1967

CANADA

LAW REPORTS

RAPPORTS JUDICIAIRES

DU CANADA

Exchequer Court of Canada

Cour de l'Échiquier du Canada

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Official Law Editors
Arrêtistes

Published under authority by Gabriel Belleau, Q.C.
Registrar of the Court

Publié par Gabriel Belleau, C.R.
Registraire de la Cour

ROGER DUHAMEL, F.R.S.C.	ROGER DUHAMEL, m.s.r.c.
Queen's Printer and	Imprimeur de la Reine et
Controller of Stationery	Contrôleur de la Papeterie

Ottawa, 1968

94074—A

JUDGES
OF THE
EXCHEQUER COURT OF CANADA

During the period of these Reports:

PRESIDENT:

THE HONOURABLE WILBUR ROY JACKETT
(Appointed May 4, 1964)

PUISNE JUDGES:

THE HONOURABLE JOHN DOHERTY KEARNEY
(Appointed November 1, 1951)

THE HONOURABLE JACQUES DUMOULIN
(Appointed December 1, 1955)

THE HONOURABLE ARTHUR LOUIS THURLOW
(Appointed August 29, 1956)

THE HONOURABLE CAMILIEN NOËL
(Appointed March 12, 1962)

THE HONOURABLE ANGUS ALEXANDER CATTANACH
(Appointed March 27, 1962)

THE HONOURABLE HUGH FRANCIS GIBSON
(Appointed May 4, 1964)

THE HONOURABLE ALLISON ARTHUR MARIOTTI WALSH
(Appointed July 1, 1964)

THE HONOURABLE RODERICK KERR
(Appointed November 1, 1967)

DISTRICT JUDGES IN ADMIRALTY OF THE EXCHEQUER COURT OF CANADA

The Honourable W. ARTHUR I. ANGLIN, New Brunswick Admiralty District—appointed June 9, 1945.

His Honour VINCENT JOSEPH POTTIER, Nova Scotia Admiralty District—appointed February 8, 1950.

The Honourable ARTHUR IVES SMITH, Quebec Admiralty District—appointed June 16, 1950.

The Honourable ROBERT STAFFORD FURLONG, Newfoundland Admiralty District—appointed October 8, 1959.

The Honourable DALTON COURTWRIGHT WELLS, Ontario Admiralty District—appointed January 28, 1960.

The Honourable THOMAS GRANTHAM NORRIS, British Columbia Admiralty District—appointed September 28, 1961.

The Honourable GEORGE ERIC TRITSCHLER, Manitoba Admiralty District—appointed October 19, 1962.

GORDON R. HOLMES, Q.C., Prince Edward Island Admiralty District—appointed May 24, 1963.

The Honourable HAROLD GEORGE PUDDESTER, Newfoundland Admiralty District—appointed June 4, 1963.

The Honourable JAMES DOUGLAS HIGGINS, Newfoundland Admiralty District—appointed May 28, 1964.

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The Honourable CHARLES WILLIAM TYSOE, British Columbia Admiralty District—appointed January 31, 1963.

His Honour REGINALD D. KEIRSTEAD, New Brunswick Admiralty District—appointed February 28, 1957.

The Honourable ANDRÉ DEMERS, Quebec Admiralty District—appointed November 26, 1965.

SURROGATE JUDGE IN ADMIRALTY OF THE EXCHEQUER COURT OF CANADA

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ATTORNEY-GENERAL OF CANADA:

The Honourable PIERRE ELLIOTT TRUDEAU

SOLICITOR GENERAL OF CANADA:

The Honourable L. T. PENNELL

JUGES

DE LA

COUR DE L'ÉCHIQUIER DU CANADA

en fonction au cours de la période de publication de ces rapports:

PRÉSIDENT:

L'HONORABLE WILBUR ROY JACKETT
(*nommé le 4 mai 1964*)

JUGES PUÎNÉS:

L'HONORABLE JOHN DOHERTY KEARNEY
(*nommé le 1er novembre 1951*)

L'HONORABLE JACQUES DUMOULIN
(*nommé le 1er décembre 1955*)

L'HONORABLE ARTHUR LOUIS THURLOW
(*nommé le 29 août 1956*)

L'HONORABLE CAMILIEN NOËL
(*nommé le 12 mars 1962*)

L'HONORABLE ANGUS ALEXANDER CATTANACH
(*nommé le 27 mars 1962*)

L'HONORABLE HUGH FRANCIS GIBSON
(*nommé le 4 mai 1964*)

L'HONORABLE ALLISON ARTHUR MARIOTTI WALSH
(*nommé le 1er juillet 1964*)

L'HONORABLE RODERICK KERR
(*nommé le 1er novembre 1967*)

JUGES DE DISTRICT EN AMIRAUTÉ DE LA COUR DE L'ÉCHIQUIER DU CANADA

L'honorable W. ARTHUR I. ANGLIN, district d'amirauté du Nouveau-Brunswick—nommé le 9 juin 1945.

Son honneur VINCENT JOSEPH POTTIER, district d'amirauté de la Nouvelle-Écosse—nommé le 8 février 1950.

L'honorable ARTHUR IVES SMITH, district d'amirauté de Québec—nommé le 16 juin 1950.

L'honorable ROBERT STAFFORD FURLONG, district d'amirauté de Terre-Neuve—nommé le 8 octobre 1959.

L'honorable DALTON COURTWRIGHT WELLS, district d'amirauté d'Ontario—nommé le 28 janvier 1960.

L'honorable THOMAS GRANTHAM NORRIS, district d'amirauté de la Colombie-Britannique—nommé le 28 septembre 1961.

L'honorable GEORGE ERIC TRITSCHLER, district d'amirauté de Manitoba—nommé le 19 octobre 1962.

GORDON R. HOLMES, C.R., district d'amirauté de l'Île du Prince-Édouard—nommé le 24 mai 1963.

L'honorable HAROLD GEORGE PUDDESTER, district d'amirauté de Terre-Neuve—nommé le 4 juin 1963.

L'honorable JAMES DOUGLAS HIGGINS, district d'amirauté de Terre-Neuve—nommé le 28 mai 1964.

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Son honneur REGINALD D. KEIRSTEAD, district d'amirauté du Nouveau-Brunswick—nommé le 28 février 1957.

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PROCUREUR GÉNÉRAL DU CANADA:

L'honorable PIERRE ELLIOTT TRUDEAU

SOLLICITEUR GÉNÉRAL DU CANADA:

L'honorable L. T. PENNELL

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EN SA JURIDICTION DE COUR
DE PREMIÈRE INSTANCE

ET

EN SA JURIDICTION D'APPEL

94070—1

Ottawa 1967

Feb. 2

BETWEEN:

RESEARCH-COTTRELL (CANADA) LIMITED .... APPELLANT;

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE FOR CUSTOMS AND EXCISE ......

AND

JOY MANUFACTURING COMPANY (CANADA) LIMITED .. RESPONDENTS.

Customs duty—Claim for drawback of duty—Imported and domestic materials assembled into precipitators in Canada—Whether "manufacture" in Canada.

In 1961 appellant company in carrying out a contract with a Canadian mining company imported certain components made in the U.S.A., and these together with other components made in Canada were assembled by various operations, *viz* cutting, fitting, welding, wiring, joining, bolting and fabricating, into electrostatic precipitators at Copper Cliff, Ontario. The Tariff Board affirmed the decision of the Deputy Minister of Customs and Excise refusing a drawback of duty on the imported materials under Customs Tariff Schedule B items 1056 and 1059 on the ground that the work done at Copper Cliff was assembly and erection rather than manufacture.

Held, allowing the appeal, inasmuch as the precipitators did not exist before their assembly and erection at Copper Cliff the Tariff Board erred in law in concluding that what was done at Copper Cliff was not manufacture in Canada.

Customs Act, R.S.C. 1952, c. 58, amended 1958, c. 26, s. 2; *Customs Tariff,* R.S.C. 1952, c. 60, s. 11(1) Schedule A, tariff item 410*z*; Schedule B, tariff items 1056 and 1059.

APPEAL from Tariff Board.

Gordon F. Henderson, Q.C. and *A. de Lobe Panet* for appellant.

C. R. O. Munro, Q.C. and *André Garneau* for respondent Deputy Minister of National Revenue for Customs and Excise and *John M. Coyne, Q.C.* for respondent Joy Manufacturing Company (Canada) Ltd.

CATTANACH J.:—This is an appeal from a declaration of the Tariff Board, dated November 23, 1965 in appeal No. 790, pursuant to section 45 of the *Customs Act,* R.S.C.

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1952, chapter 58, as amended by S. of C. 1958, chapter 26, section 2, whereby a decision of the Deputy Minister that duty paid by the appellant on goods and materials imported by it under tariff item 410*z* (now item 41062-1) of Schedule A to the *Customs Tariff*, R.S.C. 1952, chapter 60, as amended, was not subject to drawback under tariff item 1056 or 1059 (now items 97056-1 and 97059-1) of Schedule B to that Act, was confirmed. For purposes of convenience I shall refer to the tariff items by their former numbers which were applicable when this cause arose.

Section 3(1) of the *Customs Tariff* provides:

3. (1) Subject to the provisions of this Act and of the *Customs Act*, there shall be levied, collected and paid upon all goods enumerated, or referred to as not enumerated, in Schedule A, when such goods are imported into Canada or taken out of warehouse for consumption therein, the several rates of duties of Customs, if any, set opposite to each item respectively or charged on goods as not enumerated, in the column of the tariff applicable to the goods, subject to the conditions specified in this section.

Tariff item 410*z* of Schedule "A" to the *Customs Tariff* reads as follows:

GOODS SUBJECT TO DUTY AND FREE GOODS

Tariff Item		British Preferential Tariff	Most-Favoured-Nation Tariff	General Tariff
410*z*	Machinery and apparatus, n.o.p. and parts thereof, for the recovery of solid or liquid particles from flue or other waste gases at metallurgical or industrial plants. not to include motive power, tanks for gas, nor pipes and valves 10½ inches or less in diameter........................	5 p c.	10 p.c.	12½ p.c.

It is common ground among the parties that the machinery, apparatus and parts imported by the appellant, fell within the foregoing item 410*z*. Duty was paid in accordance with that item on such goods which are described as electrostatic "precipitators".

Section 11(1) of the *Customs Tariff* provides:

11. (1) On the materials set forth in Schedule B, when used for consumption in Canada for the purpose specified in that Schedule, there may be paid, out of the Consolidated Revenue Fund, the several rates of drawback of Customs duties set opposite to each item respectively in that Schedule, under regulations by the Governor in Council.

The problem herein arises upon the appellant claiming payments by way of drawback by virtue of section 11(1),

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under tariff item 1056 or 1059 of Schedule B of the *Customs Tariff*. Those items read as follows:

GOODS SUBJECT TO DRAWBACK FOR HOME CONSUMPTION

Item No.	Goods	When Subject to Drawback	Portion of Duty Payable as Drawback
1056	Materials, including all parts, wholly or in chief part of metal, of a class or kind not made in Canada.	When used in the manufacture of goods entitled to entry under tariff items 410*z*.....	99 p.c.
1059	Materials	When used in the manufacture of articles entitled to entry under tariff items 410*b* and 410*z*, when such articles are used as specified in said items	70 p.c.

The distinction between items 1056 and 1059 is that to fall in item 1056 the materials must be "of a class or kind not made in Canada" whereas that is not a requirement of item 1059.

By agreement among the parties, the hearing before the Tariff Board was conducted on the issue as to whether, on the facts of the case, the materials imported by the appellant were "used in the manufacture of" the ultimate product, within the meaning of those words as used in items 1056 and 1059. Depending on the disposition of that issue the appellant and the Deputy Minister undertook to review the numerous items imported and conclude whether the respective items fell within tariff item 1056 or 1059 or neither.

The present appeal was conducted on a like basis by agreement among the parties. Under section 45 of the *Customs Act* a party to an appeal from a decision of the Deputy Minister has an appeal, as of right, to this Court upon any question of law. The right of appeal conferred by section 45 is, therefore, limited to a question of law. If the decision of the Tariff Board was a finding of fact, and there was material before it on which it could reasonably have based its finding, it is not within the competence of this Court to interfere with that finding, no matter what the conclusion of this Court might have been if a right of appeal "*de plano*" had been conferred. Therefore my function is to determine whether the Tariff Board erred as a matter of law in finding as it did.

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The appeal was argued before me, and as nearly as I can ascertain before the Tariff Board, on the basis that the "precipitators" when they had been duly erected in accordance with the contract between the appellant and the purchaser, were chattels.

Neither was there any suggestion, either before me or before the Tariff Board, that a "precipitator" was not an object in itself but merely a collection of a number of segregated parts functioning as such. It was assumed that such parts were merged into a new entity which was referred to as a precipitator.

The only question in respect of which any attack was made on the Board's decision was whether "assembly and erection" of the articles, some of which were imported and some of which were not, constituted "manufacture" of the precipitators within the meaning of that word in tariff items 1056 and 1059 of the *Customs Tariff.*

As I have indicated, none of the parties took the position that such "assembly and erection" constituted an improvement to the land on which the "assembly and erection" took place, nor that a "precipitator" is but a collection together of a number of parts not merged into a distinct new entity. Accordingly I do not have to consider the difficult problems that might have arisen if such positions had been taken.

The Tariff Board, after hearing several witnesses and receiving documentary evidence delivered a reasoned judgment reading as follows:

In the spring of 1961 the appellant, Research-Cottrell (Canada) Limited contracted to *design, furnish and erect* eight electrical precipitators designed for the recovery of iron ore particles from flue gases for the International Nickel of Canada Limited.

The precipitators are large and relatively complex equipment which together, installed, cost $1,000,000. Each may be roughly described as a group of rectangular, metal gas-passages with wires suspended between the wall plates of the passages; by the introduction of direct current negative voltage in the wires, an electrical field is created which ionizes the fine particles in the flue gases thereby attracting them to the positively charged gas-passage walls; from these walls the particles are dislodged by rapping or vibration and fall into hoppers at the base of the equipment. In addition, there are controls, meters, switches, transformers, rectifiers, heat insulation, safety devices and other ancillary equipment.

The precipitators were designed in the United States of America by Research Cottrell Inc., the parent company of the appellant company. Some of the components of the precipitators were made in the United States by Research Cottrell Inc, some were made in the United States by others and some were made in Canada. Purchase orders covering most, if not all, of the components were placed by Research Cottrell Inc. These components were shipped to Copper Cliff, Ontario, where by operations described by the appellant as, "cutting, fitting, welding, wiring, joining, bolting and fabricating", they were assembled into precipitators on the site.

When the precipitators were completed the appellant claimed drawback of customs duty under drawback items 1056 and 1059.

> 1056—Materials, including all parts, wholly or in chief part of metal, of a class or kind not made in Canada, when used in the manufacture of goods entitled to entry under tariff items 410*a* (iii), 410*g*, 410*l*, 410*m*, 410*o*, 410*p*, 410*q*, 410*s*, 410*t*, 410*v*, 410*w*, 410*x*, 410*z*, 411, 411*a*, 411*b*, 427*b*, 427*c*, 427*f*, 428*c*, 428*e*, 440*k* and 447*a*.
>
> 1059—Materials, when used in the manufacture of articles entitled to entry under tariff items 410*b* and 410*z* when such articles are used as specified in said items.

The appellant's claim was based on the contention that the precipitators would be entitled to entry under tariff item 410*z*.

> 410*z*—Machinery and apparatus, n.o.p., and parts thereof, for the recovery of solid or liquid particles from flue or other waste gases at metallurgical or industrial plants, not including motive power, tanks for gas, valves ten and one-half inches or less in diameter, nor pipes of iron or steel.

On October 30, 1964, the Deputy Minister for National Revenue, Customs and Excise, decided that the appellant was not entitled to the claimed drawback because the appellant neither performed, nor caused to be performed, any manufacturing operation in connection with the precipitators.

There are many issues which could come before the Board in this appeal: Are the goods materials? Are they wholly or in chief part of metal? Are they of a class or kind not made in Canada? Are the precipitators entitled to entry under tariff item 410*z*?

By agreement between the parties they come before the Board on the sole issue of whether or not the precipitators were "manufactured" in Canada within the meaning of the drawback items in issue. The Board accepts this agreement and is considering only this issue in its declaration.

There is evidence, both documentary and oral, concerning the various companies which performed the work in Canada; the real issue appears to the Board to be not the identity of those carrying out the required steps but rather the nature of these steps to determine whether or not they constitute manufacture in Canada.

The appellant quoted authority to the Board to show that manufacturing involved the application of knowledge, art, care, skill and labour to articles, substances or materials to bring about a substantial transformation in form, quality and adaptability in use and thus bring into being, a new, different, useful and marketable product. (Re H. Robinson Corporation Ltd., The King v. Martin, (1937) 19 C.B.R. 22, affirmed 1938 O.W.N. 243; Rex v. Wheeler (1819) 2 B and Ald., 345; Ralston v. Smith (1865) H.L C. 223; Re McGaghran (1931) 40 O.W.N. 122; Commonwealth v. Combustion Engineering Inc. 2 Penn. Tax Cases 21, 590; In Re Appeal of Titzel Engineering Inc. 2 Penn. Tax Cases 21, 526).

The Board adopts the observation of Sir Lyman Duff, C.J.C., in King v. Vandeweghe Ltd. 1934 S.C.R. 244:

> The words "produced" and "manufactured" are not words of any very precise meaning and consequently we must look to the context

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for the purpose of ascertaining their meaning and application in the provisions we have to construe.

It will not, for the purposes of this appeal, seek to establish any definition of general application to all cases but rather to declare whether or not the actions performed in this case constituted manufacturing.

The intent of tariff item 410*z* appears to be to benefit metallurgical or industrial plants in their acquisition of a certain type of machinery and apparatus by the imposition of lower rates of customs duties than would be levied were item 410*z* not in the Customs Tariff.

The intent of the drawback items 1056 and 1059 is clearly the encouragement of the manufacture in Canada of the goods or articles described in tariff item 410*z* as opposed to their acquisition abroad. In such a context it hardly seems a reasonable construction of the word manufacture to extend the benefits of the drawback items to imported goods which are simply assembled and erected on site.

In referring to the making of blast furnaces, oxygen furnaces, blast furnace stoves, open hearth furnaces and soaking pit furnaces, the word used in drawback item 1044 (now item number 97044-1) is "construction"; similarly, the word used to describe the making of bridges is "construction" in tariff item 460 (now item number 46000-1). Nor do the contracts for the installation of the precipitators use the word "manufacture", rather they use the words "erect" and "install".

In the present case, the Board finds the work carried out at Copper Cliff, Ontario, to be assembly and erection rather than manufacture.

Without adjudication upon any other phase of contention or possible contention between the parties now or at a later date, the board holds that the imported goods, not having been used in Canada in the manufacture of the precipitators, are not subject to drawback under items 1056 or 1059.

Accordingly the appeal is dismissed.

Counsel for the Deputy Minister contends that the Tariff Board, in holding that the precipitators were not "manufactured" in Canada but rather that the work carried on by the appellant at the site was merely "assembly and erection", did not err on any material point of law, that the finding of the Board that the erection of the precipitators did not constitute manufacturing within the meaning of tariff item 1056 or 1059 was one of fact, that there was ample evidence upon which the Board could so find and accordingly there is no appeal from that finding. In this contention he is supported by Counsel for the intervenant.

The rival contention of Counsel for the appellant is that the Board in declaring that the imported goods were not subject to drawback under tariff item 1056 or 1059 erred as a matter of law in that it misdirected itself on the wording and meaning of the tariff items in question and, as a consequence of that misdirection, posed to itself as the question to be answered "did the activities of the appellant constitute *manufacture* in Canada" rather than the question "were the goods *used in the manufacture*" of the eight electrostatic precipitators which latter question, Counsel for the appellant contends to be the correct one.

The Board considered the issue before it to be "whether or not the actions performed in this case constituted manufacturing" and found "the work carried out at Copper Cliff, Ontario to be assembly and erection rather than manufacture".

Counsel for the appellant, during the course of his argument, readily conceded that the work done by the appellant at the site constituted "assembly and erection" but he further contended "assembly and erection" constituted the final step in the manufacture of the precipitators and therefore the imported goods were there used in manufacture within the legal meaning of those words in tariff items 1056 and 1059 and accordingly the Board, by deciding that the activities of the appellant were assembly and erection and therefore not manufacture, failed to decide the question whether those activities constituted a part of the process of manufacture which, he contends, was the question which the Board was obliged to answer.

Section 11(1) provides for payment of drawback on imported materials set forth in Schedule "B" "when used for consumption in Canada" and "for the purposes specified" in Schedule "B".

On the evidence before the Tariff Board there is no doubt whatsoever that the materials imported were consumed in Canada. They were incorporated in the eight electrostatic precipitators at Copper Cliff, Ontario. The words, "in Canada" modify the words "used for consumption". Tariff items 1056 and 1059 provide for drawback on "materials, including all parts" and "materials", "when used in the manufacture of" goods or articles entitled to entry under tariff item 410*z* of Schedule "A". The goods or articles entiled to entry under tariff item 410*z* are, in effect, the electrostatic precipitators.

The relevant words of the foregoing section and tariff items, therefore mean, when applied to the facts of this appeal, that a portion of the duty paid will be payable as drawback on imported materials "when used in the manufacture of" electrostatic precipitators.

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If this had been a case where an article (i.e. a precipitator) had been made in its entirety in the United States and for the purposes of shipping had been broken down into its parts, I would readily agree that the assembly and erection on the site did not constitute manufacturing. But this is not such a case. The Board, in the third paragraph of its decision, specifically points out that "some of the components were made in the United States by others and some were made in Canada". Therefore, this is a case where only a part of what was required to create the "precipitator" had been imported. Indeed such objects had not been, prior to importation into Canada, put in the precise forms in which they had to be put before they could be used in the creation of the precipitators. Things had to be done at the site which were variously described as "cutting, fitting, welding, wiring, joining, bolting and fabricating".

There was no evidence before the Board upon which it could have concluded that the precipitators were in existence before ultimate assembly and erection. There is no suggestion in the Board's judgment that they had any existence before that time. On the contrary the Board said "These components", some of which were made in the United States and some were not, "were shipped to Copper Cliff, Ontario, where . . . they were assembled into precipitators on the site". If the component parts, not having been previously physically fitted together, were assembled into precipitators on the site, that negatives any possibility that the precipitators had a prior existence.

In the absence of a finding by the Board either express or implied, that the precipitators had an existence outside Canada, then I am of the opinion that a finding that the precipitators were not "manufactured" in Canada because they were merely "assembled and erected" in Canada, is wrong in law. I am of the opinion that the Board erred as a matter of law in concluding, as they did, that if what was done in Canada can properly be described as assembly and erection, it follows that the ultimate article was not manufactured in Canada. Where the article never existed until after the acts performed by the appellant on the site, then in my view, as a matter of law the article must be regarded as having been manufactured in Canada.

The appeal is, therefore, allowed with costs.

BETWEEN: Montreal 1967

VIKING FOOD PRODUCTS LTD. ....APPELLANT; Feb. 15

AND Feb. 24

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Associated companies—Both controlled by same group —Controlling shares of one under option to outsider—Whether actual control thereby divested—Construction of statute—Income Tax Act, R.S.C. 1952, c. 148, s. 139(5d)(b), am. 1953-4, c. 57, s. 31.

In 1963 all of appellant company's issued shares (20) were held by W (10), his son H (9) and the son's wife (1), and all of the issued shares (5,000) of another company were held by W (1,250) and H (3,750). In 1962 appellant's three shareholders had granted M an option to buy all of appellant's issued shares but the option was not exercised until after the expiration of appellant's 1963 taxation year. Appellant was assessed for 1963 at the normal instead of the reduced rate of tax on the ground that appellant and the other company were controlled by the same group in 1963 and were therefore associated companies as provided by s. 39(4)(*b*) of the *Income Tax Act*. Appellant appealed contending that since M by reason of his option to purchase the shares of appellant was deemed by s. 139(5d)(*b*) to have had the same position in relation to the control of appellant during 1963 as if he owned the shares it was a necessary implication of s. 139 (5d)(*b*) that appellant's actual shareholders must be deemed not to have owned those shares and accordingly the two companies were not controlled by the same group and were not associated companies.

Held, having regard to the legislative history and purpose of s. 139(5d)(*b*), *viz* to guard against tax avoidance, the court could not infer that Parliament intended the construction urged by appellant, and the appeal must be dismissed.

Yardley Plastics of Canada, Limited v. M.N.R. [1966] Ex. C.R. 1027 applied.

APPEAL from Tax Appeal Board.

S. Vineberg for appellant.

M. A. Mogan and *P. F. Cumyn* for respondent.

JACKETT P.:—This is an appeal from a judgment of the Income Tax Appeal Board which was set down, and brought on for hearing before me, on a stated case.

The sole question that I have to decide is a question as to the application to the agreed facts of subsection (5d) of section 139 of the *Income Tax Act*, which reads in part as follows:

139. (5d) For the purpose of subsection (5a)

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(b) a person who had a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, shares in a corporation, or to control the voting rights of shares in a corporation, shall, except where the contract provided that the right is not exercisable until the death of an individual designated therein, be deemed to have had the same position in relation to the control of the corporation as if he owned the shares and

. . .

The problem may be explained as follows:

1. The individuals concerned are William Cohen, his son, Harry Cohen, Harry Cohen's wife, Belle Cohen, and Martin Cohen, the son of Harry and Belle Cohen.

2. Throughout the appellant company's taxation year 1963 (12 months ending March 31, 1963), its issued shares were held as follows:

William	10
Harry	9
Belle	1

and during the same period all the issued shares of another company that I may refer to as "Empire" were held as follows:

William	1250
Harry	3750

3. In these circumstances, it is common ground that, if there were no other relevant fact, the appellant and Empire would have been associated companies during the appellant's taxation year 1963 for the purposes of section 39 of the *Income Tax Act*, by virtue of subsection (4) of that section.

4. The other fact, which the appellant says is relevant and the respondent says is not relevant, is that, on February 16, 1962 (i.e., before the commencement of the appellant's 1963 taxation year) William, Harry and Belle executed a document which, it is common ground for the purposes of this appeal, conferred upon Martin "a right under a contract...to acquire"[1]

[1] An argument was put forward that no such right had been created, but that argument was withdrawn by counsel for the Minister during the course of the hearing. After such withdrawal, it was conceded, for the purposes of this appeal, that such a right did exist during the taxation year in question.

all the shares in the appellant company at a specified price, which right was exercisable at Martin's option until December 31, 1964. He did not exercise the right until after the expiration of the appellant's 1963 taxation year.

5. It is common ground, therefore, that, by virtue of the operation of paragraph (*b*) of subsection (5d) of section 139 (*supra*) (which has application in relation to this problem by virtue of subsection (4a) of section 39), Martin must be deemed to have had, during the appellant company's 1963 taxation year, the same position in relation to the control of the appellant company as if he had owned, during that taxation year, all the shares of the appellant company.

6. Where the parties part company is that the appellant says, and the respondent denies, that it also follows, as a necessary implication of paragraph (*b*) of subsection (5d), that, if Martin is deemed to have been in the same position in relation to the control of the appellant *as if he owned* the appellant's shares, William, Harry and Belle must be deemed to have been in the same position in relation to the control of the appellant *as if they did not own* the appellant's shares.

The question that I have to decide is therefore a question as to the effect of subsection (5d) of section 139, which may be put in general terms as follows:

> If a person, by virtue of subsection (5d), is "deemed" to have had during a certain period "the same position in relation to...control" of a corporation "as if" he owned certain shares in that corporation, does it follow that the person who during that period actually owned those shares is "deemed" to have had during that period "the same position in relation to...control" of that corporation "as if" he did not own those shares?

As I understand the appellant's contention, it is that, while subsection (5d) does not expressly deem William, Harry and Belle to have been in the same position in the appellant's 1963 taxation year as if they did not own any of its shares, it does so impliedly. The appellant must go so far as to say that, when subsection (5d) expressly enacts that, upon certain facts being established, a person who did not

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own the shares is to be deemed to be in the same position as if he did own them, it impliedly enacts that, upon the same circumstances being established, the person who did own the shares is to be deemed to be in the same position as if he did not own them.

Whether or not such an inference can be read into subsection (5d) is a matter of interpretation, which must be considered in the general context in which subsection (5d) is found. Inasmuch as subsection (5d) is an interpretation provision that may have operative effect in several different parts of the Act, it is not improper to consider first, in general terms (and without intending to express any opinion concerning the precise effect of provisions relating to other problems), the background of the Act as a whole in so far as the concept of "control" of a corporation is concerned.

There are at least three different groups of sections in which it may become relevant to reach a conclusion as to whether a person or a number of persons "control" a corporation:

1. provisions where the legislative intent is expressed by reference to "control" of a corporation or to a corporation being "controlled", e.g., section 27(5) and (5a), section 28(2) and section 68;

2. provisions where the legislative intent is expressed by reference to persons dealing "at arm's length", e.g., section 11(3e) and (15), section 17, section 18, section 20, section 79, section 85, section 85A and section 137(3);

3. section 39, in which, as I have already indicated, we find a definition, for the purposes of that section, of the special statutory concept of one corporation being "associated" with another.

In so far as the simple concept of "control" of a corporation is concerned, there is no special provision in the statute, as far as I am aware, to guide in the determination of what is intended.[1] The meaning of the expression has now

[1] See, however, section 139(1)(*ag*), which defines "subsidiary controlled corporation" to mean, for the purposes of the Act, "a corporation more than 50 per cent of the issued share capital of which (having full voting rights under all circumstances) belongs to the corporation to which it is subsidiary".

been determined, however, by the Supreme Court of Canada in its unreported decision in *The Minister of National Revenue v. Aaron's Ladies Apparel Limited*, (1967), as being, in effect, ownership of shares carrying the right to sufficient votes to determine the election of the Board of Directors.

On the other hand, there are quite complicated provisions to regulate the determination of a question as to whether persons are or were dealing "at arm's length". In so far as relevant to the present purpose these may be summarized as follows: In addition to persons who, in fact, do not deal at arm's length (section 139(5)(*b*)), it is enacted that "related persons" must be "deemed not to deal with each other at arm's length" (section 139(5)); and the statute spells out what it means by "related persons". Individuals connected by blood relationship, marriage or adoption are "related persons" (section 139(5a)(*a*)). A corporation and a person who controls it are "related persons" (section 139(5a)(*b*)(i)). So are a corporation and members of certain kinds of groups by which it is controlled (section 139(5a)(*b*)(ii)) and a corporation and certain persons having a specified relationship to those by whom it is controlled (section 139(5a)(*b*)(iii)). Similarly, two corporations controlled by the same person or group of persons or controlled in other specified ways are "related persons" (section 139(5a)(*c*)).

Subsection (5d) of section 139, the provision that I must interpret, was enacted, in the first instance (section 31 of chapter 57 of 1953-4), as part of the set of provisions to which I have referred concerning the effect to be given to the concept of persons not dealing at arm's length; and it is convenient, at this point, to consider the question that I have to decide as it would have had to be decided if it had arisen immediately after subsection (5d) was enacted in its original form. For that purpose, I here set out sufficient of the provisions then added to section 139 to make it possible to consider what was intended by Parliament at that time.

(5) For the purposes of this Act,

(*a*) related persons shall be deemed not to deal with each other at arm's length; and

(*b*) it is a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length.

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(5a) For the purpose of subsections (5), (5c) and this subsection, "related persons", or persons related to each other, are

(*a*) individuals connected by blood relationship, marriage or adoption;

(*b*) a corporation and

(i) a person who controls the corporation, if it is controlled by one person,

(ii) a person who is a member of a related group that controls the corporation, or

(iii) any person related to a person described by subparagraph (i) or (ii);

(*c*) any two corporations

(i) if they are controlled by the same person or group of persons,

(ii) if each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,

(iii) if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation,

(iv) if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,

(v) if any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation, or

(vi) if each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation.

. . . .

(5d) For the purpose of subsection (5a)

(*a*) where a related group is in a position to control a corporation, it shall be deemed to be a related group that controls the corporation whether or not it is part of a larger group by whom the corporation is in fact controlled; and

(*b*) a person who had a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, shares in a corporation, or to control the voting rights of shares in a corporation, shall be deemed to have had the same position in relation to the control of the corporation as if he owned the shares.

Generally speaking, it may be said, that the effect of a determination that a corporation does not deal at arm's length with some other person is that either that corporation or someone else is denied an advantage that it or he would otherwise have in the computation of the tax payable under the Act (e.g., it is not permitted to deduct capital cost allowance computed on the actual cost to it of its depreciable assets—section 20(4)), or it is required to compute its profits on a higher basis than is reflected by its

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actual transactions (e.g., on the basis of fair market value—section 17).[1] While it is impossible to generalize with any degree of precision, it is probably not too inaccurate to say that, where special rules are made for situations where persons are not dealing at arm's length, the legislative purpose is to guard against tax avoidance, which tax avoidance would put some persons in a specially favoured position with a resultant unfairness to taxpayers not in a position to make similar arrangements.[2] (The attempt to formulate the legislative purpose for this kind of provision is necessary in order to test the appellant's contention that there is an inference in subsection (5d) of section 139 that is not expressed therein.)

Having regard to the general scheme of the provisions in which the concept of not dealing at arm's length was employed, as I understand it, and to the expressed legislative intent that the non-arm's length concept extends not only to any case where parties were not, in fact, dealing at arm's length (subsection (5)(*b*)) but also to a variety of arbitrarily defined circumstances where the parties might, in fact, be dealing at arm's length, it seems improbable that Parliament intended that paragraph (*b*) of subsection (5d) would have the unexpressed effect of artificially deeming a person to have ceased to control a company whose issued shares all belonged to him merely because he had granted an option to someone else to buy such shares.

To test the question further, it seems to me to be appropriate to consider the application of the concept of an arm's length transaction, for the purpose of subsection (4) of section 20, where a corporation bought depreciable property from

(a) the owner of all its shares at a time when he had not granted a right to any other person in respect of such shares,

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[1] In some cases, it is true, the provision containing a "non-arm's length" clause may, incidentally, operate to relieve a taxpayer of a tax liability to which he would otherwise be subject (e.g. section 85A(5)).

[2] The legislative view, presumably, is that, in the particular class of case, persons not dealing at arm's length will be tempted to make arrangements that are not dictated by business considerations but by a desire to minimize tax liability; and that such temptation does not exist where the parties are at arm's length and must therefore heed business considerations ahead of tax considerations.

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(b) the owner of all its shares after he had granted an option to another person to buy the shares and before such option had been exercised, or

(c) a person having an option to buy all its shares.

Clearly the corporation and the owner of its shares, in case No. (a), are related persons by virtue of subsection (5a)(*b*)(i) and, therefore, are deemed "not to deal with each other at arm's length" by subsection (5)(*a*). Similarly, it is clear that in case No. (c), the person who had an option is deemed, by subsection (5d)(*b*), to have had the same position in relation to the control of the corporation as if he owned the shares and he and the corporation are, therefore, related persons by virtue of subsection (5a)(*b*)(i) and are deemed not to deal with each other at arm's length by subsection (5)(*a*). This result clearly follows even if the vendor merely has an option to acquire the shares that he may never be able to exercise (n.b. the words in subsection (5d)(b) "a right . . . either absolutely or contingently"). Parliament seems to have adopted the policy, at least in this case, that, if a person is put in a position where he is entitled, even contingently, to acquire control, the same disadvantages arise as if he actually had control. That being so, it seems quite consistent that Parliament deliberately stopped where it did in subsection (5d)(*b*), it having been intended that, where a situation existed

(i) where one person in fact had control, and

(ii) where another person had a right to acquire control,

each of them should be "deemed" not to deal with the corporation at arm's length. It follows that, in my case No. (b) (*supra*), subsection (4) of section 20 would operate in the case of a purchase by a corporation of depreciable property from a shareholder who had granted an option in respect of its shares to someone else as well as in the case of a purchase from a shareholder who had not granted any such option.

My conclusion is that I cannot infer, in the context of this legislation, from the fact that Parliament cast the net of this class of legislation so as to embrace a somewhat dubious[1] class of case, that it meant to withdraw its application from the obvious[1] case of the corporation and the person actually owning its shares.

I come now to section 39 of the *Income Tax Act* and its special statutory concept of "associated" companies. That concept is part of a scheme for ensuring that the lower corporate tax rate of 18 per cent provided for by that section is allowed on only one amount of $35,000 where there are a number of companies "associated" with each other within that statutory concept, and is not allowed on $35,000 for each of such companies. As I have already indicated, the present case arises out of a dispute as to whether the appellant is associated with Empire for the purpose of section 39.

Prior to 1960, the definition of "associated" company in section 39 made use of the "arm's length" concept. Any reference to that concept was, however, dropped when section 39 was amended in 1960. The following provisions were, at that time, enacted as part of section 39 (section 11 of chapter 43 of 1960):

39(4). For the purpose of this section, one corporation is associated with another in a taxation year if, at any time in the year,

(*a*) one of the corporations controlled the other,

(*b*) both of the corporations were controlled by the same person or group of persons,

(*c*) each of the corporations was controlled by one person and the person who controlled one of the corporations was related to the person who controlled the other, and one of those persons owned directly or indirectly one or more shares of the capital stock of each of the corporations,

(*d*) one of the corporations was controlled by one person and that person was related to each member of a group of persons that controlled the other corporation, and one of those persons owned directly or indirectly one or more shares of the capital stock of each of the corporations, or

(*e*) each of the corporations was controlled by a related group and each of the members of one of the related groups was related to all of

[1] I use "dubious" here in the sense that it is doubtful that persons in such a class would have been in fact persons who did "not deal with each other at arm's length"; and "obvious" in the sense that it is probable that persons in such a class did, in fact, "not deal with each other at arm's length".

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the members of the other related group, and one of the members of one of the related groups owned directly or indirectly one or more shares of the capital stock of each of the corporations.

(4a) For the purpose of subsection (4),

(*a*) one person is related to another person if they are "related persons" or persons related to each other within the meaning of subsection (5a) of section 139;

(*b*) "related group" has the meaning given that expression in subsection (5c) of section 139; and

(*c*) subsection (5d) of section 139 is applicable *mutatis mutandis*.

In my view, the meaning to be given to subsection (5d) of section 139 must be determined in the light of the context in which it was when it was first enacted; and, when it was incorporated by cross reference in section 39, its meaning for the purpose of that section was precisely the same, subject only to necessary verbal variations, as it had previously been.

Changes have been made in subsection (5d) since that time, but, in my view, they do not affect the question that I have to decide.

I have set out the reasons for my conclusion in my own words and at some length out of deference to the submission of counsel for the appellant that the question that I have to decide is quite different in principle from that which my brother Noël had to decide in *Yardley Plastics of Canada Limited v. The Minister of National Revenue*[1]. While the problem that arose in that case had to do with a similar contention concerning the effect of paragraph (*a*) of subsection (5d) rather than paragraph (*b*) thereof, in my view, the two paragraphs cannot be given a different effect, as far as the present problem is concerned. I therefore apply, as I think I ought, the conclusion expressed in the following sentence in Noël J.'s judgment:

> The appellant has not, however, succeeded in this regard because although section 139(5d) and its subsections directly affect section 39(4) in extending the meaning of control therein, they do not restrict its meaning.

I am, moreover, in complete agreement with that conclusion, which is expressed by Noël J. much more succinctly than I have found it possible to do.

The appeal is dismissed with costs.

[1] [1966] C.T.C. 215.

APPENDIX

After the above reasons were prepared, counsel for the appellant filed written submissions with regard to *Yardley Plastics of Canada, Limited v. Minister of National Revenue,* in which the following passage appears:

> The depths of absurdity reached by any other construction are well illustrated by the example adduced at the hearing by Mr. Mogan, counsel for the Respondent. Suppose Eatons had a wholly owned subsidiary, all of the shares of which were optioned to Simpsons. Suppose further that the total number of shares issued and outstanding are one hundred shares. Under the construction which Mr. Mogan advanced, Eatons, Simpsons and the subsidiary would all be associated with each other. Under the construction for which I argued, Simpsons and the subsidiary would alone be associated. Eatons would not be associated with the subsidiary or with Simpsons.
>
> If the artificial concept of ownership dictated by Section 139(5d)(*b*) is not exclusive it would necessarily follow that none of the companies would be associated! If Simpsons, because of its option, is deemed to have had the same position in relationship to control of the corporation as if it owned a hundred shares and if, notwithstanding the foregoing, Eatons is regarded as being still the owner of a hundred shares, then the subsidiary is not associated with Eatons and it is not associated with Simpsons. If you add to the artificial deemed to be shareholdings of Simpsons the one hundred shares actually owned by Eatons, there emerges a company in which, in relation to control, Eatons and Simpsons each own or is deemed to own one hundred shares. As the number of shares balance each other and neither of the two companies in relationship to control has more than fifty per cent of the total share issue and deemed to be share issue, there will be no association, and the formerly associated subsidiary would become disassociated from anybody by the option itself.

In my view, this *reductio ad absurdum* argument is based upon an incorrect reading of subsection (5d). That subsection applies, when the question arises as to whether the owner of a "right" controlled the corporation and it directs that he should be deemed to have had the same position in relation to control of the corporation "as if" he owned "*the* shares". When the question arises as to whether the real owner of the shares controlled the corporation, there is no occasion to apply the deeming provision in subsection (5d). There is no possible justification for reading the provision as deeming the existence of two sets of shares in place of the one set that actually existed.

Montreal 1967

Feb. 17

Feb. 28

BETWEEN:

KONINKLIJKE NEDERLANDSCHE STOOMBOOTMAATSCHAPPIJ N.V. (The Royal Netherlands Steamship Company) .... SUPPLIANT;

AND

HER MAJESTY THE QUEEN ....RESPONDENT.

Pleadings—Facts occurring subsequent to date cause of action arose—Abuse of process—Whether subsequent facts relevant to prove antecedent facts—Exchequer Court Rules 88, 114.

Suppliant claimed damages arising out of a collision of ships in Lake St. Peter, Quebec on April 10th 1965 at 6:28 a.m. allegedly due to the misalignment of lights maintained by the Department of Transport as aids to navigation. Respondent moved under Exchequer Court Rule 114 to strike out allegations in the petition of right that the Pilotage and Navigation authorities misled pilots by maintaining publicly as late as two weeks after the collision that the navigation lights were reliable and by failing until June 18th 1965 to ascertain and disseminate notice of the true state of facts concerning navigation lights, thereby indicating a lack of system and a pattern of carelessness in the performance of their duties by servants of the Crown.

Held, the allegations of facts occurring after the collision, which constituted no part of suppliant's cause of action, must be struck out as embarrassing and an abuse of the process of the court. The allegations as to lack of system and pattern of carelessness must also be struck out, not because they were allegations of evidence rather than facts in violation of Rule 88, but because they could not stand by themselves but referred to facts occurring after the collision.

A pleading of evidence contrary to Rule 88 will not be struck out unless the applicant establishes some embarrassment or other substantial ground under Rule 114 or under the inherent jurisdiction of the court, on risk of paying the costs thrown away by bringing a frivolous motion.

While events subsequent to the collision might have probative value as to the state of affairs before the collision and so oblige the respondent to give discovery with reference thereto, the determination of the respondent's obligation to give discovery must be decided by reference to the facts pleaded as constituting the cause of action and not to the facts the pleading indicates that suppliant proposes to prove to establish the facts constituting the cause of action.

APPLICATION to strike out parts of petition of right.

J. Brisset, Q.C. for suppliant.

Léon Lalande, Q.C. and *Pierre Bourque* for respondent.

JACKETT P.:—This is a motion on behalf of the respondent for an order striking out certain parts of the Petition of Right.

The Petition of Right is for damages arising out of a collision alleged to have occurred between the suppliant's vessel *Hermes* and another vessel, called the *Transatlantic*, in Lake St. Peter, while the *Hermes* was on her way from Montreal to Three Rivers, on April 10, 1965 at 0628 hours. According to the Petition of Right the collision occurred as a result of the *Hermes* being, shortly before the collision, a substantial distance from the centre line of the dredged channel resulting in her becoming "subject to bank effect as a result of which she suddenly took a sharp sheer to port onto the upbound *Transatlantic*, thus rendering the collision unavoidable". The reason why the *Hermes* was so far from the centre of the channel (where those who were responsible for her navigation thought that she was) that she became subject to "bank effect" with the result that there was a collision, according to the allegations in the Petition of Right, is that certain lights or beacons constructed and maintained by the Department of Transport as aids to navigation had got out of alignment with the result that, when the *Hermes* kept the beacons in line in a way that should have kept her in the centre of the dredged channel, she found herself 235 feet south of the centre.

