

1944
 May 15 & 16, 1944
 Aug. 2

BETWEEN:

ST. JOHN DRY DOCK & SHIPBUILD-
 ING COMPANY LIMITED..... } APPELLANT;

AND

THE MINISTER OF NATIONAL
 REVENUE } RESPONDENT.

*Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, sec. 3—
 Dominion Government subsidy paid under The Dry Dock Subsidies
 Act, 1910, 9-10 Edw. VII, c. 17, as amended, as an aid to the con-
 struction of a dry dock—Purpose of Act may determine non-taxable
 character of payment authorized by it.*

The Dry Dock Subsidies Act, 1910, 9-10 Edw. VII, c. 17, as amended, now R.S.C. 1927, c. 191, authorized the payment of a subsidy "as an aid to the construction of any dry dock" when the Governor in Council was satisfied that such a dry dock was needed in the public interest. On July 18, 1918, a subsidy agreement was entered into between the appellant and His Majesty the King, under which the appellant agreed to build a dry dock of the first class which had to be large enough to receive and repair therein with ease and safety the largest ships or vessels of the British Navy then existing, and His Majesty agreed on completion of the dry dock to pay the subsidy authorized by the Act. The subsidy was based on the cost of construction of the dry dock which was fixed by the Governor in Council at \$5,500,000. The subsidy payable under the Act was described as a sum not exceeding 4½ per cent of the cost of the work as fixed by the Governor in Council half yearly during a period not exceeding thirty-five years. Bonds could not be issued by the appellant without the consent of the Minister of Public Works. The Act, however, authorized payments on account of the subsidy during construction and as such payments were approved bonds were issued with the consent of the Minister and the subsidy payments were assigned to the trustee of the bondholders as security for the bonds issued. The dock was completed by the appellant on June 30, 1924, and the final payments on account of the subsidy were approved. The appellant thereupon became entitled to subsidy payments of \$247,500 per year for a period of thirty-five years, payable in semi-annual instalments. The subsidy payments were all assigned to the trustee for the bondholders as security for the bonds issued. The semi-annual instalments of subsidy were each exactly equal to the aggregate of the interest and principal that fell due on the bonds in each half year.

Up. to 1939 the appellant carried the amount of the two semi-annual instalments of subsidy into its profit and loss account and charged against it the amount applied by the trustee in payment of interest on the bonds, but paid income tax on the amount applied in payment of the instalments of principal. Having been advised by a firm of accountants that it had been in error in this practice, it appealed against the 1939 assessment on the grounds that the subsidy payments were capital payments and did not constitute taxable income, and that, in any event, it had never received them. The

decision of the respondent was that the subsidy payments were directly or indirectly received by the appellant and subject to tax under the Income War Tax Act. From this decision the appellant appealed.

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED
v.
MINISTER OF
NATIONAL
REVENUE.

Held: That the appellant did not receive the subsidy in the course of its trade or business operations or because of them. It was not a trade or business receipt or revenue or an item of trade or business profit or gain and had nothing to do with the trade or business operations of the appellant. The subsidy was given as an aid to the construction of the dry dock, and not as an aid to its operation.

2. That the appellant did not receive the subsidy as interest or as a return on its capital. It was a construction subsidy payable in respect of a capital expenditure of the appellant. It was a fixed sum payable by instalments, calculated on the cost of the dock as fixed by the Governor in Council, and was paid and received in respect of its construction and as an aid to its construction. *Blake v. Imperial Brazilian Railway* (1884) 2 T.C. 58 and *H.R.H. The Nizam State Railway Co. v. Wyatt* (1890) 24 Q.B.D. 548, distinguished.
3. That when a payment is made under the authority of an Act of Parliament, the statutory purpose for which such payment is authorized may be considered in determining whether the payment is to be regarded as an item of annual net profit or gain or gratuity and taxable income in the hands of the recipient, within the meaning of section 3 of The Income War Tax Act. Parliament can so fix the character of a payment authorized by it that it cannot properly be regarded as taxable income in the hands of the recipient within the meaning of the Income War Tax Act.
4. That the purpose of The Dry Dock Subsidies Act, 1910, as amended, and the agreements and Orders in Council made under its authority was to secure the construction of a dry dock of the first class on the Atlantic Coast and the subsidy payments were made as an aid to such construction in order to accomplish the purpose of the Act. That purpose was a special one, in the public interest, quite apart from the trade and business operations of the appellant and had nothing whatever to do with its trade or business profits or gains. The subsidy was paid and received for the purpose which the Act was designed to achieve and the statutory purpose stamps the subsidy as an amount that should not be regarded as an item of annual net profit or gain or gratuity to the appellant or taken into computation for income tax purposes. *The Seaham Harbour Dock Co. v. Crook* (1931) 16 T.C. 333, followed and applied.

APPEAL under the provisions of The Income War Tax Act from the decision of the Minister of National Revenue.

The appeal was heard before the Honourable Mr. Justice Thorson, President of the Court, at Ottawa.

R. O. Daly, K.C. and *W. Judson* for appellant.

R. Forsyth, K.C. and *E. S. McLatchy* for respondent.

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

1944

THE PRESIDENT now (August 2, 1944) delivered the following judgment:

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED
v.
MINISTER OF
NATIONAL
REVENUE.
Thorson J.

The issue in this appeal is whether a Dominion Government subsidy paid under the authority of the Dry Docks Subsidies Act, 1910, as amended, constitutes taxable income to the appellant under the Income War Tax Act.

