1937
Sept. 16 & 17.
1938
April 12.

BETWEEN:

RIEDLE BREWERY LIMITED.....APPELLANT;

AND

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

Revenue—Income—Deductions—Money spent by brewer for treating purposes—Income War Tax Act, R.S.C., 1927, c. 97, s. 6 (a).

Held: That money paid by appellant, a brewer, for the purpose of treating in the premises of beer licensees, does not constitute a disbursement or expense "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" of appellant.

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 Maclean, President of the Court, at Winnipeg and Ottawa.

Arthur Sullivan, K.C. and *B. B. Dubienski* for appellant.

W. C. Hamilton, K.C. and *J. R. Tolmie* for respondent.

The facts are stated in the reasons for judgment.

THE PRESIDENT, now (April 12, 1938) delivered the following judgment:

This is an appeal from a decision of the Minister of National Revenue disallowing as a deduction the sum of $4,206.40 claimed by the appellant, in respect of its income tax assessment, for the fiscal year ended October 31, 1933. The appeal, I understand, is in the nature of a test case.

The appellant is an incorporated company, with its head office at Winnipeg, in the Province of Manitoba, and carries on the business of brewing and selling beer in that Province. During the taxation period in question practically all the shares of the appellant company were owned by Mr. A. W. Riedle, probably the founder of the business, but he is now deceased. Similarly, Riedle controlled eleven other corporations each of which was the

owner of a hotel in the Province of Manitoba, and which hotels were licensed, under the laws of Manitoba, to sell beer by retail. The relations between the appellant and the hotel corporations were quite intimate, and to some extent at least the operations of the latter were directed by the appellant. I was led to understand that other Manitoba brewers owned or controlled hotels licensed to sell beer.

The purpose and intent of the Government Liquor Control Act of Manitoba was to prohibit all transactions in liquor which take place within that Province, except under government control as specifically provided for by the terms of that Act, through the instrumentality of a Commission, known as the Government Liquor Control Commission. The appellant was licensed to sell beer manufactured by it to the Commission, and so far as I can see, to no other person or body within the Province, but it might deliver beer lawfully sold, when and as authorized in writing by the Commission, to persons licensed to sell beer by retail, or to a permittee, that is, a person who has been granted a permit to buy liquor from the Commission.

In the period in question the appellant, by its officers, employees or agents, at various times and places, pursued the policy of purchasing its own manufactured beer on sale in licensed premises throughout Manitoba, including the hotels controlled by Riedle, for the purpose of treating frequenters of such premises. Occasionally, it was said, if a person being treated expressed a preference for a beer other than that produced by the appellant, he would be supplied with the beer designated by him, but this would rarely occur. The alleged object of this treating was to make known the appellant's beer, Riedle beer so-called, and to acquire the good will of the proprietors of licensed premises. It was urged that the Manitoba Liquor Control Act, and the Commission which administers that Act, imposed such restrictions upon the advertising of liquor, which includes beer, that the practice of treating by brewers became necessary as an advertising medium. The expenditures made by the appellant for treating, during the taxation period in question, were $4,206.40, shown in its books as "treating expenses," or "treating at

1938

RIEDLE BREWERY LIMITED. v. MINISTER OF NATIONAL REVENUE.

Maclean J.

hotels," while its disbursements for advertising otherwise were $331.29 for the same period, its total sales for the period being $154,000. This system of treating is apparently engaged in by all brewers in Manitoba, some six or seven in number, and the expenditures of three of them, for treating, were given. Shea's Winnipeg Brewery Ltd. expended, in 1933, $18,199.20 for treating and $2,910.16 for advertising otherwise, its gross sales for that year being $848,636.39. Pelissier's Brewery Ltd. expended. for the year ending January 31, 1934, $12,619.69 for treating purposes, and $1,997.75 for advertising, its gross sales for the same period being $244,769.66. The Kiewel Brewing Company Ltd. expended, in the year 1933, $15,508.45 for treating, and $1,881.80 for advertising, its gross sales for that period being $271.633.87.