The legal nature of the claim against the Crown is revealed by the following paragraphs in the Petition of Right:

21. The collision and the consequent damages sustained by the Suppliants were the result of a breach of duty on the part of the Crown and its servants, attaching to the ownership, possession, occupation or control of property namely the structures on which the leading lights and beacons in Lake St. Peter had been installed and more particularly the lower leading light and beacon of Pointe du Lac and the downbound "Rivière du Loup" leading lights and beacons, with the result that their misalignment caused such leading lights and beacons to be a danger to navigation rather than an aid to navigation, and in that the officers and servants of Her Majesty failed to ascertain such misalignment or to give proper warning of it to those in charge of the navigation of the vessels *Hermes* and *Transatlantic* who relied for the safety of their vessels upon being given due warning that such leading lights and beacons were no longer serving the purposes intended and publicized for the information of mariners;

22. Such collision and the consequent damages sustained by the Suppliants were also the result of delicts and quasidelicts committed by servants of the Crown, namely the District Marine Agent of the Department of Transport in Sorel in charge of such aids to navigation, the

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Superintendent of Pilotage in Ottawa, the District Superintendent of Pilots in the District of Montreal and the Chief of the Aids to Navigation Branch of the Department of Transport, and more particularly;

(*a*) As to the District Marine Agent of the Department of Transport in Sorel—

(i) because of his failure to ascertain and correct the misalignment of the leading lights and beacons of Pointe du Lac which had resulted from the shifting and tilting to the south which was known or should have been known to him of the base on which the front range had been installed, which shifting and tilting had already become important in the fall of the year 1964 and had by the beginning of April, 1965 increased to such an extent as to place a downbound vessel, keeping the beacons in alignment on the south bank of the dredged channel;

(ii) because of his failure to ascertain and correct the misalignment of the downbound "Rivière du Loup" leading lights and beacons which had also resulted from the shifting and tilting to the south of the base on which the lower beacon had been installed; and,

(iii) because of his failure to at least warn mariners of the consequent unreliability of such aids to navigation,

the whole in spite of his knowledge of the justifiable reliance by the navigators of vessels passing through Lake St. Peter, and in particular by the navigators of the *Hermes* and the *Transatlantic,* on the performance of his duties by the said servant of the Crown and the acceptance of such duties by such servant, the more so in view of the conditions referred to in Paragraph 15(*c*) which still prevailed;

(*b*) As to the Superintendent of Pilotage in Ottawa as well as to the District Superintendent of Pilots in Montreal because of their failure to provide to the Pilots assigned to vessels in the Pilotage District of Montreal the information required by them to competently discharge their duties in the conduct of such vessels, but on the contrary in lulling such Pilots into a false sense of security by maintaining publicly even as late as two weeks after the collision herein referred to that the Pointe du Lac leading lights and beacons were entirely reliable as indicating the center of the navigable channel in accordance with the charts and other marine publications issued by the Canadian Hydrographic Service and the Department of Transport, thereby indicating a pattern of carelessness in the performance of their duties by the servants of the Crown;

(*c*) As to the Chief of the Aids to Navigation Branch of the Department of Transport and to the Superintendents referred to in Paragraph (*b*) hereof, all of whom were servants of the Crown and subject to the direction and control of the Minister of Transport because of their failure in their duty to commercial shipping and to your Suppliants in particular—

(i) to establish any suitable system to receive reports of navigational dangers in the area in question and to act upon the same; and,

(ii) more particularly, in that they knew or ought to have known that other vessels and, more particularly, the downbound cargo vessel *Mancester Commerce* and the downbound passenger vessel *Carinthia* had previously to the date here in question, namely on the 3rd and 9th days of April, 1965, respectively, encountered difficulties and danger while traversing the dredged channel across Lake St. Peter in exactly the same locality where the *Hermes* and *Transatlantic* came into collision, which said difficulty and danger were reported or should have been reported to the servants of the Crown herein mentioned, any lack of knowledge on their part being indicative of their failure in their duty as aforesaid to create an effective system for the receipt of such information;

(iii) by failing subsequently to ascertain what was the true state of facts concerning particularly the leading lights and beacons as described in Paragraph 15 hereof and to disseminate sufficient and effective Notice of same, which failure continued until at least the 18th of June, 1965, the said lapse of time being a fact upon which your Suppliants rely as to the lack of system hereinabove referred to and the pattern of carelessness in the performance of their duties by the servants of the Crown as hereinabove alleged;

23. The officers and servants of the Crown mentioned in the preceding paragraph, although having at all relevant times the equipment, personnel and funds required, failed in their duty to inspect and ascertain the condition of the said aids to navigation or to warn mariners of defects developing in them to ensure that navigators, relying upon the performance of the said duty and acting upon the information publicized, would not be misled into navigating in the channel of Lake St. Peter in the belief that they might do so safely in the manner they were directed and invited to do by the said information;

While the Notice of Motion gave notice that an application would be made for an order striking out paragraph 22(*b*), paragraph 22(*c*)(ii) and paragraph 22(*c*)(iii), upon the hearing of the application, it was limited to a motion for an order that all that part of paragraph 22(*b*) beginning with the words "but on the contrary" in the seventh line thereof and all of Paragraph 22(*c*)(iii) be struck out. The two allegations that the Court is asked to strike out are, in effect:

(a) an allegation that the collision was the result of a delict or quasi-delict committed by servants of the Crown—the Superintendent of Pilotage in Ottawa and the District Superintendent of Pilots in Montreal—consisting, in part at least, in lulling pilots assigned to vessels in the Pilotage District of Montreal into a false sense of security by maintaining publicly *as late as two weeks after the collision* that the lights and beacons in question were entirely reliable as indicating the centre of the navigable channel in accordance with the charts and other marine publications

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issued by the Canadian Hydrographic Service and the Department of Transport "thereby indicating a pattern of carelessness in the performance of their duties by the servants of the Crown"; and

(b) an allegation that the collision was the result of a delict or quasi-delict committed by servants of the Crown—the Chief of the Aids to Navigation Branch of the Department of Transport, the Superintendent of Pilotage in Ottawa, and the District Superintendent of Pilots in Montreal—consisting, in part at least, in their failure in their duty to commercial shipping and to the suppliant in particular "by failing subsequently[1] to ascertain what was the true state of facts" concerning the lights and beacons in question and to disseminate sufficient and effective notice of same "which failure continued until at least the 18th of June, 1965".

While they do not fit into the somewhat complicated sentence of which paragraph 22 consists, the last five lines of subparagraph (c)(iii) thereof constitute, in effect, a statement that the "said lapse of time" (i.e. the period until June 18, 1965, during which no sufficient notice was disseminated concerning the misalignment of the lights) is a fact upon which the suppliant relies as to the "lack of system" and "pattern of carelessness in the performance of their duties by the servants of the Crown" alleged in other parts of paragraph 22.

The application is made under Rule 114 of the Exchequer Court Rules, which reads as follows:

Striking out Pleadings

(1) The Court may at any stage of the proceedings order to be struck out or amended any pleading or anything in any pleading on the ground that

(*a*) it discloses no reasonable cause of action or defence, as the case may be,

(*b*) it is scandalous, frivolous or vexatious,

(*c*) it may prejudice, embarrass or delay the fair trial of the action,

(*d*) it constitutes a departure from a previous pleading, or

(*e*) it is otherwise an abuse of the process of the Court;

and may order the action to be stayed or dismissed or judgment to be entered accordingly, as the case may be.

[1] It is not clear to me what point of time is referred to by the word "subsequently".

(2) No evidence shall be admissible on an application under sub-paragraph (*a*) of paragraph (1).

(3) For the purpose of this rule the word "pleading" includes any document whereby any proceeding in the Court was initiated or any claim was defined and any document whereby any claim was defended or answered.

For the respondent, the application is put on the basis that if the suppliant has a legal claim against the respondent for the collision it must be based on facts that existed before the collision. I accept this submission. If facts in existence at or before the collision do not make the respondent liable therefor, no fact occurring subsequent to the collision can, on any view of the nature of the applicable law that has been suggested to me, make Her liable.

Counsel for the suppliant did not suggest that any of the facts alleged in the passages that have been attacked are a part of the facts constituting the suppliant's cause of action. What he did say, as I understood him, is in effect, that one of the facts upon which he does rely is that, prior to the collision, servants of the Crown distributed to mariners notices leading them to rely on the accuracy of the aids to navigation in question without having established a proper "system" to ensure that, to the extent reasonably possible, the representation that such aids to navigation were reliable would not continue to be acted on after they ceased to be reliable and that the facts alleged in the passages attacked tend to establish the absence of any such system.

In other words, as I appreciate such submission, it is conceded that the facts in the passages under attack *are not* part of the cause of action upon which the suppliant relies; but it is contended that they are facts upon which, along with others, the suppliant relies to establish facts that *are* part of such cause of action. In other words, they are *evidence* of facts that constitute part of the cause of action.

Even if I accepted such view of the pleading, the allegations offend Rule 88 of the Rules of this Court, which provides that every pleading shall contain a statement of the "material facts" on which the party pleading relies "but not the evidence".

However, when the passages attacked are read in the context of the whole sentence in which they appear, as I have endeavoured to read them in the summary that I have made above of their effect, in my view, the passages

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attacked, in so far as they purport to be allegations of fact at all, purport to be allegations of facts constituting the whole or part of delicts or quasi-delicts alleged against servants of the Crown. As I have already indicated, moreover, counsel for the suppliant did not attempt to answer the submission of counsel for the respondent that they could not be supported as constituting, in themselves, any part of the suppliant's cause of action. That being so, the passages in question must be struck out under Rule 114, not because they offend Rule 88, but because they are embarrassing and an abuse of the process of the Court in that, as long as they remain in the Petition of Right, the respondent cannot ignore the possibility that they are what they purport to be (i.e. a further alternative cause of action).

That brings me to the last five lines of subparagraph (*c*)(iii) which is, in terms, not an allegation of a fact upon which the suppliant relies as part of its cause of action but a notice to the respondent that it proposes to rely on a specified fact as tending to prove two other facts that have been pleaded elsewhere as part of the cause of action.

While this is a pleading of evidence contrary to Rule 88, I should not, for that reason alone, have granted a motion to strike it out. Any party bringing a motion to strike out a plea that is, in effect, only giving the other party notice of the evidence on which he proposes to rely would have to establish, in addition to the technical breach of Rule 88, some embarrassment or other substantial ground under Rule 114 or under the inherent jurisdiction of the Court, for bringing the motion or expose himself to the risk of paying the costs thrown away by bringing a frivolous or fruitless motion.

However, here the notice of the intention to use certain facts as evidence cannot stand by itself and therefore must be struck out with the words to which it makes reference, which, as I have already held, purport to plead an alternative cause of action that is admittedly unsupportable.

There is another reason why, in this case, I am inclined to the view that the latter part of subparagraph (*c*)(iii) must be struck out even though it were construed independently as nothing more than a notice of evidence that is going to be tendered at the trial. It became apparent during the argument that the real controversy between the parties is whether the respondent is bound to give discovery of documents or oral discovery in relation to the facts alleged by the passages under attack as having occurred after the collision. In my view, which I indicated during the course of argument, I am inclined to think that facts such as those alleged in the passages under attack may well have probative value concerning the allegations of fact as to the state of affairs before the collision; and, if there is a possibility that any such facts might be of some such assistance to the suppliant, the respondent would be bound to give discovery of documents and oral discovery with reference thereto.[1]

It is apparent to me that a question concerning the precise extent of any such right to discovery may well arise in these proceedings. When it does arise, it should be decided by answering the question whether the facts subsequent to the collision may possibly have some probative value in relation to the facts existing before the collision that constitute the cause or causes of action raised by the Petition of Right. The decision of that question must depend upon the facts properly alleged as constituting the cause or causes of action. To permit the suppliant to retain in its Petition of Right allegations as to the evidence it proposes to adduce to establish the facts constituting the causes of action for the apparent purpose of supporting the position it proposes to take on the dispute as to discovery, would, in my view, be an improper exercise of the court's discretion.

To put it another way, when a question arises, for example, as to whether the Crown should make discovery of a particular document, or as to whether an officer of the Crown should answer a particular question, that question must be decided by reference to

(a) its relevance to the facts pleaded in the petition of right as constituting the cause of action,

and not by reference to

(b) its relevance to the facts that the suppliant indicates by his pleading that he proposes to prove to establish the facts constituting his cause of action.

To clear the way for the controversy concerning the proper ambit of discovery, the pleas of evidentiary facts,

[1] Compare *Canadian Pacific Railway v. Calgary*, (1966) 59 D.L.R. (2d) 642 (Alta. C.A.)

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the relevance of which is a matter of controversy, should be struck out even if they were in a form in which they could otherwise be allowed to remain.[1]

An order is granted in the terms sought during the hearing of the application. Costs to the respondent in the cause.

APPENDIX

The argument of this motion by counsel from the Province of Quebec before a judge whose background is predominantly in the field of the common law has suggested to me that there are some differences in terminology and in practice between the courts of Quebec and those of the common law provinces, which are of some importance in this national court largely, if not entirely, by reason of the possible misunderstandings to which they might give rise.

In a common law court, according to the use that I make of the words (and I do not profess to know that such usage is universal), any fact constituting part of a cause of action or of a defence or of an answer is a "material" fact, and should be pleaded; any fact that tends to prove or refute a material fact is "relevant" to the issue as to the truth of the "material" fact and may, as such, be proved at trial; and discovery of documents or examination for discovery must be restricted to documents or facts that may have relevance to an issue as to the truth of a material fact.

Generally speaking, therefore, the rules of the common law courts require that the pleadings must contain allegations of all "material" facts but are not to contain allegations of "evidence". This is the rule that has been adopted in the rules of this Court. In practice, evidentiary facts are frequently pleaded and, where this is done merely to ensure that the other side is not taken by surprise—and inciden-

[1] As it seems to me, a question as to whether certain facts are or may be relevant, in an unusual case such as this, should be decided when it comes up for decision as such, either on an application for an order for further discovery or when the trial judge has to rule on an objection as to the admissibility of the evidence at trial. When so raised, it is probable that the presiding judge will be in a better position to appreciate the way in which the party proposes to link the proposed evidence up. If, however the party is permitted to retain an allegation of such an evidentiary fact in his pleading, its relevance may well be regarded as beyond attack either for purposes of discovery or at trial.

tally to let the judge know as early as possible the strength of the pleader's case—it is ordinarily not considered a fit subject matter for attack.

When I turn to practice in the courts of Quebec, I find, as I should have expected, that a pleader must certainly plead all the facts constituting his cause of action or defence. Compare Article 165 of the new Code of Civil Procedure, which provides for dismissal of an action if the suit is unfounded in law "even if the facts alleged are true", and Article 172 which provides that the defendant may plead "any ground of . . . fact" which shows that the conclusions of the demand cannot be granted. (See also Article 183, which refers to the facts alleged in the defence as "material facts".)

In practice however, as it seems to me, in Quebec pleadings, allegations are not restricted to the facts necessary to constitute the cause of action or defence. Some at least of what I regard as evidentiary facts (i.e. facts relevant to the material facts that have been or may be put in issue) are pleaded. For example, it would apparently be regarded as essential to plead an admission of a fact that constitutes part of the cause of action. I can nowhere find this expressly provided for, but I accept it as being universal practice. I also find that, while the word "material" is sometimes used (e.g. Article 183), the word "relevant" appears to be used to describe allegations that are properly pleaded and therefore to include facts that constitute the cause of action as well as documents and other facts that (to me) are of an evidentiary character, and that it is considered proper or essential to plead.

Under the Quebec practice, as I understand it, if a fact of an evidentiary character were not pleaded and its existence has taken the opponent by surprise, the party who should have pleaded it might not be allowed to prove it. On the other hand, it has been decided that the existence of an allegation of a fact that has not been struck out by a preliminary proceeding does not entitle the party to prove it if the trial judge does not consider it relevant or otherwise admissible as evidence. Compare *Leon v. Dominion Square Corporation*[1]. This was not, however, always the position taken by the Courts in Quebec. See Case Note in 16 R. du B. at pages 431 *et seq.*

[1] [1956] Q.B. 623.

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In practice, I do not think that there is much difference, from the point of view of pleading evidence, between the common law provinces and Quebec. When, however, a question arises as to precisely what facts a plaintiff is relying on as constituting his cause of action, either because of a possible attack by way of a question of law before trial, or because of a problem as to discovery, some way must, in my view, be found of settling what such facts are.

Furthermore, while the Quebec Court of Appeal has come to the conclusion that evidence can be rejected even though pleaded, and there is apprehension in Quebec that evidence is inadmissible in Quebec unless pleaded, I should have myself had doubts about the inherent soundness of that practice being such as to prevail in the long run; and I am of the view that the opposite would be the rule in this Court. Finally, it does seem to me that the institutions of discovery in this Court are sufficiently different from those in the Quebec courts to make it important, in certain exceptional cases, to draw a strict line between the facts that constitute the cause of action and the facts that are relevant to the truth or falsity of such facts.

Winnipeg 1967 Jan. 24-26 — Feb. 28

BETWEEN:

METROPOLITAN TAXI LIMITED ......APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Capital cost allowances—Licence to operate taxicab—Whether purchase-price part of cost of vehicle—Whether an intangible advantage of enduring nature—Income Tax Regulations, classes 10 and 14.

On January 26th 1961 appellant company which operated 19 taxicabs in Winnipeg purchased for $104,441 the assets of another taxicab company mainly for the purpose of acquiring 14 taxicabs which were licensed to operate until February 28th 1961. In assessing appellant for 1961 the Minister allocated $18,590 of the purchase-price to the 14 taxicabs which were depreciable under class 10 of the capital cost allowances and $72,031 was allocated to non-depreciable property. Appellant appealed contending that the $72,031 should be regarded as part of the cost of the 14 taxicabs on the ground that the licences to operate them were component parts of the licensed property, or alternatively that the $72,031 was expended to acquire the 14 licences which were property depreciable under class 14. The number of taxicabs in Winnipeg was limited to 400 by the Taxicab Board operating under statutory powers. Licences to operate taxicabs were issued annually by the Board to the owners for specific vehicles and the renewal of a licence or the issue of a licence for a substitute vehicle or to a new owner was virtually automatic though not obligatory and a licence could be cancelled or suspended by the Board for violations of the law. Licences had a value in the market place of between $5,000 and $6,000 in 1961.

Held, a licence to operate a taxicab was not a component part of the taxicab but was personal to the owner and capital cost allowances therefore were not authorized under either class 10 or class 14. What appellant purchased for the $72,031 was a long term commercial benefit which was an intangible enduring advantage of a capital nature, *viz* the reasonable expectation of succeeding to the vendor's position before the Taxicab Board and of expanding its business by 14 taxicabs.

Cartwright v. Sculcoates Union [1900] A.C. 150; *Rex v. Shoreditch Assessment Committee* [1910] 2 K.B. 859; *Fitzwilliam (Earl) v. Inland Revenue Commissioners* [1914] A.C. 753, distinguished.

APPEAL and CROSS-APPEAL from Tax Appeal Board.

A. J. Irving for appellant.

D. G. H. Bowman and *J. R. London* for respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1] dated April 29, 1966 in respect of an income tax assessment for the 1961 taxation year of the appellant.

The appellant, a corporation incorporated pursuant to the laws of the Province of Manitoba, carries on the business of operating taxicabs in the Metropolitan area of the City of Winnipeg, in that province. Pursuant to an agreement dated January 26, 1961 the appellant acquired the assets of another corporation, Adolph's Taxi Company Limited (hereinafter referred to as Adolph's), also engaged in the operation of taxicabs in the City of Winnipeg, for a total consideration of $104,441.65. The assets so acquired included garage and office equipment, meters, radios and automobiles, including 14 vehicles which Adolph's was licensed to operate as taxicabs.

In filing its return of income for its 1961 taxation year, the appellant did not claim that any portion of the purchase price represented the consideration for assets falling

[1] (1966) 41 Tax A.B.C. 117.

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within Class 14 of Schedule B to the Regulations made pursuant to section 11(1)(*a*) of the *Income Tax Act*, that is "property that is a patent, franchise, concession or licence for a limited period in respect of property". Rather the appellant allocated the purchase price as follows:

(1) Garage and Office Equipment (Class 8)	$ 2,000
(2) Radios (Class 9)	8,250
(3) Taxicabs (Class 10)	93,550
Total	$103,800

The Minister, in assessing the appellant, allocated the purchase price of $104,441.65, (which includes legal fees of $641.65 thereby accounting for the discrepancy in the above total), as follows:

(1) Garage and Office Equipment (Class 8)	$ 2,000
(2) Meters (Class 8)	3,570
(3) Radios (Class 9)	8,250
(4) Automobiles (Class 10)	18,590
(5) Consideration not attributable to depreciable property	72,031.65
Total	$104,441.65

Only the fifth item in the Minister's allocation of the purchase price is in dispute between the parties before me and this was also the only item in dispute before the Tax Appeal Board.

So far as I can determine, the appellant's contention before the Tax Appeal Board was that the sum of $72,031.65 was laid out to acquire fourteen licences for a limited period, that such amount was reasonable to allocate to the licences under section 20(6)(*g*) of the *Income Tax Act* and accordingly an allowance in respect of that capital cost should be permitted and depreciated over the terms of the licences. It was further contended that no goodwill was acquired.

The Tax Appeal Board found that the appellant "sought and acquired an intangible, enduring advantage of a capital nature and the evidence confirms that the greater part of the sum of $72,000 ($72,031.65) was paid for the privilege of expanding its operations by acquiring the business previously carried on by Adolph's Taxi Company" and that "there is no provision in the *Income Tax Regulations* for an allowance which might be granted in respect of such an asset".

However, the Board found that the licences on the fourteen taxicabs purchased by the appellant on January 26, 1961 expired on February 28, 1961 and accordingly must be deemed as belonging to those assets falling within Class 14 of Schedule B and an allowance should be granted in respect of the capital cost for the unexpired portions of the licences. The appeal was, therefore, allowed and the assessment was referred back to the Minister to ascertain the portion of the purchase price attributable to licences for the period from the date of their acquisition to the date of their expiration in order that an allowance may be granted with respect to that amount to be found.

It is from the foregoing decision of the Tax Appeal Board that the appellant now appeals, contending that the whole sum of $72,031.65 is subject to a capital cost allowance and the Minister cross-appeals from that part of the decision of the *Tax Appeal Board* which permitted an allowance on an amount to be determined as attributable to the unexpired period of the licences.

However, counsel for the appellant advanced as his principal argument before me a position that was not taken and argued before the Tax Appeal Board. His position before me, as I understand it, is that licences or authorizations issued in respect of an asset or property are an element of and a component part of that asset or property, and that licences issued in respect of property do not stand by themselves as property but form part of the licensed property. If those premises are accepted he then contends that the pertinent provisions of the *Income Tax Act* and regulations thereunder do not purport to isolate elements of an asset or property. It would follow from this that the entire amount of $72,031.65 was expended for the fourteen vehicles, licensed to operate as taxicabs and as such subject to capital cost allowance as automotive equipment within Class 10 of Schedule B to the regulations.

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Under the *Taxicab Act,* chapter 260, R.S.M. 1954 a Taxicab Board was established with extensive powers to regulate the taxicab business in greater Winnipeg and to exercise a general supervision over owners, operators and drivers.

The Statute provides that there shall be a separate licence (1) to carry on a taxicab business, (2) to operate a taxicab and (3) to drive a taxicab.

Under the authority conferred by section 7 of the Act, the Taxicab Board, considering the public convenience and necessity, limited the number of taxicabs that may be operated to four hundred. This quota was set by the Taxicab Board in 1947 and was an increase over the previously prevailing number of 283 to accommodate returning war veterans. The prescribed quota has been fully occupied from the date of its establishment. While it is possible that the number might be increased at some future time, that possibility seems very remote.

In order to obtain a licence to operate a taxicab there must be a specific vehicle and a licence is issued to the owner with respect to that vehicle which is described in the licence. The licence on its face is described as a "Licence to Operate a Taxicab" and in smaller type immediately thereunder appear the words "and Certificate of Registration of Vehicle". The operative language reads that the owner "is hereby licensed to operate the motor vehicle described herein as a Taxicab". When the vehicle, with respect to which a licence has been issued, becomes worn out or no longer serviceable, (the normal life of a taxicab being three years) a new licence will be issued for a substitute vehicle and the former licence is cancelled.

Licences to operate a taxicab are issued annually by the Board upon payment of the prescribed fee. Once issued the renewal of a licence to the same owner is virtually automatic, although the Board need not renew any particular licence. Further, section 5 of the Statute provides that the Board may suspend or cancel any licence issued by it in the event of any contravention of the provisions of the *Highway Act,* the *Taxicab Act* or the regulations, directives or decisions of the Board.

Because the quota of four hundred has been filled and a long waiting list exists, the only practicable ways in which a person might become eligible to operate a taxicab, or if already engaged in the taxicab business to increase the number of taxicabs which he may operate, are to buy the shares of a corporate taxicab operator or to succeed to the position of an already licensed operator by buying from that operator one or more vehicles with respect to which a licence has been issued.

In the present instance the appellant adopted the latter course in the expectation of increasing its then fleet of nineteen taxicabs to thirty-three by the addition of the fourteen licensed taxicabs owned by Adolph's. Mr. Abramson, the president of the appellant, testified that his purpose in purchasing the assets of Adolph's was to acquire the fourteen taxicabs. He was not interested in the other assets which were only purchased incidentally. Neither was he interested in the taxicabs as vehicles, but only because they were licensed to operate as taxicabs. Seven of the taxicabs were operated by the appellant, under the name "Adolph's" for the short period it took to replace them with new vehicles. The remaining seven taxicabs were operated for a slightly longer period. When new vehicles were available to replace them, the appellant sold the fourteen acquired from Adolph's at negligible prices.

The agreement between the appellant and Adolph's was entered into on January 26, 1961 and the licences on the taxicabs acquired would have expired on February 28, 1961. Mr. Abramson testified that he had no interest whatsoever in the unexpired period as such. He added that he would have paid the same price on March 1, 1961 that he had paid on January 26, 1961. His obvious interest was to effect a permanent expansion of the appellant's business.

Because of the circumstances above outlined, it is quite obvious that the licences to operate taxicabs in greater Winnipeg have acquired a considerable value. In the language of the market place these licences commanded prices between \$5,000 and \$6,000 in 1961. In 1967 the price is about \$9,000. In view of the fact that the licences are not transferable, but that a new licence is issued in the name of the purchaser of a vehicle with respect to which a taxicab licence has been issued, I construe that language as meaning that a purchaser would pay those amounts at those times to acquire the position of the vendor *vis-à-vis* the Taxicab Board.

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Mr. Abramson stated that the formula he used to arrive at the price of the licensed taxicabs purchased from Adolph's was to take the market value of the taxicab as an automobile and add $5,000 to that amount.

The agreement of January 26, 1961 between the appellant and Adolph's referred to the assets purchased by the appellant as "all the taxicabs, stock-in-trade, machinery and office equipment and other goods and chattels owned by the vendor and used in connection with" the vendor's taxicab business. By paragraph 6 of the agreement the vendor agreed to transfer into the name of the purchaser all licences which the vendor held. (The language of paragraph 6 is inaccurate in so far as it may contemplate the vendor transferring taxicab operating licences into the name of the purchaser bearing in mind that a new licence is issued by the Taxicab Board in the name of the new owner with respect to a vehicle previously licensed as a taxicab.)

The vendor also covenanted not to compete with the appellant for a period of five years.

Paragraph 17 of the agreement stated that in the event that the Taxicab Board did not grant its approval to the transaction the appellant would reconvey all assets to the vendor and the parties would be placed in their same respective positions as if the agreement had not been entered into.

However, the Taxicab Board did not withhold its approval and licences were issued to the appellant.

The Bill of Sale dated January 27, 1961 between Adolph's and the appellant sets out the subject matter thereof in two schedules at a total purchase price of $103,800. In paragraph 2 of the Bill of Sale the goodwill and rights to the taxicab business and the trade names of Adolph's are included at a value of $15,000.

Neither the agreement for sale, nor the Bill of Sale establishes any specific amount of the purchase price for the licences, although paragraph 6 of the agreement for sale sets out the vendor's undertaking to transfer the licences to the appellant. There is no question whatsoever that the prime (if not the sole) purpose of the appellant in purchasing the assets of Adolph's was to stand in Adolph's position before the Taxicab Board by obtaining the fourteen licensed vehicles possession of which, by virtue of the prevailing practice of the Taxicab Board, would give the appellant the almost certain expectation that licences in substitution therefor would be granted to the appellant and renewed in each succeeding year on payment of an annual fee subject. of course, to the possibility of the licences being cancelled for cause.

The question to be determined is for what did the appellant expend the sum of $72,031.65 and, when that determination has been made, to determine whether what that sum was expended for is depreciable property subject to capital cost allowance in accordance with the regulations under the *Income Tax Act*.

The relevant sections of the *Income Tax Act* and regulations made thereunder are:

11 (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

(*a*) such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation;

. . .

20. (5) In this section and regulations made under paragraph (*a*) of subsection (1) of section 11,

(*a*) "depreciable property" of a taxpayer as of any time in a taxation year means property in respect of which the taxpayer has been allowed, or is entitled to, a deduction under regulations made under paragraph (*a*) of subsection (1) of section 11 in computing income for that or a previous taxation year;

Section 1100 of the *Income Tax Regulations*:

1100 (1) Under paragraph (*a*) of subsection (1) of section 11 of the Act, there is hereby allowed to a taxpayer, in computing his income from a business or property, as the case may be, deductions for each taxation year equal to

(*a*) such amounts as he may claim in respect of property of each of the following classes in Schedule B not exceeding in respect of property

. . .

(*x*) of class 10, 30%

of the undepreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;

. . .

(*c*) such amount as he may claim in respect of property of class 14 in Schedule B not exceeding the lesser of

(i) the aggregate of the amounts for the year obtained by apportioning the capital cost to him of each property over the life of the property remaining at the time the cost was incurred, or

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(ii) the undepreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;

Classes 10 and 14 of Schedule B read as follows:

CLASS 10

Property not included in any other class that is

(*a*) automotive equipment (the remaining language is omitted as not being applicable)

CLASS 14

Property that is a patent, franchise, concession or licence for a limited period in respect of property . . .

As previously intimated the principal argument advanced before me by counsel for the appellant was that the entire amount of $72,031.65 is properly attributable to the purchase price of the fourteen licensed taxicabs the value of which was enhanced by that amount by virtue of their being licensed. In the event that it should be considered that the licences are property in themselves and not an element or component part of the vehicles, he then contends, as an alternative, that the licences fall within Class 14 of Schedule B as property that is a licence for a limited period in respect of property.

In support of his principal contention counsel for the appellant relies on the rating cases, particularly *Cartwright v. Sculcoates Union*[1] and *Rex v. Shoreditch Assessment Committee*[2]. In the rating cases the assessor was obliged to assess the value of a licensed public house for the poor rate. The Act of Parliament stated very concisely that the question to be solved was, what would it be reasonably expected that the premises would be let to a tenant for. In answering such a question it was held that it is proper to consider the existence of a licence and the amount of trade that came or was actually carried on to arrive at the rent at which the house may reasonably be expected to let.

He also placed strong reliance on *Fitzwilliam (Earl) v. Inland Revenue Commissioners*[3]. In that case the problem was to estimate the total value of land for the purpose of assessing a reversion duty which by section 13 of the *Finance Act* was assessed on the value of the benefit accruing to a lessor by reason of the determination of the lease. On

[1] [1900] A.C. 150.
[2] [1910] 2 K.B. 859.
[3] [1914] A.C. 753.

this particular leasehold there was a house which was licensed as a public house. For the purposes of the reversion duty the total value of the land was the market price. It was notorious that licensed premises commanded more than unlicensed premises. It was agreed that the value of the property if the house were unlicensed was 300*l* but that the value of the property including the licence was 500*l*. It was held that the value of the licence to use the dwelling house on the land as a public house was an element to be taken into account in determining the value of the land for reversion duty purposes.

In commenting upon the premises licensed for the sale of liquor in the *Fitzwilliam* case (*supra*) Lord Atkinson had this to say at pages 757 and 758:

> . . . Now the condition of the premises was, amongst other things, this, that they were suitable for the carrying on in them of the business of a publican. That was one of their inherent capacities affecting their value, and, secondly, they were premises in which a person had by the licence of the proper authorities been authorized to utilize this capacity, and to carry on in them this very trade and business, but the fact that a person had been so authorized to utilize this capacity gave to any person who might become owner of the premises a right or claim to have the licence continued.
>
> . . .
>
> The person who would purchase the premises in the market would not purchase the existing licence, but no doubt the right or chance of obtaining a similar licence would belong to him. The lessor is, as I have already pointed out, in as good, if not in a better position, in this respect.
>
> Under s. 25 of the Licensing (Consolidation) Act, 1910, he could obtain a transfer of the licence to himself when he went into occupation, or he could let to a new tenant, who could apply for a transfer. Under s. 26 the owner could object successfully to his former tenant obtaining a removal of the licence from the lessor's premises to some other premises newly acquired by him. The lessor could obtain a protection order authorizing him to continue to carry on this trade in his premises during the currency of the old licence until the time arrived for applying for a transfer. He gets the advantages specified in the Fourth Schedule to this statute. And lastly, he acquires an absolute right, if the business be properly conducted, to have the licence renewed, or compensation paid in case the renewal be refused.

In my view the facts of the foregoing cases are readily distinguishable from those in the present case.

It is apparent from the above quoted language of Lord Atkinson that the licence there in question bore a definite link with and formed an integral part of the land. In the present case the intention of the appellant in entering into the contract of sale with Adolph's was not primarily to

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acquire the physical assets of Adolph's, but rather the acquisition of those assets for the purpose of succeeding to Adolph's privileged position and reasonable expectation of being able to participate to the extent of fourteen taxicabs in the total of four hundred taxicabs which are permitted to be operated in greater Winnipeg. This to me, is the implication inherent in the contract between the parties. There was something more involved than mere ownership of a physical asset. Because of the policy adopted by the Taxicab Board of granting a licence to the purchaser of a licensed taxicab, what the purchaser acquires is an expectation, amounting almost to a certainty, of being granted a licence but it is only an expectation that is acquired, not a right.

I am, therefore, in agreement with the finding of the Chairman of the Tax Appeal Board, based upon the evidence before him, which was substantially the same as that adduced before me, that the appellant agreed to the purchase price of the assets of Adolph's to be in a position to apply for a grant of fourteen licences to operate taxicabs. It should be emphasized that the grant of a licence to a purchaser is not the transfer of the licence of the former owner of the taxicabs, but a new grant to the new owner. While it is true that the licence to the owner is with respect to specifically described automobiles, nevertheless, I am of the opinion that the licence so granted is personal to the owner. The licence is granted to a named person authorizing that person to operate the vehicle described therein as a taxicab. A vehicle so employed can be expected to be suitable for that purpose for a period of short duration and must be replaced by a new vehicle. This the Taxicab Board recognizes by its policy of issuing a new licence to the same owner for the replacement. I am certain that if a vehicle were lost or destroyed a new licence would be readily forthcoming for its replacement. Therefore the reference to the registration of a specifically described vehicle in the licence to the owner is merely an incidental feature. It does not detract from the personal nature of the licence.

I am also in complete accord with the finding of the Chairman of the Tax Appeal Board that what the appellant sought and acquired was "an intangible, enduring advantage of a capital nature" and that the evidence before him, which was substantially the same as that before me, "confirms that the greater part of the sum of $72,000 was paid for the privilege of expanding its operations by acquiring the business previously carried on by Adolph's Taxi Company."

I do not accept the premise of counsel for the appellant that the licences here issued in respect of the vehicles constitute an element or a component part of that property. In my view the licences here granted are personal to the respective owners and the purchase of the licensed taxicabs formed part of the bargain whereby the appellant acquired a reasonable expectation of being able to expand its business to the extent of the fourteen taxicabs it purchased from Adolph's. Accordingly there is a clear distinction between the value of the vehicles as such and the value of their purchase as a means to accomplish the above mentioned end.

It will be recalled that in the Bill of Sale dated January 27, 1961 between the appellant and Adolph's an amount of $15,000 of the purchase price was attributed to the goodwill and rights to the taxicab business and trade names of Adolph's. The above amount of $15,000 is included in the amount of $72,031.65 here in dispute.

While the appellant contended that no goodwill was acquired because Adolph's was not operating profitably due to mismanagement, defalcations by an employee and similar causes, nevertheless, the appellant did make use of the Adolph trade name and carried on considerable advertising under that name. I am, therefore, convinced that an element of goodwill was acquired, which is not subject to capital cost allowance, but because of the conclusions I have reached, it is not necessary for me to attribute any specific part of the sum of $72,031.65 to goodwill.

I am convinced that what the appellant paid for was a long-term commercial benefit. When the appellant bought the assets of Adolph's it succeeded to Adolph's position before the Taxicab Board and, because of the well known policy of that Board, could reasonably expect to be able to operate an expanded fleet of taxicabs from year to year. For that expectation and privilege the appellant was prepared to pay and did pay a substantial amount. To attribute that

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amount to the value of the fourteen taxicabs, as contended by the appellant, would, in my opinion, be unreasonable and, as I conceive it, a distortion of the true substance of the transaction.

Section 20(6)(*g*) of the *Income Tax Act* provides:

20. (6) For the purpose of this section and regulations made under paragraph (*a*) of subsection (1) of section 11, the following rules apply:

. . .

(*g*) where an amount can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property of that class irrespective of the form or legal effect of the contract or agreement; and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount;

In assessing the appellant, the Minister considered that an amount of $18,590 of the purchase price could be reasonably regarded the consideration for the fourteen taxicabs as automobiles, being depreciable property with Class 10 of the *Income Tax Regulations* and subject to a capital cost allowance accordingly. The evidence before me established that the amount of $18,590 so attributed by the Minister was, in fact, generous, the automobiles being sold shortly after their acquisition by the appellant for approximately $4,000. The sum of $72,031.65 was attributed by the Minister as consideration for "something else". I have concluded that the consideration which can be reasonably regarded as being in part for "something else" was, in fact, the consideration for the privilege of assuming the position of Adolph's before the Taxicab Board and the reasonable expectation of the appellant being able to expand its business to that extent.

There is no provision in the *Income Tax Act* nor the regulations thereunder for an allowance which might be granted for such an asset.

The appellant's alternative argument was that advanced before the Tax Appeal Board that the sum of $72,031.65 was expended to acquire the fourteen licences which were property within Class 14 of the *Income Tax Regulations,* i.e. a licence for a limited period in respect of property.

In view of my conclusion that the licences granted by the Taxicab Board are personal to the owner, although with respect to a specific vehicle, it follows that they are not transferable in themselves and are not the subject matter of barter or sale. Therefore, the appellant did not buy the licences in question but by its purchase of fourteen licensed taxicabs placed itself in a better position from which to apply to the Taxicab Board for licences on its own behalf.

Accordingly the appellant's appeal does not succeed.

I turn now to the Minister's cross-appeal from that portion of the Tax Appeal Board's decision by which the assessment was referred back to the Minister to ascertain the portion of the purchase price attributable to the unexpired period of the licences between January 26, 1961 and February 28, 1961 in order that an allowance might be granted with respect to that amount to be found. It follows from my conclusion that the licences are personal to the owner and are not the subject matter of sale but that the appellant in actuality, bought the privilege of standing in Adolph's stead, that there is no provision for an allowance on such an intangible asset which does not constitute depreciable property within any class prescribed in the *Income Tax Regulations*. Further, Mr. Abramson, the president of the appellant, testified that he was not interested in purchasing the unexpired term of the licences from Adolph's and that the price he would have paid for the assets of Adolph's would have been the same on March 1, 1961 as it was on January 26, 1961. In my opinion, the evidence is conclusive that nothing was paid which is properly attributable to that factor.

The Minister is, therefore, successful in his cross-appeal.

In the result the appeal is dismissed, the cross-appeal of the Minister is allowed, with costs to the Minister throughout and the assessment of the Minister is restored.

Montreal 1967

Feb. 16

Feb. 17

BETWEEN:

TERRA NOVA PROPERTIES LTD. ....APPELLANT;

AND

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

Income tax—Overpayment of tax—Refund—Interest on overpayment —"Interest", meaning of—Whether taxable—Income Tax Act, R.S.C. 1952, c. 148, ss. 6(1)(b), 57(3) and (3a).

Appellant paid tax for 1959 and 1960 as assessed but following an appeal was reassessed in 1963 at a lesser amount and the overpayment was refunded to appellant in 1963 together with interest thereon of $3,290 65 pursuant to s. 57(3) and (3a) of the *Income Tax Act.*

Appellant was assessed to income tax for 1963 in respect of the said $3,290.65 and appealed, contending that the right to a refund did not arise until the reassessment in 1963 and that the $3,290.65 was therefore not "interest" within the meaning of s. 6(1)(*b*) of the *Income Tax Act,* which word in its ordinary significance implied a borrower-lender relationship, a debtor-creditor relationship, or the use of another's property for a period.

Held, affirming the Tax Appeal Board, the $3,290.65 was "interest" within the meaning of s. 6(1)(*b*) of the *Income Tax Act.* Under s. 57(3) interest is payable on an actual overpayment of tax by a taxpayer. The actual amount of tax payable by a taxpayer is a constant amount determined by the substantive provisions of the Act as distinguished from the Minister's assessment of the taxpayer's liability which may be varied by new assessments or judicial decisions.

In *re Farm Security Act, 1944* [1947] S.C.R. 394, per Rand J. at p. 411, applied.

APPEAL from Tax Appeal Board.

Appellant paid income tax for 1959 and 1960 as assessed by the Minister of National Revenue for those two years but objected to the 1959 assessment. The Tax Appeal Board allowed its appeal from the 1959 assessment but an appeal by the Minister from the judgment of the Tax Appeal Board to the Exchequer Court of Canada was allowed by consent of the parties and the 1959 assessment was referred back to the Minister for reconsideration and reassessment. In result appellant was reassessed in 1963 for both 1959 and 1960 and the tax payable by appellant for both those years was thereby reduced from the amount previously assessed, which had been paid by appellant. The overpayment was returned to appellant in 1963 and, in accordance with the provisions of s. 57(3) and (3a) of the *Income Tax Act,* R.S.C. 1952, c. 148, interest on the overpayment amounting to $3,290.65 for both 1959 and 1960 was also paid to appellant in 1963. In assessing appellant for 1963 the Minister included the interest so paid, *viz* $3,290.65, as income under s. 6(1)(*b*) of the *Income Tax Act.* An appeal by appellant to the Tax Appeal Board against the assessment in respect of the $3,290.65 was dismissed by Mr. Roland St-Onge on April 12th 1966 (66 D.T.C. 311).

J. Claude Couture, Q.C. for appellant.

M. A. Mogan and *P. F. Cumyn* for respondent.

JACKETT P. (orally):—This is an appeal from a decision of the Tax Appeal Board which was set down for hearing, and was argued before me, on a stated case.

The appeal raises a single question. That question is whether amounts paid as "interest" under subsection (3) of section 57 of the *Income Tax Act,* R.S.C. 1952, chapter 148, as amended,[1] should be included in computing the recipient's income for the taxation year in which they were received. If this question is answered in the affirmative, the appeal is to be dismissed. If it is answered in the negative, the appeal is to be allowed.

I have perused the reasons given by the Tax Appeal Board[2] for concluding that amounts so paid are "interest" within the meaning of that word in paragraph (*b*) of subsection (1) of section 6 of the *Income Tax Act,* and I should be prepared to dispose of this appeal for the reasons so expressed, with which I agree.[3] However, out of respect

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[1] All relevant amendments were made prior to the taxation year in question, being the 1963 taxation year. The stated case raises the question both when the payment is made under subsection (3) of section 57 read alone, and when payment is made under subsection (3) read with subsection (3a), but it was not suggested that there could be any difference between the two cases.

[2] 66 D.T.C. 311.

[3] I do not find it necessary to express any view on the further ground adopted by the Board that such payments were "income" from "property" within the meaning of those words in section 3 of the Act

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for the argument presented by counsel for the appellant, I propose to outline, in my own words, my reasons for dismissing the appeal.

As a background for so doing, I shall first outline, as I understand it, the scheme of the provisions of the *Income Tax Act* having to do with the determination of the amount of income tax payable and with the payment of income tax.

Even before the end of a taxation year, a taxpayer is usually required to make payments on account of his income tax for that year; for example, by way of deductions at the source (section 47); by quarterly payments (section 49); or by monthly payments (section 50). After the end of the taxation year, the taxpayer is required to file an income tax return (section 44) in which he is required to estimate the amount of tax payable by him for that year (section 45). Thirty days after mailing his income tax return, the taxpayer is required to pay any tax then remaining unpaid (section 51). He is further liable to pay interest at 6 per cent per annum on any part of the tax payable that has not been paid before the expiration of the time for filing his return (section 54).

After a taxpayer has filed his return, the Minister is required to assess the tax payable and to send a notice of assessment to the taxpayer (section 46). The taxpayer is then entitled, by sending a notice of objection, to require the Minister to reconsider the assessment (section 58). After such reconsideration by the Minister, he is entitled to have the correctness of the assessment reviewed, first by the Tax Appeal Board (section 59), then by this Court (section 60), and, ultimately, by the Supreme Court of Canada. When it appears, by virtue of an assessment, that there has been an overpayment of tax, there is provision for refund (section 57(1)). Such a refund may also be ordered by the Court (section 101).

Prior to 1951, while there was the provision to which I have already referred for payment of interest *by* a taxpayer on an underpayment of tax, there was no provision for payment of interest *to* a taxpayer in respect of an overpayment of tax, regardless of the length of time that had elapsed between the time when the taxpayer had paid more than, as ultimately determined, the law required him to pay, and the time that the excess was refunded to him. This situation has now been altered as appears from a reading of subsection (3) and subsection (3a) of section 57, which read as follows:

57. (3) Where an amount in respect of an overpayment is refunded, or applied under this section on other liability, interest at the rate of 3% per annum shall be paid or applied thereon for the period commencing with the latest of

(*a*) the day when the overpayment arose,

(*b*) the day on or before which the return of the income in respect of which the tax was paid was required to be filed, or

(*c*) the day when the return of income was actually filed,

and ending with the day of refunding or application aforesaid, unless the amount of the interest so calculated is less than $1, in which event no interest shall be paid or applied under this subsection.

(3a) Where, by a decision of the Minister under section 58 or by a decision of the Tax Appeal Board, the Exchequer Court of Canada or the Supreme Court of Canada, it is finally determined that the tax payable by a taxpayer for a taxation year under this Part is less than the amount assessed by the assessment under section 46 to which the objection was made or from which the appeal was taken and the decision makes it appear that there has been an overpayment for the taxation year, the interest payable under subsection (3) on that overpayment shall be computed at 6% instead of 3%.

As I have already indicated, on the view that I take of the matter, the only question that needs to be decided to dispose of this appeal is whether "interest" paid pursuant to subsection (3) of section 57 is "interest" within the meaning of that word as it appears in section 6(1)(*b*) of the Act, which reads as follows:

6. (1) Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

. . .