There is no dispute as to the facts. The Dry Docks Subsidies Act, 1910, Statutes of Canada, 1910, Chap. 17 (now R.S.C. 1927, Chap. 191), intituled "An Act to Encourage the Construction of Dry Docks", authorized the payment of a subsidy "as an aid to the construction of any dry dock" and prescribed the conditions under which it might be paid. Section 3 reads as follows:

3. The Governor in Council may, as an aid to the construction of any dry dock, authorize the payment out of any unappropriated money forming part of the Consolidated Revenue Fund of Canada of a subsidy, in accordance with the provisions of this Act, to any incorporated company, approved by the Governor in Council as having the ability to perform the work, which shall enter into an agreement with His Majesty to construct a dry dock under the provisions of this Act, with all necessary equipment, machinery and plant, for the reception and repairing of vessels.

2. No such aid shall be granted unless the Governor in Council is satisfied, upon a report of the Minister, based upon a report of the chief engineer of the Department of Public Works, and such other evidence as he deems necessary, that such dry dock is needed in the public interest, and is, as proposed, of sufficient capacity to meet the public requirements where such dry dock is to be located.

Three classes of dry docks were contemplated by the Act. We are concerned only with dry docks of the first class, which were for naval and general purposes and had to be large enough to receive and repair therein with ease and safety the largest ships or vessels of the British Navy existing at the time at which the contract was entered into for the Act provided that priority in the use of the dry dock was to be given to ships or vessels in the British or Canadian naval service or owned or employed by His Majesty.

The subsidy was to be calculated on the cost of the dry dock as fixed and determined by the Governor in Council before a subsidy agreement was entered into and in the case of a dry dock of the first class the cost for the purposes of the subsidy calculation was not to exceed

\$5,500,000. The amount of the subsidy payable in respect of such a dry dock was specified by section 9 of the Act as follows:

9. The subsidy payable in respect of dry docks which have been constructed under this Act of the first class shall be a sum not exceeding four and one-half per cent per annum of the cost of the work as fixed and determined under the last preceding section, half yearly during a period not exceeding thirty-five years from the time the Governor in Council has determined under this Act that the work has been completed.

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 Thorson J.

The construction of the dry dock had to be in accordance with plans and specifications submitted to the Department of Public Works and the work of construction had to be done under the supervision of such Department.

At the outbreak of the last war there was no first-class dry dock on the Atlantic Coast. A company known as Norton Griffiths & Company, Limited, had tried to build one without any subsidy agreement with the Government but had gone into bankruptcy in 1916, having done work to the value of over \$1,093,000. The appellant, which was incorporated in June, 1916, under the Dominion Companies' Act, with a capital of \$1,000,000 consisting of 10,000 shares of the par value of \$100 each, then entered into negotiations with the Government to complete the dock and applied for a subsidy under the Act. By Order in Council, P.C. 1532, dated June 22, 1918, authority was granted for the making of a subsidy agreement with the appellant and on July 18, 1918, a subsidy agreement was entered into between it and His Majesty the King under which the appellant agreed to construct a dry dock of the first class and His Majesty agreed upon the completion of the work to pay the appellant in half yearly payments an annual subsidy of 4½ per cent per annum during 35 years upon the sum of \$5,500,000, being the maximum amount allowed under the Act.

The appellant then proceeded with the construction of the dry dock, having acquired the work previously done by Norton Griffiths & Company, Limited, and used its share capital for such purpose.

Section 9 of the Act provided for half-yearly payments on account of the subsidy, during the construction of the dock, at the rate of 4½ per cent per annum on 75 per cent

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 Thorson J.

of the cost of all work done and materials provided at the time of such payment. From time to time as the work of construction proceeded the appellant applied for semi-annual payments on account of the subsidy. The first series of these was approved by Order in Council, P.C. 39, dated January 26, 1920, and was based upon the cost of the new work done by the appellant at the time of the application and the value of the old work done by the previous company and acquired by the appellant, the total cost being calculated at \$1,694,781.25. The first semi-annual payment was fixed at \$28,599.44, and payment of 70 such semi-annual payments was guaranteed.

Section 9 of the Act forbade the issue of any bonds, debentures or securities without the consent in writing of the Minister of Public Works, but provided that after \$1,000,000 had been expended the Minister might permit the issue of bonds, debentures, or other securities and that any subsidy might with the approval of the Minister be assigned to a trustee for the holder of such bonds, debentures, or other securities and that the subsidy should in such event be payable directly to such trustee.

The appellant, having obtained approval for the first series of semi-annual instalments on account of the subsidy, proceeded to realize upon the subsidy. With the consent of the Minister it determined to create bonds to the extent of \$3,826,272.34, bearing interest at 5½ per cent per annum, in respect of the whole of its assets, including the dry dock; appointed Montreal Trust Company as trustee for the bondholders; and determined to issue immediately a first series of bonds amounting to \$884,276.50. On February 23, 1920, the appellant assigned the first series of semi-annual subsidy payments to Montreal Trust Company as trustee for the bondholders as security for the first series of bonds. The Minister of Public Works consented in writing to the creation of the whole bond issue, the immediate issue of the first series of bonds and the assignment of the first series of semi-annual subsidy payments. On the same date the appellant entered into a trust deed with Montreal Trust Company as trustee for the bondholders. The bonds issued were payable by instalments and were so arranged that the aggregate amount of

principal and interest falling due in each half year was exactly equal to the semi-annual payment of \$28,599.44.

