the partnership, but at enabling Mr. Prince to protect his own interests.

But in that case Wrottesley, J. did allow deductions in respect of legal costs incurred by the partnership itself. Mr. Spofforth received a letter from the Solicitor of Inland Revenue stating that the latter wished to take statements of evidence from two employees of the Appellants. Mr.

(1) (1945) 26 R.T.C. 310.

Spofforth immediately consulted his partner, Mr. Prince, and sought an interview with their solicitors on the 18th of December, 1940, and on the 31st of December, 1940, the solicitors wrote to the Solicitor of Inland Revenue. The appellant partnership claimed that the legal expense so incurred by it should be allowed as a deduction, and, in allowing them, Wrottesley, J. said at p. 315:

> From the letter written by Messrs. Rowe & Maw on 31st December, 1940, it would appear that at and down to this stage this firm was acting for the appellants in the ordinary course of business, and in circumstances in which the appellants can fairly say that the purpose for which they gave the instructions and incurred the resulting costs were their ordinary professional purposes. There had been a somewhat unusual demand by a government department to interview servants of the firm, and in that case it was an ordinary business precaution that the firm's solicitors should be called in to advise. If, therefore, any appreciable sum of costs was incurred by the firm up to this point, it is, in my view, properly to be deducted.

In that case, therefore, the legal expenses actually incurred by the partnership in preparing to meet a demand by a department of Government were considered to be in the ordinary course of business and deductible as such. It was apparently not necessary in that case to reach any conclusion as to whether the legal expenses at the trial would have been allowed had the partnership been charged with and acquitted of conspiracy, for, while the learned judge posed that as one of the questions which he might have to determine, I am unable to find that he did so.

Reference may also be made to *Mitchell (Inspector of Taxes)* v. *B. W. Noble Ltd.* (1). In that case the directors of the company, being satisfied that in order to save the company from scandal it was necessary to get rid of a certain director, paid him a large sum of money and claimed the right to deduct that sum in computing its profits. The Court of Appeal in affirming the judgment of Rowlatt, J. held that that sum must be regarded as money "wholly and exclusively laid out and expended for the purposes of the trade" of the company, and were deductible as such.

Lord Hanworth, M.R. said in part at p. 737:

> It was a payment made in the course of business, with reference to a particular difficulty which arose in the course of the year, and was made not in order to secure an actual asset to the company but to enable the company to continue to carry on, as it had done in the past, the

(1) (1927) 1 K.B. 719.

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same type and high quality of business, unfettered and unimperilled by the presence of one who, if the public had known about his position, might have caused difficulty in its business and whom it was necessary to deal and settle with at once.

And in the same case Sargent, L.J. said that

> it is quite impossible to put against the capital account of the company . . . a payment of this nature. It seems to me that the payment . . . was not of such a nature; it certainly was not capital withdrawn from the company, or any sum employed or intended to be employed as capital in the business . . . To my mind, it is essentially different from these various payments in the cases which have been referred to, which were of the nature of adding to, or improving the equipment, or otherwise made for the permanent benefit of the company.

It is true that the deduction permitted in that case was not in respect of legal expenses, but as I have said above, the tests to be applied are the same for legal expenses as for other expenses. It seems to me that in many respects the opinions so expressed by the Master of the Rolls and Sargent, L.J. are applicable here. The payments were made in the usual course of business and were made with reference to a particular difficulty which arose in the course of the year, namely, the investigation by the Commissioner, the charge laid against the respondent and the unfavourable and damaging publicity which resulted therefrom, and which would have been greatly enhanced had the charge been sustained. The disbursements had nothing to do with the assets or capital of the company, but were made in an effort—which in the result turned out to be successful—to establish that its trading practices were not illegal, and to enable it to carry on as it had in the past, unimperilled by charges that such practices were illegal. They were wholly, exclusively and necessarily paid out for these purposes and were therefore, in my opinion, laid out for the purposes of its trade and for the purposes of earning the income.

Reference may also be made to the *Governor and Company of Adventurers of England Trading into Hudson's Bay* v. *Minister of National Revenue* (1). In that case the company claimed the right to deduct legal expenses incurred in connection with an action brought by it in the United States to restrain a firm from using a name

(1) (1947) Ex. C.R. 130.

similar to that of the company. In allowing the deduction, Angers J. said:

> The legal expenses and costs laid out by the appellant to protect its trade name, business and reputation were not incurred with the object of creating or acquiring any new asset but were incurred in the ordinary course of protecting and maintaining its already existing assets. On the other hand, I do not believe that these expenses and costs can be considered as being a capital outlay or loss.
>
> . . . There was no new asset brought into existence by these proceedings. The expenses were incurred in the ordinary course of maintaining the already existing assets of the Company.

I am of the opinion, therefore, that the judgment of the Income Tax Appeal Board was right and that the disbursements claimed by the respondent do not fall within the exclusions of the Income War Tax Act.

There will therefore be judgment affirming the decision of the Income Tax Appeal Board and dismissing this appeal. The respondent is entitled to its costs after taxation.

Judgment accordingly.