(*b*) amounts received in the year or receivable in the year (depending upon the method regularly followed by the taxpayer in computing his profit) as interest or on account or in lieu of payment of, or in satisfaction of interest;

The contention on behalf of the appellant is that as, even though a taxpayer may have launched proceedings to attack the correctness of an assessment made by the Minister, he is required, after having been assessed, to pay the

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amount of the tax as so assessed; it follows that, having made such payment, he has discharged his tax obligation; and he has no right under the statute to receive anything by way of refund until that assessment has been replaced by an amended or corrected assessment. When the assessment has been corrected so as to show that he has paid too much tax, then, for the first time, according to the contention, he has a right to a refund of the overpayment. During this period, so the contention goes, as the taxpayer has no right to receive any amount, there is no amount in respect of which interest, in the ordinary significance of the word, and therefore in the significance in which the word is used in section 6, can be payable. The contention is further that, in its ordinary significance, "interest" in respect of a period implies that, during that period, there was a borrower-lender relationship, a debtor-creditor relationship, or the use of property (money) belonging to one party by another; and that, clearly, there is under the *Income Tax Act* no such state of affairs during the period in respect of which interest is payable under subsection (3) of section 57.

It must be recognized that the mere fact that a statutory or contractual payment is described in the statute or contract, as the case may be, as "interest" does not determine the question as to whether such a payment is "interest" within the meaning of a provision such as section 6(1)(*b*). See *C. George McCullagh Estate v. Minister of National Revenue*[1] and *Huston & Whitehead v. Minister of National Revenue*[2], per Thurlow J. at page 75, *et seq.* The question must be determined as a matter of substance having regard to the sense in which, properly understood, the word "interest" is used in section 6(1)(*b*). On the other hand, when Parliament has used the same word in two different statutes, it is not unreasonable, in the absence of something to indicate to the contrary, to assume that the word has been used with the same meaning in both statutes. Compare *Westminster Bank, Ltd. v. Riches (H.L.)*[3]. When it is noted that Parliament has here added to the *Income Tax*

[1] [1959] Ex. C.R. 312.
[2] [1962] Ex C R 69.
[3] (1947) 28 T.C. 159.

Act a provision for payments referred to therein as "interest" at a time when this word was already used in section 6(1)(*b*), there is even more justification for assuming that the payment was intended to be a payment of "interest" in the sense in which that word was used in section 6(1)(*b*). The matter may, however, in my view, be decided by reference to the substance of the matter, without relying on any such assumption.

The fallacy that underlies the appellant's contention, in my view, is the failure to distinguish between the actual *amount* of the taxpayer's income tax liability for a particular year as imposed by the substantive provisions of the Act, on the one hand, and, on the other hand, the *determination* of that amount by the Minister's assessment thereof, while it remains in force, by the judgment of the Tax Appeal Board, while it remains in force, or by the judgment of this Court, while it remains in force, or, ultimately, by the Supreme Court of Canada. The actual liability is a constant amount that does not change as long as the facts and the substantive law remain unchanged. The assessed amount as varied by judicial decision, which is the amount which the Minister and all others concerned are bound to assume to be the actual amount of the liability, can change from time to time by virtue of new assessments or judicial decisions.[1]

Once that distinction between the actual amount of the taxpayer's liability[2] and the current assessment of that liability is appreciated, in my view, the problem vanishes.

If the Minister wrongly assesses a taxpayer for an excessive amount of income tax for a year, and if the taxpayer

[1] This effect has been achieved by the drafting device of providing in the *Income Tax Act* (section 139(1)(*ba*)) that "the tax payable by a taxpayer under Part I...means the tax payable by him as fixed by assessment or re-assessment subject to variation on objection or appeal..." and by such provisions as section 51(1), which requires the taxpayer, after the mailing of the notice of assessment, to pay any part of the "assessed tax" then remaining unpaid. See *Davidson v. The King,* [*1945*] *Ex. C.R. 160,* and *Subsidiaries Holding Company, Limited v. The Queen,* [1956] Ex. C R. 443.

[2] Which is, as a practical matter, the amount at which it is ultimately determined.

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pays that amount, the taxpayer has made, as will ultimately be determined, an overpayment of tax in respect of which interest will ultimately be payable.

The overpayment occurs when the excess payment is made. The ultimate decision does not create the overpayment; it merely establishes that there was an overpayment. If this were not so, subsection (3) of section 57 would be of little practical value because, under it, the period in respect of which interest is payable commences not earlier than "the day when the overpayment arose". Moreover, this is the view upon which subsection (3a) of section 57 was framed as appears from the fact that it deals with a situation where the ministerial or judicial decision "makes it *appear* that there *has been* an overpayment".

In my view, the "interest" payable under subsection (3) of section 57 on an overpayment falls within the ordinary meaning of the word "interest" no matter how narrow a definition thereof be adopted. Immediately an overpayment of tax has been made, the taxpayer has a right to obtain a refund of the amount of the overpayment by following the procedures set forth in the Act. The interest in question is in respect of an amount of money that the taxpayer has paid to the Crown by reason of some one's error and that he is entitled to have refunded to him. This clearly falls within the description of interest quoted by counsel for both parties from the judgment of Rand J. in *Re Farm Security Act*, 1944[1]:

> Interest is, in general terms, the return or consideration or compensation for the use or retention by one person of a sum of money, belonging to, in a colloquial sense, or owed to, another.

The appeal is dismissed with costs.

[1] [1947] S.C.R. 394.

HER MAJESTY THE QUEEN

v.

CANADIAN COAT AND APRON SUPPLY LIMITED et al[1]

Montreal 1966 Dec. 12-14

1967 Mar. 9, 14

Combines—Conspiracy to restrain trade in linen towel rental supply business—"Supply", "rental", meaning—Whether a service—Combines Investigation Act, R.S.C. 1952, c. 314, s. 32(1)(c), am. 1960, c. 45, s. 13.

The 22 accused who were in the business of supplying linen towels etc. to customers on a rental basis were indicted under s. 32(1)(*c*) of the *Combines Investigation Act* for conspiring between January 1st 1950 and September 30th 1960 "to prevent, or lessen unduly, competition in the rental or supply in . . . Montreal of . . . towels, uniforms, . . . ". The court found that they did conspire as charged with the object of establishing a virtual monopoly or at least to interfere with free competition in a most substantial or inordinate manner against the public interest, and therefore unduly, by arranging as to prices, allocation of customers, and method of distribution in 85% to 90% of the market for their products which was mainly in Montreal.

Held, the accused were guilty. They did "supply" the products in question within the meaning of that word as used in the *Combines Investigation Act.* "Supply" includes "rental". What the accused did was not a service outside the scope of the *Combines Investigation Act.* The offence was properly described in the indictment (see s. 492(1) and (2) of the Criminal Code).

Container Materials Ltd. et al v. The King [1942] S.C.R. 147; *Rex v. Elliott* (1905) 9 O.L.R. 648; *Weidman v. Shragge* (1912) 46 S.C.R. 1; *Regina v. Abitibi Power & Paper Co Ltd et al* 131 C.C.C. 201; *Howard Smith Paper Mills Ltd et al v. The Queen* [1957] S.C.R. 403; *Regina v. Electrical Contractors Ass'n of Ontario and Dent* [1961] O.R. 265, 131 C.C.C. 145; *Regina v. Crown Zellerbach Canada Ltd* [1955] 5 D.L.R. 27, [1955] 15 W.W.R. 563; *Stinson-Reeb Builders Supply Co et al v. The King* [1929] S.C.R. 276 referred to. *Regina v. Canadian Breweries Ltd* [1960] O.R. 601; 33 C.R. 1; 126 C.C.C. 133 distinguished.

PROSECUTION under *Combines Investigation Act.*

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[1] The other accused are: Canadian Silk Manufacturing Co. (Quebec) Ltd., J. P. Drolet & Fils Ltée, C. E. Durette Ltée, R. Forget Ltée, Hygienic Coat & Towel Supply Ltd., International Linen Supply Ltd., Hector Jolicoeur Inc., J. N. Jolicoeur Ltée, Roger Laverdure Ltée, Maple Leaf Coat & Towel Supply Ltd., The Montreal League of Linen Supply Owners Co., New Ideal Uniform & Overall Supply Inc., New System Towel Supply Co. Ltd., Roy Cleaners Ltd., Sanitary Towel Supply Co. Ltd., Sano-Wrap Towel Service Co. Inc., Toilet Laundries Ltd., J. P. Malo carrying on business under the registered name of A. Malo Enrg, Hyman Seltzer carrying on business under the firm name and style of Modern Supply Co, R. Parent carrying on business under the firm name and style of Parent Toilet Service, M. Levine carrying on business under the firm name and style of Progress Supply Co.

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THE QUEEN
v.
CANADIAN
COAT AND
APRON
SUPPLY LTD.
et al.

Leon Lalande, Q.C., André Villeneuve, Q.C., J. J. Quinlan, Q.C. and *S. F. Sommerfeld* for The Queen.

Maxwell Cohen, Q.C., Philip F. Vineberg, Q.C., A. L. Steen and *Jean Filion* for accused.

GIBSON J.:—The indictment found against these twenty-two accused in this case, eighteen of whom are corporations and four of whom are individuals, to which all pleaded not guilty, reads that they stand charged:

That between the first day of January, 1950, and the 30th day of September, 1960, in the Island of Montreal and elsewhere in the Province of Quebec, did unlawfully conspire, combine, agree or arrange together and with one another and with

Canadian Wiper Corporation,

Central Overall Cleaners and Supply Co. Inc.,

J. Broderick Service Inc.,

Lucien Drolet and Paul-Emile Drolet carrying on business under the firm name and style of *J. P. Drolet & Fils Enrg.,*

J. P. Jolicoeur and Edmond Jolicoeur carrying on business under the firm name and style of *J. N. Jolicoeur Enrg.* and the said *J. P. Jolicoeur* carrying on business under the firm name and style of *J. N. Jolicoeur Enrg.,*

C. E. Pitsiladis carrying on business under the firm name and style of *Maple Leaf Coat & Towel Supply Company,*

Albert Shetzer and Sam Shetzer carrying on business under the firm name and style of *Sano-Wrap Towel Service,*

Albert Béchard,

J. E. Cloutier carrying on business under the firm name and style of *J. E. Cloutier & Fils Enrg.,*

R. Deschatelets,

Nicholas Sapena, carrying on business under the firm name and style of *Imperial Supply Company,*

C. Vorias carrying on business under the firm name and style of *International Linen Supply Company,*

or with some or one of them, to prevent, or lessen, unduly, competition in the rental or supply in the Island of Montreal in the Province of Quebec, of articles or commodities that may be the subject of trade or commerce, to wit, woven towels, uniforms, and related textile products, and did thereby commit an indictable offence contrary to section 32(1)(*c*) of the *Combines Investigation Act.*

This is the first trial of an indictable offence contrary to the *Combines Investigation Act* in the Exchequer Court of Canada since this Court was constituted a Superior Court of Criminal Jurisdiction in 1960 for the purpose of trying certain offences contrary to that Act.[1]

The Criminal Procedure Rules of the *Criminal Code of Canada* in the matters relating to this prosecution were used because no special Exchequer Court of Canada rules concerning the same had been made by the time of this trial pursuant to the enabling power contained in section 87 of the *Exchequer Court Act*[2].

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[1] Section 41A, *Combines Investigation Act*, S. of C. 1960, c. 45, s. 19(1).

41A. (1) Subject to this section, the Attorney General of Canada may institute and conduct any prosecution or other proceedings under section 31 or Part V, except section 33c, in the Exchequer Court of Canada, and for the purposes of such prosecution or other proceedings the Exchequer Court has all the powers and jurisdiction of a superior court of criminal jurisdiction under the *Criminal Code* and under this Act.

(2) The trial of an offence under Part V in the Exchequer Court shall be without a jury.

(3) For the purposes of Part XVIII of the *Criminal Code* the judgment of the Exchequer Court in any prosecution or proceedings under Part V of this Act shall be deemed to be the judgment of a court of appeal and an appeal therefrom lies to the Supreme Court of Canada as provided in Part XVIII of the *Criminal Code* for appeals from a court of appeal.

(4) Proceedings under subsection (2) of section 31 may in the discretion of the Attorney General be instituted in either the Exchequer Court or a superior court of criminal jurisdiction in the province, but no prosecution shall be instituted in the Exchequer Court in respect of an offence under Part V without the consent of all the accused.

[2] Special rules governing the procedure to be followed in criminal prosecutions under the *Combines Investigation Act* may be made by virtue of the enabling power contained in section 87 of the *Exchequer Court Act* in so far as they are not inconsistent with the *Criminal Code of Canada* or any other Act of the Parliament of Canada (See section 424 of the *Criminal Code of Canada*).

Section 88(1) of the *Exchequer Court Act* provides that rules made under section 87 may extend to any matter of procedure or otherwise "not provided for by any Act, but for which it is found necessary to provide in order to ensure their proper working and for the better attainment of the objects thereof".

Section 424 of the *Criminal Code of Canada* specifically enables the Exchequer Court of Canada to make rules of criminal procedure of its own and as stated the only limitation on such power is that such rules be "not inconsistent with this Act or any other Act of the Parliament of Canada".

Section 424 of the *Criminal Code of Canada* and sections 87 and 88 of the *Exchequer Court Act* must be read in the light of section 28(1) of the *Interpretation Act* which judicially interpreted has made the provisions of the *Criminal Code of Canada* both as to substance and procedure applicable to the trial of offences under the *Combines Investigation Act*. By section 2 of the *Interpretation Act*, section 28(1) of the same Act applies

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This would have been a protracted trial, which would not have changed the result, if counsel for the Crown and the accused had not, prior to this trial, agreed to the admissibility without the usual formal proof of many items of evidence.

In this matter, although about 5,000 documents were seized from the various accused and co-conspirators during the investigation prior to the preferment of this indictment, only approximately 767 were tendered and put in evidence at this trial. Counsel for the accused agreed that they could be introduced in evidence without formal proof for all purposes as for example, the origin of such documents, and that copies were proof and the original documents were not necessary, (while making all necessary reservations in respect to materiality and relevancy). And in addition, counsel for the accused, pursuant to section 562 of the *Criminal Code of Canada,* made six admissions of fact (at the same time reserving all proper objections as to relevancy).

The admissions of fact were as follows:

Admission No. 1

That each company or corporation accused or mentioned in the indictment as a co-conspirator is a legal entity with corporate existence and accordingly is a person as defined in the Criminal Code and that each company, corporation or individual accused or mentioned in the indictment as a co-conspirator, during the period covered by the indictment, unless otherwise stated, was engaged in the supplying and servicing of woven towels, and/or uniforms, and/or related textile products, and/or some of them, to persons using and serviced with such products on the Island of Montreal under arrangements whereby title to the said woven towels, uniforms and related products remained in such supplier,

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unless such application is inconsistent with the *Combines Investigation Act,* the *Criminal Code of Canada* or the *Exchequer Court Act.*

In so far as the criminal procedure for finding an indictment in the Exchequer Court of Canada is concerned, it is necessary if any prosecution under the *Combines Investigation Act* is to be taken in this Court in the Provinces of Ontario, Nova Scotia or Prince Edward Island to enact procedural rules concerning same under the enabling power contained in section 87 of the *Exchequer Court Act*—because the *Criminal Code of Canada* provides no machinery for finding an indictment when a prosecution is launched in the Exchequer Court of Canada in any of those Provinces, (see sections 485, 488 and 489 of the *Criminal Code of Canada*); the enactment of rules prescribing the procedure to find indictments in the Exchequer Court of Canada would not conflict with the said referred to provisions contained in section 88(1) of the *Exchequer Court Act,* section 424 of the *Criminal Code of Canada* and sections 2 and 28(1) of the *Interpretation Act.* (c f. also *Regina v. Beaudry* (1967) 50 C.R. 1).

and that:

(a) *Albert Bechard,* carrying on business under the name of *Albert Bechard.* Albert Bechard was a member of The Montreal League of Linen Supply Owners Company for the period covered by the indictment.

(b) etc.

[All other accused and co-conspirators are listed.]

Admission No. 2

That the photographic copies which are described herein are true copies of documents obtained or received by the Director of Investigation and Research under the Combines Investigation Act, the said documents having come from the possession of the accused or co-conspirators on premises used or occupied by them or from Banque Canadienne Nationale and Chesley Printing Co Ltd ; and that the said Director had the photographic copies made from the said documents;

and that Counsel for the accused consent to the production of the photographic copies of the documents bearing the serial numbers listed in the attached list as evidence for the Crown in this prosecution.

a) *Roger Laverdure Ltée:*

1. Documents identified by the stamped code letters EPI followed by the hand-written initials L.P L. (being the initials of Louis Phillipe Landry, of the staff of the Director of Investigation and Research under the Combines Investigation Act), and further identified by serial numbers stamped at or near the bottom right-hand corner, as follows (all serials being inclusive of the first and last number):

2. etc.

[There follows a detail list indicating where all other documents were found and how such are identified.]

Admission No. 3

That each of the persons listed below was an officer, agent, servant, employee or representative of the company listed opposite his name during the period covered by the charge:

[There follows the detail of this.]

Admission No 4

That during the period covered by the indictment, the accused and co-conspirators did, or accounted for, 85 to 90 per cent of the volume of the business on the Island of Montreal of supplying and servicing those woven towels, and/or uniforms, and/or related textile products, and/or some of them, (hereinafter referred to collectively as products) to persons using and serviced with such products under arrangements whereby title to the said products remained in the supplier and servicer who from time to time picked up from such users soiled products which were replaced with clean products.

Admission No. 5

The accused by their respective counsel, without admitting that such acts constitute an offence under the Act, admit that from the 1st day of

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January, 1950 to the 30th day of September, 1960, in the Island of Montreal and elsewhere in the Province of Quebec did arrange together and with one another and with

(names of co-conspirators)

or with some or one of them, to prevent or lessen competition in the operation of their respective business (by arranging among themselves in respect of prices to be charged to their customers and in respect of customers) in the Island of Montreal in the Province of Quebec, which consisted in providing their customers with a continuous flow on a weekly, semi-weekly or daily basis of freshly cleaned, ironed, pressed, folded and ready-to-use linens, towels, uniforms and related textile products picked up and delivered regularly.

Admission No. 6

That Counsel for the accused admit that the documents attached to this admission come from the possession of the accused or co-conspirators and consent to their production as evidence for the Crown in this prosecution.

Instead also of calling certain expert witnesses for the purpose of describing the linen supply industry in Montreal and in the Province of Quebec in relation to its customers, and also the concept of a market generally, and the alleged relevant market of the subject linen supply industry, and subject to the objections of the Crown counsel as to the relevancy of parts of it, there were filed Exhibits D-1 and D-2 by the accused; and in like manner, on consent also, in rebuttal to Part IV of Exhibit D-1 instead of calling an expert witness to give such testimony, the Crown introduced Exhibit 6, the purpose of which it submitted was to answer certain economic opinion evidence contained in Part IV of Exhibit D-1, and especially in relation to the alleged particular market sought to be established by the facts adduced in this case.

In addition, certain verbal evidence as to market was adduced by the accused in defence.

As the jurisprudence clearly indicates, the purpose of the legislation, which this indictment alleges the accused violated, is to protect the public interest in "free competition". (See Duff C.J.C. in *Container Materials, Ltd. et al v. The King*[1]).

This judicial concept of "free competition" has a meaning which is not precisely equivalent to any other concept employed and understood by various experts in the social

[1] [1942] 1 D.L.R. 529 at p. 533.

sciences and other experts in their respective fields, as will be discussed later in these Reasons.

The test of illegality is injury to the public interest. But such injury relates only to the extent that the public interest in "free competition" is or is likely to be interfered with.

And the public interest in "free competition" is sought to be protected by the Courts in Canada by relying on the market to give the kind of business performance considered desirable.

Therefore, the structure of markets in Canada must be such as to enforce acceptable competitive behaviour. In other words, there must be limits to the permissible degree of market power or bargaining power in any individual or group of individuals.

And the determination by a Court in Canada of whether or not a conspiracy (combination, agreement or arrangement) has as its object the prevention or lessening of competition in any particular market "unduly", within the meaning of section 32(1)(*c*) of the *Combines Investigation Act*, is a question of fact. (*See Rex v. Elliott*[1]; *Container Materials, Ltd. et al v. The King*[2]).

The legislation prescribing the offence charged in this case came into force on August 10, 1960.

Prior to that date, the prohibition against conspiracy in restraint of trade was prescribed in section 411 of the *Criminal Code of Canada* and its predecessor sections. In addition, prohibitions against combines by way of combination in restraint of trade were prescribed in sections 2(*a*) and 32 of the *Combines Investigation Act*. But, on August 10, 1960, section 411 of the *Criminal Code of Canada* ceased to be law and with minor amendments to its wording, it became section 32(1) of the *Combines Investigation Act* and it replaced the former combination provisions in the said Act.

The combination, prior to August 10, 1960, prohibited by sections 2(*a*) and 32 of the *Combines Investigation Act*, was a prohibition in essence against conspiracy or an offence which had such characteristics that the conspiracy principles were applicable.

[1] (1905) 9 O.L.R. 648, Osler J.A., at p. 661.

[2] [1942] 1 D.L.R. 529, Kerwin J., as he then was at p. 539.

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Section 32(1) in the present Act by its express words, prohibits any conspiracy, combination, agreement or arrangement in undue restraint of trade.

The relevant law which must be considered in relation to the offence charged in this case, sufficient for the purpose of this case, as I understand it, may be briefly stated in this way:

Specifically, the accused stand charged with a breach of section 32(1)(*c*) of the *Combines Investigation Act* which subsection reads:

> 32. (1) Every one who conspires, combines, agrees or arranges with another person
>
> . . .
>
> (*c*) to prevent, or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of an article, or in the price of insurance upon persons or property, or
>
> . . .
>
> is guilty of an indictable offence and is liable to imprisonment for two years.

It is a statutory defence if a conspiracy, combination, agreement or arrangement relates only to one or more of the following, namely, as recited in section 32(2):

> 32. (1) . . .
>
> (2) Subject to subsection (3), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to one or more of the following:
>
> (*a*) the exchange of statistics,
> (*b*) the defining of product standards,
> (*c*) the exchange of credit information,
> (*d*) definition of trade terms,
> (*e*) co-operation in research and development,
> (*f*) restriction of advertising, or
> (*g*) some other matter not enumerated in subsection (3).

The matters enumerated in subsection (3) are, namely:

> 32. . . .
>
> (3) Subsection (2) does not apply if the conspiracy, combination, agreement or arrangement has lessened or is likely to lessen competition unduly in respect of one of the following:
>
> (*a*) prices,
> (*b*) quantity or quality of production,
> (*c*) markets or customers, or
> (*d*) channels or methods of distribution,
>
> or if the conspiracy, combination, agreement or arrangement has restricted or is likely to restrict any person from entering into or expanding a business in a trade or industry.

Subsections (4) and (5) of section 32 are not relevant to this case.[1]

In essence, section 32(1)(*c*) of the Act prohibits conspiracies in restraint of trade, which if carried into effect, would prevent or lessen competition unduly; and again it is the public interest in "free competition" only that is relevant in the determination of whether or not the prevention or lessening agreed upon is undue so as to constitute an offence.

The evidence to prove such an offence usually consists of proof of a "device" or "devices"[2] that the parties to an agreement contemplate employing. The Court, in most cases, is called upon to weigh the intended effect of the "device" or the cumulative effect of all the "devices" that the parties to an agreement contemplate employing, and decide whether or not beyond a reasonable doubt the object of the agreement was to prevent or lessen competition "unduly", and so violate the subsection of the said Act.

Proof only of employment by the parties of one or more of the "devices" listed in section 32(2) does not constitute

[1] It is also provided that even a case of a conspiracy in respect of which section 32(2) does not provide a defence, that the Court shall not convict if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada. This is provided in section 32(4) which reads as follows:

32. . . .

(4) Subject to subsection (5), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada.

And finally, the defence afforded by section 32(4) is not available in the circumstances described in section 32(5) which reads as follows:

32. . . .

(5) Subsection (4) does not apply if the conspiracy, combination, agreement or arrangement

(*a*) has resulted or is likely to result in a reduction or limitation of the volume of exports of an article;

(*b*) has restrained or injured or is likely to restrain or injure the export business of any domestic competitor who is not a party to the conspiracy, combination, agreement or arrangement;

(*c*) has restricted or is likely to restrict any person from entering into the business of exporting articles from Canada; or

(*d*) has lessened or is likely to lessen competition unduly in relation to an article in the domestic market.

[2] This is the word frequently used in the cases. See e.g. Idington J., at p. 25 in *Weidman v. Shragge* (1912) 46 S.C.R. 1.

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an offence, but the enactment of that subsection makes it clear that in some circumstances, except for that subsection, proof of the agreement of parties contemplating the employment of one or more of those "devices" might be proof that those parties had as their object the prevention or lessening of competition unduly so as to constitute an offence.

By reason of section 32(2)(*g*), however, (which provides that it is not an offence if the "device" contemplated being employed (and also, in some cases employed), relates only to some other matter not pertaining to prices, quantity or quality of production, markets or customers, or channels or methods of distribution, or if the conspiracy, combination, agreement or arrangement has not restricted, or is not likely to restrict any person from entering into or expanding a business in a trade or industry), it follows that as the statute now reads since the 1960 amendment, proof of any of the "devices" which are contemplated being employed (and also, in some cases, the employment of any of them), by parties to a conspiracy, combination, agreement or arrangement so as to constitute an offence under section 32(1)(*c*) must relate to one at least of the following: "(*a*) prices, (*b*) quantity or quality of production, (*c*) markets or customers, (*d*) channels or methods of distribution," and (*e*) if it does not relate to any of the "devices" listed in section 32(2)(*a*) to (*g*) and section 32(3)(*a*) to (*d*) of the Act, then it must be proven that the parties have contemplated employing (and, in some cases, employed) some other "device" which has as its result, that "the conspiracy, combination, agreement or arrangement has restricted or is likely to restrict any person from entering into or expanding a business in a trade or industry".

In assessing the quality and quantity of the evidence adduced for the purpose of establishing whether or not a particular agreement or conspiracy contemplates (or, also has as its effect in the relevant cases), the prevention or lessening of competition unduly within the meaning of section 32(1)(*c*) of the *Combines Investigation Act*, it is the meaning of the words "prevent", "lessen", "unduly" and "competition", as they have been determined by the Courts, only, that is relevant.

"Prevent" and "lessen" do not mean "extinguish". (*See Regina v. Abitibi Power & Paper Co. Ltd et al*[1].) Also, "prevent" is used in a sense of "hinder" or "impede". "In the French version the word is 'prévenir' which is also commonly used in the sense of 'empêcher'. In this sense the word 'unduly' is appropriate in connection with both 'prevent' and 'lessen'." (See *Howard Smith Paper Mills Limited et al v. The Queen*[2].)

"Unduly" is not a word of art and must be applied in all cases in its meaning as a word of the vernacular. It is not restricted in its application to those agreements only, which if carried into effect would give the parties to it the power to carry on their business virtually without competition, that is virtual monopolization situations. Instead, there are cases in violation of the law in which the object (or, in relevant cases, effect) of the agreement or conspiracy was not the quantitative prevention or lessening of competition to the point of a virtual monopolization situation. These latter cases are also within the statutory prohibition, as it was so succinctly put per Laidlaw J.A., in *Regina v. Electrical Contractors Association of Ontario and Dent*[3] (adopting the words of Manson J., in *Regina v. Crown Zellerbach Canada Limited*[4]) *viz*, "There are no words in the statute which put the Crown under the onus of proving a monopoly or virtual monopoly. I cannot subscribe to the proposition tha tany such onus rests upon the Crown.".

"Competition" in the cases under section 32(1)(*c*) of the *Combines Investigation Act* (and the predecessor sections and also predecessor alternative sections in the *Criminal Code of Canada*), as stated, is equated by the Courts with "free competition".

The question of fact in any particular case as to whether or not the agreement by the parties contemplates interference to prevent or lessen competition "unduly" (or, in relevant cases, also has that effect) in this meaning, (being one for the jury in jury trials and one which the Court without a jury must answer after properly instructing itself

[1] 131 C.C.C 201 Batshaw J., at pp. 251-52.
[2] [1957] S C R 403 Kellock J.
[3] 131 C.C.C. 145 at pp. 159-60.
[4] [1955] 5 D.L.R. 27 at p. 33.

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as to the law) is one which in all restrictive trade cases perhaps should be addressed to the hypothetical reagent appropriate to such cases.

In negligence cases, the appropriate hypothetical reagent is equated with the "reasonable man". That is the standard.

In patent cases, the appropriate hypothetical reagent is equated with the "person skilled in the art or science to which it appertains or with which it is most closely connected". (See section 36(1) of the *Patent Act*). In such cases also, the Courts have sometimes applied a standard for such a hypothetical person in determining whether or not an invention exists by asking whether it is or is not "beyond the expected skill of the calling" or "beyond the skill of the routineer".

In negligence and patent cases the standard of proof is that required in a civil case namely, more probable than not or the preponderance of believable evidence, whereas in restrictive trade cases such as this, the legal standard of proof is beyond a reasonable doubt. But other than that, there is no difference in respect of the question put to the respective hypothetical reagents in any of these cases.

In restrictive trade cases, the norm or standard of what is "due" will vary from case to case, being dependent on what degree of "market power" is proven by the evidence adduced.

(The "market power" referred to means the ability of one or a group of businessmen in a particular market at a particular time to control it.)

In Canadian jurisprudence there has not been established a hypothetical reagent in restrictive trade cases such as this; but perhaps the hypothetical reagent in cases under section 32(1)(*c*) of the Act should be equated with the respective norm or standard applicable to a person competing in each such respective category of market power in which none have conspired, combined, agreed or arranged with another person.

In any event, the question of fact that the Court has to decide in each case is whether or not the object of the subject conspiracy or agreement (or, in relevant cases, also the effect) is undue prevention or lessening of competition, in violation of the statute.

Idington J., in *Weidman v. Shragge* (*supra*)[1] commented on the difficulty the court has in obtaining the necessary facts and opinions to adjudicate correctly in restrictive trade cases saying "that the requisite knowledge of the social and commercial forces shaping the social structure does not lie in the daily path of the lawyer's life and that it cannot be well supplied by expert evidence".

Now, to digress, for the purpose of relating judicial concepts to the concepts used by economists and others who discuss and deal in restrictive trade cases such as this, three things are said:[2]

Firstly, some of the expressions, as I understand them, that are so used by economists and certain other persons, may be mentioned.

1. "Monopoly" means control over the supply and therefore over price; or exclusive possession of the trade in some commodity.

2. "Pure competition", a term frequently used by economists, means to them a situation in which no seller or buyer has any control over the price of his product—a fictitious situation.

3. The intermediate ground between "monopoly" and "pure competition" is sometimes broken down into

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[1] Page 20: This being a criminal statute we must try to find the vicious purpose aimed at in order to bring parties within its prohibitions

Page 21: The test must in each case be the true purpose and its relation to the activities specified in and by the words of the statute and a finding of an evil or vice answering to the descriptive word "unduly".

Pages 26-7: We must assume that an Act such as this is not placed on the statute book for an idle purpose. Its operation must not be minimized simply because of difficulties in the way of enforcing it. Its purpose is to crush out of existence an evil. Its success, if any, must depend on its administration. Its great risk of failure lies in the fact that the requisite knowledge of the social and commercial forces shaping the social structure does not lie in the daily path of the lawyer's life, and that it cannot be well supplied by expert evidence.

I desire to guard against the impression that each of many of the devices I have referred to by way of illustration, and others of a like kind that do exist, must necessarily be obnoxious to the Act. It is the purpose to which they may be put that is the test. If that purpose be to bring about what the Act is designed to frustrate, it is vicious. My endeavour herein is to point the attitude to be taken and the path or way to ascertain and identify in the concrete an evil which is incapable of concise and accurate definition.

[2] Chamberlin: *The Theory of Monopolistic Competition,* Harvard University Press, 1960.

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three categories, namely, (i) "duopoly",—where there are two sellers, (ii) "oligopoly",—where there are a few sellers, and (iii) "monopolistic competition".

4. "Monopolistic competition" is a category of market as described by economists. Monopoly and competition are not mutually exclusive alternatives. The actual situations in Canada are typically a combination of the two—composites of both competition and monopoly—called by economists, situations of "monopolistic competition".

Such is not only a matter of numbers in a market but also relates to differentiation of product.

Illustrative of the latter is that commodities are differentiated partly by their very nature, and partly in response to differences in buyer's tastes, preferences, locations, etc., and this is true not only within any broad class of product but also between one class of product and another. Heterogeneity from these causes is vastly increased by businessmen under "free enterprise" in their efforts to distinguish their commodity from others and to manipulate the demand of it through advertising. In other words, an essential part of free enterprise is the attempt of every businessman to build up his own monopoly, extending it whenever possible and defending it against the attempts of others to extend theirs.

But, it is only the restrictive agreements, conspiracies, etc., arising out of the former (the matter of numbers in a market—and in the typical "monopolistic competition" market that is usually the subject of a restrictive trade prosecution, there are relatively many) which are designed to increase the participants' own bargaining or market power in a particular market which interfere with "free competition" judicially defined that the Courts are concerned with in restrictive trade cases such as this.

Secondly, a rudimentary classification often used by economists, distinguishing markets according to number of sellers and whether or not their products are differentiated, as I understand it, may also be mentioned:

1. Markets with many sellers:
   (*a*) Pure competition,
   (*b*) Monopolistic competition.
2. Markets with few sellers:
   (*a*) Pure oligopoly,
   (*b*) Heterogeneous oligopoly.
3. Single-firm monopoly.

"Free competition" as understood by the Courts is not identified with "pure competition" as meant by economists as defined above. Instead, it is identified with "monopolistic competition" as meant by economists.

The typical and most frequent outcome of "free competition" in fact in Canada, is such "monopolistic competition".

And, in a typical case and in the majority of cases under section 32(1)(*c*) (and predecessor sections) which have arisen, the subject category of market power was monopolistic competition as so described. But that is not to say that cases have not arisen and will not arise where the category of market power was, and will be, oligopoly.

However, putting a label on the relevant category of market power in any case for decision is not important. What is important is the establishment in evidence of whether or not the object of the conspiracy or collusive agreement (or, in any relevant case, also the effect) was to deviate from the norm or standard in the subject market, in violation of the statute.

"Free enterprise" in a condition of monopolistic competition as described, may lead to agreements or conspiracies and to various associative action between firms or individuals. Such agreements or conspiracies may interfere with "free competition" as judicially understood, and in any event, are clearly monopolistic as understood by economists; and if the parties to such contemplate the employment of any of the "devices" referred to in section 32(3)(*a*) to (*d*) of the Act—or in addition, (as in concluding words of that subsection), in a manner that is contrary to section 32(1)(*c*) of the Act, the parties to any such agreements or conspiracies are liable to be indicted.

"Free competition" as judicially understood, affirmatively may be stated, as a situation in which the freedom of

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any individual or firm to engage in legitimate economic activity is not restrained by (1) agreements or conspiracies between competitors, or (2) by predatory practices of a rival, contrary to the *Combines Investigation Act.* And "free competition" thus understood is quite compatible with the presence of monopoly elements, as understood by economists, in the economic sense of the word monopoly, for the antithesis of the economic conception of monopoly is not "free competition", as understood by the Courts, but "pure competition".

Thirdly, it is not monopolistic power as an analytical concept but monopolistic power in its collusive aspects in a particular market as described, injurious to the public—against the public interest that is the issue in a restrictive trade case such as this; or putting it another way, such monopolistic power against the public interest, in the cases, has been considered by the Courts as the antithesis of "free competition".

The elements out of which the Courts have built their ideas of such monopolistic power are: (1) restriction of trade, and (2) control of the market. These elements are not independent.

But in cases under section 32(1)(*c*) of the Act (and the predecessor sections in the Act and in the former alternative section in the *Criminal Code of Canada*), although there are references to control of the market as evidence of monopolistic power, (in its collusive aspects in a particular market as described) the Courts in Canada have focussed their attention, in the main, on the other element, restriction of trade, as the decisive consideration.

The sources of evidence of control of the market have however, been known. They are for example, the behaviour of prices and outputs, the relation of prices and costs, profits before and after the combination share of market controlled, existence of business practices such as price discrimination, price stabilization, etc.

But, notwithstanding this, the Courts in Canada when they have found monopolistic power (in its collusive aspects in a particular market as described) or an attempt at such monopolistic power in breach of section 32(1)(*c*) of the *Combines Investigation Act* (or any of the prececessor sections or former alternative provision in the *Criminal Code*) have not meant, in the main, control of the market, but restriction of competition; or in other words, whatever is the public interest that has been interfered with resulting from monopoly in said collusive aspects (i.e., a monopolistic situation or an attempt to monopolize), has been evidenced to the Courts in Canada, in the main, by a limitation of "free competition".

So much for the concepts used by economists and others, and their relation to judicial concepts.

In the restrictive trade cases of the subject type which have been decided by the Supreme Court of Canada all have been of the class of cases where the object contemplated by the particular conspiracy or agreement was the virtual elimination of competition—a virtual monopolization situation; and in each the *per se* rule was applied.

And the said 1960 legislation retained the *per se* rule.

The alternative to the application of the *per se* rule is the application of what is sometimes called the rule of reason.

The application of the *per se* rule involves a presumptive conclusion that a specified course of action is in violation of the law, and therefore it carried with it a refusal to examine the effects. And the rule is predicated on the premise that the facts established in the evidence, that is the market situation or course of conduct complained of, permit a legitimate inference as to effects.

The application of the rule of reason requires an examination of the actual and probable effects of an alleged violation in order to determine whether in fact a violation has occurred. In other words, where this rule is relevant from the evidence and analysis as to the economic significance on the market of a course of action, the determination is made as to whether or not there has been a violation of the law.

The difference between the application of the *per se* rule and the application of the rule of reason is essentially therefore, a difference in the detail of evidence required in establishing a deviation from a standard or norm in order to permit an inference concerning effects.

But it should be noted (in relation to this understanding of the Courts that the public interest is what must be protected), that the difficulty in inferring economic effects from market situations or business practices lies in the fact that in a given case, in determining whether or not the

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public interest is being protected, that there may be two kinds of effects, namely (i) excessive market power concentrated in the hands of a relatively small group, and (ii) efficiency. This is so because on the one hand from our competitive free enterprise system there is expected a set of powerful motivations and drives towards increased output, product improvement and cost reduction, or putting it in general terms, towards increased efficiency in the use of resources. On the other hand, from the competitive system, also, there is expected a set of effective limitations to the growth of private economic power.

In certain cases, therefore, there may be these two kinds of effects, namely, efficiency and power—the one to be encouraged and the other to be rejected. And since both these aims are important, it is essential that the Courts serve and protect the public interest by keeping both.

The subject type of Canadian restrictive trade cases may be divided into two categories:

Firstly, there is the category of cases in situations where the object of the conspiracy, or agreement contemplated that competition be completely or virtually eliminated —that is virtual monopolization situations (See *Weidman v. Shragge* (*supra*); *Stinson-Reeb Builders Supply Company et al v. the King*[1]; *Container Materials, Limited et al v. The King*[2]; and *Howard Smith Paper Mills Limited et al v. The Queen* (*supra*)).

Secondly, there is the category of cases in which the object contemplated was something less than virtual monopoly, but in which on the respective facts of which cases, the Courts are able to reach a conclusion of undue interference with competition in violation of the statutory provision. Two examples of cases in this category are: *Regina v. Electrical Contractors Association of Ontario and Dent*[3]; *Regina v. Abitibi Power and Paper Limited et al.*[4] (The Court in both these cases held the Crown had proven that the object of the conspiracies was to prevent or lessen competition unduly in violation of the law, even though it was not proven that the conspirators had as their object a virtual monopolization situation. Laidlaw J.A., (as previously quoted) in the former case described why this second category of cases was contemplated by the statute when he

[1] [1929] S C R. 276.
[2] [1942] S.C.R. 147.
[3] [1961] O.R. 265.
[4] 131 C.C.C. 201.

used and adopted the words of Manson J., in *Regina v. Crown Zellerbach Canada Limited*[1], *viz*: "But there are no words in the statute which put the Crown under the onus of proving a monopoly or virtual monopoly. I cannot subscribe to the proposition that any such onus rests upon the Crown."[2])

In cases which fall within this second category of cases, the question of "unduly" or not, must be resolved case by case in the light of the particular evidence.

But in all cases, the justification for convictions of any alleged violations of section 32(1)(*c*) of the Act of course must always depend on valid inference beyond a reasonable doubt from proof of the facts adduced in evidence. Again, the effects sought to be inferred from the proof of such facts have to do, on the one hand with market power or limitation of competition, and on the other hand with efficiency.

So much for the relevant law, as I understand it.

The defence, other than the general defence in the plea of not guilty raises four specific defences, namely: that

1. the conspiracy in this case did not have as its object the prevention or lessening of competition unduly and did not "unduly" prevent or lessen competition;
2. the parties at all material times carried on business in a "service" industry which is not within the purview of section 32(1)(*c*) of the Act;
3. the category of "rental", as charged in the indictment and as mentioned in section 32(1)(*c*) of the Act, did not become a category in that subsection until August 10, 1960 and, therefore, although the accused are charged with conspiring within the period of over ten years from January 1950 to September 30, 1960, the charge in so far as it is predicated on finding "rental"

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[1] (1955) 15 W.W.R. 563 at p. 570.

[2] In this connection, with respect, the opinion of McRuer C J.O., as he then was, in *Regina v. Canadian Breweries Ltd.* [1960] O.R. 601; 33 C.R. 1; 126 C.C.C. 133 would not appear to be correct.

In any event, that was a case where the accused was alleged to be a party, or privy to, or knowingly to have assisted in the formation or operation of a combine within the meaning of the *Combines Investigation Act*, to wit a merger, trust or monopoly. It had nothing to do with a charge of conspiring to prevent or lessen unduly competition.

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as an essential ingredient of the offence, is limited to one month and twenty days of the period alleged in the indictment;

4. the indictment does not describe the offence charged.

In brief, the evidence in chief was directed to establishing that the following devices were contemplated being employed and were employed by the accused, namely:

1. that there was agreement on prices;
2. that there was agreement on customers;
3. that the accused formed an organization called the Montreal League of Linen Supply Owners Company for the purpose of assisting in implementing the objects of their conspiracy; and it was most elaborate and effective, and it caused the inforcement of its rules on its members;
4. that collusively through the said League, also in furtherance of the objects of the conspiracy, there was acquisition of independent and other suppliers, and so control and abridgment of channels of distribution;
5. and that also in furtherance of the objects of the conspiracy, collusive efforts were made to eliminate independent suppliers in the industry who were not members of the said League.

The linen supply business in the Montreal area, speaking generally, during the material time, consisted of providing customers with cleaned, ironed, pressed and ready to use linen towels and other articles mentioned in the indictment, on a regular basis. The total yearly volume of revenue obtained by persons in the linen supply industry in Montreal during 1961 for example, amounted to about 13 million dollars of which the persons indicted (who also were members of the Montreal League of Linen Supply Owners Company) accounted for about 11 million. During the period covered by the indictment, namely, 1950 to 1960, the total revenue in this business was generally in escalation but it is a fair conclusion to state that during the whole of the relevant period the business was most substantial. During the period covered by the indictment according to Admission No. 4 the accused and co-conspirators did or accounted for 85 to 90% of the volume of this business on the Island of Montreal.

In 1950, there was incorporated by Letters Patent the corporation known as the said Montreal League of Linen Supply Owners Company. Only two of the 22 accused were not members of it in 1950 and all 22 accused were members in 1960.

The business of the members of the said Montreal League of Linen Supply Owners Company, at all material times, was not unduly concentrated in any single firm. The largest firm had approximately 10% of the total market. The next three or four firms each did about 7% of the volume of the League members' business. After the four or five largest firms, the shares of the market of individual companies diminished to about four or five per cent each. The contributions of individual one truck members was almost minimal.

In 1950, the members paid dues to this League in the sum of $10 per truck per month that each operated. In 1954, the fees charged were increased to $15 per truck per month, and in 1959 the fees were a minimum of $30 per truck per month with some other provisions for setting the fees. This resulted in the Montreal League of Linen Supply Owners Company having at various times substantial monies in the bank. For example, at one time in 1960, the amount in its bank account was $41,880.

This League adopted elaborate and coercive rules to govern its members. The rules are set out in Book I, page 2356 and following, of the documentary evidence filed as exhibits. The recital spelling out the reasons these rules were made, states that the Montreal League of Linen Supply Owners Company, having been formed as a corporation not for profit under the *General Corporations Act* of Quebec had as its purpose or purposes as follows, *viz.*, "to enable the members to act in unison in an effort to improve the general conditions of our industry and to promulgate and inculcate the principles of public service. Therefore, we have adopted and voted the following as a code of regulations for its Government".

There are then set out 18 rules which read:

RULE 1 "STANDARDS".

The purpose of this Association is directed to the end that the greatest possible degree of quality, efficiency and sanitation shall be maintained at all times by its membership.

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The following rules presume that all members of this Association furnish a reasonably good quality of goods, properly washed, ironed, mended and delivered to the customer in good order at the time and place mutually agreed upon. Any member found to maintain standard which reflect adversely upon the members of this Association for the Linen Supply Industry shall be called before the Board of Directors to show cause why it should continue to enjoy the advantages offered under these rules.

RULE 2 "RESPONSIBILITY".

Every member shall be held strictly responsible and accountable for all acts of his agents and employees in the solicitation of and or in the securing of business during the period of service of each employee or agent.

RULE 3 "TERMS AND DEFINITION RE NEW ORDERS".

An individual, Firm or Corporation, opening a business for the first time, or opening a branch of same, shall be considered as a "New Order" and all members shall be privileged to solicit same, subject to terms and conditions as hereinafter provided. A bona fide or valid "New Order" is an order for Linen or Towel Service secured from the customer in a fair and ethical manner, in accordance with the spirit and intent of these rules and in all other regulations of this Association, without misrepresentation, undue pressure, price or other concessions or other special inducement of any kind. Any supplier found taking "New Accounts" by price cuttings, gifts, money or any under handed method, such supplier will be heavily penalized; the penalty to be decided by the President and his Committee and such supplier cannot supply said customer. However a maximum of $15.00 is to be allowed new customer for advertising or flower.

RULE 4 RE "LOST CUSTOMER".