A similar procedure was followed on three other occasions. In each case an application was made by the appellant for semi-annual payments on account of the subsidy, based on the cost of construction done since the previous payments were authorized; the semi-annual payments were approved by Order in Council; as they were approved, a further series of bonds was issued; and the semi-annual payments on account of the subsidy were assigned to the trustee as security for the series of bonds issued. In each case the approval and consent of the Minister of Public Works was given. The semi-annual subsidy payments were always exactly equal to the semi-annual payments of principal and interest of the series of bonds for which they were security.

After the trustee for the bondholders had been appointed the payments of semi-annual instalments on account of the subsidy were, on their assignment to the trustee, ordered to be paid directly to the trustee and payment of them for the 35-year period was guaranteed to the trustee.

The construction of the dry dock was completed on June 30, 1924, and by Order in Council, P.C. 1199, dated July 11, 1924, the fifth and final series of semi-annual payments on account of the subsidy was approved. This authorization differed from the previous ones in that it was not based upon a progress report, nor on 75 per cent of cost, but upon a final report that the dock had been completed and the total cost as fixed. The amount finally approved was a semi-annual payment of \$24,520.27, and represented the amount remaining to be paid of the whole subsidy, namely \$247,500 per year in semi-annual payments of \$123,750, less the four payments already approved.

The fifth and final series of bonds, exhausting the whole bond issue, was then issued and the final semi-annual payments were assigned to the trustee as security for the final series of bonds. Order in Council P.C. 1199 (filed as Exhibit 12) recites in detail the whole history of the subsidy arrangements made with the appellant and the trustee for the bondholders.

The final result was that the total annual subsidy of \$247,500, being $4\frac{1}{2}$ per cent per annum of the cost of the

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITEDv.
MINISTER OF
NATIONAL
REVENUE.

Thorson J.

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 Thorson J.

dock, fixed at \$5,500,000 for calculation of the subsidy, was payable in semi-annual instalments of \$123,750 each for a period of 35 years. The whole subsidy had been assigned to Montreal Trust Company as trustee for the bondholders as security for the bonds totalling for the five series issued the sum of \$3,826,277.34. The annual payment of \$247,500 was exactly sufficient to pay the interest and the instalments of principal that fell due on the bonds each year, so that when the subsidy payments had all been made, all the bonds would be fully paid both as to interest and principal.

Subsequently, in 1934, and again in 1936, the appellant, with the approval and consent of the Minister, re-arranged its bond issues, whereby it put out larger issues of bonds at lower rates of interest. These two refundings, in my opinion, cannot alter the quality of the subsidy payments made and received or affect in any way the questions involved in this appeal.

Up to 1939 the appellant had taken into its annual profit or loss account the full amount of the two semi-annual subsidy payments which had been made direct to Montreal Trust Company as trustee for the bondholders and had charged against it such amounts as the trustee had applied each year in payment of interest on the bonds, and had paid income tax on the balance, namely, the amounts which the trustee had applied in payment of the instalments of principal of the bonds as they fell due. In its income tax return for 1939, the appellant had included as income—Dominion Government Subsidy applicable to Retirement of Bonds—\$145,761.78. The practice followed by the appellant had not seriously affected it in the earlier years for the reason that the amounts of principal that fell due on the bonds were relatively small as compared with the payments of interest, which had been allowed by way of deduction, and the appellant had also received substantial allowances for depreciation, a factor which also prevented the matter from coming to a head earlier, but as the payments of principal increased and those for interest decreased the question became one of grave importance to the appellant and in 1940 it called in the services of a firm of chartered accountants, who advised it that it had been in error in ever taking any part of the subsidy payments

into its accounts as income at all, with the result that when the appellant received its assessment notice, dated December 29, 1943, it took the ground that the item of \$145,761.78, which represented the amount applied by Montreal Trust Company in payment of the instalments of principal due on the bonds, was wrongfully included in its income tax return for 1939 and appealed from the assessment on the grounds that the Government subsidy of \$247,500 was a capital payment and did not constitute taxable income and that in any event it had never received it. The decision of the Minister of National Revenue was that the subsidy payments constituted income directly or indirectly received by the appellant within the meaning of the Income War Tax Act and the assessment was affirmed. From this decision an appeal to this court is taken.

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 THORSON J.

The appeal raises two issues, one, whether the Dominion Government subsidy paid under the authority of the Dry Dock Subsidies Act, 1910, was income, and the other, whether it was ever received directly or indirectly by the appellant. The determination of the latter issue will be necessary only if it be held that the subsidy was income.

The fact that an amount is described as a Government subsidy does not of itself determine its character in the hands of the recipient for taxation purposes. In each case the true character of the subsidy must be ascertained and in so doing the purpose for which it was granted may properly be considered.

There are no Canadian decisions on the subject. Counsel for the respondent relied entirely upon two English decisions, *Blake v. Imperial Brazilian Railway* (1), and *H.R.H. The Nizam State Railway Co. v. Wyatt* (2), in support of his contention that the annual subsidy payments now under discussion were income to the appellant and taxable under the Income War Tax Act.

In *Blake v. Imperial Brazilian Railway (supra)*, the Company was formed for the purpose of constructing and working a railway in Brazil, with a share capital of £500,000, of which £250,000 was issued as Preference shares. The Company also issued £368,300 in debentures.