Some features concerning the expenditures made by the appellant might be mentioned. In the eleven licensed hotels which Riedle controlled the appellant treated with its own draught beer almost exclusively, though these hotels carried some bottled beer produced by other brewers. Of the total expenditure of some $4,200 which the appellant claims to have made on account of treating, almost $1,600 was expended in the hotels controlled by Riedle; the value of the sales of the appellant's beer to the licensees of these eleven hotels, in the period in question, amounted to $61,424.80, out of total sales amounting to $154,254.55 for the whole of the Province of Manitoba. Again, the appellant's expenditures for treating were made in sixty-seven different licensed premises,—largely in Winnipeg—in nineteen of which the total expenditure was one dollar and under, and in some instances it was but twenty cents. In some few cases no paid sales of Riedle beer appear to have resulted from any expenditures made for treating purposes.

It is proper, I think, to refer briefly to a few of the provisions of the Government Liquor Control Act of Manitoba, because, it seems to me, they bear some relation to the question of the necessity of the disbursements here in dispute. There is a limitation in the number of beer licences to be issued in Manitoba at hotels, clubs, etc. In the City of Winnipeg beer licences must not exceed one licence "for each forty-three hundred population"; in other parts of Manitoba the number of beer licences

to be issued is limited, but that is determined on a basis of population different from that applicable to the City of Winnipeg. A licensed beer vendor is required to purchase his beer from the Commission, and as I have already pointed out licensed brewers may sell and deliver beer to the Commission. A brewer's licence is defined by sec. 2, ss. (3) of the Act as meaning "a licence granted under this Act authorizing a brewer who is duly licensed by the Government of Canada for the manufacture of beer, to sell beer manufactured by him to the Commission and to deliver the beer so sold to the Commission, or to any one on the authorization of the Commission; . . ." The prices which a beer licensee may charge for beer are fixed by the Act but this may be varied by regulations enacted by the Commission, and all sales must be for cash; the beer licensee is not permitted to advance money for the purchase of beer, nor can he take or receive any money by way of a deposit or pledge for the purpose of securing the price of any beer to be supplied by the licensee at any future time. Sec. 141 (1) of the Act is as follows:

> Except as permitted by this Act or the regulations made thereunder, no person within the Province shall: (*a*) canvass for, receive, take or solicit orders for the purchase or sale of any liquor or act as agent or intermediary for the sale or purchase of any liquor, or hold himself out as such agent or intermediary; (*b*) exhibit or display or permit to be exhibited or displayed, any sign or poster containing the words "bar," "bar-room," "saloon," "tavern," "beer," "spirits," or "liquors" or words of like import; (*c*) exhibit or display or permit to be exhibited or displayed, any advertisement or notice about or concerning liquor.

The whole spirit of the Act would appear to indicate that it was the intention of the legislature that the sale and consumption of liquor should not be accelerated or encouraged, by advertising appeals of one kind or another, by brewers or beer licensees, except as permitted by the regulations of the Commission. All licensed brewers, and all beer licensees were in every respect to be on an equal footing. Competitive advertising as between brewers, or as between licensed retailers of beer, is something which the Act appears to discourage, or seeks to reduce to a minimum.

There was evidence, from persons interested in Manitoba breweries, to the effect that if treating were systematically practised by the brewers their beer sales to the

1938

RIEDLE BREWERY LIMITED. v. MINISTER OF NATIONAL REVENUE.

Maclean J.

Commission would increase, and if this were not done their sales would fall, a result which I find rather difficult to understand when looking at the trade as a whole. One licensed hotel proprietor stated in evidence that he would not buy the beer of a brewer who did not treat in his licensed premises, and the same witness stated he would "throw business" to the brewers who treated, and who continued to treat periodically. And I would gather from the evidence that some licensed beer retailers will not hesitate to inform a brewer that one of his rivals had just recently treated his patrons with free beer, which would be an invitation to that brewer to do the same thing. Another witness stated that a brewer would be "in disfavour" if he did not periodically treat in the premises of a licensed retailer. For obvious reasons the practice of treating is quite acceptable to the licensed retailer, and to the recipient of free beer; once the practice is established the licensed retailer will encourage the brewers to continue in their generous deeds, and the persons accustomed to being treated will never insist that the practice be discontinued. My conclusion from the evidence is that treating expenditures are made with the hope of putting the licensed retailer under an obligation to favour the brewer in his purchases of beer from the Commission. I do not think that the patrons of the beer licensees, who expect to be treated, could be seriously considered as an advertising or sales promotion medium, and one might safely say that no brewer's business could long survive on any patronage derived from those who look to be served with free beer. The licensed retailer conceivably might increase or lessen his purchases of any particular brewer's beer, if he were so inclined, but, it is difficult to understand why he should do this, because the cost and selling price of all beer is the same for all beer licensees, the conditions under which the trade of licensees is carried on are precisely the same, and there is therefore no competition of the character obtaining in most any other class of business; it would seem that the business interests of licensees would be best served by keeping in stock and selling the beer for which their patrons have a preference. I have no doubt but that the appellant made some expenditures on account of treating, but the

question I have to decide is whether such expenditures, were wholly, exclusively and necessarily, made for the purpose of earning the income.