The supplier has 30 days to notify the Secretary re "Lost Linen Account" and 60 days to notify the Secretary on customer's own Washing Accounts. Any supplier who takes a customer from another supply member will have to give back this customer within 30 days after he has been notified by the Committee or a customer to the satisfaction of the supplier that lost the account. If this supplier does not settle this account within 30 days, he will be responsible to pay a minimum of $50 00 to $100 00 to the dollar of weekly collection Until this settlement is reached, 25% of the collection of the said customer is to be paid to the supplier that lost this account. Under all circumstances, the Committee will decide the validity of the claim and the settlement. To establish the amount that the supplier had taken from the other supplier, it is understood that he will take the value in the proportion of a 4 week collection of the previous supplier or the future 4 weeks service whichever is the greater. However, special cases will be brought before the Committee for their decision.

RULE 5 "TEMPORARY CLOSING AND SUSPENSION OF SERVICE".

A) Temporary closing of a customer's business establishment for the purpose of making alterations, repairs, etc, shall not affect the interest of the member serving this customer, provided there shall be no change of ownership of the business during the period of time in which the customer's establishment shall have been closed. Should there be a change of ownership during this period, this customer may become a "New Order" on the terms and conditions as hereinafter described.

B) Terms for temporary closing or suspended service shall be limited to a 3 month period from the date that service is suspended except in the case of season stops wherein this rule does not apply. Member companies must register with the Office of the Association, notice of temporary closing or suspension of service within 15 days after last delivery, in order to protect their interest in such customer.

C) Should a member's customer be compelled to temporary [*sic*] discontinue business due to a fire, this customer shall be deemed a closed order for a period of 3 months. However, letters of renewal must be made in order to protect his interest in the customer.

RULE 6 "SUPPLIER LOSING PART OF AN ACCOUNT".

In a business where two owners are operating, for example a grocer and a butcher, and if one buys the other and continues to own and operate both business [*sic*] and this proprietor wishes to be served by only one supplier where two are serving, supplier that keeps this customer will have to give back a customer of the same value to the supplier that lost his part. However the supplier that loses the customer must be satisfied.

RULE 7 "CONCESSIONS".

A) Club Concessions as defined: any Club, Eating Place or Drinking Place that comes under the jurisdiction of the Liquor Commission is considered the customer of the lessee.

B) Department Store and Industrial Plants & Institutions (1958) Concession as defined. Concessions are open to all for new business upon there being a change.

C) Grocer & Butcher Store Concession as defined: one customer, the rightful customer being the lessee.

D) Drug Store Concessions and Fountain as defined: the lessee being the customer.

GENERAL SUMMARY—The lessee is the customer whether he partitions off or leases out part of his store where there is one door.

RULE 8 "MERGING".

In the event of a merge of two companies where one supplier loses and another gains, the adjustment is to be left to the discretion of the Investigating Committee. Their decision will be final.

RULE 9 "SEASON STOP".

A) A business suspending its operation during a portion of each year shall be considered a "season stop".

B) Temporary closing of a "season stop" shall not affect the interest of the member serving, provided that there shall be no change of ownership or lessor. Should there be a change of ownership or lessor during the period of suspended service, the customer shall be deemed a "new order".

RULE 10 "EMPLOYEE CLAUSE".

It is clearly understood that no Linen Supplier will engage an employee of another Linen Supplier without the consent of the Linen Supplier losing the employee.

RULE 11 "NON MEMBERED COMPANY".

A) No member of the Association shall purchase, sell or merge with a "non membered Company" in the Linen Supply Business unless such purchase, merge or consolidation shall first be sanctioned by the Board of Directors of this Association.

B) Territory or areas in which this rule shall apply shall be decided by the Board of Directors of this Association when and if such situation shall arise. The decision of the Board of Directors shall be final.

C) The same clause also apply [*sic*] to the Overall Trade.

RULE 12 "LOSING CUSTOMERS TO NON MEMBERS"

A member supplier losing a customer to a supplier outside the Association, the said member may report this loss to the Association. If any member has enough influence to take back this customer, then such losing supplier should be compensated at the discretion of the Committee. Time limit 6 months.

RULE 14 "RE VOTING".

Each Company shall have only one vote, irrespective of the number of people of said Company attending meetings or the number of trucks they pay for.

RULE 15 "CHAIN OPERATIONS".

A) Chain Operations shall consist of 8 (6—Oct/58) operations or more under the same ownership.

B) In the case of a new Branch, the signature of a Branch Manager shall not be recognized. It must be an authorized Purchasing Order by the Purchasing Department of that Chain Operation.

C) When one member shall have install his service in 8 or more operations of a Chain, he may then register the Chain with the "Secretary". The Secretary shall ascertain the name of members at that time serving the Operation. They shall thereafter control the prices of that Operation and shall be entitled to quote on any New Branch of that Operation whatever Chain Prices they agree on.

D) When it becomes advisable to lower prices to registered Chain Operation to below the price list, the Secretary shall call a meeting of all members then serving that Chain. At this meeting such members shall decide upon the price changes.

RULE 16 "REGISTRATION OF NEW CUSTOMERS".

A motion made by Roger Laverdure re Registration of New Customers and seconded by Norman Rill, that any supplier getting a new customer send a letter to the Secretary or to a specified person, and stating the name and address of said customer, the date the order was taken and the reference bill or contract number. Those in favour please raise your hands. Approved by Roger Laverdure, George Jolicœur of R. Forget, Edmond Jolicœur of J. N. Jolicœur, Lionel McKay of Toilet Laundries, H. Sacks of Central Overall, Lucien Drolet of Lucien Drolet & Fils, Mr. Parent, Mr. Nelson Lothrop of Sherbrooke Laundry, C. Lebrun of H. Jolicœur, Edgard Patenaude of New Ideal, Van Pitsladis of Maple Leaf Coat & Supply. S. Yaffe of New System abstained from the vote. It is further agreed that when a contract is obtained and a letter is sent in to the Secretary, it is not necessary to leave any goods in that particular customer's business. It is clearly understood that this particular signed order must be a recognized authority of said establishment such as the Proprietor or Manager.

RULE 17 "UNFAIR TRADE PRACTICES".

The Board of Directors of this Association reserve the right to decide what shall be considered as unfair trade practices, when and if such situation shall develop by any active members of this association.

RULE 18 RE "CONVERSION OF WASHING ACCOUNTS TO LINEN OR INDUSTRIAL ACCOUNTS".

A) It is clearly understood that no supplier will convert a washing account belonging to any member; only the supplier that has done the washing for this customer has the privilege.

B) First registration to the Secretary's Office will give that supplier priority to work on the conversion.

C) On conversion of washing account where no member supplier is doing the washing, then this account upon registration to the Secretary will be protected for a period of 12 months. After 12 months this account will be open to any other supplier for conversion.

The evidence on page 1123 and following of the said Book I, filed, discloses the said League's price lists of charges to customers for supplying various of the types of products referred to in the indictment, which price lists were seized from various of the accused. All are identical.

At page 4341 of the same book, there appears the bill for the printing of these price lists which was sent to one of the accused only.

At pages 88-9 of the same book, there is a sample of one of many letters of complaints addressed by one of the accused to the said Montreal League of Linen Supply Owners Company, protesting that one of the fellow association members had cut prices to a customer which caused the former to lose that customer and requesting action to be taken to obtain redress for the complainant.

At page 3975 of the same book, there is a document setting out the regulations of the League to be followed by its members regarding the particular category of the business called the continuous towels in cabinets, and it reads in part: "Any cabinet supplier is entitled to go to any and all linen supplier customers and install cabinets where that customer is using the paper towels. However, if the linen supplier loses some linen business through this cabinet installation he must be compensated by the cabinet supplier within one week."

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The evidence also discloses that there were convention meetings, monthly meetings and sometimes weekly meetings of the Montreal League of Linen Supply Owners Company at which plans for the furtherance and continuance of their collusive agreement were formulated.

An example of such a convention meeting and the kind of matter decided at such, is shown by the minutes of the convention meeting contained in Book I, page 2367. These minutes refer, *inter alia,* to a discussion of "prices on long coats". It is there recorded that "After some discussion, it was decided to leave prices as they were."

An example of one of a monthly meeting and the kind of matter to be decided at such, is shown by a copy of the notice of which is in Book I, page 3325, filed. It is there recorded that the secretary served notice that "we will discuss our price structure".

The evidence also in Book I at page 2125, discloses a type of frequent complaint by one of the accused to the League, *viz.,* the complaint that one of the members reduced the prices of industrial towel service in order to obtain a contract from the Department of Defence Production in which the complainant submitted to the League that "we would expect to be compensated for every last dollar we may have lost, because of the indiscretion of the Management of Canadian Silk Manufacturing Company (Quebec) Limited" (one of the accused).

This documentary evidence filed in reference to this matter clearly indicates that during the material time the accused had as their object and were parties to price fixing arrangements for the supply of the type of products referred to in the indictment in the Montreal area.

The evidence in Book II also filed as an exhibit, discloses documentary proof of the agreements contemplated and put into effect by the accused as to customers.

For example, at page 2365 of Book II, there is a copy of the minutes of the convention of the Montreal League of Linen Supply Owners Company held at Grey Rocks Inn, St. Jovite, Quebec on October 20, 1955 and in part those minutes read: "We discussed registration of new customers". There then follows in Book II copies of various letters from certain of the accused requesting reimbursement pursuant to the above quoted rules of the League, from fellow-accused members for accounts lost to such other persons. In this regard, for example, at page 1092, there is a copy of a letter which is an exemplification of the enforcement of Rule 4. And there are many of these in Book II.

In Book III also filed as an exhibit, there is documentary proof of the organization and operation of the Montreal League of Linen Supply Owners Company.

For example, at page 269, there is set out a proposal by the Committee of the League for new accounts, which proposal subsequently in substance was adopted. One of the items of such provided as follows: "Members will vote on guilt or innocence of accused in closed ballot. Member found guilty will be penalized as per penalties that have been set up with time limit to pay penalty."

There is also set out in Book III filed, the persons who were members of the League at various times between 1950 and 1960. For example, in 1950 there were 30 members; in 1960 there were 29 members and of these, 23 were members in 1950. Also, nine out of 12 of the alleged co-conspirators in this matter were members in 1950, while in 1960 there were eleven.

There is also in Book III, documentary proof of the sums deposited in the League's bank account at the Banque Canadienne Nationale at 334 St. Catherine Street East, Montreal from 1956 to 1960, *viz*:

In

1956	$ 23,760
1957	$ 22,000
1958	$ 19,820
1959	$ 29,000
1960	$ 39,800

There are also set out in Book III copies of invoices for dues; and copies of documents relating to the operation of the organization, as for example, specimen cards calling weekly meetings, notices calling monthly meetings, copies of the minutes of three conventions, memoranda re the committee to combat competition from other outside businesses in the industry who were not members of the association and a memorandum indicating how to solicit accounts of customers of businesses in the industry who were not members of the League.

The evidence in Book IV also filed as an exhibit records the investigations made by the League of its own members and also of persons who were in business in the industry but not members of the League.

There follows the documentary evidence showing how the rules of the League were enforced against the members.

In brief, the evidence establishes that it was done in this way: For the purpose of investigation, the League hired a private detective agency during the material time, namely, J. Broderick Agency. Any member complaining about a fellow member could cause the League to hire this agency to send out a private detective to check on what that member was doing in the trade in so far, for example, as to the prices he was charging for supplying the products, as to whether he was soliciting another member's customers or as to any other matter which was considered in breach of the rules of the League. Thereafter, if any complaint was found to be well founded, the League enforced its appropriate rule against such non-conforming member.

The documentary evidence also shows what was done about new firms trying to enter this industry and about non-member firms already in this industry, namely: This same private detective agency was caused to be hired by the League on the agreement of the executive committee of it to investigate the customers of any new firm or person, not a member of the League, trying to enter the business of this industry, or of any established non-member firm, and to supply the details of the same to the League. Thereafter, the League at one of its meetings, acting on this information, caused one or more of its members to canvass the customers of such firm or person, and if they were required to do so, they cut prices, *inter alia,* for example, to acquire the customers from such non-member firm or person. Having done so, such member firms were reimbursed out of the League funds for the difference between such prices and the usual prices agreed to by the League.

In one instance, also, the documentary evidence discloses what was done when one new group of persons who began to operate in the industry and after being dealt with in this fashion by the League, refused to cease business. Briefly, this is what happened. The people who owned this new business in the industry were of Greek origin, and they had a substantial fruit and vegetable business in the Montreal area. According to the minutes, these people refused to cease business, when requested by the League. Thereafter, the League planned and did take certain steps to try to put them out of the fruit and vegetable business. Eventually that effort was also not successful; and the League then purchased the linen supply business from these people out of League funds in order to get them out of this industry.

The evidence also in Book IV, filed, contains many surveillance reports on members made by this detective agency, of the character mentioned. It also shows how the detective agency was paid for their services. The bills were made out to John Doe, the cheques were made out to cash and were endorsed by the J. Broderick Agency.

From this evidence and the rest of the documentary evidence filed, it was clearly established that the accused at all material times had as one of their objects of their conspiracy, arrangement of the market, and that they also succeeded in accomplishing substantial allocation of customers, and prevention of entry of any new firm into the market.

The evidence in Book V of the documentary evidence filed, proves in substantial detail the efforts made to eliminate independent suppliers in this market who were not members of the League.

The evidence also in Exhibit 3, filed after the filing of Book V, discloses a number of other pertinent documents. They consist of letters, bills and price lists from the premises of various accused in which the words "rental" and "supply" appear. The purpose of these apparently was to establish that these documents on their face indicate that the relationship between the members of the Montreal League of Linen Supply Owners Company and their respective customers was one of "supply" and "rental".

So much for a review of the salient parts of the Crown's evidence in chief.

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The defence adduced evidence *viva voce* relating to the alleged character of the relevant market in which the accused were engaged at the material times, and also documentary expert opinion evidence regarding such market, and the meaning of a market generally.

The Crown in rebuttal adduced documentary expert opinion evidence disagreeing with said defence documentary expert opinion evidence.

I have carefully reviewed and considered this evidence and the whole of the rest of the evidence in relation to the relevant law and the submissions of counsel and have reached the following conclusions, namely, that is to say:

A. 1. That the accused with their co-conspirators did conspire, combine, agree or arrange to fix prices, the allocation of customers in the market and the method of distribution of the products mentioned in the indictment;

2. that the products referred in the indictment are articles within the meaning of the word "article" as statutorily defined in section 2(*a*)[1] of the *Combines Investigation Act*;

3. that the market, in the main, was the Island of Montreal;

4. that the market was the section of the public on the Island of Montreal that needed and wanted not paper towels, or other substitute products, but cleaned, ironed, pressed, ready to use linen towels and other articles mentioned in the indictment and for whom paper towels and other substitute products were not satisfactory products; and

5. that the accused and co-conspirators did or accounted for 85 to 90% of the volume of that market;

and that:

B. 1. what the accused stand charged with concerns the "supply" of such articles within the meaning that the

[1] 2. (*a*) "article" means an article or commodity that may be the subject of trade or commerce;

word "supply" is used in the *Combines Investigation Act*; and that the word "supply" as so used and in its grammatical sense appropriate to the facts of this case, refers to what was done at all material times in this case, and it also includes the usual dictionary meaning of "rental";

2. what was done as described in this case was not a "service" as that concept is sometimes used when a generalization is made that the *Combines Investigation Act* is not legislation that touches and concerns "services" except these specifically referred to, as for example, insurance;

3. the Crown established an agreement or conspiracy by the accused in relation to the said products and market, having as its object the establishment of a virtual monopoly, contrary to section 32(1)(*c*) of the *Combines Investigation Act,* within the meaning of the ratio of such cases as *Weidman v. Shragge, (supra), Stinson-Reeb Builders Supply Company et al v. The King, (supra), Container Materials, Limited et al v. The King, (supra), and Howard Smith Paper Mills Limited et al v. The Queen, (supra),* but even if it did not, then, in any event, the Crown established an agreement or conspiracy by the accused, in relation to the said products and market, having as its object at all material times, the prevention or lessening of competition unduly within the meaning of section 32(1)(*c*) of the Act, in that the Crown proved that the object was to interfere with "free competition" in the said products in the said market above prescribed in a most substantial or inordinate manner against the public interest as those two latter words are meant judicially as referred to earlier in these Reasons; and

4. the expert evidence in defence, particularly Part IV of Exhibit D-1, which in the main was addressed to what share of the market was left to others than the accused and their co-conspirators at the material

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times, did nothing to rebut the proof of undue interference by the accused in violation of the law, adduced in chief;

and that:

C. 1. the words of the indictment are sufficient (see section 492(1) and (2) of the *Criminal Code of Canada*[1]); and the accused were not misled. (See Admission No. 5, quoted above.)

The verdict of the Court is that all the accused are guilty as charged.

Montreal
1967
Mar. 14-15
Ottawa
Apr. 5

BETWEEN:

CAPITAL MANAGEMENT LIMITED ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Capital cost allowances—Open-end mutual investment fund —Purchase of exclusive right to manage—Whether "a franchise, concession or licence in respect of property"—Income Tax Act, s. 11(1)(a)—Income Tax Regs., Sch. B, class 14.

In 1959 appellant acquired for $1,913,060 by assignment from another company the exclusive right to manage for 10 years two open-end mutual investment funds established under trust indentures between appellant's assignor and a trust company. In the operation of the business purchase money for certificates evidencing ownership of investments was received from subscribers by the trust company in a fiduciary character as agent, and appellant as manager had no beneficial interest in the certificates or in the investments. Appellant was remunerated for its services by a commission on the corpus of the funds and on the purchase price of units.

Held, the management right acquired by appellant was not "a franchise, concession or licence . . . in respect of property" and no capital cost allowance was therefore allowable on the cost of its acquisition under class 14 of Schedule B to the *Income Tax Regulations.*

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[1] 492. (1) Each count in an indictment shall in general apply to a single transaction and shall contain and is sufficient if it contains in substance a statement that the accused committed an indictable offence therein specified.

(2) The statement referred to in subsection (1) may be

(*a*) in popular language without technical averments or allegations of matters that are not essential to be proved,

(*b*) in the words of the enactment that describes the offence or declares the matters charged to be an indictable offence, or

(*c*) in words that are sufficient to give to the accused notice of the offence with which he is charged.

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CAPITAL MANAGEMENT LTD. v. MINISTER OF NATIONAL REVENUE

APPEAL from income tax assessment.

R. deW. MacKay, Q.C. and *P. Manson* for appellant.

G. W. Ainslie and *Bruce Verchere* for respondent.

GIBSON J.:—This is an appeal by Capital Management Limited, the appellant, from the assessment made by the Minister, the respondent, for the appellant's 1960 taxation year.

The issue for determination is whether the respondent erred when on assessing he refused to allow the appellant, in computing its income for 1960, to deduct pursuant to paragraph (*c*) of subsection (1) of section 1100 of the *Income Tax Regulations,* the sum of $191,306 as a capital cost allowance in respect to the capital cost to the appellant of acquiring certain rights and liabilities from the Capital Management Corporation Limited. The determination of this issue is dependent upon the answer to the question:

> "Are the rights or obligations obtained and assumed by the appellant, pursuant to an Agreement dated October 31, 1959, (Exhibit ASF 1) between Capital Management Corporation Limited and the appellant 'Property that is a...franchise, concession or licence for a limited period in respect of property' within the meaning of Class 14 of Schedule B of the *Income Tax Act?*"

The parties, at the commencement of this trial, filed an Agreed Statement of Facts which consists of seventy paragraphs and copies of supporting documents consisting of 171 pages.

The rights and obligations obtained and assumed by the appellant pursuant to the said Agreement dated October 31, 1959 between the Capital Management Corporation Limited and the appellant are contained in two other agreements, namely: (1) The Indenture of the 1st day of October 1954 between Capital Management Corporation Limited and Montreal Trust Company dated 1 October A.D. 1954 which established what is called the All Canadian Dividend Fund (Exhibit ASF 4), and (2) the Indenture of the 1st day of October 1954 between Capital Management Corporation Limited and Montreal Trust

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Company dated the 1st day of October A.D. 1954 which established what is called the All-Canadian Compound Fund (Exhibit ASF 9).

The rights and obligations the appellant so acquired may be stated to be the rights and obligations to manage for the period from October 16, 1959 to October 15, 1969 the All Canadian Dividend Fund and the All-Canadian Compound Fund. These funds are what are usually referred to as open-end mutual funds.

The appellant submits, *inter alia,* that the rights and obligations obtained by it pursuant to the said Agreement dated October 31, 1959 included a chose in action, the right to assign, the right to direct when and what securities the trustee should buy and sell from time to time, the right to vote of all securities held in the portfolio of these mutual funds, the right to direct the person through whom unit shares in these mutual funds could be purchased and sold, and the right to estimate quarterly the "portion of the gains made from the realization of the securities in the portfolio".

In order to resolve the issue in this case, it is not necessary to decide what precisely the relationship was among the appellant (the Manager), the Montreal Trust Company (the trustee) and the unit subscribers in these mutual funds during the taxation year 1960.

The respondent submits that the relationship was that of a manager, trustee, and *cestui que trust.*

The appellant disagrees and submits that any categorization is unnecessary, and that it is only necessary to consider what the appellant-Manager bought as set out in the said Agreement of October 31, 1959 (Exhibit ASF 1).

The difficulty of characterizing the status of each of the said parties in these said mutual funds arises not from the fact that mutual funds such as these are a relatively new phenomenon in the Canadian capital market, most of which having been formed since 1950, but from the fact that the relationship of principal and agent may be either that of trustee and *cestui que trust,* or that of debtor and creditor.

But it is clear from the evidence, without making any distinction between trust and contract, that the agent, the Montreal Trust Company, in connection with those subject mutual funds, received all the purchase monies for unit certificates from each individual subscriber (through the brokers appointed by the Manager) for such unit certificates, in a fiduciary character as agent, and that the Manager, the appellant, had no beneficial interest in any such unit certificates, evidencing ownership of the investments or in the investments themselves or in the investment portfolio held by the Montreal Trust Company.

And three other things are also clear from the evidence, *viz.*: Firstly, that the Manager for his services by these said contracts received and is entitled to receive during the contract period a management fee of 1/8th of 1% per quarter payable out of the corpus of both these said mutual funds, and also in the case of the All Canadian Dividend Fund, from the purchase monies of the unit subscribers a 2% acquisition fee;

Secondly, that the right to receive these fees for ten years from October 16, 1959 and the other rights in the said contract dated October 31, 1959 (Exhibit ASF 1) the appellant acquired by the payment of $1,913,060;

And thirdly, that among these latter rights was the right to appoint selling agents for the unit certificates, and to direct the trustee to issue unit certificates only to subscribers purchasing through such selling agents; but that such rights did not extend to or include any real or personal property rights, or industrial property rights, or any other category of rights that enabled the appellant-Manager to carry on its business or facilitated the carrying on of its business, as distinct from the rights to remuneration for the performance of certain specified services. (c.f. *The Investors Group v. M.N.R.*[1])

In my view, therefore, the answer to the question put at the beginning of these reasons is "no"; and the appeal is dismissed with costs.

[1] [1965] 2 Ex. C.R. 520.

Toronto 1967

Mar. 14-16

BETWEEN:

ALGOMA CENTRAL RAILWAY ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Deductions—Business expense—Expenditure by railway company to obtain geological information of area—Exploitation of area by public contemplated—Whether a current or capital expense—Income Tax Act, s 12(1)(b)

Because of a decrease in the volume of traffic carried by appellant's railway in an unpopulated area appellant employed mining geologists to survey the area with the intention of making the information thereby obtained available to the public in the hope that it would lead to development of the area and so produce traffic for its railway.

Held, the sum paid for the survey was deductible as a current business expense: it was not a payment on account of capital within the meaning of s. 12(1)(*b*) of the *Income Tax Act.* Neither the geological information directly obtained as a result of the expenditure nor the possibility of an increase in railway traffic resulting from exploitation of the area as a result of the use of such information, both of which objects appellant had in view in making the expenditure, was an advantage for the enduring benefit of its business.

British Insulated and Helsby Cables Ltd. v. Atherton [1926] A C. 205; *B.C. Electric Ry Co. v. M N R.* [1958] S C R. 133; *Sun Newspapers Ltd. v. Fed Com'n of Taxation* (1938) 61 C L R 337; *Ounsworth v. Vickers, Ltd.* [1915] 3 K B. 267; *Regent Oil Co v Strick* [1965] 3 W L.R. 636; *Van Den Berghs Ltd. v. Clark* [1935] A C. 431, distinguished

APPEAL from income tax assessments.

R. F. Wilson, Q.C. for appellant.

D. G. H. Bowman and *J. R. London* for respondent.

JACKETT P. (orally):—This is an appeal directly to this Court from the assessments of the appellant under Part I of the *Income Tax Act* for the taxation years 1960, 1961 and 1962.

In so far as the appeal for the 1962 taxation year raised a question as to the deductibility of an amount of $6,149.32 representing logging taxes, interest and penalties in respect of the 1957 and 1959 taxation years, the parties have agreed that there is to be judgment without costs, allowing the appeal and referring the assessment back to the respondent for reconsideration. In that connection, I should say that judgment will go in that form, and without any direction as to whether there is to be any, and if so what, re-assessment in respect of that amount of $6,149.32, because the parties have expressly agreed that the respondent is to re-consider the matter without any condition being imposed upon what action, if any, he is to take as a result of that re-consideration.

There remains for decision a question as to whether certain amounts paid by the appellant to Franc. R. Joubin & Associates Mining Geologists Limited (hereinafter referred to as the "Joubin company"), being

(*a*) $43,603.40 in respect of 1960

(*b*) $85,189.06 in respect of 1961

(*c*) $138,369.41 in respect of 1962

are deductible in computing the appellant's profits from its business for those respective years for the purposes of Part I of the *Income Tax Act.*

The appellant, at all relevant times, operated a railway and a line of steamships. The part of Ontario serviced by the appellant was, to a substantial extent, unpopulated, with the result that there were very serious limitations on the possibilities open to the appellant for obtaining new customers for its transportation businesses, when the advent of the Trans-Canada Highway and pipelines and dieselization of the Canadian National Railway resulted in a diminution of the volume of traffic that would otherwise have been carried by it. A large part of the unpopulated land through which the appellant's railway ran belonged to the appellant and the balance was, for the most part, Crown land.

In these circumstances, in July, 1960, the appellant arranged with the Joubin company for a survey over a period of five years of the mineral possibilities of the unpopulated lands in question at an average cost of approximately $100,000 per year. This arrangement was made with the intention of making information arising from the survey available to interested members of the public in the hope and expectation that it would lead to development of the area (possible mines, secondary industry, etc.) that would produce traffic for the appellant's transportation system. The expenditures in dispute were made to the Joubin company pursuant to that arrangement.

Considerable evidence was led by the appellant to show that the geological surveys were carried out, that a substantial group of persons had manifested an interest in the area in a concrete way, and that the company was continuing up to the present time with similar work of gathering geological information concerning the area and making it available to interested members of the public, doing so in more recent times by staff in the employ of the appellant rather than by an independent contractor. This evidence tends to support the more direct evidence concerning what I regard as the significant fact, namely, that the appellant embarked on the survey programme, and therefore made the expenditures in question, for the reason that I have already outlined.

The two provisions upon which the respondent relied in the reply to the Notice of Appeal as prohibiting the deduction of the amounts in dispute in the computation of the appellant's profits are paragraphs (*a*) and (*b*) of subsection (1) of section 12 of the *Income Tax Act*, which read as follows:

12. (1) In computing income, no deduction shall be made in respect of

(*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer,

(*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,

At the hearing, however, it was common ground that the expenditures in dispute were made by the appellant for the purpose of gaining or producing income from property or a business of the appellant and, therefore, that the deduction of such amounts in computing the appellant's profits for the respective years is not prohibited by section 12(1)(*a*) of the *Income Tax Act*.

The respondent took the position, however, that the expenditures in dispute were either outlays "of capital" or payments "on account of capital" within the meaning of those expressions in section 12(1)(*b*) of the *Income Tax Act* and that their deduction in computing the profits from the appellant's business for the years in question is, therefore, prohibited by that provision. The appellant disputed the position so taken by the respondent. The question so raised is the sole question that remains to be decided in the appeal.

The position is, therefore, that, if the expenditures were outlays "of capital" or payments "on account of capital", within the meaning of those expressions in section 12(1)(*b*), the appeal must be dismissed, and, if they do not fall within either of those expressions, the appeal must be allowed, in so far as the expenditures in question are concerned.

Leaving aside allowances in respect of depreciation, obsolescence or depletion, section 12(1)(*b*) prohibits the deduction of

(*a*) "an outlay . . . of capital",

(*b*) "a(n) . . . loss . . . of capital",

(*c*) "a(n) . . . replacement of capital",

or

(*d*) "a payment on account of capital".

As far as I know, the precise significance of these various expressions in section 12(1)(*b*) has not been the subject of judicial consideration. Whether or not there might be "an outlay . . . of capital"[1] that would escape the prohibition in section 12(1)(*a*) and would not fall within the expression "a payment on account of capital", I need not consider, for, as far as the expenditures in dispute are concerned, I am satisfied that, if they are not payments on account of capital, they are not, within the meaning of section 12(1)(*b*) outlays "of capital". I propose to consider, therefore, whether the expenditures in dispute were payments "on account of capital". In other words, the question, as I understand it, is: Is such an expenditure in substance "a revenue or a capital expenditure"? (See *British Insulated and Helsby Cables v. Atherton Ltd.*[2] per Viscount Cave, L.C. at page 213.)

[1] A distribution on winding up or on reduction of capital would presumably be an outlay "of capital" but not a payment "on account of capital". It may be that all outlays "of capital" are adequately covered by section 12(1)(*a*) and need not have been covered by section 12(1)(*b*).

[2] [1926] A.C. 205.

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The "usual test" applied to determine whether such a payment is one made on account of capital is, "was it made 'with a view of bringing into existence an advantage for the enduring benefit of the appellant's business' "? See *B.C. Electric Ry. Co. Ltd. v. Minister of National Revenue*[1] per Abbott J. at pages 137-8, where he applied the principle that was enunciated by Viscount Cave in *British Insulated and Helsby Cables, Ltd. v. Atherton, supra,* and that had been applied by Kerwin J., as he then was, in *Montreal Light, Heat & Power Consolidated v. Minister of National Revenue*[2].

The question is therefore whether what the appellant in this appeal had in "view" when it made the expenditures in dispute was "an advantage for the enduring benefit" of its business within the meaning of the test as it has been developed by the decisions. As I understand the respondent's position, it depends on an affirmative answer to that question. I do not overlook the fact that the respondent placed emphasis on various other factors as deserving some consideration. I have not, however, been able to appreciate how any of such factors are relevant on the facts of this case.

What the contractor contracted for and received for the expenditures in dispute was information produced by geological surveys that could be placed in the hands of interested members of the public. That is what the appellant had in "view" as the immediate and direct result of the expenditures that it was making. The respondent does not, however, suggest, as I understand it, that such information was "an advantage for the enduring benefit" of the appellant's business within the meaning of the test.

However, the appellant also had in "view", in one sense of the word, the possibility that, as a consequence of placing such information in the hands of appropriate members of the public, some of them would be attracted to the area through which the appellant's railway ran, would conduct exploration operations, would make mineral finds, and would develop mines, with the consequence that businesses of various kinds would be established in the area and thus a substantial volume of traffic would find its way on to the appellant's transportation systems, which traffic would not

[1] [1958] S.C.R. 133. [2] [1942] S.C.R. 89 at 105.

otherwise find its way there. This is the "advantage for the enduring benefit" of the appellant's business that, according to the respondent's submission, the appellant contemplated bringing into existence by the expenditures in dispute.

As the test upon which the respondent relies has been established by judicial decisions, reference must be made to the circumstances to which it has been applied by such decisions to find the answer to the problem raised by the respondent's submission as to whether the "advantage" envisaged by the taxpayer when making the expenditure that the test contemplates is whatever is acquired as an immediate consequence of the expenditure or is the ultimate effect on the taxpayer's business that is expected to flow from what is so acquired. A further question must also be considered, even if that question is answered in the affirmative, as to whether a mere increase in the volume of the taxpayer's business—no matter how large that increase may be—is an "advantage" of the taxpayer as contemplated by the test.

Without attempting to survey all of the cases in which the test has been applied, the following may be referred to as being representative:

1. In the *British Columbia Electric* case, the appellant was required to make a payment of $220,000 to municipalities for the improvement of roads as a condition precedent to being granted leave to discontinue a railway passenger service and to have a subsidiary company operate a substitute bus service with a consequent improvement in its overall financial position for the future. The payment of $220,000 was held to be a payment on account of capital.

2. In the *British Insulated and Helsby Cables* case, the taxpayer, for competitive reasons, felt the need of a pension fund for its employees. To place the fund on a sound actuarial basis, it made a payment of 31,784 pounds to the trustees of the fund that it established so that the past years of service of the then existing staff could rank for pension. That payment was held to be on capital account.

3. In *Sun Newspapers Limited v. The Federal Commissioner of Taxation*[1], a newspaper made a payment of 86,500 pounds under a contract designed to prevent the publication of a competing paper. That payment was held to be

[1] (1938) 61 C.L.R. 337.

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on capital account. (This case is to be contrasted with *Commissioner of Taxes v. Nchanga Consolidated Copper Mines, Ltd.*[1] where it was held that a payment of 1,384,569 pounds to compensate a competitor for going out of production for one year was a payment on current account.)

4. In *Ounsworth v. Vickers, Limited*[2], the taxpayer made a payment of 97,431 pounds as a contribution to the cost of dredging a channel and constructing a deep water berth. The work was done by a harbour authority, who undertook the maintenance of the resulting channel berth. The work had to be done so the taxpayer could deliver ships from its shipbuilding works. The contribution apparently had to be made by the taxpayer in order to persuade the harbour authority to do the work. The contribution was held to be on capital account.

5. In *Regent Oil Co. Ltd. v. Strick*[3], lump sums were paid by an oil company to operators of garage and filling station premises as consideration for the operators entering into arrangements under which the operators gave the oil company an interest in their business premises and were bound to take their oil supplies from the oil company. The lump sums were held to be on capital account.

6. In *Van Den Berghs, Ltd. v. Clark*[4], a payment of 450,000 pounds received for giving up rights under a quasi-partnership type of contractual arrangement between the taxpayer and a foreign company in a similar business was held to have been received on capital account.

In all these cases, and in the other cases referred to in the various decisions to which reference was made during the argument, the *"advantage"* that was held to be of an enduring benefit to the taxpayer's business was the thing contracted for or otherwise anticipated by the taxpayer as the direct result of the expenditure. In all such cases it was the "advantage" so acquired that, it was contemplated, would endure to the benefit of the taxpayer's business. In my view, the information received by the appellant here, in consideration of the expenditures in dispute, is not such an "advantage" of an enduring benefit to the taxpayer's business.

[1] [1964] 1 All E.R. 208 (P.C.).
[2] [1915] 3 K.B. 267.
[3] (1965) 3 W.L.R. 636.
[4] [1935] A.C. 431.

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Having reached that conclusion, it is not necessary to say more. I should add, however, that in my view, once it is accepted that the expenditures in dispute were made for the purpose of gaining income, on the view, as I understand it, that they were part of a programme for increasing the number of persons who would offer traffic to the appellant's transportation systems, I have great difficulty in distinguishing them in principle from expenditures, made by a businessman whose business is lagging, on a mammoth advertising campaign designed to attract substantial amounts of new custom by some spectacular appeal to the public. Such an advertising campaign is designed to create a dramatic increase in the volume of business. In a very real sense, it is designed to benefit the business in an enduring way. According to my understanding of commercial principles, however, advertising expenses paid out while a business is operating, and directed to attracting customers to a business, are *current* expenses. They are not, in the sense of Viscount Cave's rule, made with a view to "bringing into existence" an "advantage" for the enduring benefit of the business. If this be true of advertising expenses, in my view, it is equally true of other expenses incurred while the business is running with a view to increasing the volume of that business—so long as such expenses are incurred for the purpose of gaining income in such a way that their deduction is not prohibited by section 12(1)(*a*)[1]. I can see no difference in principle between the two cases.

The appeal is allowed. The 1960 and 1961 assessments are referred back to the respondent for re-assessment on the basis that the amounts of $43,603.40 and $85,189.06, referred to in paragraph A(1) of the Notice of Appeal, are deductible in computing the appellant's profits for the 1960 taxation year and the 1961 taxation year, respectively. The 1962 assessment is referred back to the respondent for

(*a*) reconsideration of the sum of $6,149.32 representing logging taxes, interest and penalties referred to in

[1] There can be expenditures that, in a broad sense, are made to improve the position of the business and that, nevertheless, do not escape the prohibition in section 12(1)(*a*). See, for example, *Canada Safeway Ltd. v. Minister of National Revenue,* [1957] S.C.R. 717.

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paragraph A(2) of the Notice of Appeal, and for any re-assessment that may arise from such reconsideration, and

(b) for re-assessment on the basis that the sum of $138,369.41 referred to in paragraph A(1) of the Notice of Appeal is deductible in computing the appellant's profit for the 1962 taxation year.

The respondent is to pay the appellant's costs of the appeal other than costs that are attributable to the dispute concerning the amount referred to in paragraph A(2) of the Notice of Appeal.

Edmonton 1967 Mar 6, 7 — Ottawa Mar. 20

BETWEEN:

ASSOCIATED INVESTORS OF CANADA LIMITED .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Business income—Computation of—Deductions—Advances to commission salesmen—Write-off of amount deemed irrecoverable—Whether income or capital transaction—In what year deduction allowable—Income Tax Act, ss. 11(1)(f), 12(1)(a).

Appellant was in the business of investing money received from persons under contracts negotiated by its salesmen. Appellant made advances against commissions to salesmen and these were shown as an asset in its balance sheet but only the amount of advances deemed irrecoverable at the end of any year was treated as a business expense of that year In 1960 and in 1961 appellant wrote off $25,000 of approximately $85,000 which had been advanced to a certain employee in previous years and claimed the amount so written off as a business expense of 1960 and 1961.

Held, appellant was entitled to the deductions claimed in computing its income for tax purposes.

1. The advances to salesmen were not capital transactions but an integral part of appellant's business operations and a loss in their value must on ordinary commercial principles be taken into account in computing the profit of its business for the year in which the appellant as a businessman recognized that the loss had occurred.

Can. Gen. Elec. Co. v. M N R. [1962] S C.R 3; *Oxford Motors Ltd v. M.N R* [1959] S.C.R 548; *Strick v. Regent Oil Co.* [1965] 3 W.L R. 636; *M.N.R. v. Anaconda American Brass Ltd* [1956] A C. 85; *M.N.R. v. Independence Founders Ltd* [1953] S C R. 389; *B.C. Elec. Ry. Co. v. M.N.R.* [1958] S.C.R. 133; *Tip Top*

Tailors Ltd v. M.N.R [1957] S.C.R. 703; *British Insulated and Helsby Cables Ltd v Atherton* [1926] A.C. 205; *Van Den Berghs, Ld. v. Clark* [1935] A.C. 431; *Davies v. The Shell Co. of China, Ltd* (1951) 32 T.C. 133; *Landes Bros. v. Simpson* 19 T.C. 62; *Imperial Tobacco Co v Kelly* 25 T.C. 292; *Dominion Taxicab Assn v. M.N.R.* [1954] S.C.R. 82; *John Cronk & Sons Ltd v. Harrison* (1935) 20 T.C. 612; *Absalom v. Talbot* (1944) 26 T.C. 166, *C.I.R. v Gardner Mountain & D'Ambrumenil Ltd* (1947) 29 T.C. 69; *Hall's* case, 12 T.C. 382; *Collin's* case 12 T.C. 773; *Whimster's* case 12 T.C. 813; *The Naval Colliery* case 12 T.C. 1017; *M.N.R. v. Consolidated Glass Ltd* [1957] S.C.R. 167; *Owen v Southern Rly. of Peru Ltd* (1956) 36 T.C. 602; *English Crown Spelter Co. v. Baker* (1908) 5 T.C. 327; *Chas. Marsden & Sons, Ltd v. C.I.R.* (1919) 12 T.C. 217; *Curtis v. J. & G. Oldfield Ltd* (1925) 9 T.C. 319; *The Roebank Printing Co. v. C.I.R.* (1928) 13 T.C. 864; *Marshall Richards Machine Co. v. Jewitt* (1956) 36 T.C. 511, considered.

2. The deduction claimed was not impliedly excluded by reason of being outside the language of s. 11(1)(*f*) of the *Income Tax Act*, which authorizes a deduction for certain bad debts.

3. Sec. 12(1)(*a*) of the *Income Tax Act* does not limit the deduction of outlays and expenses of a business for a year to those made or incurred in that year.

Rossmor Auto Supply Ltd v. M.N.R. [1962] C.T.C. 123 discussed and not followed; *I.R.C. v. Gardner Mountain & D'Ambrumenil Ltd.* (1947) 29 T.C. 93; *Naval Colliery Co. v. C.I.R.* (1928) 12 T.C. 1017, applied.

APPEAL from Tax Appeal Board.

Neil S. Crawford for appellant.

D. G. H. Bowman and *C. Anderson* for respondent.

JACKETT P.:—This is an appeal from a decision of the Tax Appeal Board dismissing appeals by the appellant from assessments under the *Income Tax Act*[1] for the 1960 and 1961 taxation years.

The facts established by the evidence in this Court are substantially the same as those that are set out in the judgment appealed from and it is therefore unnecessary for me to set them out at length. It is sufficient for the purpose of indicating the question that I have to decide to summarize the facts as follows:

1. During the relevant period—1954 to 1961—the appellant carried on a business that consisted of
   (*a*) negotiating contracts with members of the public under which, in consideration of being paid a

[1] R.S.C. 1952, chapter 148, as amended

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series of amounts over a period of time, it agreed to pay a specified amount at some time in the future; and

(*b*) investing the amounts received under such contracts.

2. To negotiate such contracts, the appellant employed a staff of salesmen who obtained applications from members of the public and were paid for their services by way of commissions, the payment of which depended upon the receipt by the appellant of certain of the amounts payable to it under the contracts. Such salesmen were employed, organized and supervised, for the appellant, by managers who were similarly paid having regard to the results achieved by the salesmen working under them.

3. As there was, in the nature of the appellant's business, a certain delay between the time when a sales employee expended his effort on the appellant's behalf and the receipt by the employee of commissions for such services, it was a necessary feature of the appellant's method of carrying on business that it make advances to each of its sales employees, which advances were ordinarily recovered by being set off against the commissions that became payable to the employee.

4. According to the way in which the appellant computed its annual profit from its business,

   (*a*) advances so made during a year that were still regarded by the appellant at the end of the year as recoverable in the ordinary course of business were shown in the balance sheet as an asset of the business and were not treated in the profit and loss account as an expense of doing business;

   (*b*) advances so made that were regarded by the appellant at the end of any year as having become, during that year, irrecoverable, were treated as an expense of doing business that year whether or not the advances were made that year or in a previous year.

5. While, in the ordinary course, an advance to a sales employee would have been relatively small, in the case of one Mitchell, who had been employed as a provincial manager by a special contract, under which he was to receive advances of $3,000 per month, in the expectation that he would be instrumental over a period of time in substantially increasing the appellant's business, the excess of the advances over commissions earned in the period from 1954 to 1960 amounted to over $85,000.

6. At the end of 1960, the appellant, having concluded that the value of its claim against Mitchell for advances that had not been repaid was at least $25,000 less than the nominal amount thereof, treated the matter in a way in which it had never had occasion to treat advances made to other sales employees, namely, it wrote the asset value of the Mitchell advances down by $25,000 and included the amount of $25,000 as an expense of doing business for the 1960 year—doing so by including it in its profit and loss account as an expense of "Sales Promotion".

7. At the end of 1961, having concluded that the value of its claim against Mitchell was then at least $50,000 less than the nominal amount thereof, the appellant wrote its asset value down by another $25,000 and included the amount of $25,000 as an expense of its business for the 1961 year—again doing so by including it in its profit and loss account as an expense of "Sales Promotion".

In these circumstances the respondent disallowed as an expense of the appellant's business for the 1960 taxation year, for purposes of the *Income Tax Act,* all of the sum of $25,000 deducted by the appellant for 1960 except the amount by which the advances to Mitchell in 1960 exceeded the commissions earned by Mitchell in 1960; and disallowed as an expense of the appellant's business for the 1961 taxation year, for purposes of the *Income Tax Act,* all of the sum of $25,000 deducted by the appellant except the amount by which the advances to Mitchell in 1961 exceeded the commissions earned by Mitchell in 1961.

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While the assessments appear to have been made on the basis that advances made by the appellant are deductible in computing the profits from its business for the year in which they were made to the extent that they have not been repaid in that year by offsetting commissions earned in the year, the position taken in this Court on behalf of the respondent was, in effect, as I understand it, that such advances can never be taken into account in the computation of profit from the appellant's business.

The contention that such advances can never be taken into account was based, in the first place, upon a submission that the advances were not made in the carrying on of the appellant's business. The alternative contention was that the deductions in dispute were, in effect, deductions for "bad debts", that no deduction for a "bad debt" may be made for purposes of the *Income Tax Act,* unless it is authorized by section 11(1)(*f*) and that section 11(1)(*f*) does not embrace such deductions.[1]

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[1] A submission was also made that section 12(1)(*a*) of the *Income Tax Act,* which reads as follows:

> 12 (1) In computing income, no deduction shall be made in respect of
>
> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer,

must be interpreted as prohibiting the deduction in the computation of profit from a business for a year of any outlay or expense not made or incurred in that year. In support of this submission, reliance was placed on *Rossmor Auto Supply Ltd. v. M N R ,* [1962] C T.C 123. per Thorson P. at page 126, where he said, "As I view Section 12(1)(*a*), the outlay or expense that may be deducted in computing the taxpayer's income for the year is limited to an outlay or expense that was *made or incurred* by the taxpayer *in the year* for which the taxpayer is assessed" (the italics are mine) If this view were a necessary part of the reasoning upon which the decision in that case was based, I should feel constrained to follow it although, in my view, it is not based on a principle that is applicable in all circumstances. In that case, however, the loan was clearly not made in the course of the appellant's business and the President so held. In my view, while certain types of expense must be deducted in the year when made or incurred, or not at all, (e g., repairs as in *Naval Colliery Co. Ltd. v. C I R ,* (1928) 12 T C 1017, or weeding as in *Vallambrosa Rubber Co., Ltd. v. Farmer,* (1910) 5 T.C. 529), there are many types of expenditure that are deductible in computing profit for the year "in respect of" which they were paid or payable. (Compare sections 11(1)(*c*) and 14 of the Act.) This is, for example, the effect of the ordinary method of computing gross trading profit (proceeds of sales in the year less the amount by which opening inventories plus cost of purchases in the year exceeds closing

Under the *Income Tax Act,* in determining the income tax payable by the appellant for a year, the first step is to determine the "income" from the appellant's business for the year (section 3). Subject to any special provision that may be applicable, the "income" from a "business" for a year is the "profit" therefrom for the year (section 4).