(1) (1884) 2 T.C. 58.

(2) (1890) 24 Q.B.D. 548.

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 Thorson J.

The Brazilian Government guaranteed 7 per cent per annum for 30 years on the sum of £618,300. The debentures carried interest at 5½ per cent per annum for 30 years. Under a deed of trust between the Company and the trustees for the debenture holders the debentures were to be redeemed by an annual sinking fund extending over 30 years, the difference between the 5½ per cent paid to the debenture holders and the 7 per cent received from the Brazilian Government being applied to the sinking fund. The Company contended that the amount thus set aside for the purpose of the sinking fund was not subject to income tax. The English Court of Appeal unanimously held that the 7 per cent per annum received by the Company had been received as interest. Brett M.R. held that it was interest upon money paid or found by the Company for the Government. Cotton L.J. held that it was not a contribution towards the cost of constructing the railway but was paid as interest on a certain sum and "not as a sum which was to go towards the providing of capital which was to be expended, or as a sum to be expended in the construction of the line". Lindley L.J. was of the same opinion.

This case was followed in *H.R.H. The Nizam State Railway Co. v. Wyatt (supra)*. In that case, the facts were that the Company was formed for the purpose of making and carrying out an agreement with the Government of the Nizam for the acquisition, extension and working by the Company of a certain railway in India. The capital of the Company was to be £2,000,000, divided into 100,000 shares of £20 each, and debentures to the extent of £2,500,000 bearing interest at 4 per cent per annum were to be issued. The Government of the Nizam agreed for the period of 20 years to pay to the Company an annuity equal to 5 per cent per annum on the issued capital of the Company, both share and debenture, not exceeding £4,500,000, the Company being bound to apply the same in payment of interest at 5 per cent per annum on the paid-up share capital, in payment of the debenture interest at 4 per cent per annum, and to pay the remainder, being 1 per cent on the debenture capital, to trustees to be invested and form a sinking fund

for the redemption of the debenture capital. The Company received the annuity, paid the 1 per cent balance to the trustees and claimed that this amount was not subject to income tax. Counsel for the Company sought to distinguish the case from *Blake v. Imperial Brazilian Railway* (*supra*) on the ground that in that case the Company had not been under any obligation to the Government to apply any portion of the 7 per cent received from it to a sinking fund but that in this case the Company was obliged to pay 1 per cent of the interest on the debenture capital to trustees for sinking fund purposes. The Court held that *Blake v. Brazilian Railway* (*supra*) governed the case, that the whole amount of the annuity was subject to income tax, and that the company was not entitled to any deduction in respect of the 1 per cent paid to the trustees for sinking fund purposes, even although it was under an obligation to make such payment.

On the strength of these two decisions counsel for the respondent contended that the subsidy payments in this case constituted taxable income to the appellant.

Counsel for the appellant took the position that the subsidy payments were not income at all but capital receipts. His contention was that the only portion of the definition of taxable income contained in Section 3 of the Income War Tax Act under which the appellant could possibly be taxed was that which referred to "annual net profit or gain or gratuity" 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", and that the annual subsidy payments were not trade or business gains or profits or trade or business receipts at all. He relied upon the decision of the House of Lords in *The Seaham Harbour Dock Co. v. Crook* (1) as conclusive in his favour. In that case, the Company contemplated an extension to its docks, obtained an Act of Parliament enabling it to do so and commenced work on the extension, the estimated cost of which was £152,000. The Act of Parliament allowed the Company to raise by debenture issue only the sum of £75,000, and debentures to this amount were issued. Of

1944

ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED

v.
 MINISTER OF
 NATIONAL
 REVENUE.

THORSON J.

(1) (1931) 16 T.C. 333.

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 Thorson J.

the balance required for the extension, £75,000 was obtained by unsecured loans from other sources. This left a small amount of capital still to be found. On September 10, 1923, the Company applied to the Unemployment Grants Committee asking for assistance in carrying through the work of extending the docks and on November 6, 1923, the Committee replied that they were prepared to sanction a grant "equivalent to half the interest at a rate not exceeding an average up to 5½ per cent per annum on approved expenditure met out of loan (not exceeding £152,000) for a period of two years from the date or dates on which the payments are made". Applications for payment of the grant in respect of the work done, as certified by the engineer and auditors of the Company in conformity with the letter from the Unemployment Grants Committee, were made periodically by the Company and instalments of the grant were received periodically by it during the years 1924 to 1928, totalling altogether £7,500. The instalments of the grant were always credited to revenue in the accounts of the Company. On being assessed for income tax in respect of the grants the Company appealed on the grounds that the grant was capital; that it was not made for the purpose of meeting interest but in respect of expenditure and for the purpose of helping the Company through with its cost of construction; that the term "equivalent to half the interest" was only a method of calculation for arriving at the amount of grant to be paid; and that there was no trading and no revenue at that time and that there were no profits or gains in carrying on a business or trade and, as no trade was being carried on, that there could be no revenue and that the grant was a capital payment only and not taxable income. The Commissioners, before whom these arguments were made, held that the grant was revenue and taxable income of the Company. An appeal from their decision was dismissed by Rowlatt J. The Court of Appeal, however, unanimously reversed the decision of Rowlatt J., and the House of Lords unanimously dismissed an appeal from the judgment of the Court of Appeal. Lord Hanworth M.R. took the view that an application had been made by the Company, which was slightly short of capital, for assistance in order to carry on