The statutory provision with which we are concerned is sec. 6 (*a*) of the Income War Tax Act, which reads: "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." It will be obvious that narrow words were necessary in defining what deductions were permissible. It was not the intention of the legislature to lay down a general rule that whatever a subject liked to expend in his business, even if commercially advantageous, could be deducted as a business expense, but only such sums are to be allowed to which the character could be assigned that they had been "wholly, exclusively and necessarily" laid out for the purpose of earning the income. Expenditures may be wisely made, they may have been prudent, but it must also be shown that they were wholly necessary for the purpose of earning the income. The character of the deductions claimed in any case must therefore be carefully examined, particularly where they are of an unusual nature, as in this case.

Now, can it be said that the expenditure made by the appellant for treating, in the premises of beer licensees, and to a great extent in licensed premises which it doubtless controlled, was a necessary business expense in respect of income? I do not think so. I cannot avoid the conviction that such an expenditure was not a necessary business expense, and the fact that treating by brewers has apparently become a custom, in Manitoba, does not make such expenditures a necessary business expense. If it be true that the patronage of a beer licensee for a brewer's beer is only obtainable on the terms that the brewer must at times treat the patrons of the licensee, and if brewers are "in disfavour" with licensees if they do not treat, as was suggested by some witnesses, then such expenditures would seem to have come to be something in the nature of a levy made upon the brewer by the licensee, but however it may be classified, it does not, in my opinion, fall within the category of a business expense, wholly and necessarily incurred to earn the income. It is

1938

RIEDLE BREWERY LIMITED. v. MINISTER OF NATIONAL REVENUE.

Maclean J.

difficult to understand why it is considered necessary for brewers to make gifts of beer to the patrons of beer licensees, and one cannot but wonder why they do not agree among themselves to refrain from the practice. But, if a brewer wishes to indulge in the practice of treating, that is not a reason why he should be allowed a deduction for expenditures made in that connection, in computing his net income derived from his business as a brewer. If treating were not practised, all brewers and beer licensees would be on an equal footing, and the merits of their several beer products, the tastes of consumers, salesmanship, or something else, would be the determining factor in sales and consumption. I am inclined also to think that the expenditures made by the appellant cannot be considered a necessary business expense because of the provisions of the Government Liquor Control Act of Manitoba, if indeed they are not expressly or impliedly forbidden by that Act, the sale of beer is so controlled and regulated that expenditures for treating would seem altogether unnecessary because everybody concerned with the trade is exactly upon the same footing; everything in the nature of advertising is severely limited, and no doubt that was deliberately done as a matter of public policy, in connection with this particular trade. Then, I think, the expenditures with which we are here concerned must be treated as having been made for the general benefit of the appellant's business and not in respect of annual income, and were in the nature of capital expenditures for which no deduction is allowable. Further, I think the expenditure cannot be classified as a deductible business expense because there is no satisfactory or reliable way of accounting for the same, as is the case in all ordinary and necessary business expenses, and such expenditures if allowed as a business expense would be calculated to lead to intolerable abuses, at the expense of the public revenues. Many of the observations of Audette J., in the case of *O'Reilly & Belanger* v. *The Minister* (1) are applicable to the state of facts here. My conclusion therefore is that the expenditure in question here does not constitute a business expense necessarily incurred for the purpose of earning the income of

(1) (1928) Ex. C.R. 61.

1938

RIEDLE BREWERY LIMITED. v. MINISTER OF NATIONAL REVENUE.

Maclean J.

the appellant. However the expenditures may be classified, and whatever their effect or influence on the trade of the appellant, they are not, in my opinion, of the character for which the appellant is entitled to a deduction in computing the amount of its profits or gains.

In fairness to counsel I perhaps should make one further observation. By counsel on both sides I was referred to many English and American authorities. I can only say that I have consulted such authorities but I found myself unable to procure any assistance from them. In my view they are not applicable to the state of facts here and therefore I have not discussed them.

The appeal is therefore refused and with costs.

Judgment accordingly.