Profit from a business, subject to any special directions in the statute, must be determined in accordance with ordinary commercial principles.[1] The question is ultimately "one of law for the court". It must be answered having regard to the facts of the particular case and the weight which must be given to a particular circumstance must

inventories) the effect of which (leaving aside the possibility of market being less than cost) is that the cost of the goods sold in the year is deducted from the proceeds of the sale of those goods even though the goods were acquired and paid for in an earlier year. This is, of course, the only sound basis for computing the profits from the sales made in the year. Compare *I R C. v. Gardner Mountain & D'Ambrumenil, Ltd*, (1947) 29 T C. per Viscount Simon at page 93: "In calculating the taxable profit of a business . . . services completely rendered or goods supplied, which are not to be paid for till a subsequent year, cannot, generally speaking, be dealt with by treating the taxpayer's outlay as pure loss in the year in which it was incurred and bringing in the remuneration as pure profit in the subsequent year in which it is paid, or is due to be paid In making an assessment . . . the net result of the transaction, setting expenses on the one side and a figure for remuneration on the other side, ought to appear . . . in the same year's profit and loss account, and that year will be the year when the service was rendered or the goods delivered" (Applied in this Court in *Ken Steeves Sales Ltd v Minister of National Revenue,* [1955] Ex. C.R 108, per Cameron J at page 119) The situation is different in the case of "running expenses" See *Naval Colliery Co. Ltd. v. C.I.R , supra,* per Rowlatt J at page 1027: ". . . and expenditure incurred in repairs, the running expenses of a business and so on, cannot be allocated directly to corresponding items of receipts, and it cannot be restricted in its allowance in some way corresponding, or in an endeavour to make it correspond, to the actual receipts during the particular year. If running repairs are made, if lubricants are bought, of course no enquiry is instituted as to whether those repairs were partly owing to wear and tear that earned profits in the preceding year or whether they will not help to make profits in the following year and so on. The way it is looked at, and must be looked at, is this, that that sort of expenditure is expenditure incurred on the running of the business as a whole in each year, and the income is the income of the business as a whole for the year, without trying to trace items of expenditure as earning particular items of profit". See also *Riedle Brewery Ltd. v. Minister of National Revenue,* [1939] S C.R. 253. With regard to the flexibility of method permitted under the *Income Tax Act* for computing profit, see Cameron J. in the *Ken Steeves* case, *supra,* at pages 113-4.

[1] *Canadian General Electric Co. Ltd. v. Minister of National Revenue,* [1962] S.C.R. 3, per Martland J. at page 12.

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depend upon practical considerations. As it is a question of law, the evidence of experts is not conclusive.[1]

My first task is therefore to determine the proper treatment of the amounts in question in accordance with ordinary commercial principles. Having ascertained that, I must consider whether any different treatment is dictated by any special provision of the statute.

Ordinary commercial principles dictate, according to the decisions, that the annual profit from a business must be ascertained by setting against the revenues from the business for the year, the expenses incurred in earning such revenues.

In considering whether the results of any transaction can be considered in computing the profit of a business for a particular year, the first question is whether it was entered into for the purpose of gaining or producing income from the business.[2] If it was not, such results cannot be taken into account in computing such profits. Even if the transaction was entered into for the purpose of the business, if it was a capital transaction, its results must also be omitted from the calculation of the profits from the business for any particular year.[3] There is no doubt that the appellant made advances to its sales employees as part of its effort to make a profit from its business. What is said, however, is, in effect, that they were capital transactions.

(It was not argued that a loss could not be taken into account in computing profit unless it arose from an operation or transaction calculated or intended to produce a profit. It is clear that such a contention could not succeed. A profit arising from an operation or transaction that is an integral part of the current profit-making activities must be included in the profits from the business. See *Minister of National Revenue v. Independence Founders Limited,*[4] and the foreign exchange cases such as *Tip Top Tailors*

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[1] See *Oxford Motors Ltd. v. Minister of National Revenue,* [1959] S.C.R. 548, per Abbott J. at page 553, and *Strick v Regent Oil Co. Ltd.,* [1965] 3 W.L.R. 636 per Reid J., at pages 645-6. See also *Minister of National Revenue v. Anaconda American Brass Ltd.,* [1956] A.C. 85 at page 102.

[2] Compare section 12(1)(*a*).

[3] Compare section 12(1)(*b*). See *B.C. Electric Railway Co. Ltd. v. Minister of National Revenue,* [1958] S.C.R. 133, per Abbott J. at page 137.

[4] [1953] S.C.R. 389.

Limited v. Minister of National Revenue.[1] If such a profit must be included in computing profits from a business, then a loss arising from any such source—that is, from an operation or transaction that is a part of the current profit-making activities of the business—must also be taken into account in computing the overall profit from the business.)[2]

No simple principle has been enunciated that serves, in all circumstances, to solve a question as to whether a transaction is a capital transaction. The general concept is that a transaction whereby an enduring asset or advantage is acquired for the business is a capital transaction.[3] This is not, however, a concept that is easy to apply in all circumstances. Clearly, the acquisition of property in which to carry on the business, or of plant or equipment to be used in carrying on the business, is a capital transaction. The acquisition of less tangible assets of an enduring nature have also been held to be a capital transaction. Transactions whereby a "trading structure"[4] is created are also capital

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1 [1957] S.C.R. 703.

2 Note that, while section 12(1)(*b*) prohibits any deduction of a "loss...of capital" in computing profit from a business, there is no prohibition against deduction of other losses in either section 12(1)(*a*) or section 12(1)(*b*).

3 See *British Insulated and Helsby Cables, Ltd. v. Atherton,* [1926] A.C. 205.

4 See *Van Den Berghs, Ld. v. Clark,* [1935] A.C. 431. Compare *B.C. Electric Railway Co Ltd. v. Minister of National Revenue,* [1958] S.C.R. 133, and *Davies v. The Shell Company of China, Ltd.,* (1951) 32 T.C. 133. The basic difference between the deposits in the latter case and the advances in this case is indicated by Jenkins L.J. at pages 156-7, where he says:

> "If the agent's deposit had in truth been a payment in advance to be applied by the Company in discharging the sums from time to time due from the agent in respect of petroleum products transferred to the agent and sold by him the case might well be different and might well fall within the *ratio decidendi* of *Landes Brothers v. Simpson,* 19 T.C. 62, and *Imperial Tobacco Co. v. Kelly,* 25 T.C. 292. But that is not the character of the deposits here in question. The intention manifested by the terms of the agreement is that the deposit should be retained by the Company, carrying interest for the benefit of the depositor throughout the terms of the agency. It is to be available during the period of the agency for making good the agent's defaults in the event of any default by him; but otherwise it remains, as I see it, simply as a loan owing by the Company to the agent and repayable on the termination of the agency; and I do not see how the fact that the purpose for which it is given is to provide a security against any possible default by the agent can invest it with the character of a trading receipt."

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transactions. The advances made by the appellant to its sales employees do not in my view fall in any of these categories. They were intended to provide the employees with an income during the periods while they were awaiting returns from their endeavours in the appellant's service. They were by their very nature short term loans. They did not result in the acquisition of any asset or advantage of an enduring nature, nor did they create a "trading structure" of a permanent character. In my opinion, they were an integral part of the appellant's current business operations.

Having concluded that the making of the advances was an integral part of the appellant's current business operations, the next task is to determine how the results of such transactions are to be taken into account in computing the profits from the appellant's business.

In approaching this problem, it is important to have in mind the precise elements involved in one of these "advance" transactions. What happened was that

(a) the appellant made a payment to the employee,

(b) when the payment was made, there came into existence an indebtedness from the employee to the appellant in the amount of that payment,

(c) if and to the extent that the employee repaid the advance, the indebtedness disappeared.

The situation was therefore that, at the time that the advance was made, the appellant had exchanged its money for a "right" that was, from a businessman's point of view, of equal value. It had substituted one asset in money for another of equal amount. As of that time, therefore, the making of the advance did not affect the overall value of the appellant's assets. The advance cannot, therefore, as of that time, be regarded, from a businessman's point of view, as having affected the appellant's profit from his business.[1]

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[1] In *Dominion Taxicab Association v. Minister of National Revenue*, [1954] S C R 82, it was held that deposits could not be included as revenues of a business as long as there was a contingent liability to repay them. See per Cartwright J. delivering the judgment of the majority at page 86· "... unless and until the necessary conditions were fulfilled to give absolute ownership of a deposit to the appellant and to extinguish its liability therefor to the depositing member, such deposit could not properly be regarded as a profit from the appellant's business " Similarly, here, an advance cannot be regarded as an expense of the business as long as the businessman has an asset—the right to be repaid—of equivalent value.

Similarly, if the advance was entirely repaid, there was again a substitution of one asset for another of equivalent value and there was no overall effect on the appellant's asset position. When, however, the chose in action depreciated in value, there was an effect on the appellant's asset position and accordingly, at that time, for the first time, the advance transaction resulted in the appellant having sustained a loss.[1] As that loss arose out of a transaction in the course of the appellant's current business operations, it must be taken into account in computing the profits from the appellant's business or they will be overstated. In my view, it must be so taken into account in computing the profit from the business for the year in which the appellant, as a "businessman", recognized that the loss had occurred. It cannot properly be taken into account in computing the profit for a previous year. There is no sound basis for taking it into account in computing the profit for a subsequent year.[2] (It was not argued that the rule concerning when a "capital loss" is "sustained" that was established by *Minister of National Revenue v. Consolidated Glass Limited*,[3] has any application to determining when a profit or loss is to be regarded as having

[1] Just as a "receipt" from a sale of stock-in-trade in the course of business that is of dubious value should only be included in computing profit for the year of the sale at a valuation, and, in some circumstances, it may be that, if it cannot be valued, it should not be brought into account until it is realized (see *John Cronk & Sons, Ltd v. Harrison*, (1935) 20 T C. 612; compare *Absalom v. Talbot*, (1944) 26 T C 166, and *C.I.R v Gardner Mountain & D'Ambrumenil, Ltd.*, (1947) 29 T C 69), so an expenditure that is made in the carrying on of the business and that may or may not result in an actual cost of operation should only be charged against the receipts of the business in the year when the contingency is realized, and then only to the extent of the net outlay involved at that time.

[2] I am not concerned here with the question whether the method adopted by the appellant in showing the deduction in its accounts was the appropriate way of reflecting the transaction in the accounts I am only concerned with whether the "profit" was correctly computed There is no allegation or suggestion of misrepresentation that is material to the issue raised by the appeal. This is not a case of attempting to deduct an anticipated loss that has not been realized in the year (*Hall*'s case, 12 T C. 382, *Collin*'s case, 12 T C. 773, and *Whimster*'s case, 12 T C 813), or of attempting to deduct a running expense that will have to be made in a future year. (The Naval Colliery case, 12 T C. 1017) This is, in effect, the deduction of a running expense in the year in which it becomes a cost of the business.

[3] [1957] S.C.R. 167.

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arisen in the course of current operations of a business. Presumably, having regard to *Canadian General Electric Co. Ltd. v. Minister of National Revenue*,[1] it was recognized that that rule can have no application to prevent a businessman taking into account the revaluation of an asset or liability, the amount of which affects the annual profit or loss from the business. See *Canadian General Electric* case per Martland J. at page 14. Compare *Owen v. Southern Railway of Peru, Ltd.*[2] per Lord Radcliffe at page 642.)

For the above reasons,[3] I am of opinion that the two deductions in question were properly made unless their deduction is prohibited by some provision in the *Income Tax Act*. As indicated above, the provision relied upon by the respondent as constituting such a prohibition is section

[1] [1962] S.C.R. 3. [2] (1956) 36 T.C. 602.

[3] The respondent referred to a number of cases where the factual situation bore some resemblance to the facts of the present appeal. In my view, none of these decisions is in point and, to the extent that the reasoning in them is relevant, they support the conclusion that I have reached. I propose to mention some of them to indicate what I mean In *English Crown Spelter Co. Ltd. v. Baker,* (1908) 5 T.C. 327, it was held that advances made by the appellant company to a "new Company" formed as a supplier of a raw material required by it were an investment of capital and could not be deducted as a "bad debt" when the new company went into liquidation some years after the advances were made; but Bray J. said at page 337: "Now, it is said that that is money really exclusively employed for the purposes of the trade. If this were an ordinary business transaction of a contract by which the Welsh Company were to deliver certain blende ... and that this was really nothing more than an advance on account of the price of that blende, there would be a great deal to be said in favour of the Appellants." In *Charles Marsden & Sons, Ltd. v. C.I.R.,* (1919) 12 T.C. 217, Rowlatt J. applied the *Crown Spelter* case to an advance between companies. *Curtis v. J. & G. Oldfield, Limited,* (1925) 9 T.C. 319, was a case where the managing director of a company died owing the company money. Rowlatt J. held, in effect, that the money was taken wrongfully completely apart from the business operations of the Company. In *The Rocbank Printing Company, Limited v. C.I.R.,* (1928) 13 T C. 864, Lord President Clyde held that, while he was not laying down "any universally applicable proposition to the effect that losses arising from such payments in advance can in no circumstances form a proper charge against a trading account," in that case, the advances to the managing director, that were recoverable by set-off against his commissions, played no part in, and were not conducive to, the making of profit in the company's trade. On the contrary, he thought that the managing director had been using the company "as his banker". In *Marshall Richards Machine Co., Ltd. v. Jewitt,* (1956) 36 T.C. 511, where the question was whether advances made by a parent company to a subsidiary that performed services for it, were made on capital account, Upjohn J. said that "the whole truth of the matter was this, that the parent company had to finance the subsidiary company".

11(1)(*f*). This provision should be read as part of the scheme concerning bad and doubtful debts, which is found in the following provisions:

6. (1) Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

. . .

(*e*) the amount deducted as a reserve for doubtful debts in computing the taxpayer's income for the immediately preceding year;

. . .

(*f*) amounts received in the year on account of debts in respect of which a deduction for bad debts had been made in computing the taxpayer's income for a previous year whether or not the taxpayer was carrying on the business in the taxation year;

. . .

11. (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

. . .

(*e*) a reasonable amount as a reserve for
(i) doubtful debts that have been included in computing the income of the taxpayer for that year or a previous year, and
(ii) doubtful debts arising from loans made in the ordinary course of business by a taxpayer part of whose ordinary business was the lending of money;

(*f*) the aggregate of debts owing to the taxpayer
(i) that are established by him to have become bad debts in the year, and
(ii) that have (except in the case of debts arising from loans made in the ordinary course of business by a taxpayer part of whose ordinary business was the lending of money) been included in computing his income for that year or a previous year;

These provisions create a system whereby a businessman who computes his trading profit on an accrual basis under which he includes in his revenues, as "proceeds of sales", the prices at which he has sold his goods in the year in which he sold them, whether or not he has collected the amounts thereof from his customers, may in due course reflect in his profit computation in a year in which it occurs the amounts by which his claims against the customer for such prices depreciate in value.

Section 11(1)(*f*) does not, in terms, prohibit any deduction for "bad debts". It does, however, expressly authorize in qualified terms a deduction that could have been made, in accordance with ordinary business principles, in the computation of profit from a business. It might therefore have

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been thought, as the respondent contends, that a deduction for a "bad debt" that is excluded from section 11(1)(*f*) by the qualifications expressed in it is impliedly prohibited. Such an interpretation would, however, have results that cannot, in my view, have been contemplated. For example, a bond dealer, who, in effect, buys and sells "debts", would, on such an interpretation, be precluded from taking into account losses arising from bonds becoming valueless by reason of the issuing company becoming insolvent. If section 11(1)(*f*) is not to be interpreted as impliedly prohibiting such an obvious and necessary deduction in arriving at the profits of a business, I am of opinion that it is not to be interpreted as impliedly excluding the deduction of the losses that are in question in this appeal, which, in my opinion, are just as obvious and necessary in computing the profits from the appellant's business.[1]

The appeal will be allowed, with costs, and the assessments will be referred back to the respondent for re-assessment on the basis that the two amounts of $25,000 were properly deductible in computing the profits from the appellant's business for 1960 and 1961, respectively.

[1] If it had been necessary to reach a conclusion on the further question that would have arisen if I had not reached the conclusion that section 11(1)(*f*) does not impliedly prohibit such deductions, I should have had to decide that question also against the respondent, but not on the view taken by the appellant. In my view, the parenthetical words in section 11(1)(*f*)(ii) extend only to debts arising from loans made in the ordinary course of the money lending part of a business although I recognize that, read literally, and without regard to the obvious purpose of the exception, the words seem to encompass the debts in question in this appeal. On the other hand, the appellant's claim against Mitchell had not become a "bad debt" within section 11(1)(*f*)(i) merely because it had depreciated in value. Section 11(1)(*f*) provides for the deduction of the whole of a debt that has become bad.

BETWEEN: Ottawa 1967 Apr. 10

LUDLOW MUSIC INC. ....PLAINTIFF;

AND

CANINT MUSIC CORP. LTD. AND ARC SOUND LTD. .... DEFENDANTS.

Copyright—Infringement—Record of song with changed lyric—Song a single musical work consisting of words and tune—Copyright Act, R.S.C. 1952, c. 55, ss. 2(p), 19.

A song, which consists of words set to a tune, is a combination of melody and harmony and therefore a single musical work as defined by s. 2(*p*) of the *Copyright Act*. Accordingly s. 19 which permits the reproduction by records, etc., of a musical work on specified conditions upon payment of a royalty does not permit the reproduction of the tune of a song with substantially different words.

APPLICATION for interlocutory injunction.

G. F. Henderson, Q.C. and *C. R. Carson* for plaintiff.

Donald F. Sim, Q.C. and *D. Hill* for defendants.

JACKETT P. (*orally*):—This is an application for an order restraining the defendants from selling records using the tune of the composition *This Land is Your Land* with words other than the plaintiff's until the trial or other disposition of this action.

The application was argued before me on April 6, 1967, and, at the conclusion of the argument, I adjourned the matter until today for the purpose of rendering a decision.

In so far as the defendant Canint Music Corp. Ltd. is concerned, counsel for the defendants offered, on behalf of that defendant, to file an undertaking that it would not sell records using the tune of the composition *This Land is Your Land* with words other than the plaintiff's. Subject to such undertaking being filed, the application is dismissed as against that defendant. I do not think that the costs of the application have been appreciably increased by that defendant having been included and there will be no order for the costs of the application either for or against that defendant.

Where I refer hereafter in these reasons to "the defendant", the reference will be to the defendant "Arc Sound Limited".

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In 1950, one "Woody" Guthrie executed, in the United States, an assignment of an unpublished "original musical composition" entitled *This Land* in favour of the plaintiff (whose name at that time was "Spencer Music Corporation") and, by the same document, warranted and represented to the plaintiff that he was the sole "writer, composer and owner" of the said composition. Before the assignment was signed, Guthrie had convinced the officers of the plaintiff that he was the composer of the composition in question. Subsequently the name of the composition was changed to *This Land is Your Land.*

In 1956, application for copyright in the unpublished work *This Land is Your Land* was filed in the United States Copyright Office by the plaintiff.

On December 15, 1958 the song *This Land is Your Land* was first published and offered for sale in Canada, in Great Britain and in the United States, in the form of sheet music representing that it was a song composed by "Woody Guthrie".

Application for copyright in the published work *This Land is Your Land* was filed in the United States Copyright Office on January 2, 1959.

The words of *This Land is Your Land* in its original form were:

Chorus: THIS LAND IS YOUR LAND
This land is my land
from California to the New York island
From the red wood forest
to the Gulf Stream waters;
This land was made for you and me—me.

Verses: As I was walking that ribbon of highway
I saw above me that endless skyway
I saw below me that golden valley
This land was made for you and me.

I've roamed and rambled and I
followed my footsteps
to the sparkling sands of her diamond deserts
And all around me a voice was sounding
This land was made for you and me.

When the sun comes shining and I was strolling
and the wheat fields waving
and the dust clouds rolling
As the fog was lifting a voice was chanting
This land was made for you and me.

The plaintiff authorized the preparation of an adaptation of the song *This Land is Your Land* for use in Canada; and

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a group of singers called "The Travellers" prepared such an adaptation, which is exactly the same as the original except that the words "Bonavista to Vancouver" are substituted for "California to the New York" and the words "Arctic Circle to the Great Lake" are substituted for "red wood forest to the Gulf Stream" in the chorus, and the words "fir clad forests of our mighty mountains" are substituted for the words "sparkling sands of her diamond deserts" in the second verse. In the adaptation, the words of the chorus and verses are otherwise unchanged and the music is unchanged. A document dated July 24, 1959, was executed by "The Travellers", reading in part as follows:

> On the understanding that you have given the undersigned permission to make changes in the lyric of your song, THIS LAND IS YOUR LAND by Woody Guthrie and The Travellers we hereby assign all rights and title to these changes to your Company.

The song was widely distributed in sheet music form throughout Canada. On the front of the sheet music as so distributed appeared the following:

Words and Music by WOODY GUTHRIE
CANADIAN ADAPTATION BY "THE TRAVELLERS"

The song is described by an affidavit taken by an officer of the plaintiff company as follows:

> 11 The song "This Land is Your Land" including the Canadian Adaptation is attached to this my affidavit as Exhibit 7. This song is a patriotic song and has been widely distributed in schools throughout Canada. The song will again be published in 1967 by the Centennial Commission in the songbook "Young Canada Sings—"Le Jeune Canada Chante", 10,000 copies of the songbook will be distributed throughout Canada Attached as Exhibit 8 to this my affidavit is a copy of a letter from The Centennial Commission to Ludlow Music, Incorporated requesting permission to use the song "This Land is Your Land". Ludlow Music, Inc., has consented to such use in both 1966 and 1967.
>
> 12. The song "This Land is Your Land" is a standard, or song which will have a long life in Canada, and the use of words which are in bad taste and insulting to the Canadian public with the music of the composition "This Land is Your Land" will cause incalculable damage to the Plaintiff and destroy the meaning and acceptance of the song in the minds of the Canadian public.

The manager of "The Travellers" refers to the song, in an affidavit filed by the defendant on this application, as follows:

> 2. The Canadian version of the song "This Land is Your Land" was written by Jerry Gray, Jerry Goodis, Guy Carawan and myself and has since been performed publicly by The Travellers throughout Canada, at

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concerts, public performances, universities, and including a performance before Her Majesty the Queen and Prince Philip at Charlottetown, Prince Edward Island.

Referred to in that same affidavit, as an Exhibit, is a "long playing record album" entitled "Introducing The Travellers" recorded in 1960, in which album the Canadian version of *This Land is Your Land* was first recorded. On the back of this album appears the following sentence: "With a few changes, Woody Guthrie's song, This Land is Your Land, becomes Canadian". Referred to in the same affidavit filed by the defendant is another "long playing record album" entitled *This Land* on the outside of which is shown as its first number "This Land is Your Land (Woody Guthrie) Ludlow Music".

I interrupt my review of the facts at this point to deal with two objections made by the defendant to the sufficiency of the plaintiff's material to establish its right to seek the order sought. Such objections are

(a) that the plaintiff's material does not establish that "Woody" Guthrie was the author of *This Land is Your Land,* and

(b) that the plaintiff's material does not show that "Woody" Guthrie was a citizen of the United States at the time he composed that work.

To appreciate these objections, it is necessary to refer to certain provisions in the *Copyright Act,* R.S.C. 1952, chapter 55, *viz.*

4. (1) Subject to the provisions of this Act, copyright shall subsist in Canada for the term hereinafter mentioned, in every original literary, dramatic, musical and artistic work, if the author was at the date of the making of the work a British subject, a citizen or subject of a foreign country that has adhered to the Convention and the Additional Protocol thereto set out in the second Schedule, or resident within Her Majesty's Dominions; and if, in the case of a published work, the work was first published within Her Majesty's Dominions or in such foreign country; but in no other works, except so far as the protection conferred by this Act is extended as hereinafter provided to foreign countries to which this Act does not extend.

* * *

12. (1) Subject to the provisions of this Act, the author of a work shall be the first owner of the copyright therein.

With reference to the question whether the material shows that "Woody" Guthrie was the author of the song in question, I am fully aware of the unsatisfactory character of the material that has been put before me. On the other hand, it must be recognized that difficult problems of proof are involved whenever a contemporary title to property has its origin in a fact that occurred at some time in the past and that business people do not organize their affairs so that they will be prepared at a moment's notice to bring evidence, in the orderly and complete form in which courts would prefer to receive it, of the facts on which their titles to various kinds of personal property are based. Fortunately, the occasion rarely arises for a person to demonstrate his title to the things that others all recognize as belonging to him. When it does arise, because it becomes necessary to seek the aid of the Court to protect his property from trespass by a third person, it becomes necessary to assemble evidence the gathering and recording of which would otherwise be an unprofitable exercise and when the challenge to his property rights is sudden and unforeseen, it must be met with such evidence as can be gathered on short notice. (Here indeed the defendant reproaches the plaintiff with a delay of two weeks from the cessation of correspondence between the parties to the launching of this application.) I am of the view that, when weighing the evidence adduced to establish the essential facts on an application of this kind, one must keep the above considerations in mind. In this case, there is another consideration, in that the defendant, as well as the plaintiff, has proceeded on the basis that the song in question was composed by "Woody" Guthrie. The dispute here did not arise out of a *bona fide* dispute as to that fact. The dispute arose on another question, to which I will come later in these reasons. The challenge to Guthrie's authorship did not arise until, in the course of the proceedings, it appeared that there was a lack of direct evidence on this point available to the plaintiff. Here again, I do not think that the Court should be overly ready to allow any decision, at least in a civil matter, to turn on an accidental circumstance completely unrelated to the source of the dispute that brought the parties to Court.

I have concluded, not completely unaffected by the above considerations, that the balance of probability, on the facts that I have outlined, is that Guthrie was the author of the words and music of the song in question; and I so find for the purposes of this application.

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The second objection made by the defendant to the plaintiff's material, to which I have referred, is that that material does not show that "Woody" Guthrie was a citizen of the United States at the time that he composed the song in question. Involved in this objection are two questions:

(a) Is it a condition precedent to the existence of copyright in the case of a published work, on a correct interpretation of section 4(1) of the *Copyright Act*, *supra*, not only that the work has been first published within Her Majesty's Dominions or a foreign country that adhered to the Copyright Convention therein referred to, but that the author was, at the date of the making of the work, a British subject, a citizen or subject of a foreign country that has adhered to that Convention or resident within Her Majesty's Dominions? and

(b) Is there evidence that establishes that the balance of probability is that, at the date of composing the song in question, "Woody" Guthrie was a citizen of the United States?

Obviously, on the first question, I have not to reach a concluded opinion but only to decide whether that question will probably be answered ultimately in the negative or whether there is a fairly arguable case that it should be answered in the negative. Having regard to the way in which section 4(1) is broken up by semi-colons rather than commas, I should have been inclined to regard the part thereof between the first semi-colon and the second semi-colon as an elliptical independent enactment, which, if extended, would read "...and copyright shall subsist in Canada...in every original...work...if, in the case of a published work, the work was first published within Her Majesty's Dominions or in such foreign country", and which would therefore extend, in the case of published works, the class of cases in which copyright otherwise exists in both published and unpublished works by virtue of the part of section 4(1) before the first semi-colon. (Compare *Imperial Act, Copyright Act,* 1911, chapter 46, section 1.) On the other hand, I assume, for the purpose of this application, that it is proper to construe section 4(1), which is certainly open to a charge of ambiguity, in the light of Article 4 of the Convention contained in the Second

Schedule to the Act, and this would appear to indicate that, as far as the Convention is concerned, the requirement of first publication is a requirement that, in the case of published works, is in addition to the requirement, in respect of all works, of being a citizen or subject of a specified class or having a specified kind of residence. On the whole, I regard this question of interpretation as being, on the basis of what has come to my attention up to this point, no more than fairly arguable from the plaintiff's point of view. I cannot say that I am of the view that citizenship, etc., is probably not a condition precedent in the case of a published work.

With reference to the question of fact as to whether Guthrie was a United States citizen at the date when he composed the song, the situation is that there are indications on the file that he was, at that time, a United States citizen, and there is nothing to suggest the contrary. On the other hand, there is considerable doubt that the material containing such indications is of probative value, at least as far as Guthrie's citizenship is concerned. In the circumstances, I hereby grant the plaintiff leave to file supplementary material on this point. On the assumption that such material will have been filed within twenty-five days from today and that the Court will conclude that it establishes that Guthrie was a United States citizen at the time of the composition of the song *This Land,* I reject the second attack on the adequacy of the plaintiff's material as filed in support of this application.

In the event that such satisfactory supplementary material is not filed, it will be open to the defendant to apply for rescission of the interlocutory injunction, which I may now indicate that I propose to grant, on the basis that it will then be necessary to consider the balance of convenience in the light of the conclusion that I have already reached as to the fairly arguable view as to the meaning of section 4(1), on which the plaintiff's title will then depend.

As the further facts that are relevant to the questions that I have to consider bear on the application of section 19 of the *Copyright Act,* I quote now the portions of the section that may have to be considered.

19. (1) It shall not be deemed to be an infringement of copyright in any musical, literary or dramatic work for any person to make within

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Canada records, perforated rolls, or other contrivances, by means of which sounds may be reproduced and by means of which the work may be mechanically performed, if such person proves

(a) that such contrivances have previously been made by, or with the consent or acquiescence of, the owner of the copyright in the work; and

(b) that he has given the prescribed notice of his intention to make the contrivances, and that there has been paid in the prescribed manner to, or for the benefit of, the owner of the copyright in the work royalties in respect of all such contrivances sold by him, as hereinafter mentioned.

(2) Nothing in subsection (1) authorizes any alterations in, or omissions from, the work reproduced, unless contrivances reproducing the work subject to similar alterations and omissions have been previously made by, or with the consent or acquiescence of, the owner of the copyright, or unless such alterations or omissions are reasonably necessary for the adaptation of the work to the contrivances in question.

* * *

(4) The making of the necessary manuscript arrangement and instrumentations of the copyrighted work, for the sole purpose of the adaptation of the work to the contrivances in question, shall not be deemed an infringement of copyright.

(5) The royalty as aforesaid shall be two cents for each playing surface of each such record and two cents for each such perforated roll or other contrivance.

(6) Where any such contrivance is made reproducing on the same playing surface two or more different works in which copyright subsists, and the owners of the copyright therein are different persons, the sums payable by way of royalties under this section shall be apportioned amongst the several owners of the copyright equally.

* * *

(8) For the purposes of this section, the Governor in Council may make regulations prescribing anything that under this section is to be prescribed, and prescribing the mode in which notices are to be given and the particulars to be given in such notices, and the mode, time, and frequency of the payment of royalties; and any such regulations may, if the governor in Council thinks fit, include regulations requiring payment in advance or otherwise securing the payment of royalties.

Regulations have been made under section 19; see Rule 21(2) and Rule 22(a) of the *Copyright Rules,* which read:

21. (2) Where a person intends to make a contrivance, the notice required by paragraph (b) of subsection (1) of section 19 of the Act shall contain the following particulars:

(a) the name and address of the person intending to make the contrivances;

(b) the name of the work which it is intended to reproduce and of the author, if known, and, if necessary, a description sufficient to identify the work;

(c) the class of contrivance on which it is intended to reproduce the work, that is to say, whether on discs, cylinders, music rolls, or otherwise;

(d) the earliest date at which any of the contrivances will be delivered to a purchaser; and

(e) whether any other work is to be reproduced on the same playing surface of a disc or on the same perforated roll or other contrivance with the work specified in accordance with paragraph (b).

22. Not less than 10 days before any contrivances on which the work is reproduced are delivered to a purchaser,

(a) if the name and address of the owner of the copyright, or his agent for the receipt of notice, are known or can with reasonable diligence be ascertained, the notice described in rule 21 shall be sent by registered mail or by prepaid telegraph to such owner or agent at such address; or

It is fair to say here that the defendant, in effect, concedes that, subject to the objections that I have already disposed of, it proposes to do things that would be an infringement of the plaintiff's copyright unless, on the facts, it has statutory authority to do such things by virtue of section 19. It is also fair to say here that the plaintiff concedes that the condition contained in section 10(1)(a) has been satisfied.

I return now to the facts.

A letter dated February 15, 1967 addressed to the plaintiff and signed by the defendant Canint Music Corp. Ltd., re "This Land is Your Land—Composer Woody Guthrie", reads as follows:

Please be advised that the tune to the above mentioned song has been used with another set of words, written by Mr. Alec Somerville, and recorded on an Arc single 45 rpm recording, A-1161 by The Brothers-In-Law.

The Publisher royalties for this record will be split, 50% to Harry Fox for Ludlow Music and 50% to Canint Music Corp. Ltd.

A reply was made to this letter by a letter dated February 17, 1967, reading:

This will acknowledge receipt of your letter of February 15, 1967 subject as above.

We hasten to advise you that any usage whatsoever of our above copyrighted composition with any lyric written without our consent is an absolute and flagrant violation and infringement of our copyright in the above composition.

Further you are advised that under no circumstances would we permit any lyric other than one specifically authorized by us and same would be in contradiction of our legal rights. Accordingly, demand is hereby made upon you to cease and desist from any use whatsoever of our said composition.

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Your failure to comply with the above demand shall necessitate our bringing legal action against you to enjoin any unauthorized use and seek the appropriate remedies at law

We expect your confirmation of compliance with the above by return mail.

A reply was written to this letter, by a person who is an officer of both of the defendant companies, on February 24, 1967, reading as follows:

I wish to apologize for not being able to speak with you on the 'phone the other day when you called long distance and realizing your concern I have taken this opportunity of replying to your letter of February 17, 1967.

A group called "The Brothers-In-Law" of which Alec Somerville is the creative genius, has taken substantially the tune "THIS LAND IS YOUR LAND" and has written a clever totally new set of lyrics which gently chides the Canadian Government and the Canadian people for their alleged feelings of inferiority. This album fits very nicely into the feeling on the Canadian scene in this particular year as it is the 100th anniversary of Canada as a nation.

There is no dispute with you as to the payment of royalties required by Canadian Copyright Law as regards the tune, but with respect to the lyrics the English courts have taken the stand that a satire or parody on the lyrics of an existing copyrighted tune does not constitute infringement provided that the lyrics are rewritten skilfully. Having heard the Somerville lyrics, I feel perfectly safe in taking the stand that Mr. Somerville has shown inventiveness, imagination and considerable skill in the choice of the words expressing the various thoughts and ideas that he intended to portray and therefore the lyrics fall safely within the previously noted English law. This is not a question of simple modification of a few thoughts or words, but a total rewriting of lyrics thereby precluding the necessity of authorization by the copyright owner as regards lyrics.

Accordingly, if you will be so kind as to provide me with good evidence as of the ownership of the song "THIS LAND IS YOUR LAND", one half of the Canadian statutory royalty will be paid in the prescribed form on behalf of the tune only. Nothing will be paid of course on behalf of the lyrics.

A letter dated March 1, 1967 was written to the defendant, Canint Music Corp. Ltd., by solicitors for the plaintiff. That letter reads:

We have been retained by Ludlow Music, Inc., the owner of the copyright in the words and music of the song, "This Land is Your Land".

We are informed that your firm has infringed our client's above noted copyright by recording our client's music with another set of words.

Unless we receive your undertaking by telephone on or before Friday, March 3, we have been instructed to proceed with the commencement of legal proceedings in the Exchequer Court of Canada to protect our client's copyright. We also require your written undertaking not to infringe the copyright in "This Land is Your Land". We will require an affidavit from an officer of your company under oath, setting out the number of infringing records sold and a statement that all remaining records on hand have been destroyed. The matter of damages can be determined as soon as we are aware of the extent of distribution of the infringing record

A letter dated March 6, 1967 was then written on behalf of the defendant to a representative of the plaintiff. That letter reads:

I have been contacted by Mr. Carson of Gowling, MacTavish, Osborne & Henderson by letter and 'phone and I have taken the liberty of sending a letter to Mr. Carson with the new lyrics composed by Alec Somerville.

I take this opportunity of forwarding to you as well, a copy of the new lyrics proposed to be put to the tune "This Land is Your Land" and marketed under the title "This Land is Whose Land". As you can see these lyrics are taken in a jocular vein and could not, by any reasonable interpretation, be regarded as competing on the market in the same phonograph record area as "This Land Is Your Land".

Please disregard the former Notice of Intent to Use which was mailed through error under Canint Music Corporation letterhead and in its place find a new Intent to Use under Arc Sound.

A letter bearing date March 7, 1967, was written by the same representative of the defendants to the plaintiff's solicitors re *This Land is Your Land (This Land is Whose Land)*. That letter reads:

This will confirm my telephone conversation with you on Monday, March 6, 1967 in the matter of the above subject.

This will confirm that no-one is laying claim to ownership of the tune "This Land Is Your Land", ownership of which is claimed by Ludlow Music Inc, but that entirely new lyrics in parody form were written by one Alec Somerville, which lyrics were put with the above noted tune.

Arc Sound Limited will be distributing phonograph records embodying this material entitled "This Land Is Whose Land" and will be responsible for paying royalties on the tune and the lyrics The royalties on the tune will be paid by Arc directly to Ludlow when they establish satisfactorily their right to royalty claim as copyright owners of the tune and the royalty on the lyrics will be paid by Arc to Canint Music Corporation, which company acquired the new lyrics from Alec Somerville. As requested I enclose herewith a true copy of the new lyrics for your perusal and I can confirm that on this day I sent out a copy of same to Mr Shulman, your client.

As I pointed out to you in my telephone conversation, this project was not launched spuriously without due consideration being given to the possibility of infringing upon the rights of the copyright owners of "This Land Is Your Land" both as regards the tune and the lyrics I discussed the proposed song "This Land Is Whose Land" with Donald Sim of the firm of McCarthy and McCarthy who took the trouble of looking up the law on the matter of writing new lyrics to existing songs comprising of a tune with words. The test clearly seems to be according to the English

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application, that the author of the lyrics must have shown skill and imagination in composing the new lyrics to a degree sufficient to separate the new set of lyrics clearly apart from the lyrics of the original composer. Minor rearranging and replacing of words would of course not fall within this interpretation according to the case in question.

By the lyrics composed by Alec Somerville, copy of which is enclosed, it can be readily seen that the entire concept and portrayal of the Somerville lyrics are new and different completely from the original lyrics of "This Land Is Your Land". Copyright is intended to protect the owner, author or composer against infringement by others who would seek to make profit on the ingenuity and creativity of such owner, author or composer. The prohibition against such infringement is certainly clear enough to preclude any doubts in this regard but there doesn't appear to be any prohibition against new lyrics being set to an existing copyrighted tune, either by statute or decisions of the court. These new lyrics are the creation of another person entirely, totally different from the original. Therefore it appears that the copyright owner of a tune to which entirely new lyrics are introduced, would be entitled to payment of royalties covering the tune portion only after Notice of Intent to Use has been communicated. It therefore follows that the owner of the copyright of the new lyrics would be entitled to payment of royalties for the lyric portion.

There is no intention by Arc Sound Limited or anyone else associated with same to avoid this responsibility, but since the song "This Land Is Whose Land" incorporates a copyrighted tune presumably owned by your client and Arc Sound has put to it lyrics composed by Alec Somerville and signed to Canint Music Corporation, then the royalty must be split, half for the lyrics and half for the tune and this is exactly what Arc proposes to do.

Through an error the Intent to Use originally went out under the Canint Music Corporation letterhead. I can advise that a new Intent to Use form has been made under the Arc Sound letterhead, which has been forwarded on to Ludlow correcting this error, and notification to Ludlow has been made that the original Intent to Use in the name of Canint Music is being withdrawn.

I trust that your investigation of this matter will bring you to the same conclusion as Mr. Donald Sim and that this matter can be thereby resolved quite simply.

The Notice of Intent referred to in that letter bears date March 7, 1967 and reads as follows:

You are hereby notified that we intend to reproduce on phonograph records the following song on which we understand you own or control the copyright. Kindly prove ownership including photostat copies of assignment contracts and/or songwriter's contracts plus U.S. or Berne Convention Country copyright number and date of first registration.

We will pay statutory royalties according to the Canadian Copyright Act (1952) or as follows, if you send a mechanical license agreement *for world use* at the rates listed below:

L.P.'s retailing at $1.98 or less—1c

L.P.'s retailing at above $1.98 to $2.98—1-1/2c each

L.P.'s retailing at above $2.98—2c

SELECTION: THIS LAND IS WHOSE LAND (THIS LAND IS YOUR LAND) Tune only

COMPOSER:

TO BE USED ON THE SAME SIDE AS:

COME UP TO CANADA
GERDA
THE PARLIAMENT GAME
MONTCALM'S RETREAT

The words of the "new lyrics" referred to in the letter written on behalf of the defendant on March 7 reads as follows:

First came the Norsemen, extremely coarse men;
Mostly unshavian, all Scandinavian,
They wandered inland and called it Vinland,
This land that's made for you and me......

This land is your land, this land is my land,
This far-from-Norway, just-won't-try-land;
The average Viking has no great liking,
This land that's made for you and me.

The early French had great persistence,
Despite the Indians' combined resistance;
With righteous feeling, they started stealing,
This land that's made for you and me......

This land is your land, this land is my land,
This voyageur and fleur-de-lie-land;
So populate it, then separate it,
This land is made for you and me.

Then came the English and assorted henchmen,
Who started fighting with all those Frenchmen;
All through this bother, they told each other,
This land is made for you and me......

This land is your land, this land is my land,
This Rule Britannia, steak-and-kidney-pie-land;
This land of Tory, and Hope and Glory,
This land that's made for you and me.

While French and English were busy crying,
U.S. investors were quietly buying;
We didn't spot it until they'd got it,
This land that's meant for you and me.

This land ain't your land, this land ain't my land,
This All-Canadian, pie-in-the-sky-land;
Though we bemoan it, we'll never own it,
This land that's made for you and me;
and me; and me; and me......

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Beginning at some time of which no evidence appears in the record,[1] the defendant made records containing *inter alia* the "new lyrics", sung to the tune of the plaintiff's copyrighted song. Such records were first delivered to purchasers on March 20, 1967.

On March 22, 1967, the Statement of Claim herein was filed in this Court and this application was filed on March 25. At 3:30 p.m. on March 30, 1967, the day on which the defendant gave this Court an undertaking to refrain from such distribution pending disposition of this application, slightly over 11,000 of such records had been "shipped out" by the defendant. The defendant has 7,660 such records in its possession and firm orders for more than 12,600 of them. Unless enjoined from doing so, it intends to continue the production and distribution of such records.

On March 31, 1967, a further letter was written for the defendant to the plaintiff reading:

> The letter of February 15, 1967 written by CANINT was premature and should be ignored.
>
> It has come to my attention that our Notice of Intent to Use (March 7, 1967) re the above omitted notification of the earliest date at which time the then proposed records would be delivered to a purchaser. The enclosed Notice of Intent to Use is therefore submitted.

The Notice of Intent referred to therein bears date March 31, 1967 and reads:

> You are hereby notified that we intend to reproduce on phonograph records the following song on which we understand you own or control the copyright. Kindly prove ownership including photostat copies of assignment contracts and/or songwriter's contracts plus U.S. or Berne Convention Country copyright number and date of first registration.
>
> We will pay statutory royalties according to the Canadian Copyright Act (1952) or as follows, if you send a mechanical license agreement *for world use* at the rates listed below:
>
> L.P.'s retailing at $1.98 or less—1c each
>
> L.P.'s retailing at above $1 98 to $2.98—1-1/2c each
>
> L P.'s retailing at above $2.98—2c

[1] According to the letter of February 15, 1967 from Canint Music Corp. Ltd., such records had already been made then.

SELECTION: THIS LAND IS WHOSE LAND (THIS LAND IS YOUR LAND) Tune only
COMPOSER:
TO BE USED ON THE SAME SIDE AS:
COME UP TO CANADA
GERDA
THE PARLIAMENT GAME
MONTCALM'S RETREAT
FIRST INTENDED USE IN RESPECT OF THIS NOTICE OF INTENT TO USE IS TUESDAY, APRIL 11th, 1967.

As I have already indicated, the defendant, in effect, concedes, subject to the objections as to the plaintiff's material with which I have already dealt, that, unless it is entitled, by virtue of section 19, to use, make and sell records of performances in which its "new lyrics" are sung to the tune of *This Land is Your Land*, it would be an infringement of the plaintiff's copyright for it to make and sell in the future the records that it was making and selling before it gave its undertaking to this Court. The contention that it has such a right by virtue of section 19 is based on the view that the plaintiff has one copyright in the *words* of its song and another copyright in the *tune* of its song, that what the defendant has been doing in no way constitutes a use of the *words* of the song, and that the use of the *tune* of the plaintiff's song as the defendant has been using it is authorized, in effect, by section 19. This position seems to be tenable only on the view that the words of a song do constitute one work for copyright purposes and that the tune is another work for copyright purposes. If the song is a single work for copyright purposes, it can hardly be said that, having regard to subsection (2) of section 19, subsection (1) of section 19 can be regarded as authorizing the taking of the tune separately from the words.