the work and that its request had been granted. The amount of the grant was arrived at by the formula indicated by the Committee, and was paid according to the formula for the purpose of the dock extension. This was a capital outlay by the Company. He agreed with the arguments on behalf of the Company before the Commissioners. Lord Hanworth M.R. distinguished the cases previously referred to. With respect to *Blake v. Imperial Brazilian Railway* (*supra*), his view was that all that it decided was, that when the Company received 7 per cent under the guarantee to it it received such sum as interest, and the fact that it devoted a portion of it to a sinking fund for the repayment of capital did not alter its original character; that this was merely in accordance with the principle of *Mersey Docks and Harbour Board v. Lucas* (1), that the application which the recipient makes of a sum has nothing to do with the question of whether it was at the time of its receipt a taxable profit or gain to him. Lord Hanworth took a similar view with regard to the *Nizam State Railway Co. Case* (*supra*) and concluded his opinion with the view that the sums were paid in order "to advance a capital expenditure to be made by the Seaham Harbour Dock Company" and could not be said to be sums received in respect of trade and so taxable. With these views the other judges of the Court of Appeal agreed. While the House of Lords unanimously dismissed an appeal from the judgment of the Court of Appeal, and agreed that the grant was not a trade receipt or an item of profit or gain from trade, its decision is of particular importance by reason of the special grounds upon which it is based. The House of Lords was not concerned with whether the sums received by the Dock Company were applied for capital or revenue purposes, but looked rather at the purpose of the grant in order to determine whether the amount of it should be included in taxable revenue. Lord Buckmaster after stating "most unhesitatingly" that the grant was not a trade receipt, went on to say, at page 353:

It appears to me that it was nothing whatever of the kind. It was a grant which was made by a government department with the idea that by its use men might be kept in employment, and it was paid to and

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 THORSON J.

(1) (1883) 2 T.C. 25.

1944
 St. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 ———
 Thorson J.

received by the Dock Company without any special allocation to any particular part of their property, either capital or revenue, and was simply to enable them to carry out the work upon which they were engaged, with the idea that by so doing people might be employed. I find myself quite unable to see that it was a trade receipt, or that it bore any resemblance to a trade receipt. It appears to me to have been simply a grant made by the Government for the purposes which I have mentioned, and in those circumstances cannot be included in revenue for the purposes of the tax.

Lord Atkin was of the same opinion but was more explicit. He pointed out that the sum was paid under the authority of the Appropriation Act of 1924, which authorized grants "for assistance in carrying out approved schemes of useful work to relieve unemployment", and after certain remarks to which reference will be made later, he said, at page 353:

It appears to me that when these sums were granted and when they were received, they were received by the appropriate body not as part of their profits or gains or as a sum which went to make up the profits or gains of their trade. It is a receipt which is given for the express purpose which is named and it has nothing to do with their trade in the sense in which you are considering the profits or gains of the trade. It appears to me, with respect, to be quite irrelevant whether the money, when received, is applied for capital purposes or is applied for revenue purposes; in neither case is the money properly said to be brought into a computation of the profits or gains of the trade.

Lord Macmillan considered it sufficient to say that the moneys received were not profits or gains of the trade. The ratio of the decision, in my opinion, is that the grant was made under statutory authority for unemployment relief purposes; that such purposes had nothing to do with the trade of the Dock Company; and that, since the amount of the grant was received for the purposes for which it was paid, it could not be regarded as a trade receipt or revenue, or as an item of trade profit or gain. It was the purpose of the statute, under the authority of which the grant was paid, that determined its non-taxable character in the hands of the recipient.

In my opinion, the principles underlying this decision are applicable to the subsidy payments under review. The present case is quite different from the case in which a subsidy payment has been held to be taxable. An illustration of an income subsidy is to be found in *Charles Brown & Company v. Commissioners of Inland Revenue* (1). There the Company carried on its business as a miller under the control of the Food Controller from 1917 to 1921 and was

compelled to buy and sell at prices fixed by the Controller. In lieu of making an application before the Defence of the Realm (Losses) Commission for compensation for losses sustained through the exercise of the Crown's powers, the Company entered into an agreement with the controller under which a standard profit was fixed. Under this agreement, if the profits exceeded the standard the Company was to pay the excess to the Controller, but if the profits fell short of the standard the deficiency was to be paid by the Controller to the Company. In respect of two periods of account the Company paid excesses to the Controller but in respect of four periods it received payments of the amounts by which its profits fell short of the standard. The Company contended that such amounts were not part of its trading receipts but were a compensation for loss or damage and were not subject to excess profits duty. Rowlatt J. held that the Company received the amounts because of continuing the operations of its trade and with this view the Court of Appeal unanimously agreed. The Government had given a guarantee of a standard profit and the amounts paid by the Controller were received by the Company as trade profits, although they came from the Crown, just as much as if they had come from customers.

Another illustration of an income subsidy is to be found in *Lincolnshire Sugar Company, Limited v. Smart* (1). In that case the Company carried on business as manufacturers of sugar from beet grown in Great Britain. It had received subsidies under the British Sugar (Subsidy) Act, 1925, but in 1931, in view of the fall in the price of sugar, further state aid was given to companies which would otherwise have experienced difficulty in paying the prices contracted to be paid to beet growers. This was authorized by the British Sugar Industry (Assistance) Act, 1931, whereby "advances" were to be made during the period of one year, with provision for repayment under certain circumstances. The Company had received advances under this Act, without any liability to repay having arisen, but contended that under the Act the amounts received were not trading receipts in that year but loans. The Commissioners and Findlay J. upheld

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED

v.