The plaintiff's main basis for rejecting this position is that it has a copyright in a single musical work being the words of its song set to its tune.[1]

[1]Presumably the plaintiff takes the alternative position as well that, even if it has separate copyrights in the words and tune respectively, the "new lyrics" are a substantial taking of the words of the plaintiff's song and contain such alterations and omissions as to invoke subsection (2) of section 19 so as to take the new lyrics out of the statutory authority that might otherwise be contained in subsection (1). If this contention had to be dealt with, it would be necessary to decide, in accordance with the type of reasoning to be found in *Joy Music, Ltd. v. Sunday Pictorial Newspapers (1920), Ltd*, *(1960) 1 A.E.R. 703*, whether the "new lyrics" are a new composition or a mere adaptation of the plaintiff's words.

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In the absence of authority, there is no doubt in my mind that, according to the ordinary use of English words by ordinary people, a song is a musical work and the words of a song (considered apart from the tune of the song) do not constitute a musical work. Similarly, the tune of a song (considered apart from the words of the song) is not a song. I am of the view that the situation is the same under the *Copyright Act*. A song, in my understanding of the meaning of the word, consists of words so uttered as to convey to the listener not only the words, but a tune. So considered, I have no doubt that a song is a "combination of melody and harmony, or either of them", within the meaning of those words in the definition of "musical work" in section 2(*p*) of the *Copyright Act*, which reads as follows:

> (*p*) "musical work" means any combination of melody and harmony, or either of them, printed, reduced to writing, or otherwise graphically produced or reproduced;

and that, when it is printed, it is a "musical work" within the meaning of that expression as used in the Act.

When melody or harmony or both is communicated to the listener's ears by noises made only by musical instruments, it is a musical work "without words". A song is, however, melody or harmony or both communicated to the listener's ear by noises in the form of words made by a human voice and is therefore a musical work "with words". Section 2(*v*)[1] recognizes that at least for the purposes of our *Copyright Act*, a musical work may be "with or without words". [I do not have to consider what the copyright situation is where different persons compose the words and the tune, respectively. It may be, depending on the circumstances, that such persons are joint composers of the song and own the copyright jointly, or that one has a copyright in the words (which would then not be a musical work) and that the other has the copyright in the tune (which

[1] 2(*v*) "every original literary, dramatic, musical and artistic work" includes every original production in the literary, scientific or artistic domain, whatever may be the mode or form of its expression, such as books, pamphlets, and other writings, lectures, dramatic or dramatico-musical works, musical works or compositions with or without words, illustrations, sketches, and plastic works relative to geography, topography, architecture or science.

would be an independent musical work). On the other hand, it may be that each would have a copyright in his part of the single work, namely, the song.]

It follows that, in my view, the plaintiff has copyright in the song *This Land is Your Land*—being the words of the song and the tune of the song considered as a single work —and that section 19 does not authorize the defendant to make records by means of which the tune of the song may be reproduced with words that are substantially different from the words of the song. I have in mind particularly subsection (2) of section 19. On the considerations that have been put before me, therefore, I am of the view that the plaintiff will probably obtain judgment in the action and that the defendant's position is not fairly arguable.

On that view of the matter, upon a proper exercise of judicial discretion, I am of the view, without considering the question of balance of convenience, that an interlocutory injunction should be granted as requested. If, on the other hand, it transpires that the plaintiff cannot establish "Woody" Guthrie's United States citizenship as of the time of the making of the work, then, it would appear that the matter will become one that is fairly arguable and consideration will have to be given to the balance of convenience. The order will therefore contain a term that it is subject to the right of the defendant to apply to have it rescinded, in the event that the plaintiff does not file satisfactory evidence of "Woody" Guthrie's United States citizenship as of the time when he composed the work, within twenty-five days from this date. On such an application the question of the adequacy of the proof of citizenship and of balance of convenience may be raised. The order will also contain a term that the defendant may apply to have it rescinded upon showing that the plaintiff is not proceeding with all reasonable expedition to bring the action to a conclusion on the basis of the substantive differences between the parties.

Having come to the above conclusion, I do not have to make any finding in connection with the question as to whether either of the notices given by the defendant to the plaintiff satisfy the requirements of paragraph (*b*) of section 19(1). In my view, as I see the matter at the present time, I should have to hold that the notice of March 7 was not a "prescribed notice", because it did not contain one of

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the five particulars specified by section 21(2) of the *Copyright Rules*, and that the notice of March 31 does not avail the defendant, even for the future, because section 22 of the *Rules* requires that "the notice described in rule 21 shall be sent" not less than 10 days before "any contrivances on which the work is reproduced" are delivered to a purchaser. In my view, this latter provision makes it clear that the statutory authority conferred by section 19 is not available for the future to a person who has been infringing in the past. After all, section 19 is a somewhat unusual cutting down of the copyright and must be applied strictly. Section 19 makes it a condition to the section applying that the person making the contrivances "has given the prescribed notice of his intention to make the contrivances" and the notice prescribed is a notice sent to the owner of the copyright containing prescribed information not less than 10 days before "any" contrivances on which the work is reproduced" are delivered to a purchaser. In this case no notice containing the prescribed information was given before "any contrivances on which the work is reproduced" were delivered to a purchaser.

In addition to the terms I have already referred to, it will be a condition to the issuing of the restraining order that the plaintiff undertake to abide by any order that the Court may make respecting damages that the defendant may sustain by reason of the order. Compare *Novello v. James,*[1] *and Vieweger Construction Co. Ltd. v. Rush & Tompkins Construction Ltd.*[2]

Costs of the application in the cause.

By way of postscript, it might be well if I set out more explicitly the view concerning the factor of balance of convenience upon which I have proceeded in reaching the above conclusions.

In the first place, I should say that I have not had occasion in the past, or time on this occasion, to review the decisions on this question, and I shall be prepared to reconsider the view I am about to express upon full argument on a subsequent occasion if it becomes relevant to do so.

My view is that, in a case such as this, if there were a fairly arguable question as to whether the plaintiff or defendant owned the copyright, the question as to whether

[1] (1854) 43 E.R. 1111. [2] [1965] S.C.R. 195.

matters ought to be kept in *statu quo*, or whether one party or the other should be allowed to exercise the copyright, would have to be decided on a balance of convenience. It does not follow as a matter of course from the fact that there is a fairly arguable question that the Court should refuse an injunction. Compare *Ollendorf v. Black*.[1] See, on the other hand, *McNeill v. Williams*.[2] So, here, if the plaintiff cannot establish Guthrie's United States citizenship, there will be a fairly arguable question on the interpretation of section 4(1) as to whether the plaintiff owns the copyright or the work is in the public domain, in which case the question as to balance of convenience will arise. On the other hand, where, on an application of this kind it appears to the Court, as it does in this case, that the plaintiff is very probably the owner of the copyright and it is quite improbable that the defendant has any right to use the copyrighted work, then it seems sufficiently probable that the plaintiff is entitled to relief that it ought to have an interlocutory restraining order regardless of the balance of convenience. The reason for this latter conclusion is simply that, as I view the matter, a person who has no fairly arguable right to use property should not be able to put himself in a position where the Court will aid him in using the property as against the person who is apparently the owner by embarking on an enterprise that involves such a use of the property that he will lose money or fail to make an anticipated profit if he is not permitted to use the property. In effect, as it seems to me, it is a proper exercise of judicial discretion to protect property rights against encroachment that has no apparent justification, and, in particular, to protect copyright against what appears to be piracy. Compare *Mawman v. Tegg*[3] and cases annotated in the digest of that case in 28 E. & E. Digest (2nd ed.) at page 749. The decision in *Saunders v. Smith*[4] would seem to be distinguishable as there was there conduct by the plaintiffs by which they had in effect acquiesced in the use of their copyrighted work, or might be taken to have done so. On the other hand, in *Grafton v. Watson*[5] the Court of Appeal held that, where the owner of an industrial design

[1] (1850) 64 E R. 801.
[2] (1847) 11 Jur. 344, digested in 28 E. & E Dig. 381 (1st ed)
[3] (1826) 38 E.R. 380.
[4] (1838) 40 E R. 1100
[5] (1884) 51 L.T. 141

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established a *prima facie* case of copying, the balance of convenience required that an interlocutory injunction be granted. While different considerations arise in an industrial design case, having regard to the plaintiff's contention here that what the defendant proposes to do will irreparably damage the value of its song, the decision may have some hearing if the question later arises for decision here. See generally, with reference to the exercise of discretion as to whether interlocutory injunctions should be granted in copyright cases, the cases digested in 13 E. & E. Dig. (2nd ed.) at page 130 *et seq.*

Montreal 1967 Feb. 14-15

Ottawa April 7

BETWEEN:

THE MINISTER OF NATIONAL REVENUE .... APPELLANT;

AND

DIDACE DUFRESNE ....RESPONDENT.

Income tax—Benefit conferred—Income Tax Act, s. 137(2)—Stock rights—Increased equity of minority shareholders—Whether conferred by majority shareholder—Onus of proof—Rebutting assumptions on which assessment based—Gift tax.

D held 164 of the 180 issued $100 par value common shares of a company, his wife held one share, and each of his five children three shares, the seven shareholders being the company's directors. On December 31st 1960 the five children exercised a right conferred by directors' resolution of that day to purchase at par five new shares for each share held. On December 21st 1961 the five children exercised a right conferred by directors' resolution of that day to purchase at par three new shares for each share held. As a result of these purchases the book value of the children's shares increased in December 1960 by $76,515 and in December 1961 by $104,400. The Minister in reliance on s. 137(2) of the *Income Tax Act* assessed D for gift tax on the increases in book value of the children's shares borne by D's shareholding, *viz* $68,596.73 in 1960 and $76,930.91 in 1961.

Held, affirming the assessments, the requirements of s. 137(2) had been satisfied, *viz* (1) the increase in the children's proportionate share of the company's stock was the result of at least one transaction, *viz* the subscription contract; (2) although D was only one of seven directors the balance of probability was that he exercised a controlling influence and that if a benefit was conferred on his children it was he who conferred it; (3) the assumptions on which the assessments were based, *viz* that D conferred a benefit on his children in the amounts assessed had not been rebutted and therefore stood. *Johnston v. M.N.R.* [1948] S.C.R. 486 applied.

Held also, the gift tax assessments were not invalidated by s. 8(1)(iii) of the *Income Tax Act.*

APPEAL from Tax Appeal Board.

A. Garon and *P. H. Guilbault* for appellant.

H. P. Lemay, Q.C. and *J. M. Poulin* for respondent.

JACKETT P.:—This is an appeal by the Minister of National Revenue from a decision of the Tax Appeal Board dated October 22, 1965 allowing the appeals of the respondent Didace Dufresne from re-assessments made on May 31, 1963, whereby the respondent was assessed additional amounts for gift tax under Part IV of the *Income Tax Act,* R.S.C. 1952, chapter 148, as amended, for the taxation years 1960 and 1961.

By virtue of subsection (1) of section 111 of the *Income Tax Act,* a tax is payable upon the gifts made in a taxation year by an individual resident in Canada. (An extended meaning is given, for this purpose, to the word "gift" by subsection (2) of section 111, but it has not been suggested that that subsection has any application to the determination of the question raised by this appeal.) The tax on gifts imposed by section 111 is, by virtue of section 114, payable by the donor.

The question raised by the appeal relates to the acquisition, on two separate occasions, by each of the respondent's five children of shares in a company in which the respondent was the controlling shareholder in circumstances which resulted in the children having an interest in the capital stock of the company, relative to that of the respondent, that was greater than the interest that they had, relative to his, prior to such acquisition. The Minister does not contend that the respondent thereby made gifts to the children within the meaning of that word as defined in Part IV of the Act. What he does say is that the facts are such as to bring into play subsection (2) of section 137 of the *Income Tax Act,* which reads as follows:

(2) Where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatsoever is that a person confers a benefit on a taxpayer, that person shall be deemed to have made a payment to the taxpayer equal to the amount of the benefit conferred notwithstanding the form or legal effect of the transactions or that one or

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more other persons were also parties thereto; and, whether or not there was an intention to avoid or evade taxes under this Act, the payment shall, depending upon the circumstances, be

(*a*) included in computing the taxpayer's income for the purpose of Part I,

(*b*) deemed to be a payment to a non-resident person to which Part III applies, or

(*c*) deemed to be a disposition by way of gift to which Part IV applies.

To reach a conclusion as to the correctness of this contention, it is necessary to review the facts in some detail.

The company in question is a company incorporated under the laws of the Province of Quebec and is known as Dufresne et Frères Ltée. (It is hereinafter referred to as "the company".)

At the end of the company's 1959 taxation year, being the end of the 1959 calendar year, the company had an issued share capital of $18,000 represented by 180 common shares of a par value of $100 each. As of the end of the same year, the company had undistributed income on hand, within the meaning of that expression as defined by section 82(1)(*a*) of the *Income Tax Act,* in an amount of $224,-322.57. (It should be noted that this amount does not necessarily bear any relation to the then current value of the assets of the company or to the then value of the company's issued capital stock.) The respondent owned most of the issued shares at that time.

On December 24, 1960, the respondent made a gift of two common shares in the company to each of four of his children and of one such share to his fifth child. On the same day, he made a gift of $750 to each of his five children. (In his gift tax return for the 1960 taxation year, the respondent reported such gifts and put a value on each of such shares as of December 24, 1960, of $1,421.47.)

On December 30, 1960, the authorized capital of the company was increased, by means of supplementary letters patent, from $20,000 to $300,000 divided as follows:

(a) 1,180 common shares of a par value of $100 each,

(b) 1,800 preferred shares, Class "A", with no voting rights of a par value of $100, and

(c) 2,000 preferred shares, Class "B", with a right to one vote for each share at shareholders' meetings at a par value of $1.

Immediately before a meeting of the Board of Directors of the company held on December 31, 1960, the issued common shares of the company were held as follows:

the respondent	164
his wife	1
his five children, 3 shares each	15
	180

These shares at that time had a book value of $1,421 each. The fifteen shares held by the children at that time had therefore a book value of $21,315, and those of the respondent had a book value of $243,044.

On December 31, 1960, at a meeting of the Board of Directors of the company at which the respondent, as president, presided, and which was attended by the respondent's wife and his five children, who were all shareholders and directors, a resolution was unanimously adopted conferring on each of the shareholders a right to subscribe to five new common shares of a par value of $100 per share for each share then held by him.

After that resolution was adopted, the meeting was adjourned for a few minutes to permit the shareholders to exercise the options that it conferred on them. Upon the meeting being resumed, the respondent reported that he and his wife were not exercising their options and were not subscribing to new shares, but that the five children were all exercising their options and each of them was subscribing for 15 common shares. The transactions were completed forthwith. Each of the children paid $1,500 to the company and 15 common shares were issued by the company to each of them.

After such shares were issued, the common shares in the company were held as follows:

the respondent	164
his wife	1
his five children—18 shares each	90
	255

The book value of the common shares of the company after the additional shares were so issued was $1,087 per share. At that time, therefore, the book value of the 90

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shares held by the children was $97,830, and the book value of the 164 shares held by the respondent had fallen to $178,268.

Immediately before December 21, 1961, the book value of the common shares in the company was $1,000 per share so that the 90 shares of the children then had a book value of $90,000 and the respondent's shares then had a book value of $164,000.

On December 21, 1961, a right to subscribe for three common shares at par for each share held was conferred on each shareholder in the company by a resolution along the lines of that which had been passed on December 31, 1960. Again, the children exercised the rights so conferred and the respondent and his wife did not; the result was that each child acquired an additional 54 common shares and paid $5,400 for them.

On that same day, the respondent subscribed for 2,000 Class B preferred shares and paid $2,000 for them; and they were issued to him.

The shareholding in the company after December 21, 1961 was as follows:

the respondent	164 common
	2,000 "B" preferred
his wife	1 common
his five children—	
72 shares each	360 common

The common shares then had a book value of $540 per share so that the children's shares had a book value of $199,400, and the book value of the respondent's common shares had fallen from $164,000 to $78,560.

The relevant part of section 137 of the *Income Tax Act* reads as follows:

(2) Where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatsoever is that a person confers a benefit on a taxpayer, that person shall be deemed to have made a payment to the taxpayer equal to the amount of the benefit conferred notwithstanding the form or legal effect of the transactions or that one or more other persons were also parties thereto; and, whether or not there was an intention to avoid or evade taxes under this Act, the payment shall, depending upon the circumstances be

(*a*) included in computing the taxpayer's income for the purpose of Part I,

(b) deemed to be a payment to a non-resident person to which Part III applies, or

(c) deemed to be a disposition by way of gift to which Part IV applies.

(3) Where it is established that a sale, exchange or other transaction was entered into by persons dealing at arm's length, *bona fide* and not pursuant to, or as part of, any other transaction and not to effect payment, in whole or in part, of an existing or future obligation, no party thereto shall be regarded, for the purpose of this section, as having conferred a benefit on a party with whom he was so dealing.

The basis upon which the appellant supports the assessments in this Court is set out in the part of the Notice of Appeal that reads as follows:

3 L'appelant en établissant ses cotisations du 31 mai 1963 pour les années 1960 et 1961 s'est appuyé sur le fait que les opérations décrites dans le paragraphe 4 de cet Avis d'appel ont eu pour résultat que l'intimé a conféré au sens de l'article 137(2) de la *Loi de l'impôt sur le revenu* un avantage pour l'année 1960 de $68,596.73 et de $76,930.91 pour l'année 1961 à ses enfants, Yves Dufresne, Maurice Dufresne, Dame Louise D. René de Cotret, Dame Kate D. Chenevert de Dame Denise Leclerc.

4. En établissant ses cotisations du 31 mai 1963 pour les années 1960 et 1961 et en déterminant qu'un avantage a été conféré aux enfants susdits par l'intimé au sens de l'article 137(2) de la *Loi de l'impôt sur le revenu,* l'appelant s'est appuyé sur les faits et les opérations qui suivent:

(i) Pendant les années 1960 et 1961, l'intimé contrôlait effectivement Dufresne et Frères Limitée;

(ii) Les 31 décembre 1960 et 21 décembre 1961, la compagnie Dufresne Limitée conférait à tous les détenteurs d'actions ordinaires du capital de la corporation le droit d'y acheter des actions ordinaires additionnelles à leur valeur au pair de $100 chacune;

(iii) Les détenteurs d'actions ordinaires du capital de la corporation au moment où ce droit d'acheter des actions ordinaires additionnelles à leur valeur au pair de $100 chacune fut conféré, étaient l'intimé, Dame Didace Dufresne, épouse de l'intimé, et les enfants de l'intimé susdits.

(iv) L'intimé et son épouse ont pris la décision de ne pas se prévaloir du droit d'acquérir des actions ordinaires additionnelles à leur valeur au pair de $100 chacune.

(v) Les enfants susdits se sont seuls prévalus du droit d'acheter des actions ordinaires additionnelles à leur valeur au pair de $100 chacune, ont souscrit ces actions additionnelles et les ont payées.

B. DISPOSITIONS STATUTAIRES ET LES RAISONS QUE L'APPELANT A L'INTENTION D'INVOQUER À L'APPUI DE SON APPEL

5. L'appelant s'appuie entre autres sur l'article 137(2) de la *Loi de l'impôt sur le revenu,* S.R.C. 1952, Chapitre 148.

6. L'appelant soumet que la participation de l'intimé à la décision de la compagnie Dufresne et Frères Limitée d'accorder aux détenteurs d'actions ordinaires du capital de cette corporation le droit d'acheter des actions

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ordinaires additionnelles à leur valeur au pair de $100 chacune, la décision de l'intimé de ne pas se prévaloir lui-même de ce droit d'acquérir des actions ordinaires additionnelles et l'achat par les enfants susdits de l'intimé d'acquérir des actions ordinaires additionnelles à leur valeur au pair de $100 chacune constituent des opérations qui ont eu pour résultat que l'intimé a conféré un avantage à ses enfants susdits au sens de l'article 137(2) de la *Loi de l'impôt sur le revenu.*

The explanation of how the appellant computed the amount of the benefit (avantage) for each of the years in question (paragraph 3 of the Notice of Appeal) is to be found in the explanatory memorandum attached to the reassessment appealed from, which reads in part:

M. Didace Dufresne

Calcul des bénéfices conférés à ses enfants lors de deux émissions d'actions de

«DUFRESNE ET FRÈRES LTÉE»

Émission de 75 actions ordinaires le 31 décembre 1960:

Valeur des actions des enfants après l'émission: 90 actions à $1,087 00	$ 97,830 00
Valeur des actions des enfants avant l'émission· 15 actions à $1,421 00	21,315 00
Valeur transférée	76,515 00
Prix payé—75 actions à $100 00	7,500.00
Élément de don	$ 69,015 00
Bénéfice conféré par Didace Dufresne: $\$69{,}015\ 00 \times \frac{164}{165}$	$ 68,596 73

Émission de 270 actions ordinaires le 21 décembre 1961:

Valeur des actions des enfants après l'émission: 360 actions à $540 00	$194,400 00
Valeur des actions des enfants avant l'émission: 90 actions à $1,000 00	90,000 00
Valeur transférée	104,400 00
Prix payé—270 actions à $100 00	27,000 00
Élément de don	$ 77,400.00
Bénéfice conféré par Didace Dufresne: $\$77{,}400.00 \times \frac{164}{165}$	$ 76,930 91

By his Reply to the Notice of Appeal, the respondent put the above portions of the Notice of Appeal in issue and, in effect, pleaded that what had been done was that the company had conferred a benefit on its shareholders that was exempt from income tax by section 8(1)(*c*)(iii) of the *Income Tax Act*. The Reply expressly pleaded that the respondent did not confer any advantage on his co-shareholders (co-actionnaires).

At the hearing, the parties filed an "Admission de Faits", the effect of which I have already stated, to the extent that I regard it as relevant, in my recital of the facts. In addition, by agreement, the evidence given before the Tax Appeal Board was introduced as evidence in this Court and one of the sons of the respondent, who gave evidence before the Board, was produced by the respondent for cross-examination, and was cross-examined by counsel for the appellant.

I reject the submission by the respondent that section 8 of the *Income Tax Act* operates to invalidate the gift tax assessments that are under appeal. Section 8(1) reads as follows:

8. (1) Where, in a taxation year,

(*a*) a payment has been made by a corporation to a shareholder otherwise than pursuant to a bona fide business transaction,

(*b*) funds or property of a corporation have been appropriated in any manner whatsoever to, or for the benefit of, a shareholder, or

(*c*) a benefit or advantage has been conferred on a shareholder by a corporation,

otherwise than

(i) on the reduction of capital, the redemption of shares or the winding-up, discontinuance or reorganization of its business,

(ii) by payment of a stock dividend, or

(iii) by conferring on all holders of common shares in the capital of the corporation a right to buy additional common shares therein,

the amount or value thereof shall be included in computing the income of the shareholder for the year.

If it were not for the presence in this subsection of paragraph (iii) thereof, the subsection would have made all the shareholders of the company in this case liable to include in their incomes for 1960 and 1961, respectively, for income tax purposes, the amounts of the respective benefits, if any, conferred on them by the company in 1960 and 1961 by granting to them "rights" to acquire shares at par. Paragraph (iii) exempts them from the liability that would

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otherwise have been so imposed on them. It does not have any other effect and, in particular, it does not have effect to exempt the respondent from any liability that may be imposed on him, by Part IV of the *Income Tax Act* read with section 137, to pay gift tax, even though such liability arises from a series of transactions or other events of which the company's granting of "rights" to its shareholders is one.[1]

In my view, the appeal has to be decided by answering the question whether it has been established that the "result" of one or more "transactions" is that the respondent, in one or both of the years in question, conferred a "benefit" on each of his children within the meaning of those words in section 137(2). If he did, he is deemed to have made a payment to each of the children equal to the amount of the benefit, and that payment, in the circumstances of this case, is deemed to be a "disposition by way of gift to which Part IV applies".

If the "result" of the transaction or transactions was that the respondent so conferred a "benefit", it follows from the express words of section 137(2)

(a) that it does not matter what form the "transactions" took or what the legal effect of the transactions was, and

(b) that there does not have to have been an intention to avoid or evade taxes.

Furthermore, it does not matter whether persons other than the respondent and his children were parties to the transactions. It is not surprising that Parliament inserted this latter clause because, in the nature of things, it is to be anticipated that, where a person makes arrangements to confer a benefit on another by a series of transactions, it will frequently be so arranged that the person granting the benefit will be a party to the first transaction and the person benefited will be a party to the last transaction, but

[1] In any event, it should be noted that the benefit in question here was not conferred on the children by the "conferring" on all the shareholders in the company of the "right" to acquire additional shares at par. It was the subsequent exercise of this "right" by the children together with the decision of the parents not to exercise the "right" which resulted in the benefit having been conferred.

third parties will be the other parties to those transactions and possibly to intervening transactions.

If subsection (2) of section 137 stood by itself, I should have been inclined to read into it an implied exception in favour of *bona fide* business transactions. As, however, subsection (3) of section 137, in effect, excepts from the operation of subsection (2) *bona fide* arm's length transactions subject to appropriate qualifications, I am of opinion that Parliament meant subsection (2) to be read without any implied exception.

In my view, therefore, the question in this case resolves itself into the following questions:

(a) Was a benefit conferred on each of the children in each of the two years?

(b) If so, was the benefit conferred by the respondent?

(c) If a benefit was so conferred, was the benefit the "result" of one or more "transactions"?

If the answer to all these questions is in the affirmative, it has not been suggested that there is any room for the application of subsection (3) of section 137 in this case.

I propose to consider the three questions in the reverse order from that in which I have set them out above.

It will be sufficient to consider the matter in relation to what happened in 1960. On the facts, as established, whatever result is reached for that year must be reached for 1961. It will also be more convenient to discuss the children as a group although, of course, each one engaged in the matter separately.

In 1960, the children acquired 75 shares in the company at a cost of $7,500 in circumstances such that, as a result of the acquisition, they became, after the acquisition, owners of 6/17 (90/255) of the stock in the company instead of the 1/12 (15/180) of the stock in the company that they held before such acquisition. Certainly, this "*result*" flowed from at least one transaction—that is the subscription contract—in the very special circumstances in which it was made possible for each child to enter into his or her subscription contract with the company. That being so, I do not have to decide whether the other acts that took place as a necessary part of the action required to create those

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special circumstances were "transactions" (English version) or "opérations" (French version) within the meaning of the statute. In my view they were, because, in my view, the word "transaction" or "opération" is used in the widest possible sense as meaning any act having operative effect in relation to a business or property.[1] However, I do not need to reach a concluded opinion on that question to conclude, as I do, that the "result" I have described was the result of a "transaction".

The second question is whether, if that result—acquisition at a cost of $7,500 of a holding of 6/17 of the stock of the company in place of the 1/12 previously held—was a "benefit" to the children, was that benefit conferred on them by the respondent?

That question cannot, in my view, be realistically answered by an analysis of each of the respective steps taken without taking account of the ordinary well known facts of life in the world of affairs. The resolution granting the "rights" was, it is true, passed by the Board of Directors; and the respondent was only one director and had in the proceedings of the Board only one vote. There is nothing, moreover, to show that the wife and children did not each act independently in deciding their respective courses of action in the whole series of events. Nevertheless, in the absence of any evidence by the respondent or on his behalf to show what in fact happened, I am of the view that the balance of probability is that he, as the owner of practically all the shares in the company and the head of the family, had the controlling influence in the determination of the course of events with which we are concerned. The sequence of events bears all the earmarks of a series of company transactions that had been arranged in advance by the major shareholder and father, after taking appropriate professional advice, with a view to achieving the result of increasing the children's proportions in the ownership of the stock of the company. That that is what in fact happened is corroborated by the evidence given before the Tax

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[1] Compare *Minister of National Revenue v. Granite Bay Timber Company Limited,* [1958] Ex. C.R. 179, per Thurlow J. at pages 187 to 191, and the authorities reviewed by him.

Appeal Board. There was very little, if any, consultation in advance between the children and the respondent, who, in effect, presented them with what he had arranged for their benefit and assumed that they would accept it, which they did. Moreover, the benefit, if it was one, was an increase in the proportions of the children almost entirely at the expense of a decrease in the respondent's.

There is no doubt in my mind that, if the result of the transaction was a benefit to the children, it was conferred on them by the respondent.

This brings me to the question whether it has been established that the result of the transaction was, in fact, a benefit to the children.

In considering this question, it becomes important to examine the issues on which the parties went to trial as determined by the Notice of Appeal and the Reply thereto.

By paragraph 3 of the Notice of Appeal, the appellant said that he based the assessment for 1960 on the fact (le fait) that the transactions (les opérations) described in paragraph 4 of the Notice of Appeal, had as a result that the respondent conferred (in the sense of section 137(2)) a benefit for the year 1960 of $68,596.73 on the children. (As already noted, that "benefit" is calculated as though book values of the company's assets were actual values.) In paragraph 4 of the Notice of Appeal, there is outlined the facts and transactions (les faits et les opérations) already referred to, but there is no express allegation or indication that the appellant assumed, in making the assessment, that the shares had an actual value in excess of the $7,500 paid for them.

The position taken by the appellant by this pleading was nevertheless quite clearly to the effect that the appellant had based his assessment on the assumption ("L'appelant . . . s'est appuyé sur le fait") that arranging or permitting that the children acquire a larger proportion of the stock of the company by acquiring shares at par was, in itself, conferring a benefit on them, and that the amount of that benefit was $68,596.73.

By paragraph 2 of the Reply to the Notice of Appeal, the respondent denied, *inter alia*, paragraphs 3 and 4 of the

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Notice of Appeal. He did not otherwise plead with reference to the appellant's allegation that the appellant had based the assessment upon the facts and transactions outlined in those paragraphs or with reference to the facts and transactions there outlined.

In my view, the onus was on the respondent to plead and prove either

(a) that the assessment was not based on an assumption that the result of the transactions set out in paragraph 4 of the Notice of Appeal was that the respondent conferred a benefit of $66,596.73 on the children; or

(b) that it was not, in fact, a result of such transactions that the respondent conferred a benefit in that amount on the children.

In my view, this is the result of the state of the law concerning the onus on an appellant from an income tax assessment as established by *Johnston v. Minister of National Revenue*[1]. While that decision related to proceedings under the *Income War Tax Act*, I can see no relevant difference between the procedure provided by that Act and the procedure provided by the *Income Tax Act*.

These being the two ways in which the respondent could have met the appellant's position on this point, it remains to consider what he actually did.

With reference to the first alternative open to him, the respondent did, by his pleading, deny paragraph 3 of the Notice of Appeal, but he made no attempt at the hearing to show that the appellant did not base the assessments on the assumption in question. In fact, a review of the assessment and the subsequent proceedings (which may properly be looked at for this purpose as appears from the judgments in the *Johnston* case, *supra*) clearly establishes that this was indeed one of the assumptions upon which the assessment was based.

With reference to the second alternative that was open to him on this point, not only did the respondent not challenge the correctness of the assumption in question, but it seems clear that the preliminary proceedings and the appeal were conducted on the mutual assumption that a

[1] [1948] S.C.R. 486.

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benefit had been conferred on the children by the transactions in question. The correctness of the assumption not having been challenged by the respondent, this point must be determined against the respondent.[1]

What I have said with reference to the 1960 assessment applies, as I have already indicated, to the 1961 assessment.

The appeal is allowed with costs and the assessments are restored.

[1] In my view, the principle to be found in the following passage from the judgment of Rand J., delivering the judgment of the majority, in *Johnston v. Minister of National Revenue, supra,* at page 489, is applicable here:

> ...the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant If the taxpayer here intended to contest the fact ... he should have raised that issue in his pleading, and the burden would have rested on him as on any appellant to show that the conclusion below was not warranted. For that purpose he might bring evidence before the Court notwithstanding that it had not been placed before the assessor or the Minister, but the onus was his to demolish the basic fact on which the taxation rested.

IN ADMIRALTY

BETWEEN:

Montreal
1967
Apr. 4-5

CYRILLE BELISLE .... APPELLANT;

AND

THE MINISTER OF TRANSPORT .... RESPONDENT.

Shipping—Suspension of pilot's certificate—Canada Shipping Act, R.S.C. 1952, c. 29, ss. 558, 568(1)(a)—"Wrongful act or default", meaning —Findings of fault—Reversal on appeal—Degree of fault required —Raising new contention on appeal—Not permissible.

The M/V *Hermes* piloted by appellant down the St. Lawrence River on April 10th 1965 suddenly sheered to port in a narrow channel and collided with an up-bound ship. The Commissioner appointed to investigate the collision under s. 558 of the *Canada Shipping Act* found that the *Hermes* was navigating too close to the south shore, which caused bank suction and an uncontrollable turn to port, that the lower range light at that location had been displaced 40 feet during several years before the collision and the centre line of the

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channel was consequently falsely shown 250 feet towards the south bank. He found appellant blameworthy for deciding to meet the up-bound vessel in the narrow part of the channel, and that he was at fault (a) in going full speed in the narrow part of the channel, (b) in doing so when the buoy indicating the entrance of the narrow channel was not in place, (c) in following the line indicated by the range lights when he knew that the lower range light was displaced, (d) in proceeding at full speed with his first vessel of the year, and (e) in neglecting to use his radio-telephone. The Commissioner thereupon suspended appellant's certificate under s. 568(1)(*a*) of the *Canada Shipping Act*. On appeal to this Court the Commissioner's findings of fault by appellant were rejected.

Held, the suspension of appellant's certificate must therefore be quashed. Moreover even if appellant was guilty of the acts or omissions as found by the Commissioner they were not of a sufficiently culpable nature to justify the suspension of his certificate under s. 568(1), nor were they shown to have caused or contributed to the collision. The wrongful act or default which must be proved if disciplinary action under s. 568(1) is to be taken can be any breach of duty which causes or contributes to the accident but an error of judgment in a moment of difficulty or danger may not be enough. It must be the doing of something which it was *plainly* the duty of the officer not to do or the omission to do something which it was *plainly* his duty to do. The *Princess Victoria* (1953) 2 Ll. L.L.R. 619; The *Carlisle* (1905-1908) 10 Asp. M.L.C. 287, referred to.

Held also, it was not open to the Minister of Transport to contend on the appeal that the Commissioner erred in finding that the final 11 feet displacement of the lower range light took place before and not after the collision.

APPEAL from suspension of pilot's certificate.

J. Paul Dufour for appellant.

Bernard Deschenes, Q.C. for respondent.

The judgment of the Court (JACKETT P., DUMOULIN and NOËL JJ.) was delivered by

NOËL J.:—This is an appeal from the decision of the Commissioner, Mr. Justice Charles A. Cannon, appointed by the respondent, the Minister of Transport, to hold a formal investigation pursuant to section 558 of the *Canada Shipping Act,* R.S.C. 1952, chapter 29, into the circumstances attending the collision between the M/V *Transatlantic* and the M/V *Hermes* on Lake St. Peter in the St. Lawrence River on April 10, 1965.

The collision occurred at a place situated between Sorel and Three Rivers, near the northeastern end of Yamachiche bend in an area in the navigational channel extending from curve No. 2 to the southwest at buoy 85L down channel to the northeast at curve No. 3. At that place, the channel is 550 feet wide and 35 feet deep.

The M/V *Hermes* loaded with 2,500 metric tons of general cargo on board under the command of her master, Captain Van Eyk, was proceeding downstream. Cyrille Belisle, a pilot of some 31 years of experience, was on board conning the vessel.

Upon entering Yamachiche bend and after negotiating the curve to port, the pilot was following a course fixed by lining up Pointe du Lac ranges in the same manner as he had often done in the past. Shortly after a red winter buoy, which was in the approximate position of and was replacing summer buoy 54L, was left abeam to port, the head of the *Hermes* took a sudden sheer to port and although immediate starboarding action was taken by the *Hermes* and the engines were reversed to full astern, it was not possible to prevent the vessel from colliding with the M/V *Transatlantic* which was proceeding upstream towards Montreal.

The Commissioner, who rendered his decision on March 18, 1966, held *inter alia* that the cause of the collision was that "The *Hermes* going into a narrow channel, was navigating too close to the south bank at too great a speed, which caused the phenomenon commonly known as 'bank suction'. This caused an uncontrollable turn to port and, consequently, the collision."

The Commissioner further found that if summer buoys and at least buoys 51L and 63L had been placed at the east and west ends of the Yamachiche anchorage to show navigators where the anchorage finished and where the channel began, the accident would not have happened because it would have indicated to pilot Belisle the exact place where the narrow channel began.

While there may be some doubt as to the correctness of that finding owing to the possibility that the said buoys might have been displaced by floating ice, in the meantime, there is no doubt in my view of the correctness and significance of the Commissioner's further finding that another navigational aid, the lower range light of Pointe du Lac, placed on a cement block, had been displaced for several years. He indeed held that:

> It is established by aerial photographs that between 1959 and 1964 the cement base was displaced by 29 feet. It is also established by civil

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engineer Huffy that the time of the inspection of June 8, 1965, the cement base was displaced towards the southeast by 40 feet; this means that there would have been a supplementary displacement of 11 feet between the fall of 1964 and June 1965, confirmed by triangulation of the 22nd of April (which the Commissioner later held had taken place before the 10th of April, 1965, i.e., before the collision).

The Commissioner also found that with a displacement of approximately 29 feet, the ranges in line showed the centre line of the channel near buoy 51L, where the sheering of the M/V *Hermes* took place, off true centre towards the south by 100 feet and that there would be a displacement of 250 feet off true centre with a displacement of the range of 40 feet (29 feet plus 11 feet)*.

The Commissioner then concluded as follows:

> But whatever this displacement may be, it is certain that it was sufficient to make a ship pass too close to the south bank of the channel and thus cause a swing to port in the channel, which is what happened to the *Manchester Commerce*, to the *Carinthia* and to the *Hermes* herself.

He then concluded that:

> Under the principle that the same causes bring about the same consequences, one can say certainly that the swings of the *Manchester Commerce* and of the *Carinthia* were caused by the same fact as the swing of the *Hermes*: that is to say by the fact that the line of the Pointe du Lac ranges was guiding ships too close to the south. There is therefore no doubt that this displacement existed on April 3rd and on April 9th, 1965, in order to cause the swing to port of the *Manchester Commerce* and of the *Carinthia*. Therefore it existed on the 10th of April 1965, and caused the swing of the *Hermes*.

Having thus determined the cause of the collision, the Commissioner also held that pilot Belisle on the M/V *Hermes* was blameworthy in this collision in that he "was imprudent in deciding to meet the *Transatlantic* in the narrow part of the channel when he could have met her in the wide part of the Yamachiche anchorage and that he was in fault:

> (a) in going full speed into the narrow part of the channel when he had to meet a ship in it;
>
> (b) in attempting this manoeuvre when buoy 51L that was to serve him as a guide to indicate the entrance of the narrow channel was not in place;
>
> (c) in following the line given by the Pointe du Lac ranges in line when he knew since last year that the lower range was not in its place;

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*The Court does not understand how 11 additional feet can have moved the central line of the channel 150 feet more to the south when 29 feet had moved it 100 feet. However, such was the finding of the Commissioner and no other explanation was given the Court during this appeal.

(d) in proceeding at full speed when it was the first time in 1965 that he was going down this part of the river as the pilot of a ship;

(e) in neglecting to use his radio-telephone.

He then added:

It is clear that in manoeuvring in this manner and in taking these risks pilot Belisle did not follow Rule 29 of the Regulations for Preventing Collisions at Sea, which reads as follows:

> Nothing in these Rules shall exonerate any vessel, or the owner, master or crew thereof, from the consequences of any neglect to carry lights or signals, or of any neglect to keep a proper look-out, or of the neglect of any precaution which may be required by the ordinary practice of seamen, or by the special circumstances of the case.

It is clear that pilot Belisle did not take the precautions required by the ordinary practice of seamen or by the special circumstances of the case.

I will deal firstly with the appellant's wrongful acts or omissions as found by the Commissioner and based on his finding of fact that the last displacement of one of the ranges by 11 feet had occurred prior to the accident and will later consider the attack made by counsel for the respondent of the Commissioner's decision on this matter.

With respect to the finding that Belisle was imprudent in deciding to meet the *Transatlantic* as he did there appears from the evidence to have been no good reason why the *Hermes* coming downstream should have stopped or reduced her speed in order to meet the *Transatlantic* in the anchorage section of the Yamachiche bend rather than in the bend in the dredged channel. The weather and visibility were good and had there been any reason to take any measure in order to meet a vessel coming in the opposite direction at a sharp turn or narrow passage, the ship stemming the tide, i.e., the *Transatlantic* and not the *Hermes* (which was going downstream with the current) would have had to stop or come to a position of safety below or above the point of danger in accordance with Regulation 12, P.C. 1954-1925 dated December 3, 1954, (Appendix B), (Exhibit C-5).

Furthermore, it must be borne in mind that, although the Yamachiche bend and anchorage appear clearly on Exhibit C-2, on the day of the collision there was only one spar buoy on the north side that, if visible and reliable, would be of use in indicating to those on board the M/V *Hermes* the limits of the cut of the channel at the eastern part of the anchorage. On the other hand, it must be borne in mind that while the Pointe du Lac beacons were Belisle's only aid to navigation, the Commissioner has held that ships were entitled to rely on them "to know where is the centre of the narrow channel". Belisle was therefore entitled to believe that his ship would meet the *Transatlantic* in a normal manner, port to port and without difficulty.

It therefore follows that it is not possible under these circumstances to find in the conduct of the appellant, in choosing to enter the channel and meet the *Transatlantic* therein, anything to justify the suspension of the appellant's certificate as a pilot.

The Commissioner held Belisle blameworthy for going full speed into a narrow part of the channel when he had to meet a ship in it. The evidence discloses that the speed of the *Hermes* was 15 knots which is not full speed but full manoeuvring speed and which, under the favourable weather conditions which prevailed at that time, does not appear to have been excessive. Furthermore, he was guiding the ship by the Pointe du Lac range beacons on which he was entitled to rely and while he was entering a portion of the channel that, at this point, was narrower than it had been in Yamachiche bend which he was leaving, it was still of a breadth of 550 feet, which allowed ample room for navigation having regard to the size of the two ships involved. Now, although there is always a danger of interaction between two ships meeting in a narrow channel and of bank effect, which may cause a ship to sheer if a ship is too close to the bank, the appellant had no way of knowing at the time, and there was no reason why he should have apprehended, that he was being misled by Pointe du Lac range into an area in proximity to the bank (the latter being covered by water) where danger of bank effect existed and, therefore, cannot be held blameworthy because of the speed of the *Hermes* at the time even if such speed would increase the unforeseeable bank effect on his vessel.

Indeed, had the *Hermes* been in the central portion of her own fairway as Belisle was entitled to assume he was with Pointe du Lac ranges in line, there was no imprudence in entering the cut at full manoeuvring speed.

The Commissioner blames the appellant, secondly, for attempting this manoeuvre (i.e. going full speed into the narrow part of the channel) which, for the appellant, consisted only in a slight change of course to port, when summer buoy 51L, a guide to indicate the entrance of the narrow channel, was not in place.

The evidence discloses that buoys are not considered fully reliable at any time and of course the summer buoys had not been in place here during the period of winter navigation. The only permanent aids to navigation in this area were the Pointe du Lac ranges which the appellant was entitled to rely on in order to navigate through the channel at this point regardless of the presence or absence of any floating aid to navigation. Here again, it is not possible to find, in the conduct of the appellant, anything that would justify the suspension of his certificate.

The appellant was taken to task by the Commissioner, thirdly, for "...following the line given by the Pointe du Lac ranges in line when he knew since last year that the lower range was not in its place;" and, fourthly, for "...proceeding at full speed when it was the first time in 1965 that he was going down this part of the river as the pilot of a ship;".

The evidence discloses that between 1959 and 1964 there was a movement of the cement base of the lower range (as distinct from the steel tower itself on which the range was fitted) towards the southeast of the order of approximately 21 feet with a net effect at the end of the course of a misalignment of 100 feet south of the center line. The structure itself, however, had been strengthened by lengthening two of its legs to take care of the tilt of the base prior to 1963 which would have moved the beacon and light some six feet to the northwest and compensated somewhat for the displacement of the base.

The evidence of the appellant and other pilots discloses that prior to the year 1965, they knew that, with Pointe du Lac range lights or beacons in line, a vessel proceeding downriver would be about halfway between the imaginary center line in the dredged channel and the imaginary line marking the edge of the channel to the south.

For a down bound ship it was a practice of the mariners to correct the situation by keeping the ranges in line and thus placing the ship on the starboard side of the mid-channel and for an upbound ship, it consisted in opening the ranges astern to the north, thus placing the ship on her side of true-mid-channel and thereby allowing a safe port to port meeting.

While the appellant knew of the above displacement, he had no reason to suspect that the conditions had changed

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since 1964. No notification of any such change had been issued by the Department of Transport and there is no evidence of any other ground for apprehension having come to his attention. He could not have known, and did not know, nor had he any reason to believe that between 1964 and the date of the collision, the cement base of the lower range of Pointe du Lac had been displaced towards the southeast by an additional 11 feet which had the effect of showing the center line of the channel near buoy 54L about 250 feet south of the true center.

Under the above circumstances, this Court cannot see how the appellant can be held blameworthy for the displacement of the lower range of Pointe du Lac or in proceeding at full manoeuvring speed in a channel relying on the line given by the Pointe du Lac ranges which he had no reason to believe had moved beyond the position they were in in the fall of 1964 nor can he be blamed for proceeding downstream at manoeuvring speed even if he was going down this part of the river for the first time in 1965.

The appellant was finally blamed for "...neglecting to use his radio-telephone".

The evidence discloses that no signal was given prior to the collision because both ships were too close by then and the collision had then become inevitable. As a matter of fact, the appellant being in no position that would cause him to anticipate any danger, it is difficult to understand why the appellant should have used the radio-telephone, how he could have done so and in what manner it would have prevented the collision. There is no suggestion that it occurred to the pilot on the other ship involved to use that instrument to warn the appellant of the apprehensions that he says that he had as a result of his observations and no finding or evidence upon which a finding could have been made that he could have communicated anything to the appellant that would have avoided the collision.

Prior to the sudden and unforeseeable sheering of the M/V *Hermes* both vessels were on their own side of the channel at a safe distance of each other and there was no obligation for either one to give out signals of any kind or to use the radio-telephone until the sudden and unexpected sheering to port and, of course, by then it was too late to discuss the situation over the radio-telephone. Here again, the appellant cannot be held guilty of any wrongful act or omission sufficient to justify the suspension of his certificate.

A good part of the argument in the present appeal dealt with the purpose of a formal investigation under section 558 of the *Canada Shipping Act,* R.S.C. 1952, and the disciplinary powers of the Court.

It may be useful to state hereunder what these powers are:

568. (1) The certificate of a master, mate, or engineer, or the licence of a pilot may be cancelled or suspended

(*a*) by a court holding a formal investigation into a shipping casualty under this Part, or by a naval court constituted under this Act, if the court finds that the loss or abandonment of, or serious damage to, any ship, or loss of life, has been caused by his wrongful act or default, but the court shall not cancel or suspend a certificate unless one at least of the assessors concurs in the finding of the court;

Under this provision, the Court cannot take disciplinary action against such an officer unless he has committed some "wrongful act" or has been guilty of some "default" and such wrongful act or default has "caused" the "loss or abandonment of, or serious damage to any ship or loss of life".

It is for the Court to determine whether the officer's conduct is sufficiently culpable to amount to a wrongful act or default which has "caused" such a casualty either by such misconduct or such failure in prudence, care, or watchfulness in the ordinary requirements of seamanship in regard to human life or in regard to the protection of property as to warrant disciplinary action.

The wrongful act or default so involved does not necessarily have to be of a criminal or *quasi* criminal nature. It has been said that it can be a breach of legal duty of any degree which causes or contributes to the casualty under investigation (cf. *The Princess Victoria*[1] at p. 627).

An error of judgment in a moment of difficulty and danger, however, does not necessarily render an officer's certificate liable to be dealt with. There is no test that has been formulated that serves in all circumstances for determining when an act or omission is of a character that calls for the imposition of a disciplinary action. Possibly as useful a test as any is that the wrongful act must be the doing of something that "plainly" he ought not to have done and

[1] (1953) 2 Ll. L.L.R 619

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the default must consist in omitting to do something which it was "plainly" his duty to do. (cf. *The Carlisle*[1] per Bargrave Dean J. at p. 293).

Applying that test, it follows that even if the appellant was guilty of the acts or omissions which the Court of Investigation found him to have been guilty of, which, as has already been indicated, has, in the opinion of this Court, not been demonstrated, they were not of a sufficiently culpable nature to justify the suspension of his certificate, nor was it established, in view of the Commissioner's finding that the range light's last displacement took place prior to the collision, that these acts or omissions were the cause or even a contributing cause of the collision. Counsel for the Minister of Transport took an alternative position in this Court. He attacked the position taken by the Commissioner in holding that the last displacement of the range light had occurred prior to the collision, submitting that the evidence on this point was such that it should be inferred that this displacement took place between the 14th and 17th of April 1965, which was a few days after the collision. During the course of argument the Court took the position that it was not open to the respondent to put forward this submission in this appeal. No attack was made upon the appellant's testimony that he did set his course by the range lights and followed them. In fact, one of the charges against him, of which he was found guilty, was that he did follow the range lights at too great a speed when he should not have done so. Assuming that he did follow the line indicated by the range lights, his ship could not have followed the course that it did unless the last displacement had already taken place. The only explanation of the disaster, if the last displacement had not already taken place, is that pilot Belisle had failed to set his course by reference to the range lights. An accusation that he did not avail himself of the only aid to navigation that was available to him would have been a very serious one indeed. No such charge was made against him before the Commissioner and it is too late at this stage to endeavour to support the Commissioner's decision to suspend the pilot's licence on the basis of a charge against which he has never had an opportunity to defend himself.

[1] (1905-1908) 10 Asp. M.L.C 287.

It therefore follows that this appeal is allowed and the suspension by the Commissioner of the appellant's certificate is quashed.

Having successfully appealed from the finding of the Court of Investigation there appears to be no reason why the appellant should not have the costs of the present appeal. The Court, therefore, orders that the appellant be paid the costs of this appeal as if it was an appeal to the Exchequer Court of Canada from a decision of a District Judge in Admiralty.

We are indebted to our two assessors, Captain John P. Martin, Master Foreign going and Captain Maurice Koenig, Master Foreign going and pilot for the very able advice they gave us on matters of seamanship. Both of these gentlemen have concurred in the decision of the Court.

Ottawa
1967
Apr. 6

BETWEEN:

E. I. DU PONT DE NEMOURS AND COMPANY .... PLAINTIFF;

AND

ALLIED CHEMICAL CORPORATION .... DEFENDANT.

Patents—Conflict proceeding—Patent Act, R.S.C. 1952, c. 203, s. 45(8)—Allegation that defendant not entitled to patent—Jurisdiction.

In a conflict action under s. 45 of the *Patent Act* plaintiff, in addition to asking for a determination that its inventor and not defendant's joint inventors was first inventor asked alternatively for a determination that defendant was not entitled to a patent on the ground that only one and not both of its joint inventors was the true inventor.

Held, the court has no jurisdiction to entertain an action for the alternative relief sought though such relief can be granted where plaintiff seeks an adjudication that it is entitled to the claim in conflict.

Plaintiff, the assignee of an application for a Canadian patent for an invention of Carl F. Irwin, commenced conflict proceedings in this court on March 10th 1967 following the decision of the Commissioner of Patents that Chao Shing Cheng and Richard G. Spaunburgh were the prior inventors of the invention for which a patent application was also pending in the patent office. Defendant is the assignee of Chao Shing Cheng and Richard G. Spaunburgh.

The concluding paragraphs of plaintiff's statement of claim are:

5. The plaintiff says and the fact is that as between the parties Carl F. Irwin and not Chao Shing Cheng and Richard G. Spaunburgh was the first inventor of the subject matter of conflict claims C1, C2 and C3.

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6. The plaintiff says and the fact is that the subject matter of claims C1, C2 and C3 was not invented jointly by Chao Shing Cheng and Richard G. Spaunburgh before it was invented by Carl F. Irwin

THE PLAINTIFF THEREFORE CLAIMS:

(a) That it may be ordered and adjudged that as between the parties Carl F. Irwin was the first inventor of the subject matter of Claims C1, C2 and C3 and the Plaintiff is entitled to a patent containing Claims C1, C2 and C3.
(b) That it may be ordered and adjudged that the Defendant is not entitled to a patent containing Claims C1, C2 and C3 as assignee of Chao Shing Cheng and Richard G. Spaunburgh.
(c) Such other and further relief as to this Court may seem meet and just.
(d) Its costs of this action.

Defendant applied for an order striking out paragraph 6 of the statement of claim and paragraph (b) of the prayer for relief on the ground that these were irrelevant to the issue of priority and outside the jurisdiction of the court in these proceedings.

Russel S. Smart, Q.C. for plaintiff.

David Watson for defendant.

JACKETT P. (orally):—This is an application by the defendant to strike out paragraph 6 of the Statement of Claim and paragraph (*b*) of the Prayer for Relief in the Statement of Claim.

In effect, by the portions of the Statement of Claim in question, after seeking the normal relief in a conflict proceeding, namely, a determination that the plaintiff's inventor, and not the defendant's joint inventors, is the first inventor of the invention covered by the conflict claims, the plaintiff seeks a determination, in the alternative, that the defendant's *joint* inventors did not invent such invention before the plaintiff's inventor did, and an adjudication, therefore, that the defendant is not entitled to the conflict claims as an assignee of its joint inventors.

In my view, what this Court is authorized to deal with under section 45(8) of the *Patent Act* is a claim by a party who has failed to obtain a favourable decision from the Commissioner that he is entitled, as against the person who obtained the favourable decision, to the issue of a patent including the conflict claims, "*as applied for by him*" (paragraph (*d*) of section 45(8)). This requires that evidence be placed before the Court by the plaintiff designed to show that the plaintiff's inventor did invent the invention, and when he invented it, and either that the defendant's inventor did not invent it or that he did but at a time subsequent to the making of the invention by the plaintiff's inventor. The defendant, of course, is entitled to adduce evidence in relation to the same matters. The upshot of all the evidence may be that the Court is convinced that it cannot adjudicate in favour of either of the parties under section 45(8)(*d*), but

(a) that there is in fact no conflict, in which case it adjudicates under section 45(8)(*a*), or

(b) that none of the parties is entitled to the issue of a patent containing the claims in conflict as applied for by him, in which case it adjudicates under section 45(8)(*b*).

I reiterate that I do not regard either of such latter possible classes of judgment as being the purpose of section 45(8) proceedings. I regard them as judgments arising incidentally in the course of proceedings designed to obtain a judgment under section 45(8)(*d*).

Coming then to the plaintiff's alternative position in this action, it is based on the hypothesis that, as the result of the evidence adduced with respect to the question whether the plaintiff's inventor is the first inventor, it may be made to appear that one of the defendant's joint inventors, and not the two inventors acting together, was the true inventor and invented the invention before the plaintiff's inventor.

In the event that the evidence indicates that conclusion, in my view, the plaintiff should be entitled to submit that the Court's decision should *not* be that the defendant is entitled as against the plaintiff to the issue of a patent containing the conflict claims "as applied for by him" (section 45(8)(*d*)) because he did apply for it as the invention of a single inventor, but rather that the judgment should be that none of the applicants is entitled to the issue of a patent containing the claims "as applied for by him" (section 45(8)(*b*)).

However, if the Court comes to that conclusion, in my view, the matter should then go back to the Commissioner —not on the basis that the matter is closed—but on the

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understanding that he may still see fit to deal with the matter under section 33(3), which reads as follows:

(3) Where an application is filed by joint applicants, and it subsequently appears that one or more of them has had no part in the invention, the prosecution of such application may be carried on by the remaining applicant or applicants on satisfying the Commissioner by affidavit that the remaining applicant or applicants is or are the sole inventor or inventors.

On the above view of the matter, the Court has no jurisdiction to entertain an action for the relief sought by the alternative claim even though it may grant such relief in an appropriate case where the relief sought is an adjudication that the plaintiff is entitled to the conflict claims.

The application is granted with costs to the defendant in any event of the cause.

Windsor 1966 Oct. 6 — Ottawa Oct. 21

BETWEEN:

HENRY GORDON STRATTON ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 21(1)—Transfer of property from husband to wife—Losses—Deduction by husband.

On April 16, 1951, the appellant, a physician, purchased in the joint names of himself and his wife a farm. Being unable to farm themselves, the farm was worked by a tenant. By arrangement with their tenant, they shared in the proceeds of the sale of the farm produce and in definite expenses although the appellant was alone responsible in full for other expenditures. After several years of the ownership of this farm, the appellant disposed of his one-half interest in the farm to his wife. The tenant continued the operation of the farm under the same conditions, and then the appellant's spouse sustained a loss on the farming operations in each of the four years following the transfer.

Allegedly pursuant to the provisions of Section 21(1) of the Act, the appellant deducted the losses from his income. The Minister disallowed this deduction for the year 1963 although for the taxation years 1960, 1961 and 1962, he hadn't so disallowed.

Held, The appeal is dismissed.

2. That Section 21(1) of the Act provided only that income from transferred property was imputable to the transferor and that the section has no application to a loss.

3. That "income from all sources" taxable under section 3 of the *Income Tax Act,* means net income.

4. That under Section 21(1) of the Act, property transferred by a taxpayer to his spouse is a "source" of his income, additional to the specified sources mentioned in section 3.

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5. That the loss was "from property owned by the appellant's wife, and there is no basis not only on ordinary principles of commercial accounting acceptable and within the purview of the general scheme of the Act or otherwise, but also in interpreting Section 21(1) of the Act, for utilizing this loss to reduce the taxable income of the appellant for the taxation year 1963".

APPEAL from an assessment of the Minister of National Revenue.

Keith Laird, Q.C. for the appellant.

D. G. H. Bowman for the respondent.

GIBSON J.:—In this appeal the issue is whether the appellant, a married person, who had heretofore transferred certain farm property to his wife, is entitled for the taxation year 1963 to deduct the loss in that year from the operations of such property, or whether by reason of section 21 (1)[1] of the *Income Tax Act* it is only the income[2], in the sense of the profit from the operations of such property and not the loss that is attributable to the appellant.

The facts are as follows:

The appellant is a physician practising psychiatry at the City of Windsor.

On or about April 16, 1951 the appellant purchased in the joint names of himself and his wife a farm, being the east one-half of Lot 20 in Concession 2 in the Township of Malden in the County of Essex and resided thereon. The farm was worked by one Thomas H. Bratt, who grew crops and sold the farm produce to the Harrow Farmers Co-operative. Under an oral arrangement with Bratt, two-thirds of the proceeds from the sale of the produce was sent by the Co-operative to Bratt and one-third to the appellant and his wife. The responsibilities of the appellant and his wife were to pay for electricity, municipal taxes, the upkeep of the farm and buildings and one-third of the cost of fertilizer. The farming operation in each year from the

[1] 21(1) Where a person has, on or after August 1, 1917, transferred property, either directly or indirectly, by means of a trust or by any other means whatsoever, to his spouse, or to a person who has since become his spouse, the income for a taxation year from the property or from property substituted therefor shall, during the lifetime of the transferor while he is resident in Canada and the transferee is his spouse, be deemed to be income of the transferor and not of the transferee.

[2] See section 4 of the Act, which reads:

Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

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acquisition of the farm by the appellant and his wife until the disposal by the appellant of his one-half interest to his wife resulted in a loss to the appellant and his wife.

On or about August 10, 1960, the appellant transferred his one-half interest in the said farm to his wife, Gwen Stratton.

Shortly before the transfer to the appellant's wife of the appellant's remaining one-half interest in the farm the appellant and his wife moved to Windsor and the farm was occupied by Bratt, who continued to work the farm in accordance with an oral agreement between himself and the appellant's wife, as owner. Under that agreement:

(a) Bratt paid $500 rent annually to Mrs. Stratton, the appellant's wife;

(b) Bratt paid the cost of electricity consumed on the farm;

(c) the appellant's wife paid for the upkeep of the farm and one-third of the cost of fertilizer (two-thirds thereof being paid by Bratt);

(d) when fertilizer was purchased from the Harrow Farmers Co-operative the appellant's wife and Bratt were each billed directly by the Co-operative for their proportionate share of the cost and when fencing, stock spray and other miscellaneous items were purchased, the appellant's wife was billed directly by the Co-operative;

(e) Bratt was entitled to two-thirds of the proceeds from the sale of farm produce and the appellant's wife was entitled to one-third. By arrangement with the Co-operative cheques for Bratt's and Mrs. Stratton's proportionate share of the sale price of farm produce sold were sent to Bratt and Mrs. Stratton directly;

(f) municipal taxes on the farm and insurance on the farm buildings were paid by Mrs. Stratton,

In the taxation year 1963 the appellant's wife sustained a loss on the farming operation of $1,322.88, made up as follows:

Receipts	
Sale of farm products	$ 782 73
Rent received	500 00
Total	$1,282.73

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Expenses (incurred and paid by Mrs. Stratton)	
Taxes	$ 308 42
Insurance	362 05
Mortgage Interest	389.45
Harrow Farmers Co-operative	260 96
Repairs and Maintenance	11 53
Depreciation	1,273 20
Total	$2,605.61
Loss	$1,322 88

For the taxation years 1960, 1961 and 1962 the appellant, in computing his income, deducted the losses incurred by his wife on the farming operation without objection from the respondent.

In computing his income for 1963 the appellant deducted the loss of $1,322.88 sustained by his wife and this deduction was disallowed by the respondent.

At no time did the appellant or his wife physically participate in, supervise, direct or advise on the actual farming operations.

The question for determination on this appeal is whether upon a proper construction of the *Income Tax Act* and in particular section 21(1) thereof, the said loss sustained by the appellant's wife on the farming operations may be taken into consideration to reduce the appellant's taxable income for the taxation year 1963.

Section 3 of the Act prescribes that "The income of a taxpayer for a taxation year for the purposes of this Part (Division B—Computation of Income) is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all (a) businesses, (b) property, and (c) offices and employments.

"Income. . .from all sources" for a taxation year in section 3 of the Act means net income. (See *George H. Steer v. M.N.R.*[1]; and *Wood v. M.N.R.*[2]).

By section 21(1) of the Act Parliament has also prescribed that property transferred by a taxpayer to his spouse is a "source" of his income, additional to the specified sources mentioned in section 3.

[1] [1965] 2 Ex C R. 458. [2] [1967] 1 Ex. C.R. 199.

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And section 12(1)(*a*) and (*b*)[1] do not alter the general scheme of the Act in respect to certain "sources" of income, so as to render taxable, gross revenue rather than net income.

But here the loss is from property owned by the appellant's wife, and there is no basis not only on ordinary principles of commercial accounting acceptable and within the purview of the general scheme of the Act or otherwise, but also in interpreting section 21(1) of the Act, for utilizing this loss to reduce the taxable income of the appellant for the taxation year 1963.

This appeal is therefore dismissed with costs.

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[1] 12 (1) In computing income, no deduction shall be made in respect of

(*a*) General limitation.—an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer,

(*b*) Capital outlay or loss—an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,

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Sault Ste-Marie 1966

Oct. 18, 19

Ottawa

Nov 10

BETWEEN:

HARRY MOLUCH ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4—Real estate transactions—Whether profits from subdivision of family farm involving construction of roads and installation of services—Capital gain or income—Profit on sale of farm.

In 1937, the appellant acquired 50 acres of uncleared bush land situate in an undeveloped area within the limits of the City of Sault Ste-Marie, for $2,300.00. There was an old frame house on the property without facilities or conveniences other than electricity. Over the years, in the time available to him, after his employment, the appellant, with the help of his wife and family, gradually cleared the land to grow garden and fodder crops for domestic use and repaired the house to make it more comfortable. The property was occupied by the appellant as his home.

In 1944, the appellant was obliged to acquire 5 adjoining acres to overcome a dispute respecting an encroaching farm.

In the 1950's the appellant was obliged, because of his wife's illness and under the advice of her physician, to provide more comfortable living accommodation This he did by undertaking the construction of a house on a part of his land facing a street where water and sewer services were available. He borrowed $4,000.00 from a private source to terminate this construction. But he required still further funds. He rejected as wholly inadequate an offer of $18,000.00 for his property and undertook to subdivide it and to sell lots. Municipal bylaws required him to file a plan of subdivision and enter into an agreement to install roads, water and sewer services. Although much of the labour was done by the appellant himself, nevertheless this work involved a substantial outlay.

Between 1952 and 1956, the appellant sold lots without real estate agents and with very little advertising upon which he realized a profit.

The issue was whether the appellant abandoned the intention with which the lands were originally acquired and embarked upon a business with the lands as inventory in which the appellant merely realized these lands as a capital asset.

Held, That the appellant's whole cause on conclusion constituted the embarkation of a business and the gains realized were accordingly profit from a business within the meaning of section 3 of the *Income Tax Act.*

2. That although the appellant originally acquired the land without the intention of re-sale at a profit, nevertheless at a subsequent point in time the appellant embarked upon a business using the land as inventory in the business of land subdividing for profit.

3. That whether the steps taken to place a more suitable condition for resale brings a transaction as a whole into the category of carrying on trade is a question of degree depending in the business-like enterprise and actively supervised.

4. That the change effected in the character of the property from raw land to that of serviced lots constitute an element of carrying on a trade, a transformation not similar in the "McGuire case" relied upon by the appellant.

5. That the appeal was dismissed.

APPEAL from a decision of the Tax Appeal Board.

C. B. Noble for the appellant.

L. R. Olsson and *G. V. Anderson* for the respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1], dated November 15, 1965 whereby appeals of the appellant herein against assessments to income tax for the taxation years 1959, 1960, 1961 and 1962 were dismissed.

The issue is the same with respect to each taxation year under review and is whether the appellant abandoned the intention with which certain lands were originally acquired and embarked upon a business with these lands as inventory or whether the appellant merely realized those lands as a capital asset.

[1] 39 Tax A.B.C. 428.

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The material facts are as follows:

The appellant, who is now seventy-three years of age, came to Canada from the Ukraine in 1925 and obtained employment as a labourer in a steel mill at Sault Ste. Marie, Ontario. After having established himself he was joined by his wife, some six years later, in 1931.

By conveyance dated April 21, 1937 the appellant acquired title to certain lands being Lot 5 in the Third Concession of the Township of St. Mary's, comprising approximately fifty acres. At the time of its acquisition, the property was uncleared bush land situate in an undeveloped area within the municipal limits of the City of Sault Ste. Marie. There was an old dilapidated two storey frame house resting on sills on the property without facilities or conveniences other than electricity. Water was obtained from a spring and there was no indoor plumbing. During his testimony the appellant incidentally described his efforts to install a more secure foundation. I suspect, although there was no direct evidence on the point, that there were other buildings on the property. The purchase price of the fifty acres so acquired was $2,300, of which $1,200 was advanced under a Federal plan of agricultural assistance and was secured by mortgage. The balance, I believe, was paid in cash from the appellant's savings.

The frame house was occupied by the appellant and his wife together with their two daughters as a home. The appellant continued in his employment at the steel mill but devoted his available time to clearing the land of bush. In this task he was assisted by his wife and daughters. He testified that his wife did the work of two men. Gradually small portions of the land were cleared and were devoted to gardening, the produce of which was used by the family. A team of horses was acquired to be used in removing the heavier trees and stumps. Some cows were also acquired. As more land became available for crops, a portion was used to grow fodder for the animals. None of the crops was sold but all produce was consumed by the appellant's family and livestock. In all some ten acres were rendered tillable over a period of ten years.

In 1944 the appellant was obliged to acquire five adjoining acres to overcome a dispute respecting an encroaching barn.

In the 1950's the appellant's wife became seriously ill and over a period of time underwent three successive surgical operations. The family physician advised the appellant that Mrs. Moluch could not continue the strenuous work she had been doing and that it was imperative that she be moved to more comfortable accommodation. At this time one of the appellant's daughters had married, his younger daughter was attending school and he was still working in the steel mill. He continued in that employment until 1961 when he retired therefrom. However, the appellant was unable to continue the minor farming operation which had heretofore been conducted by himself and his family.

In view of the doctor's advice, the appellant decided to build a new home on the property owned by him but on a site facing on McDonald Street, because there were water, power and sewer services available in that area.

In 1953 he borrowed $4,000 from a fellow worker and bought the materials to construct a house which he began to build in 1954 and upon which he did the bulk of the labour himself.

While the house was under construction the appellant was approached by a building contractor who verbally offered him $18,000 for the 55 acres and the house in its then present state of completion. The appellant testified that he received no other offers for his land and the offer he did receive was spurned out of hand as being ridiculously inadequate.

However, the appellant was in need of funds to complete the house and to discharge the indebtedness which he had assumed. It was decided by the appellant, undoubtedly in concert with his family and at a time which cannot be fixed with accuracy, that funds should be raised by disposing of as much as possible of the 55 acres which constituted his only asset convertible into money. The lands contiguous to the appellant's were changing in character from farming to residential lands. The area to the immediate west was totally occupied by a wartime housing development and the surrounding lands were being subdivided.

The City had passed a by-law pursuant to *The Ontario Planning Act* prohibiting the sale of lands in parcels of less than ten acres without the registration of a plan of subdivision. Further as a condition to its granting approval to a

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plan of subdivision, the City required the subdivider to enter into an agreement to provide sewers and water and to arrange for power. The City, as a matter of policy, required development to be progressive, that is that the lands closest to available services should be developed first. To further ensure orderly development the City required that a proposed plan of subdivision should compare favourably with a preconceived master plan of the Planning Board.

In April 1957 the appellant registered a plan of subdivision, known as Moluch Subdivision, comprised of 42 lots and entered into an agreement with the City to provide services to such lots. The appellant engaged a solicitor, now deceased, to negotiate arrangements with the City and to deal with other incidental matters arising from the project. The appellant stated that the advice from his solicitor was to the effect that the difference between the cost of the land and the sale price would be a capital gain and not subject to income tax.

The appellant experienced difficulty in finding a suitable contractor to construct the roads. With the assistance of his son-in-law, he undertook to construct the roads himself. He first rented a used grader in very bad need of repair which proved unsatisfactory. He therefore bought a bulldozer tractor at a cost of approximately $15,200 and a dump truck for about $2,500. He engaged a contractor to install the water lines.

In October 1956 the appellant registered a second plan of subdivision known as Moluch "A" subdivision comprised of nine lots. An agreement with the City was not necessary because these lots were already serviced. It was in this subdivision that the appellant had constructed his own house.

In January 1958 the appellant registered a third plan of subdivision known as Moluch "B" subdivision comprised of 62 lots. The appellant entered into an agreement with the City to provide services in terms similar to those respecting the first subdivision.

In April 1964, which is subsequent to the taxation years under review, the appellant registered a fourth plan of subdivision. In the agreement entered into between the appellant and the City more improvements and much more rigorous standards were imposed than in the previous agreements.

The appellant developed the property in accordance with the minimum requirements of the plans of subdivisions and his agreements with the City. He did not provide any additional improvements. However, the subdivisions did present a continuous problem to the City officials. The roads built by the appellant became impassible thereby impeding fire protection and accessibility. There were constant complaints from residents who had purchased lots from the appellant and built homes on them. The City, therefore, rebuilt the roads and installed adequate drainage wherever required and charged the appellant for that work.

When the first subdivision was completed the appellant immediately began selling the lots. He did not employ a real estate agent, nor did he employ planning consultants, although he did employ a land surveyor. At the outset he sold lots for $1,000 each, a price which he determined himself as being the then current market value. Prices were increased later. Prospective purchasers knew of the availability of the lots from their personal observation of the development work, from enquiries at the City Hall and, in some instances, from persons who had already made purchases from the appellant. All purchases were negotiated directly with the appellant. No signs were erected on the premises and when sales slackened or when more funds were required by the appellant advertisments were inserted in the classified section of the local newspaper. The total cost of newspaper advertising during the years in question was $70.05.

The appellant's records, if existing at all, were extremely haphazard. This was due to the appellant's inexperience and because, as he stated, he had been advised by his deceased solicitor that he need not keep records since the proceeds from the sale of lots would be capital gains in any event.

However, when enquiries were made by the officials of the Department of National Revenue, the appellant's younger daughter, who had meanwhile graduated from a commercial course, reconstructed a statement of expenses from her own memory, the recollections of her parents and from those receipts that were available to her.

In preparation for the assessment of the appellant to income tax the officers of the Department painstakingly reconstructed a record of the appellant's affairs, the results

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of which were appended to the Notice of Re-Assessment dated July 17, 1963 and consist of (1) a Statement of Profit and Loss for the years 1959 to 1962 inclusive, (2) a Statement of Cost of lots sold, (3) a Computation of Land Inventory and (4) a Schedule of Capital Cost Allowance.

In paragraph 12 of the Notice of Appeal it is stated that "The appellant does not quarrel with the quantum of the assessments as herein recited".

I construe the foregoing recital as being an admission that the Departmental officials' reconstruction of a record of the appellant's affairs is accurate and that there is no dispute as to the amounts but only as to the taxability thereof.

I, therefore, reproduce salient extracts from the statements so prepared.

The Statement of Profit and Loss is as follows:

	1962	1961	1960	1959
Sales	$ 20,000.00	$ 21,350 00	$ 36,950 00	$ 22,800 00
Cost of lots sold	8,640 00	7,680 00	13,440 00	9,600 00
Net profit	$ 11,360 00	$ 13,670 00	$ 23,510 00	$ 13,200 00

The Statement of Cost of Lots Sold is as follows:

Estimated fair market value of land (55 acres)		$ 35,000.00
Improvements: ...		
Roads and sewers, including Capital Cost Allowance per Schedule B	$ 73,864.58	
Survey costs	2,716 50	
		76,581.08
Legal fees		2,438 25
Municipal taxes		9,286 10
Advertising		70 05
Total Costs		$123,375.48

The cost for each serviced lot was computed at $960. It is obvious from the immediately foregoing statement that the main item of cost to the appellant was the labour and monies expended by him for roads and services totalling $76,581.08.

The appellant sold the following number of lots in the years indicated:

1955 — 5 lots	1959 — 11 lots
1956 — 23 lots	1960 — 12 lots
1957 — 18 lots	1961 — 10 lots
1958 — 10 lots	1962 — 7 lots

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In his testimony the appellant frankly stated that it was his hope and intention to sell every lot in the subdivisions excepting his own home.

It is apparent from the Minister's allowance of $35,000 as the market value of the land that the Minister conceded that at the time of the appellant's acquisition of the land he had no intention of turning it to account by profitable resale and accordingly the Minister credits the appellant with an enhancement in value from $2,300 (the purchase price) to $35,000 (the appreciated value) in assessing the appellant as he did.

There is no doubt whatsoever in my mind that when the appellant originally acquired the lands in question he did not do so with an intent to turn it to account for profit by selling it. This fact was readily conceded by counsel for the Minister in presenting his argument. However, even if, at the time of acquisition, the intention of turning the lands to account by resale was not present, it does not necessarily follow that profits resulting from sales are not assessable to income tax. If, at some subsequent point in time, the appellant embarked upon a business using the lands as inventory in the business of land subdividing for profit, then clearly the resultant profits would not be merely the realization of an enhancement in value, but rather profits from a business and so assessable to income tax in accordance with sections 3 and 4 of the *Income Tax Act*, R.S.C. 1952, chapter 148[1]. Support for the foregoing proposition, if any be needed, is found in *Cooksey and Bibbey v. Rednall*[2], where Croom-Johnston J. said at page 519:

> I have no doubt that if there had been evidence here that at some time after the original purchases of a lot of this property these two gentlemen together had gone in for a system of land development with regard to that or part of it, it would have been open to the Commissioners to find that they had turned what had been an investment into the subject matter of a trading in land.

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[1] 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

[2] (1949) 30 T.C. 514.

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As stated at the outset, the issue for determination is, therefore, a clear cut one of whether the conduct of the appellant, as above described, constituted an embarkation upon a business by him as contended by the Minister, or whether it was the realization of the lands in a manner most advantageous to the appellant by way of a series of sales, as contended by him.

In *Cragg v. Minister of National Revenue*[1], Thorson P. said,

> . . . the Court must be careful before it decides that a series of profits, each one of which would by itself have been a capital gain, has become profit or gain from a business. Such a decision cannot depend solely on the number of transactions in the series, or the period of time in which they occurred, or the amount of profit made, or the kind of property involved. Nor can it rest on statements of intention on the part of the taxpayer. The question in each case is what is the proper deduction to be drawn from the taxpayer's whole course of conduct viewed in the light of all the circumstances. The conclusion in each case must be one of fact.

Counsel for the appellant in his argument relied heavily upon the decision of Hyndman D.J. in *McGuire v. Minister of National Revenue*[2]. There the appellant had purchased a farm for a home intending to live on it and at the time of hearing of the appeal was living on it. He found that the land did not pay as a farm but he still wished to live there. He received an offer for the purchase of lot but learned that he could not give title because the *Planning Act* required the filing and approval of a plan of subdivision before an area of less than 10 acres could be sold. On the advice of the Municipal authorities he registered a plan of subdivision comprised of fifty-two lots of which he sold twenty over a period of four years. Hyndman D.J. found that the appellant did not purchase the land as a venture or speculation. He could see no "distinction between selling the land as a whole or selling half of it or selling a quarter of it or selling 50 parts of it. It was his land to sell and he felt that was the best way to dispose of some of it and that is what he did". The learned judge was not aware of any case, and apparently none were cited to him,

> which would have a bearing on the incident of selling a whole property or parts of a property where selling part of it like this, a subdivision, would make any difference unless it was a business in the regular business sense.

He then proceeded to find, on the facts before him, that the appellant was not engaged in business but was merely sell-

[1] [1952] Ex. C.R. 40. [2] [1956] Ex. C.R. 264.

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ing his own property in the most advantageous way which it was his right to do and accordingly allowed the appeal.

The *McGuire case (supra)*, I think, may be taken as authority for the proposition that the filing of a plan of subdivision and selling lots thereunder does not of itself constitute a business in the absence of other circumstances.

I am disposed to think that there are other elements and incidents which will take the case of an isolated acquisition of property and the subsequent sale thereof in a series of transactions out of the category of a mere realization of an enhanced value and bring the transaction as a whole into the category of carrying on a trade or business.

Merely putting the article into a more suitable condition for favourable sale would not necessarily have this effect, as, for example, having a house repainted or jewels cleaned and the like. I am disposed to think that the matter is one of degree depending upon the businesslike enterprise and activity displayed. I should also think that the element of carrying on a trade would be introduced if a purchaser were by himself, or his own employees or by a contractor through an expenditure of effort and monies to change the character of the property (*vide C.I.R. v. Livingston*[1]). This is what I think the appellant did. He took the raw land which he owned and by the expenditure of money and effort he ended up possessing a number of fully serviced residential lots for sale.

Neither do I think that he was forced by circumstances to adopt the course that he did because no alternative course was available to him. He voluntarily made the decision to subdivide his land with the full knowledge that he would be obliged by his agreement with the City to provide the services required. It is reasonable to conclude that the appellant foresaw, from the inadequate verbal offer by a contractor for his land and house and from the state of development about his property, an opportunity, by the exercise of his own efforts and resources, to reap a more substantial return for himself by increasing the marketability of his property. This to me is the very essence of business.

Moreover I am unable to distinguish what the appellant did after his decision to subdivide had been reached from

[1] 11 T.C. 538.

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what a person engaged in the business of land development would do once he had acquired a parcel of property.

I do not think that the manner in which the appellant conducted his sales, the unbusiness like records he maintained, the lack of aggressive advertising or his failure to set up an efficient organization to conduct his affairs have any material bearing. He had the facilities he considered to be adequate for his purposes.

Neither do I attach particular significance to the circumstance that the appellant had never before engaged in the purchase and sale of real estate. As the Lord President (Clyde) said in *Balgownie Land Trust, Ltd. v. C.I.R.*[1]:

> "A single plunge may be enough provided it is shown to the satisfaction of the Court that the plunge is made in the waters of trade."

As is indicated in the extract from the decision of Thorson P. in the *Cragg case (supra)* the question in each case is the proper deduction to be drawn from the taxpayer's whole course of conduct reviewed in the light of all the circumstances and the conclusion in each case is one of fact.

I have carefully read the reasons for judgment in the *McGuire case (supra)* as well as later decisions when similar conclusions were reached. The facts in the *McGuire* case are distinguishable from those in the present appeal in that there the effect of filing a plan of subdivision was merely to divide the land into a number of smaller parcels which were sold piecemeal without effecting any physical change in the land, whereas in the present appeal, the character of the raw land was changed to that of serviced lots by the expenditure of considerable effort and money, in addition to the land being divided into a number of smaller parcels.

Like the Chairman of the Tax Appeal Board I cannot refrain from commending the appellant and his family for their industry and perspicacity by which they improved their material circumstances. Nevertheless, I am of the opinion that the appellant's whole course of conduct constituted the embarkation upon a business and the gains realized are accordingly profit from a business within section 3 of the *Income Tax Act*. In my opinion the Minister was, therefore, right in including that profit in his assessments.

It follows that the appeal is dismissed with costs.

[1] 14 T.C. 684.

Toronto 1966

June 13-15

Ottawa Sept. 29

BETWEEN:

QUEMONT MINING CORPORATION, LIMITED .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

AND BETWEEN:

RIO ALGOM MINES LIMITED ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

AND BETWEEN:

MACLEOD-COCKSHUTT GOLD MINES LIMITED .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Deductions—Provincial mining taxes—Whether deductible in ascertaining "profits" of business—Computation of deductible amount under Reg. 701(b)—No deduction if no mining income—Income Tax Act, s. 11(1)(p), 12(1)(a)—Income Tax Regulations P.C. 1958-492, secs. 700, 701(b).

Income tax—Depletion allowances—Provincial (Quebec) mining tax—Not deductible from mining profits in ascertaining depletion allowance—"Profits", meaning of—Income Tax Regulations P.C. 1958-492, s. 1201(2)(a).

Under *Income Tax Regulation* 701(*b*) (applicable to the 1958 and subsequent taxation years) the allowable deduction for provincial mining taxes is the proportion of such taxes which the taxpayer's income from mining operations in the Province *calculated under the Income Tax Act* is of his income on which such taxes were paid *calculated under the applicable provincial statute.*

No deduction is allowable under *Income Tax Regulation* 700 (applicable to the 1957 and previous taxation years) in respect of provincial mining taxes paid in a taxation year in which the taxpayer had no income from mining. *M.N.R. v. Spruce Falls Power & Paper Co.* [1953] 2 S.C.R. 407, referred to.

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QUEMONT MINING CORP. *et al.* *v.* MINISTER OF NATIONAL REVENUE

The duties imposed under the Quebec *Mining Act* being taxes on annual profits are not laid out for the purpose of producing such profits and hence are not deductible in computing such profits under the *Income Tax Act*. *Nickel Rim Mines Ltd. v. Att'y-Gen. Ont.* [1966] 1 O R 345, applied; *Harrods (Buenos Aires) Ltd. v. Taylor-Gooby*, 41 T C. 450, distinguished; *Roemsch v M.N.R.* [1931] Ex. C.R. 1, *I.R.C. v. Dowdall, O'Mahoney & Co.* [1952] A.C. 401, applied; *Premium Iron Ores Ltd. v. M.N.R.*, 66 D.T C. 5280, distinguished.

In computing mining profits for purposes of the percentage depletion allowance under *Income Tax Regulation* 1201 duties paid under the Quebec *Mining Act* are not to be deducted since these are not expenses incurred for the purpose of producing such profits. There is no reason for construing the word "profits" as used in *Income Tax Regulation* 1201(2)(*a*) in a sense different from that attributed to it in the *Income Tax Act*. *Bishop v. Smyrna and Cassaba Rly. Co.* [1895] 2 Ch. 265, *Spanish Prospecting Co.* [1911] 1 Ch. 92, distinguished; *M.N.R. v. Anaconda American Brass Ltd.* [1956] A.C 85, *M.N.R. v. Irwin* [1964] S C R. 662, *M.N.R. v. Imperial Oil Ltd.* [1960] S.C.R. 753, applied; *Naval Colliery Co. v. C.I.R.* (1928) 12 T.C. 1017, referred to.

APPEALS by Quemont Mining Corp and MacLeod-Cockshutt Gold Mines Ltd. from Tax Appeal Board and by Rio Algom Mines Ltd. from income tax assessment.

Allan Findlay, Q.C. and *H. F. Teney* for appellant Quemont Mining Corporation, Ltd. *W. B. Williston, Q.C.* and *A. D. Calvin* for appellants Rio Algom Mines Ltd. and MacLeod-Cockshutt Gold Mines Ltd.

J. D. Arnup, Q.C. and *D. G. H. Bowman* for respondent.

CATTANACH J.:—These are appeals by the three taxpayers named in the above styles of cause and which, for the purposes of convenience, will hereinafter be referred to as Quemont, Rio Algom and MacLeod-Cockshutt.

The appeals of Quemont and MacLeod-Cockshutt are from decisions of the Tax Appeal Board dated May 5, 1964[1] and May 6, 1964[2] respectively, whereby the Board dismissed appeals from assessments to income tax by the Minister in the case of Quemont for its taxation years 1958, 1959 and 1960 and in the case of MacLeod-Cockshutt for its taxation years 1960 and 1961. The appeal of Rio Algom is from an assessment by the Minister to income tax for its 1960 taxation year.

A common issue in the appeals of all three taxpayers arises from a disagreement between them and the Minister as to the proper method of calculating the deductions to

[1] (1964) 35 Tax A.B.C. 265. [2] (1964) 35 Tax A.B.C. 269

which the taxpayers are entitled under Regulation 701 made pursuant to section 11(1)(*p*) of the *Income Tax Act* that is in arriving at the appropriate proportion of provincial mining tax paid by them in each of the taxation years under review which is to be deductible in computing their taxable income under the *Income Tax Act*. Other issues raised in the pleadings were settled by agreement among counsel. There was no dispute among the parties as to the figures employed but the difference of opinion is only in the process of calculation, except that, in the case of Quemont, there is an additional issue involving the allowance to be permitted under section 11(1)(*b*) of the *Income Tax Act*.

By agreement among counsel the appeals of the three taxpayers on the issue common to each were tried together. At the conclusion of the hearing of the common issue the remaining issue in which only Quemont was involved was heard.

Section 11(1)(*p*) of the *Income Tax Act*, during the relevant taxation years, read as follows:

11. (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

...

(*p*) such amount as may be allowed by regulation in respect of taxes on income for the year from mining or logging operations;
(This section was amended in 1962 Chapter 8, Section 2(2) by deleting a reference to logging operations applicable to the 1961 and subsequent taxation years).

The amount which is deductible under paragraph (*p*) is governed by *Income Tax Regulation 701*, which reads as follows:

701. (1) In computing his income for a taxation year, a taxpayer may deduct, under paragraph (*p*) of subsection (1) of section 11 of the Act, an amount equal to the lesser of

(*a*) the aggregate of the taxes paid, in respect of his income derived from mining operations in the province for the year,
  (i) to the province, and
  (ii) to a municipality in the province in lieu of taxes on property or any interest in property (other than his residential property or any interest therein), or

(*b*) that proportion of such taxes that his income derived from mining operations in the province for the year is of his income in respect of which the taxes were so paid.

(2) In this section,

(*a*) "income derived from mining operations" in a province for a taxation year by a taxpayer means,

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(i) if the taxpayer has no source of income other than mining operations, the amount that would otherwise be his income for the year if no amount had been deducted in computing his income under paragraph (*b*) or (*p*) of subsection (1) of section 11 of the Act, section 83A of the Act, subsection (3) of section 85I of the Act, or paragraph (*g*) of subsection (1) of section 1100 of these Regulations, or

(ii) in any other case, the amount that would otherwise be his income for the year if no amount had been deducted in computing his income under paragraph (*b*) or (*p*) of subsection (1) of section 11 of the Act, section 83A of the Act, subsection (3) of section 85I of the Act, or paragraph (*g*) of subsection (1) of section 1100 of these Regulations, minus the aggregate of

(A) his income for the year from all sources other than mining, processing and sale of mineral ores, minerals and products produced therefrom, and

(B) an amount equal to 8% of the original cost to him of properties described in Schedule B to these Regulations used by him in the year in the processing of mineral ores, minerals or products derived therefrom, or, if the amount so determined is greater than 65% of the income remaining after deducting the amount determined under clause (A), 65% of the income so remaining, or, if the amount so determined is less than 15% of the income so remaining, 15% of the income so remaining;

(*b*) "mine" includes any work or undertaking in which mineral ore is extracted or produced, including a quarry;

(*c*) "minerals" include every naturally occurring inorganic or fossilized organic substance which is mined, quarried or otherwise obtained from the earth at or below its surface but does not include petroleum or natural gas;

(*d*) "mineral ore" includes all unprocessed minerals or mineral bearing substances;

(*e*) "mining operations" means the extraction or production of mineral ore from or in any mine or its transportation to, or over any part of the distance to, the point of egress from the mine, including processing thereof prior to or in the course of such transportation but not including any processing thereof after removal from the mine; and

(*f*) "processing" as applied to mineral ores includes all forms of beneficiation, smelting and refining, and also transportation and distributing but does not include any of these operations that are performed with respect to mineral ore before it is removed from the mine.

(Regulation 701 was enacted by P.C. 1958-498 dated April 9, 1958 and made applicable to the 1957 and subsequent taxation years. In 1962 Regulation 701(2)(*a*) was amended to add references to sections 11(1)(*p*) and 83A of the *Income Tax Act* which was also made applicable to the 1957 and subsequent taxation years).

The formula prescribed by Regulation 701(1)(*b*) for the determination of the amount of provincial mining tax paid which is deductible is described therein as

> that proportion of such taxes that his income derived from mining operations for the year is of his income in respect of which the taxes were so paid.

This formula can be expressed in the following form:

$$\frac{\text{A. The taxpayer's income derived from mining operations in the province}}{\text{B. The taxpayer's income in respect of which the taxes were so paid}} \times \text{C Taxes paid in respect of the taxpayer's income derived from mining operations to the province in question} = \text{D. The deductible portion of the provincial taxes paid}$$

(For the purposes of convenience I shall refer to A as the numerator, B as the denominator and C as the multiplicand.)

All parties agreed that the foregoing formula is the correct one. It is common ground also, although this was not specifically referred to in the course of argument, that taxes paid under the Quebec *Mining Act* constitute the taxes referred to in the multiplicand C although they are imposed in respect of a larger amount than the taxpayer's "income derived from mining operations in the provinces for the year" as that phrase is defined by Regulation 701, and that taxes paid under *The Mining Tax Act* of Ontario similarly constitute taxes referred to in the multiplicand C although they are imposed in respect of an amount that not only includes income from mining operations computed on a higher basis than under the Federal Act but also includes income from processing which is not included in the Regulation 701 concept of "mining operations". (This common ground must have been reached on the assumption that the definition in paragraph 2(*a*) of Regulation 701 does not apply to the words, "his income derived from mining operations in the province for the year" in paragraph 1(*a*) of the Regulation although, in terms, it does so apply.) Each party, however, took a different view as to the composition of the fraction, A/B. Separate and distinct positions were taken on behalf of each of the parties.

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The Minister's formula for computing the deductible proportion of the provincial taxes paid can be put in the following form:

$$\frac{\text{A. Income derived from mining operations in the province computed under the Income Tax Act.}}{\text{B. Taxpayer's income in respect of which taxes were so paid computed under the Provincial Mining Act.}} \times \text{C. Taxes paid to the Province} = \text{D. Deductible portion.}$$

(i.e the fraction A/B should be $\frac{\text{Federally computed income}}{\text{Provincially computed profits}}$).

Counsel for Quemont submitted that the Minister's formula was erroneous and submitted that the right formula is,

$$\frac{\text{A. Income computed under the Quebec Mining Act, less the greater of, (a) 8\% of appellant's milling assets (8\% of \$5,478,479 20) or, (b) 15\% income from mining operations (15\% of \$3,046,495-23)}}{\text{B. Income computed under the Provincial Mining Act}} \times \text{C Tax paid to Province} = \text{D. Deductible Portion}$$

(i.e. the fraction A/B should be $\frac{\text{Income computed Provincially}}{\text{Profits computed Provincially}}$).