MINISTER OF
NATIONAL
REVENUE.

Thorson J.

(1) (1937) A.C. 697.

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 Thorson J.

that view, but it was unanimously reversed by the Court of Appeal. The House of Lords unanimously agreed with the Court of Appeal. Lord Macmillan held that the advances were made to enable the Company to meet its trading obligations and were intended to supplement its trading receipts, and were properly taken into computation in arriving at the Company's profits and gains. With this view the other members of the House of Lords concurred.

Similar instances of income subsidies are to be found in such United States decisions as *Texas & Pacific Ry. Co. v. United States* (1), where the Supreme Court of the United States held that the amount paid to a railroad by the Government under the Transportation Act to make up the minimum of operating income guaranteed for the six months following the relinquishment of federal control was taxable income, and *Helvering v. Claiborne-Annapolis Ferry Co.* (2), where the Circuit Court of Appeals held that an amount paid on a mileage basis by the State of Maryland to the Company for the maintenance of a ferry was as much an earning by the ferry company as were the tolls collected from vehicles and passengers.

These two United States decisions are to be distinguished from *Edwards v. Cuba Railroad Company* (3), where Mr. Justice Butler of the Supreme Court of the United States held that certain subsidy payments made by the Republic of Cuba to the Company to promote the construction of railroads in Cuba and in consideration also of reduced rates to the public as well as reduced rates and other privileges for the Government, the payments being on the basis of mileage actually constructed, were for the purpose of reimbursing the Company for capital expenditures and were not profits or gains from the use or operation of the railway and did not constitute taxable income.

The subsidy payments in this case clearly fall outside the ambit of the cases which I have cited as illustrations or instances of income subsidies, such as amount to a guarantee of profits or earnings or result in supplementary or additional revenues. Such subsidies come into the hands of the recipient in the course of trade or business opera-

(1) (1932) 286 U.S. 285.

(2) (1938) 93 Fed. (2nd) 875.

(3) (1925) 268 U.S. 628.

tions or because of them and, being operational revenues, may properly be described as income subsidies subject to tax. The situation in the present case is quite different. The appellant was not entitled to receive nor did it receive the subsidy in the course of its trade or business operations or because of them. The subsidy was not a trade or business receipt or revenue or an item of trade or business profit or gain. There was no guarantee of trade or business profits or earnings nor was the subsidy given to supplement or increase the operational revenues of the appellant. Indeed, the subsidy payments had nothing to do with the trade or business operations of the appellant at all. It became entitled to them immediately upon construction of the dry dock pursuant to the agreement authorized by the Act. At that time, it was not in the business of dry dock construction and was not yet engaged in the business of operating the dry dock. The appellant, moreover, would continue to be entitled to the subsidy payments even if it never operated the dry dock at all. While it is true that section 14 of the Act requires that the agreement shall include a provision that the dock shall, after completion, be kept in repair and working order by the company, default on the part of the company in this respect does not in any way affect the payment of the subsidy. This is clear from sections 15 and 16 which provide for expropriation and operation of the dry dock by the Government if it appears that it is not in a condition of repair. It was the construction of the dock and not its operation that entitled the appellant to the subsidy. The subsidy was given as an aid to the construction of the dry dock, and not as an aid to its operation; it was not an operational subsidy at all nor in any way the kind of subsidy held to be taxable in the income subsidy cases.

Nor is the case governed by the *Blake Case (supra)* and the *Nizam Case (supra)*, upon which counsel for the respondent entirely relied. It may be observed, however, that, if these cases did apply, then the whole of the annual subsidy of \$247,500, and not merely that portion of it that was applied by the trustee in payment of the instalments of principal, is subject to income tax. It cannot have the character of being partly income and partly not income.

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITEDv.
MINISTER OF
NATIONAL
REVENUE.

THORSON J.

1944

ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 THORSON J.

It is all subject to tax or none of it is. What is done with it afterwards by the recipient cannot affect its taxable or non-taxable character at the time of its receipt. This fundamental principle of income tax law was recognized in the *Blake Case (supra)* and the *Nizam Case (supra)*. In these cases the companies claimed exemption from income tax only in respect of that portion of the guarantee which the company had applied to sinking fund purposes, and no question whatever was raised as to the taxability of the remainder. That was taken for granted. The essence of the decision in each case, as pointed out by Lord Hanworth in *The Seaham Dock Co. Case (supra)*; was that the guarantee was received as interest and the subsequent application of part of it to a capital purpose such as a sinking fund could not change its character. The whole amount received by the company in each case was held to have been received as interest. In the *Blake Case (supra)* the guarantee was 7 per cent per annum on the total of the issued share capital and the issued debentures and was subject to reduction to the extent that any of the money deposited in the bank earned bank interest and in the *Nizam Case (supra)* the annuity was 5 per cent per annum on the issued capital of the company, both share and debenture. In the present case the subsidy was not based upon share or debenture capital at all. There is no reference in the Act, or in the subsidy agreement, or in any of the orders in council, to share or debenture capital. There was no guarantee of interest or a return on capital found or invested. I am quite unable to see how the receipt of the subsidy could be regarded as a receipt of interest. Section 8 of the Act makes it clear that the amount of the subsidy is to be calculated on the cost of the dry dock as fixed by the Governor in Council and the evidence shows that when each of the five series of subsidy payments was authorized, the amount approved for payment was calculated upon the cost of construction done up to the time of the application for payment. If the subsidy had been paid in a lump sum the amount of it certainly would not have been interest but a capital contribution and a capital receipt by the appellant rather than a receipt of income. The reason for paying the subsidy in annual instalments over a period of years rather

than a lump sum was no doubt due to considerations of government policy and convenience and the annuality of the payments cannot affect their character. Nor does the fact that section 9 of the Act describes the subsidy as a "sum not exceeding four and one-half per cent per annum of the cost of the work * * * half yearly during a period not exceeding thirty-five years" make the subsidy a payment or receipt of interest. The section makes it quite clear that it is not interest on a sum that is payable; it is a sum that is payable, a fixed amount calculated on the cost of the work; the formula used merely determines the amount of the sum payable by instalments over a period of years. The fact that it is payable by instalments does not change its character. A similar view was taken of the formula used by the Unemployment Grants Committee in *The Seaham Dock Co. Case (supra)*. The formula merely projects the amount that would be payable in a lump sum into the amounts of the instalments that are to be paid. That is quite different from a guarantee of interest or return on share or debenture capital. The subsidy was a construction subsidy based on the cost of the dock as fixed. Counsel for the respondent sought to distinguish the case from *The Seaham Dock Co. Case (supra)* by contending that the subsidy was not to go into the construction of the dock but was payable in respect of what had been done rather than what was to be done. It is quite clear that the subsidy was a construction subsidy and equally clear that the expenditure made by the appellant in constructing the dock was a capital expenditure. That the subsidy was payable in respect of a capital expenditure is, I think, made clear by section 9 of the Act which refers to the subsidy as being "payable in respect of dry docks which have been constructed under this Act". If the subsidy was, therefore, payable and, of course, likewise received in respect of a capital expenditure it seems immaterial to me whether the subsidy payments were made "to advance a capital expenditure to be made by the company", to use the words of Lord Hanworth in *The Seaham Harbour Dock Co. Case (supra)*, or "for the purpose of reimbursing" the appellant "for capital expenditures", in the language of Mr. Justice Butler in *Edward v. Cuba Rail-*

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED

v.
MINISTER OF
NATIONAL
REVENUE.

Thorson J

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED

v.

MINISTER OF
NATIONAL
REVENUE.

Thorson J.

road Company (supra). As a matter of fact both purposes are involved in the present case. It was only after the first series of semi-annual instalments on account of the subsidy was approved that bonds were permitted to be issued. The first series of bonds provided the capital which enabled the appellant to continue with the construction. This was intended by the Act with its provisions authorizing payments on account of the subsidy during construction, the issue of bonds only with the consent of the Minister of Public Works and the assignment of the subsidy payments as security for the bonds so issued. In that sense the first series of payments on account of the subsidy were paid to advance a capital expenditure by the appellant. The same might be said of the second, third and fourth series of payments, but it could not be said of the fifth and last series of payments, for when they were authorized the dock was fully completed. The final payments, therefore, may more properly be described as having been made for the purpose of reimbursing the appellant for capital expenditures made by it, for it will be remembered that the appellant used its own share capital before any payment on account of the subsidy was authorized to be paid. The subsidy was a fixed sum payable by instalments, calculated on the cost of the dock as fixed by the Governor in Council and was paid and received in respect of its construction and as an aid to its construction. It was in no sense paid or received as interest and, in my judgment, is clearly distinguishable from the guarantee on share and debenture capital held to be taxable in the *Blake Case (supra)* and in the *Nizam Case (supra)*.

Moreover, the case, in my view, comes within the principles enunciated by the House of Lords in *The Seaham Dock Co. Case (supra)*. As I read the reasons of Lord Buckmaster and Lord Atkin in that case, they support the view that, when a payment is made under the authority of an Act of Parliament, the statutory purpose for which such payment is authorized may be considered in determining whether the payment is to be regarded as an item of annual net profit or gain or gratuity and taxable income in the hands of the recipient, within the meaning of section 3 of the Income War Tax Act. Both judges stressed the purpose of the statute under the authority of which the grant

in that case was made. That purpose was a special one, namely, "for assistance in carrying out approved schemes of useful work to relieve unemployment". Unemployment relief had nothing to do with the trade of the Dock Company and the grant, since it was paid and received for "unemployment relief purposes", could not be a trade receipt or an item of trade profit or gain in the hands of the Company. It was received for the purpose for which it was paid and the statutory purpose of the grant determined its non-taxable character.

Parliament can, I think, so fix the character of a payment authorized by it that it cannot properly be regarded as taxable income in the hands of the recipient within the meaning of the Income War Tax Act. The decision of the House of Lords in *The Seaham Dock Co. Case (supra)*, in my opinion, fully justifies such a statement of principle.

The purpose for which the subsidy payments in the present case were made and received is to be found in The Dry Dock Subsidies Act, 1910, as amended, and in the agreements and Orders in Council made under its authority. The Act is intituled "an Act to encourage the Construction of Dry Docks" and was designed by Parliament to procure the construction of dry docks, when the Governor in Council was satisfied that they were needed in the public interest, by state aid to their construction. At the time the subsidy agreement with the appellant was authorized in July of 1918, there was no dry dock of the first class on the Atlantic Coast and the construction of such a dry dock, large enough to receive and repair therein with ease and safety the largest ships of the British Navy then existing and in which British and Canadian naval and other government-owned vessels would have priority over all other vessels was considered in the public interest. The construction of such a dry dock was not likely to be undertaken as a commercial venture and either construction by the state or state aid to its construction was necessary. Parliament had by the Act authorized the latter alternative and it was adopted. The construction of the dock, which was designed to serve a purpose of national importance particularly in a time of war, was entrusted to the appellant and state aid to its construction was approved. The whole Act shows the concern of Parliament for the construction of

1944
 ST. JOHN
 DRY DOCK &
 SHIP-
 BUILDING
 COMPANY
 LIMITED
 v.
 MINISTER OF
 NATIONAL
 REVENUE.
 THORSON J

1944

ST. JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED
v.
MINISTER OF
NATIONAL
REVENUE.
Thorson J

such a dock as would meet the public requirements; the dock had to be constructed in accordance with plans and specifications approved by the Department of Public Works and the work had to be done under the supervision of that department. The subsidy was paid as an aid to its construction, was payable, as section 9 shows, in respect of its construction and its amount was calculated on the cost of its construction. That Parliament was concerned with the construction of the dock, rather than with its maintenance or operation, is shown by the fact that no forfeiture of the subsidy payments took place if the dock was not, after its construction, kept in repair and working order. In such event the Government had the remedy of taking possession of the dock and operating it. Parliament also clearly showed that the subsidy was intended exclusively for dock construction purposes by the provisions of the Act relating to the issue of bonds. No bond issue that would be a charge on the dock was permitted at all, until not less than \$1,000,000 had been spent on it. After that, bonds might be issued but only with the consent of the Government and the Act clearly contemplated such a bond issue by allowing payments on account of the subsidy during construction, the issue of bonds with the necessary consent, and the assignment of the subsidy payments as security for such bonds. Such a bond issue was the device used by the appellant to realize the immediate value of the subsidy payments as they were approved and was part of the scheme of state aid to construction contemplated by the Act. Complete control over everything relating to the issue of bonds was vested in the Government and no consent was given for the issue of bonds that would be a charge on the dock unless the subsidy payments were assigned to the trustee for the bondholders as security for such bonds. Parliament intended by these provisions to make sure that the dock would be constructed and be available in the public interest without any risk that it would ever pass into the hands of the bondholders through any default in payment of the bonds.

In the present case, the purpose of the Act and the agreements and Orders in Council made under its authority was to secure the construction of a dry dock of the first

class on the Atlantic Coast and the subsidy payments were made as an aid to such construction in order to accomplish the purpose of the Act. That purpose was a special one, in the public interest, quite apart from the trade and business operations of the appellant and had nothing whatever to do with its trade or business profits or gains. Since the subsidy was paid and received for such special purpose, in the national interest, it cannot be said to be a trade or business receipt or revenue in the hands of the appellant or an item of trade or business profit or gain to it. It was paid and received for the purpose which the Act was designed to achieve and, in my opinion, that statutory purpose stamps the subsidy as an amount that should not be regarded as an item of annual net profit or gain or gratuity to the appellant or taken into computation for income tax purposes.

In *The Seaham Dock Co. Case (supra)*, Lord Atkin, after referring to the statutory purposes for which the grant in that case had been made, said, at page 353:

It would appear to me to be a remarkable proposition that Parliament assented to that sum being appropriated for that purpose, but intended, in certain events at any rate, only fifteen shillings in the pound to be appropriated for that purpose, five shillings in the pound of the full amount coming back in the way of Income Tax. I do not think that was the effect.

Similar remarks would be appropriate in the present case. I do not think that it was ever intended by Parliament that, after payment of the subsidy had been authorized by the Government in aid of the construction of the dry dock by the appellant, and after the dock had been completed by the appellant and the purpose of the Act accomplished, a substantial and increasingly large portion of the aid to construction should come back to the Government in the form of income tax.

The subsidy payments, even if it be assumed that they were received by the appellant, were not trade or business receipts of the appellant or part of its operating revenues, or items of its trade or business profits or gains, nor were they paid or received as interest or a return on share or debenture capital, but rather for the purpose of advancing or re-imbursing a capital expenditure by the appellant and as a capital contribution or grant in respect of such expenditure, and, furthermore, they were paid and received for the

1944

ST JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED

v.
MINISTER OF
NATIONAL
REVENUE.

Thorson J
—

1944

ST JOHN
DRY DOCK &
SHIP-
BUILDING
COMPANY
LIMITED
v.

MINISTER OF
NATIONAL
REVENUE.

THORSON J

accomplishment of a special purpose in the national interest quite apart from the trade or business operations of the appellant and not connected with them. For these several reasons I conclude that the subsidy payments in this case were not subject to income tax under the Income War Tax Act.

In view of this finding, it is not necessary to deal with the other contention of the appellant that the subsidy payments were not received by it directly or indirectly after the trustee for the bondholders became entitled to them as security for the bonds which had been issued.

For the reasons mentioned I find that the appellant was erroneously assessed for income tax in respect of the subsidy payments made in 1939. Its appeal must, therefore, be allowed with costs.

Judgment accordingly.