Counsel for Rio Algom and MacLeod-Cockshutt, while agreeing that the Minister's formula was wrong, submitted that the right formula is:

$$\frac{\text{A. Income derived from mining operations in the Province as computed under the Income Tax Act}}{\text{B Income derived from mining operations in the Province as computed under the Income Tax Act plus any other income in respect of which tax may have been imposed by the province.}} \times \text{C Tax paid to the Province} = \text{D. Deductible Portion}$$

(i e. that the fraction A/B should be $\frac{\text{Income computed Federally}}{\text{Profits computed Federally}}$).

While counsel for Quemont and counsel for Rio Algom and MacLeod-Cockshutt agree that the Minister's fraction is not the right one, nevertheless, counsel for Quemont in his principal submission is in agreement with the Minister's selection of the denominator B. His disagreement with the Minister is in the selection of the numerator A., which he contends should be income computed on the Provincial basis rather than on the Federal basis.

On the other hand counsel for Rio Algom and MacLeod-Cockshutt is in agreement with the Minister's selection of the numerator A. as being the income of the taxpayer from mining operations in the Province computed on the Federal basis but he is in disagreement with the Minister's selection of the denominator B. as being the taxpayer's income in respect of which taxes were paid computed on the Provincial basis. His contention is that the denominator B. should be the mining income in respect of which the tax was imposed by the Province, also computed on a Federal basis, plus any amount on which the Province has imposed the tax in respect of non-mining operations.

As I have already indicated, it was assumed by all parties that C, the multiplicand, refers to certain taxes that were in fact paid to the particular Province. Counsel for Rio Algom and MacLeod-Cockshutt in passing mentioned that to carry logic to its extreme limits it might be argued that the definition of the words, "income derived from mining operations" in Regulation 701(2)(*a*) should be applied to the multiplicand C as well. Obviously it would not be in his interest to press such an argument and counsel for the Crown did not adopt it.

As an alternative to his principal contention counsel for Quemont adopted the principal contention of counsel for Rio Algom and MacLeod-Cockshutt. Conversely, counsel for Rio Algom and MacLeod-Cockshutt adopted as an alternative to his principal contention the principal contention of counsel for Quemont.

In the Quemont appeal counsel for both parties agreed to proceed with the appeal from the assessment for the 1960 taxation year and that the evidence so adduced and the argument made therein should be applicable to the appeals from the assessments for the 1958 and 1959 taxation years.

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The parties hereto, by their respective counsel, hereby admit the following facts and documents, provided that such admission is made for the purpose of this action only and may not be used against either party on any other occasion or by any other person.

1. The Appellant, Quemont Mining Corporation Limited, is a company incorporated under the laws of Canada. In the taxation year 1960, the Appellant carried on the business of mining in the Province of Quebec.

2. The Appellant paid $152,854.67 to the Province of Quebec under the Quebec Mining Act for the taxation year 1960.

3. The Appellant's income for the 1960 taxation year, as computed under the Quebec Mining Act, was $3,046,495.23.

4. The amount that would otherwise be the Appellant's income, computed under the Income Tax Act, R.S.C. 1952, c. 148, if no amount had been deducted in computing its income under paragraph (*b*) or (*p*) of subsection (1) of section 11 of the Income Tax Act, section 83A of the Income Tax Act, or paragraph (*g*) of subsection (1) of section 1100 of the Regulations, was $2,880,958.32, and the original cost to the Appellant of the properties described in Schedule B to the Regulations used by it in the year in the processing of mineral ores, minerals or products derived therefrom, (hereinafter called "milling assets") was $5,478,497.30.

5. In computing the deduction of $129,926.00 claimed by it for the 1960 taxation year under section 11(1)(*p*) of the Income Tax Act and section 701 of the Regulations, the Appellant used the following formula:

The lesser of:

A. The amount paid to Quebec under the Quebec Mining Act ($152,-854.67)

OR:

B.

		income computed under the Quebec Mining Act, less the greater of (a) 8% of the Appellant's milling assets (i.e. 8% of $5,478,497.30) or (b) 15% of $3,046,495 23
Amount paid to Quebec under Quebec Mining Act	×	─────────────────
		income computed under the Quebec Mining Act

i.e.

		$3,046,495.23 less the greater of (a) $438,279.78 or (b) $456,974 28
$152,854.67	×	─────────────────
		$3,046,495 23

i.e.	$152,854.67	×	$3,046,495 23—$456,974 28 / $3,046,495.23
	$152,854 67	×	$2,589,520 95 / $3,046,495 23 = $129,926.00

As a result, the Appellant deducted $129,926.47 under Section 11(1)(*p*) and Regulation 701 in computing its income for 1960.

6. In assessing and in computing the amount of $122,558.81 which the Respondent allowed as a deduction under section 11(1)(*p*) and Regulation 701 for the Appellant's 1960 taxation year the Respondent used the following formula:

The lesser of:

A. The amount paid to Quebec under the Quebec Mining Act ($152,854.67)

OR:

B. Amount paid to Quebec under Quebec Mining Act × (the amount that would otherwise be the Appellant's income, computed under the Income Tax Act, if no amount had been deducted in computing his income under the provisions of the Income Tax Act referred to in paragraph 4 hereof ($2,880,958 32) less the greater of
(a) 8% of the original cost of the Appellant's milling assets (i.e. 8% of $5,478,497.30) or
(b) 15% of $2,880,958 32)
/ income computed under the Quebec Mining Act

i.e. $152,854 67 × ($2,880,958.32 less the greater of (a) $438,279.78 or (b) $432,143 73) / $3,046,495.23

i e $152,854.67 × ($2,880,958.32—$438,279.78) / $3,046,495.23

i.e. $152,854.67 × $2,442,678 54 / $3,046,495.23 = $122,558 81

7. Either party may adduce further evidence relevant to the issues in this appeal and not inconsistent with this agreement.

In the appeal of Rio Algom counsel also agreed upon a statement of facts which is reproduced hereunder:

The parties hereto, by their respective counsel, hereby admit the following facts and documents, provided that such admission is made for the purpose of this action only and may not be used against either party on any other occasion or by any other person.

1. Paragraph 1 of the Amended Notice of Appeal is admitted.

2. The fiscal period of Pronto Uranium Mines Limited ("Pronto") ended, in 1956, 1957, 1958 and 1959 on December 31 and in 1960 on June 30.

3. Pronto's income derived from the operation of the Pronto Uranium Mine was exempt income under section 83(5) of the Income Tax Act during the 36 month period commencing on May 1, 1956 and ending on April 30, 1959 (hereinafter sometimes referred to as the exempt period).

4. For its 1956 taxation year Pronto paid to the Province of Ontario under The Mining Tax Act, R.S.O. 1950, c. 237, tax in the amount of $64,552.31.

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5. In computing its income or loss for the 4 month period ended April 30, 1956, Pronto allocated $21,517.44, or 4/12 of the said sum of $64,552.31 to the 4 month period ended April 30, 1956 and sought to deduct that amount in computing its income under section 11(1)(*p*) of the Income Tax Act.

6. During the 4 month period ended April 30, 1956, Pronto suffered a loss on its mining operations in Ontario.

7. For its 1959 taxation year Pronto paid taxes in the amount of $358,290.85 to the Province of Ontario under The Mining Tax Act, R.S.O. 1950, c. 237. In computing its income or loss for the 4 month period ended April 30, 1959, Pronto allocated in its (Federal) Income Tax Return $127,091.87 (Department's figure $125,373.30) of the aforesaid $358,290.85 to that four month period. In computing its income or loss for the 8 month period following April 30, 1959, Pronto allocated in its (Federal) Income Tax Return $231,198.98 (Department's figure $232,917.55) of the aforesaid $358,290.85 to that eight month period. For the purposes of this appeal, the parties agree to accept the Department's figures in this paragraph as being correct.

Rio Algom is the continuing corporation resulting from the amalgamation under section 96 of the Ontario *Corporations Act, 1953* by Letters Patent dated June 30, 1960 of Algom Uranium Mines Limited, Milliken Lake Uranium Mines Limited, Northspan Uranium Mines Limited and Pronto Uranium Mines Limited.

In the appeal of MacLeod-Cockshutt, there was no agreed statement of facts but the relevant facts are set out in paragraphs A. 1 to 7 of the appellant's Notice of Appeal for the 1960 taxation year. The Minister, in his reply, admitted those paragraphs excepting paragraph 6 with respect to which he says that the Notice of Assessment speaks for itself. Accordingly I reproduce the aforesaid paragraphs of the appellant's Notice of Appeal:

A. *STATEMENT OF FACTS*

1. The taxpayer is a company incorporated under the laws of the Province of Ontario and carries on the business of mining in that Province and pays mining tax levied under The Mining Tax Act (Ontario).

2. The amount of "mining tax" paid by the taxpayer under the said Mining Tax Act in respect of its 1960 taxation year was $16,197.60.

3. Section 11(1)(*p*) of the Income Tax Act (Act) provides inter alia that a taxpayer may deduct in computing his income for the year, such amount as may be allowed by regulation in respect of taxes on income for the year from mining operations. Section 701(1) of the Income Tax Regulations (Regulations) provides as follows:

"701(1) In computing his income for a taxation year, a taxpayer may deduct, under paragraph (*p*) of subsection (1) of section 11 of the Act, an amount equal to the lesser of

(*a*) the aggregate of the taxes paid, in respect of his income derived from mining operations in a province for the year,

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(i) to the province, and

(ii) to a municipality in the province in lieu of taxes on property or any interest in property (other than his residential property or any interest therein), or

(*b*) that proportion of such taxes that his income derived from mining operations in the province for the year is of his income in respect of which the taxes were so paid."

4. In the return of income filed by the taxpayer in respect of its 1960 taxation year, the amount claimed by the taxpayer as a deduction in computing income under the above-mentioned provisions in respect of the "mining tax" so paid was $17,560.00.

5. In the assessment for the taxpayer's 1960 taxation year the Minister disallowed the aforesaid amount of $17,560 00 claimed by the taxpayer as a deduction in computing income, and allowed the amount of $8,770 00 as a deduction in lieu thereof.

6. In determining the amount of the deduction allowable to the taxpayer on account of provincial tax (which determination was made under paragraph (*b*) of Section 701(1) of the Regulations), the Minister construed the phrase "income in respect of which the taxes were so paid", as used in said paragraph (*b*) and as he considered it applicable to the taxpayer, to mean the amount of profits, ascertained and fixed under The Mining Tax Act (Ontario), on the basis of which the mining tax exigible was computed. The Minister's computation of the amount prescribed in the said paragraph (*b*) was, as shown in a schedule attached to the notice of assessment, as follows:

$$\frac{\text{Income derived from mining operations (Reg 701(2))} \times \text{Ontario Mining Tax}}{\text{Profit as assessed by Ontario Mines Department}} \text{ or}$$

$$\frac{\$151,573}{\$279,960} \times \$16,197.60 \text{ equals } \$8,770\ 00$$

7. The amount of $8,770.00 computed in the above-mentioned manner, being less than the amount of mining tax actually paid by the taxpayer to the Province of Ontario in respect of its 1960 taxation year, is the amount which the Minister allowed as a deduction under the provisions of Section 701 of the Regulations.

Section 11(1)(*p*) permits as a deduction in computing a taxpayer's income under the *Income Tax Act* such amount as may be allowed by regulation in respect of taxes on income from mining operations.

In section 2(*e*) of Regulation 701, mining operations are defined as meaning "the extraction or production of mineral ore from or in any mine or its transportation to, or over any part of the distance to, the point of egress from the mine, including processing thereof prior to or in the course of such transportation but not including any processing thereof after removal from the mine;".

It is apparent from the foregoing definition that "mining operations" are to be strictly limited to the operations of removing mineral ore from the earth and this has been

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referred to as being the movement of the ore to the "pit's mouth". Any transportation or other treatment beyond that point is not a mining operation within this concept but is rather "processing" as defined in section 2(*f*) of Regulation 701.

In the present appeals Quemont carries on its operations in the Province of Quebec and Rio Algom and MacLeod-Cockshutt carry on their respective operations in the Province of Ontario.

Under the Quebec *Mining Act,* chapter 196 Statutes of Quebec, 1941, to which Quemont is subject, a tax is imposed on the annual profit, which is computed by taking the gross value of the year's output, sold, utilized or shipped during the year and deducting therefrom certain costs of operations and expenses which have been incurred during the year and which are set out in the Statute. The word "output" as defined in the Quebec *Mining Act* includes the mineral bearing substances coming from the mine, which are sold, removed or placed upon the market, including those treated or partially treated at any smelter or mill forming part of the works. In the Quebec *Mining Act* the words, "gross value of the year's output" means the real value of the ore and minerals at the ruling market prices at the time of their sale or use.

From the foregoing it is clear that under the Quebec *Mining Act* the tax is imposed upon an annual profit and in determining such annual profit the starting point for the value of the mineral ore is at the point of shipment or use. It follows that the value of the mineral ore is not taken at the pit's mouth but at some subsequent point or points. Therefore, under the Quebec *Mining Act* there is included in the tax imposed thereby some portion thereof which is imposed as a tax on income from "processing" as defined in Regulation 701(2)(*f*) and is not deductible as a tax on income derived from "mining operations" as those words are defined in Regulation 701(2)(*e*) (being the operation of bringing the mineral ore to the surface or to the pit's mouth).

Regulation 701(2)(*a*) defines income derived from mining operations:

Subsection (i) thereof covers the case where there is no income from a source other than mining operations.

Under subsection (ii) where there is income other than from mining operations there are two divisions, A & B.

A provides for the deductions of income from sources other than mining, processing and sale of mineral ores.

B is apparently designed to exclude processing income and is designed to estimate, as for example, when a tax is imposed as under the Quebec *Mining Act* on both income from mining operations and milling operations, how much that tax should be attributed to processing income.

The device that has been apparently adopted to fix an arbitrary amount to represent processing income is to accept (1) 8% of the milling assets or (2) 15% of the total profits, whichever is the greater, as being attributable to processing income.

It follows that the maximum amount of the tax imposed under the Quebec *Mining Act* which could be deductible in computing income under the *Income Tax Act* would be 85% of the tax so imposed.

Under the Ontario Statute, the *Mining Tax Act,* chapter 242, R.S.O. 1960 to which Rio Algom and MacLeod-Cockshutt are subject, the profit for a taxation year is the difference between the amount of the gross receipts from the output of the mine, or if the ore is not sold the amount of the actual market value of the output at the pit's mouth, less certain expenses, payments, allowances or deductions which are then set out. From the foregoing it is clear that the Ontario *Mining Tax Act* imposes the Ontario tax only on income derived from the Regulation 701 concept "mining operations" since the value of the ore at the pit's mouth is taken as the base.

Accordingly the maximum amount of the tax imposed under the Ontario Statute which could be deductible in computing a taxpayer's income under the *Income Tax Act* could be 100% of the tax so imposed.

At this stage, it should be mentioned that the provincial method of arriving at the profit on which mining tax may be charged is, in certain circumstances, less favourable to the taxpayer than is the method of computing income under the *Income Tax Act*. Deductions which are permitted under the *Income Tax Act* are, in such circumstances, larger

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than those permitted under the provincial statutes here under consideration, which results in the provinces obtaining an appreciably larger tax than would be the case if the provincial method of computing profit coincided with the computation of income under the *Income Tax Act*.

Counsel for Quemont and counsel for Rio Algom and MacLeod-Cockshutt contend that the legislative intent as derived from section 11(1)(*p*) of the *Income Tax Act*, and Regulation 701 passed pursuant to the authority contained in that provision, is that all provincial taxes on income from mining operations as those words are defined by the Regulation should be deductible, that is, in the Province of Quebec, 85% for the reasons outlined above, and, in the Province of Ontario, 100%. It was counsel's contention that either formula advanced by them would accomplish that result, whereas the formula adopted by the Minister would not do so.

Only one witness was called, whose evidence, by agreement, was applicable to all three cases. This witness, by a series of mathematical computations which were filed in evidence as exhibits, showed that in applying the formula adopted by the Minister by reason of the different methods of computing income under the *Income Tax Act* and the respective provincial statutes would result, in some years, in a deductible portion of the provincial tax paid being in excess of 100% in the case of Ontario and 85% in the case of Quebec, which because of Regulation 701(1)(*a*), must be reduced to 100% and 85%, and in other years a deductible portion of less than 100% and 85%. It was also demonstrated that, because of the limitation to the aggregate of the provincial taxes paid in accordance with Regulation 701(1)(*a*), the average percentage over a period of years must always be less than 85% and 100%.

A submission was made that I should consider the tax sharing agreements between the Government of Canada and the Governments of certain of the provinces as an aid in construing Regulation 701. I doubt that I should do so; but, in any event as it appears to me, any assistance that I would get from such a consideration would merely support the conclusion that I have reached unaided thereby. It is, therefore, unnecessary to reach any concluded opinion as to whether such agreements are a proper aid to the construction of Regulation 701.

The deduction allowable under Regulation 701 is an amount which is the lesser of two alternatives. It seems logical to infer therefrom that it was contemplated by the Governor-in-Council, by whom the Regulation was made, that, in some instances, the amount that would result from an application of the formula outlined in Regulation 701(1)(*b*) would be a figure larger than the aggregate of the taxes paid to the Province as outlined in Regulation 701(1)(*a*). This could happen when in the fraction A/B the numerator A is larger than the denominator B. This might occur under the formula adopted by the Minister, i.e. where the numerator A is the income derived from mining operations in the Province computed under the *Income Tax Act* over the denominator B, which is the taxpayer's income in respect of which taxes were paid to the Province as computed under the Provincial Statute. Such result could not occur under the formula suggested by counsel for either of the appellants.

Regulation 701(1)(*b*), which gives rise to the fraction under consideration, reads as follows:

> that proportion of such taxes that his income derived from mining operations in the province for the year is of his income in respect of which the taxes were so paid.

The words, "such taxes" must mean the taxes which were paid to the Province which constitutes the multiplicand, C, in the formula which I reproduced in graphic form at the outset. That being so, the concluding words of the section "his income in respect of which taxes were so paid", must mean the taxpayer's income calculated in accordance with the Provincial Statute. The taxes that are paid to a province are not paid on income calculated under the Federal *Income Tax Act* but are paid on income calculated under the applicable Provincial Statute. I, therefore, conclude that the denominator B of the fraction A/B is a figure determined not by the Minister or by any court but under the Provincial Statute.

The numerator, A of the fraction A/B is in the words of Regulation 701(1)(*b*) "his income derived from mining operations in the Province for the year". The question immediately arising is whether the "income derived from mining operations" is to be income calculated in accordance with the *Income Tax Act* or income calculated in accordance with the applicable Provincial Statute.

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Regulation 701(2)(*a*) defines the words "income derived from mining operations" and for the purposes of convenience I reproduce that definition at this point:

701.(2) In this section,

(*a*) "income derived from mining operations" in a province for a taxation year by a taxpayer means,

(i) if the taxpayer has no source of income other than mining operations, the amount that would otherwise be his income for the year if no amount had been deducted in computing his income under paragraph (*b*) or (*p*) of subsection (1) of section 11 of the Act, section 83A of the Act, subsection (3) of section 85I of the Act, or paragraph (*g*) of subsection (1) of section 1100 of these Regulations, or

(ii) in any other case, the amount that would otherwise be his income for the year if no amount had been deducted in computing his income under paragraph (*b*) or (*p*) of subsection (1) of section 11 of the Act, section 83A of the Act, subsection (3) of section 85I of the Act, or paragraph (*g*) of subsection (1) of section 1100 of these Regulations, minus the aggregate of

(A) his income for the year from all sources other than mining, processing and sale of mineral ores, minerals and products produced therefrom, and

(B) an amount equal to 8% of the original cost to him of properties described in Schedule B to these Regulations used by him in the year in the processing of mineral ores, minerals or products derived therefrom, or if the amount so determined is greater than 65% of the income remaining after deducting the amount determined under clause (A), 65% of the income so remaining, or, if the amount so determined is less than 15% of the income so remaining, 15% of the income so remaining;

As previously pointed out, the definition is divided into separate definitions for two different cases: (i) where the taxpayer has no income other than from mining operations and (ii) where there is income from sources other than mining operations. The word "income" must have the same meaning in both parts.

On referring to paragraphs (i) and (ii) of the definition above reproduced income means what would otherwise be the taxpayer's income if no amounts were deducted under specified provisions of the *Income Tax Act* and the Regulations under the *Income Tax Act*. All such deductions are deductions under the Federal *Income Tax Act* and Regulations thereunder. Therefore, it seems to follow that the words "the amount that would otherwise be his income", from which no such deductions have been made, must be income calculated in accordance with the same *Income Tax Act*.

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Assuming I am correct in my conclusion that the definition of "income derived from mining operations" in Regulation 701(2)(*a*) means income calculated under the *Income Tax Act* it is submitted by counsel for the taxpayers that the definition should be applied to those words where they appear in both paragraphs (*a*) and (*b*) of Regulation 701(1).

Section 34 of the *Interpretation Act*, chapter 158, R.S.C. 1952 reads as follows:

> 34. Definitions or rules of interpretation contained in any Act, unless the contrary intention appears, apply to the construction of the sections of the Act that contain those definitions or rules of interpretation, as well as to the other provisions of the Act.

By virtue of section 2(1)(*b*) of the *Interpretation Act* the provisions of the Act are made applicable to regulations.

In considering the words, "income from mining operations" in the context in which they appear in Regulation 701(1)(*a*), it seems to me that the clear and unequivocal meaning of those words, considering only that paragraph, is the income in respect of which taxes were paid to the Province, which of necessity must be mining income calculated as required by the Provincial Statute. It follows, therefore, that there is a contrary intention as contemplated in section 34 of the *Interpretation Act* and accordingly the definition of the words in Regulation 701(2)(*a*) is not applicable to them as used in Regulation 701(1)(*a*).

Counsel for Rio Algom and MacLeod-Cockshutt submitted that that definition must be applied to the words, "in respect of his income derived from mining operations" where they appear in Regulation 701(1)(*a*) and that they must mean, in that provision, income in the Federal sense, although the taxes that, as all parties agree, are contemplated by that provision were, in fact, determined by reference to income computed on a Provincial basis. I cannot accept such conclusion since it is common ground that the taxes are those paid to the Province and are those that have been calculated on income determined by a method laid down by the Province without any reference whatsoever to the *Income Tax Act*.

The second of the alternative figures is that which results from the fraction in the formula outlined in Regulation 701(1)(*b*), the numerator of which I have concluded is "his

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income derived from mining operations" which by applying the definition of those words as set out in Regulation 701(2)(*a*) must mean income calculated on a Federal basis. With this conclusion counsel for the Minister and counsel for Rio Algom and MacLeod-Cockshutt in his principal argument, are in agreement, but counsel for Quemont is not. The denominator of the fraction comprised in the words, "his income in respect of which taxes were so paid" refers to "his income derived from mining operations in the Province" as contained in Regulation 701(1)(*a*) which I have concluded means the income calculated under the Provincial Statute. With this conclusion counsel for the Crown and counsel for Quemont, in his principal argument, agree but counsel for Rio Algom and MacLeod-Cockshutt does not. In his submission the denominator is Federally calculated income plus additional taxes which were paid to the Province on non-mining income. In my view the words of subsection (*b*) must mean the income with respect to which taxes were paid to the Province, that is, Provincially calculated income.

If I were to accept the submission of either counsel for Quemont or Rio Algom and MacLeod-Cockshutt that the fraction contemplated in Regulation 701(1)(*b*) is either Provincially calculated income over Provincially calculated income, or Federally calculated income over Federally calculated income, in a case where the taxpayer had no source of income other than from mining operations this would result in the entire amount of the taxes paid to the Province being deductible. This counsel submits is the intention of the legislature gleaned from the Provincial Federal agreements and both formulae advocated by them has the additional advantage of overcoming the anomalies outlined in the examples thereof which were put in evidence. However, it would appear to me that the Regulation does not contemplate such a result and if such had been the intention it would have been a simple matter so to state. It does not seem possible to me that it was intended by the Regulation to allow deductions on the basis of a larger income than that produced by the application of its own method of calculating income. The anomalies demonstrated by the examples given in evidence result from the differences in practice as to deductions allowed in computing income between the Federal and Provincial taxing authorities and to differences between the various Provincial taxing authorities.

I, therefore, conclude that the formula adopted by the Minister in computing the deduction under section 11(1)(*p*) of the *Income Tax Act* was the correct one.

In the appeal of Rio Algom a further issue arises.

From January 1, 1956 to April 30, 1956 the mine, though producing ore, did not do so in commercial quantities. However, Rio Algom paid to the Province of Ontario a tax in the amount of $64,552.31 under the Ontario *Mining Tax Act* for the calendar year 1956. In computing its loss under the *Income Tax Act* for the four month period ending April 30, 1956[1] Rio Algom allocated $21,517.44 or four twelfths of the amount of $64,552.31 to that period and sought to deduct that amount in computing its income under section 11(1)(*p*) of the *Income Tax Act* as a loss in its 1960 taxation year by reason of the provisions of section 27(1)(*e*) of the *Income Tax Act,* that is as a business loss sustained in the five taxation years immediately preceding its 1960 taxation year.

The Minister disallowed the amount of $21,517.44 as not properly deductible pursuant to section 11(1)(*p*) because he alleges (1) that no profits were earned by Rio Algom from its mining operations during the four month period ending on April 30, 1956 and accordingly (2) Rio Algom has no "income derived from mining operations" as that phrase is defined in the Regulation then applicable being 700. The relevant parts of Regulation 700 read as follows:

700.(1) The amount that a taxpayer may deduct from income under paragraph (*p*) of subsection (1) of section 11 of the Act shall be that proportion of the total taxes on income paid by him to a province, or to a Canadian municipality in lieu of taxes on property or any interest in property (other than his residential property or any interest therein), that

(*a*) his income derived from mining operations...is of the total income in respect of which the taxes were so paid.

(2) In this section,

. . .

(*b*) "income derived from mining operations" means the net profit or gain derived or deemed to have been derived from mining operations by a person engaged therein with or without an allowance in respect of depletion and if such a person receives net profit or

[1] No question was raised as to the deductibility of a loss for this four month period in a subsequent year and I express no opinion on that question.

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gain from sources other than mining operations either by reason of the carrying on by him of the processing of mineral ore extracted by him or otherwise, the net profit or gain to be deemed to have been derived by him from mining operations shall not exceed that portion of the total net profit or gain received by him from all sources, determined by deducting from the said total

(i) the returns received by him by way of dividends, interest or other like payments from stock, shares, bonds debentures, loans or other like investments;

(ii) the net profit or gain, if any, derived by him from, and attributable in accordance with sound accounting principles to, the carrying on of any business, or derived from and so attributable to any source, other than mining operations and the processing and sale of mineral ores or products produced therefrom, and other than as a return on investments mentioned in subparagraph (i); and

(iii) an amount by way of return on capital employed by him in processing mineral ores or products derived therefrom, equal to 8% of the original cost to him of the depreciable assets including machinery, equipment, plant, buildings, works and improvements, used by him in the processing of mineral ore or products derived therefrom but not in excess of 65% of that portion of the said total net profit or gain remaining after deducting therefrom the amounts specified in subparagraphs (i) and (ii); provided that, in the case of a person who mines and smelts mineral ores from which metals other than gold, silver or platinum are recovered in amounts exceeding in value 5% of the total value of the metals recovered, the amount to be deducted under this subparagraph shall not in any case be a smaller amount than the following proportion of the total net profit or gain remaining after deducting therefrom the amounts specified in subparagraphs (i) and (ii):

(A) where both copper and nickel are recovered, each in amounts which exceed in value 5% of the total value of the metals recovered 40%

(B) where both lead and zinc are recovered, each in amounts which exceed in value 5% of the total value of metals recovered 30%

(C) where both copper and zinc are recovered, each in amounts which exceed in value 5% of the total value of metals recovered 20%

(D) in other cases 15%

(*c*) "mine" includes any work or undertaking in which mineral ore is extracted or produced, including a quarry;

(*d*) "minerals" includes gold, silver, rare and precious metals or stones, copper, iron, tin, lead, zinc, nickel, salt, saline deposits, alkali, coal, limestone, granite, slate, marble or other quarriable stone, gypsum, clay, marl, gravel, sand and volcanic ash but does not include petroleum or natural gas;

(*e*) "mineral ore" includes all unprocessed minerals or mineral bearing substances;

(*f*) "mining operations" means the extraction or production of mineral ore from or in any mine or its transportation to, or any part of the distance to the point of egress from the mine including any processing thereof prior to or in the course of such transportation but not including any processing thereof after removal from the mine; and

(g) "processing" includes milling, concentrating, smelting, refining, fabricating, transporting or distributing.

(3) Nothing contained herein shall be construed as allowing a taxpayer to deduct an amount in respect of taxes imposed under a statute or by-law which is not restricted to the taxation of persons engaged in mining . . .operations.

(This regulation was by P.C. 1958-498 dated April 9, 1958 which was applicable to the 1957 and subsequent taxation years.)

The Minister's disallowance of part of the Ontario mining tax paid by Rio Algom in its 1956 taxation year is predicated upon the interpretation of the words "the total income in respect of which the taxes were so paid" as they appear at the end of Regulation 700(1)(*a*) as meaning the profits as determined under the Ontario *Mining Act*.

Regulation 700(3) limits the deduction to cases where a tax is imposed only on persons engaged in mining operations which would include a person engaged in mining and other things.

The tax with respect to which a deduction is allowed is a tax "on income paid by him to a province . . .in lieu of taxes on property or any interest in property".

The amount of the deduction is defined as that proportion of such taxes that "his income from mining operations as defined herein" is of "the total income in respect of which taxes were so paid". The formula for determining the proportion of the amount of the allowable deduction is therefore:

$$\frac{\text{A. The taxpayer's income from mining operations as defined herein}}{\text{B. The total income in respect of which taxes were so paid}} \times \text{C. Tax on income paid by taxpayer to a province in lieu of tax on property} = \text{D. Deductible portion}$$

It is clear that the denominator B, being the "income in respect of which taxes were so paid" is the income as assessed under the provincial taxing statute.

This conclusion is confirmed by *M.N.R. v. Spruce Falls Power & Paper Company Limited*[1] where the Supreme

[1] [1953] 2 S.C.R. 407.

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Court considered an allowance claimed respecting logging operations by virtue of section 5(1)(*w*) of the *Income War Tax Act*, which is the predecessor of section 11(1)(*p*) of the *Income Tax Act*, under a regulation reproduced at page 417, which very closely parallels Regulation 700.

Kellock J. said at page 417:

> . . . the deduction authorized was the fraction of the provincial or municipal tax represented by the taxpayer's income from logging operations as defined by the regulations, divided by the taxpayer's total income in respect of which the taxes mentioned in s. 5(1)(*w*) were paid, i.e. the total income from logging as defined by the provincial legislation.

The numerator A of the fraction is "the taxpayers' income from mining operations as defined herein" i.e. as defined in Regulation 700(2)(*b*). This definition is designed to arrive at a figure and is couched in terms of basic concepts, i.e. "net profit or gain" and does not require a reference back to Part I of the *Income Tax Act*. It is apparent from the Agreed Statement of Facts that the "net profit or gain" derived by Rio Algom from its mining operations for the period January 1, 1956 to April 30, 1956 was nil.

Therefore, the numerator A in the formula expressed immediately above is zero. It follows therefrom that the Minister was right in disallowing the amount of $21,517.54 claimed as a deduction by the appellant.

The necessity of considering the part of Regulation 700 dealing with provincial tax on mining operations, affords an opportunity to compare that Regulation with Regulation 701, which replaced it. Such a comparison supports the conclusions that I have reached above as to what constitutes the proper interpretation of Regulation 701.

The deduction is limited by Regulation 701(3) as it was by Regulation 700(3) to cases where a tax is imposed only on a person engaged in mining operations.

However, the tax in respect of which a deduction is allowed is no longer a tax on income in lieu of taxes on property as it was under Regulation 700, but is a tax paid in respect of "income derived from mining operations" which words are defined by Regulation 701(2) in terms of a mathematical formula so that, *prima facie*, they mean, for a particular person for a particular year, a particular dollar amount.

The amount of the deduction permitted is defined as a formula, almost exactly the same as in Regulation 700, being that proportion of such taxes that "his income derived from mining operations in the province for the year" is of "his income in respect of which the taxes were so paid".

While the words of Regulation 701(1)(*b*) describing the numerator in such fraction do not specifically contain a cross-reference to the definition in Regulation 701(2)(*a*) similar to the cross-reference in Regulation 700(1)(*a*), the words describing the numerator are the same words as those that are defined by Regulation 701(2)(*a*) and, in the absence of any indication in the context to the contrary, this amount, i.e. the numerator, must be computed in accordance with the definition in Regulation 701(2)(*a*) which, unlike the definition in Regulation 700(2)(*b*), is in terms of the concepts in Part I of the *Income Tax Act*.

The subject matter of the tax is, by virtue of Regulation 701(1)(*a*), a tax paid "in respect of his income derived from mining operations in the province for the year". Consequently it would seem that the "income in respect of which the taxes were so paid" i.e. the denominator, as described by Regulation 701(1)(*b*) must be his "income derived from mining operations in the province for the year" which are the very words used to describe the numerator and which are defined by Regulation 701(2)(*a*).

The result is that, if the words of Regulation 701 are read literally, a deduction is only permitted in the very improbable case when a provincial statute is found levying a tax in respect of "income derived from mining operations in the province for the year" as computed in accordance with Regulation 701(2)(*a*) of these Federal regulations, and then the amount deductible is to be computed in accordance with a formula where the numerator and the denominator are the same. In other words, the net result is that, if such a tax is found, the amount deductible is the amount of the tax. It seems most unlikely that the Governor-in-Council resorted to such complex language as it used in Regulation 701 if that was what was intended. It could have been simply so stated.

All counsel argued the case on the basis that Regulation 701, when it used the words "income derived from mining

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operations in a province for the year" in Regulation 701(1)(*a*), did not mean the amount computed under Regulation 701(2)(*a*) but rather meant income in a generic sense from such mining operations and that Regulation 701 when it spoke about "taxes paid in respect" of such income included taxes paid in respect of such income and any other income. This seems to me to have been the correct approach even though it means saying that the definition in Regulation 701(2)(*a*) is excluded by the context insofar as the ascertainment of the Provincial tax or the denominator is involved.

Once it is accepted that the definition in Regulation 701(2)(*a*) is excluded from application to Regulation (701)(1)(*a*) it follows that the reference in that part of Regulation 701(1)(*b*) that defines the denominator becomes a reference to the income in respect of which the Provincial taxes were actually paid and not to the amount calculated under Regulation 701(2)(*a*). In short the denominator is income computed under the Provincial Statute as I have already concluded and the numerator being described as "income derived from mining operations", which are the words defined by the definition, must be computed in accordance with it.

In the result the appeals of Rio Algom and MacLeod-Cockshutt are dismissed with costs and the appeal of Quemont on the issue common to those of Rio Algom and MacLeod-Cockshutt does not succeed.

The issues peculiar to the Quemont appeal are set out in paragraphs 9 and 10 of the Quemont's Notice of Appeal.

> 9. The duties paid by the Appellant under the Quebec Mining Act were an outlay or expense incurred by the Appellant for the purpose of gaining or producing income from the property or business of the Appellant. As such, they were wholly deductible by the Appellant in computing its income for the taxation year 1960 and their deduction was not prohibited by section 12(1)(*a*) of the Act.

Section 12(1)(*a*) of the *Income Tax Act* reads as follows:

> 12.(1) In computing income, no deduction shall be made in respect of
>
> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.
>
> . . .

Paragraph 10 of the Notice of Appeal is as follows:

> 10. In the alternative, if the duties paid by the Appellant under the Quebec Mining Act were not an outlay or expense incurred by the

Appellant for the purpose of gaining or producing income from the property or business of the Appellant and are taxes on income from mining operations within the meaning of section 11(1)(*p*) of the Act, then the portion of such duties that the Respondent allowed as a deduction in computing the income of the Appellant under section 11(1)(*p*) of the Act should not have been deducted by the Respondent in his computation of the "profits" of the Appellant to which the allowance provided for by section 11(1)(*b*) of the Act and section 1201 of the Regulations is applicable.

Section 11(1)(*b*) of the *Income Tax Act* reads as follows:

11.(1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

. . .

(*b*) such amount as an allowance in respect of an oil or gas well, mine or timber limit, if any, as is allowed to the taxpayer by regulation;

The pertinent regulations are 1200 and 1201 which read in part as follows:

1200. For the purpose of paragraph (*b*) of subsection (1) of section 11 of the Act there may be deducted in computing the income of a taxpayer for a taxation year amounts determined as hereinafter set forth in this Part.

1201(1) For the purpose of this Part,

(*a*) "resource" means

. . .

(iii) a base or precious metal mine,

. . .

(2) Where a taxpayer operates one or more resources, the deduction allowed is $33\frac{1}{3}\%$ of

(*a*) the aggregate of his profits for the taxation year reasonably attributable to the production of oil, gas, prime metal or industrial minerals from all the resources operated by him,

minus

(*b*) the aggregate amount of the deduction provided by subsection (4).

Subsection 4 of Regulation 1201 lists the items that may be deducted from the aggregate of the profits of a taxpayer attributable to the production of minerals as being (*a*) losses, (*b*) exploration expenses, (*c*) capital cost allowance, (*d*) capital interest and (*e*) exempt income.

The scheme of Regulation 1201 is that in order to determine the amount which may be deducted thereunder, the first step is to determine the taxpayer's profits reasonably attributable to the production of prime metal from which profits are then deducted the items listed in subsection 4, which do not include the amount of taxes paid to the Province of Quebec under the Quebec *Mining Act*.

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It is obviously to the taxpayer's advantage to keep the amount of his profits as high as possible for that is the amount by reference to which the deduction of 33⅓% is computed. The greater the amount of the profit, the greater is the deduction permitted. The appellant, therefore, contends that the amount paid to the Province of Quebec should not be deducted in determining its profits, whereas the Minister contends that it should be so deducted to arrive at the amount by reference to which the 33⅓% deduction is computed.

The submissions of counsel for Quemont, as I understood them, may be summarized in the following manner.

With respect to the issue raised in paragraph 10 of the Notice of Appeal, which outlines his principal argument on this issue, he contends (1) that the word "profits" as used in Regulation 1201(2)(*a*) must mean the difference between the receipts from the taxpayer's business for the taxation year and the expenditures which were laid out for the purpose of earning those receipts, (2) that the amount of the taxes paid by Quemont to the Province of Quebec under the Quebec *Mining Act* was not an expenditure laid out by it to earn its mining receipts but was a special tax on income and (3) the taxes so paid to the Province of Quebec are not deductible in determining Quemont's income under the *Income Tax Act*. Assuming the correctness of the foregoing contentions, he then points out that an expenditure of this kind is not included in subsection 4 of Regulation 1201 which governs what must be deducted from the profits.

Counsel for Quemont put forward an alternative contention, which is outlined in paragraph 9 of the Notice of Appeal and which is, in effect, that in the event that I should conclude that the taxes paid to the Province of Quebec under the Quebec *Mining Act* was an expenditure for the purpose of earning profit for the purpose of the depletion allowance, then the amount so paid to the Province of Quebec must also be deductible by virtue of the provisions of section 12(1)(*a*) of the *Income Tax Act* for the purpose of determining income in respect of which income tax is to be paid.

During the course of the argument, I intimated to counsel that my view then was that the expenditure in question was not one laid out for the purpose of earning income. Upon more considered reflection, I still adhere to that view.

It is clear from section 13 of the Quebec *Mining Act* that every mine in the Province of Quebec is liable for duties upon a graduated scale dependent upon the amount of the annual profits.

Section 14 of that Act sets out a statutory formula for ascertaining the annual profits. From the gross value of the year's output sold, utilized or shipped during the year there is to be deducted the costs of operation and expenses incurred during the year which are then enumerated under eight headings.

It will be observed that the word used in section 13 is "duties" but considering the nature of those duties and having regard to the situation revealed by this legislation, there is no doubt that these duties are, in effect, provincial taxes on annual mining profits and neither can there be any doubt, in my opinion, that the type of taxation to which section 11(1)(*p*) of the *Income Tax Act* is directed is provincial taxation specifically imposed on income from mining operations which I conceive the Quebec duties to be.

Under section 14 the gross value of the year's output includes ore which has been utilized or shipped during the year and which may not have been sold, so that part of the profit may not have been realized profits.

In *Nickel Rim Mines Ltd. v. Attorney-General for Ontario*[1] the Ontario Court of Appeal considered whether the tax imposed by section 4 of the *Mining Tax Act,* R.S.O. 1950, chapter 237 was *ultra vires* the Province as not being "direct" as it must be to fall within the taxing authority conferred on the Province by section 92 of the *British North America Act.* The section of the Ontario *Mining Tax Act* there under review, to all intents and purposes and subject to those variations which have already been mentioned, closely parallels sections 13 and 14 of the Quebec *Mining Act.* Wells J. who heard the action in the first instance came to the conclusion that the tax on the profits from the ore which was sold was a direct tax, but that the tax on the profits from the ore which was not sold was an indirect tax.

[1] [1966] 1 O.R. 345.

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On appeal Porter C.J.O. who delivered the judgment of the Court of Appeal, agreed with Wells J. that the tax, in so far as it applies to realized profits, is a direct tax. However, as to the tax on ore not sold, he took the view that it was also a direct tax. At page 363 he said:

> In the case at bar, we are considering a profit tax, to be assessed at the end of each year. Although the tax in part may be upon profits estimated before actual sale, I do not think that the nature of the tax is thereby affected....

It is clear from the above quoted language that the Court of Appeal recognized that the tax imposed under the Ontario *Mining Tax Act* on realized and estimated profits was a tax on income.

I, therefore, conclude that the duties imposed under the Quebec *Mining Act,* are taxes imposed upon annual profits, both realized and estimated, and are not an expense incurred by Quemont for the purpose of producing income from its property or business.

Neither do I think that a Provincial tax on profits is an expense of earning receipts so as to be deductible in determining profits under the *Income Tax Act.*

There are types of taxes which if paid are deductible as having been incurred in the course of the income earning process. Such taxes are expenditures made for the purpose of earning or producing income from a property or a business such as the tax under consideration in *Harrods (Buenos Aires) Ltd. v. Taylor-Gooby (H.M. Inspector of Taxes)*[1]. In that case the appellant company, which was incorporated and resident in the United Kingdom carried on the business of a departmental store in Buenos Aires. In consequence the company was liable in Argentina to a tax known as the substitute tax, which was levied on joint stock companies incorporated in Argentina, and on companies incorporated outside Argentina which carried on business there, as did the appellant company through an "*Empresa estable*". The tax was charged annually at the rate of one percent on the Company's capital and was payable whether or not there were profits liable to Argentina income tax. Under Argentina law there were sanctions available to remedy non-payment of the tax.

[1] 41 T.C. 450.

For the Crown it was contended (*inter alia*) that the company paid the tax in the capacity of taxpayer rather than trader. On behalf of the Company it was contended that it paid the substitute tax solely for the purpose of enabling it to carry on its business in Argentina and if it had not paid the tax it would have been unable to carry on its business there.

The Court of Appeal accepted the contention of the appellant company and held the tax so paid to be properly deductible as it was "money wholly and exclusively laid out or expended for the purpose of (its) trade" within the meaning of section 137(*a*) of the United Kingdom *Income Tax Act.*

Diplock L.J. pointed out at page 469 that the liability to the Argentina substitute tax was not dependent upon whether profits were made or not. This is not so in the case of the tax under the Quebec *Mining Act*. The distinction is clearly that the substitute tax was one paid to enable the taxpayer to earn profits whereas the tax imposed under the Quebec *Mining Act* is a tax on profits when earned.

In *Roenisch v. Minister of National Revenue*[1] an appeal was brought from the assessment of the appellant upon the ground of the Minister refusing to allow as a deduction under the *Income War Tax Act*, an amount of income tax paid to the Province of British Columbia. Under the British Columbia *Taxation Act* provision was made for taxing the income of the individual but provision was made therein that, for the purpose of ascertaining such income, a deduction was allowed of all income tax payable to the Crown in the right of the Dominion. There was no corresponding text in the *Income War Tax Act* respecting a deduction of Provincial Income Tax such as 11(1)(*p*) of the present *Income Tax Act*, and accordingly the appellant sought relief or remedy under section 6(1)(*a*) of that Act from which section present section 12(1)(*a*) is derived.

Audette J. held that "it is self evident that the amount of the income tax paid to the Province is not an expense for the purpose of earning income". He pointed out at page 6 that "The position is indeed quite different under the federal and provincial tax Acts, because there is a text, a provision, in the provincial statute allowing a deduction of this

[1] [1931] Ex. C.R. 1.

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kind; but there is no similar provision in the federal tax Act. All deductions and exemptions are specifically mentioned in the latter Act and no such deduction or exemption as those claimed in this case are therein mentioned."

He, therefore, concluded "...relying on the authorities above mentioned and upon what I think the proper construction and interpretation of the federal Act, that the amount of provincial income tax is not an expenditure for the purpose of earning the income and should not be deducted in arriving at the amount of the tax payable under the federal Act".

The question of the deductibility of a tax paid on profits to a foreign jurisdiction was considered in *I.R.C. v. Dowdall, O'Mahoney & Co. Ltd.*[1] where a company resident in Eire carried on business at two branches in England. The whole of its profits, including those which arose from its businesses in England, were subject to income tax in Eire and its profits from the businesses in England were subject to United Kingdom excess profits tax. The company sought to deduct a proportion of the Eire taxes in computing the profits of the businesses in England for assessment to excess profits tax in the United Kingdom. It was held by the House of Lords that the Irish taxes were not paid for the purpose of earning profits but were an application of profit when made.

Lord Oaksey said at page 409:

> ...I am of opinion that taxes such as those now in question, namely, income tax, corporation profits tax and excess profits tax, are not according to the authorities wholly and exclusively laid out for the purposes of the company's trade in the United Kingdom. Taxes such as these are not paid for the purpose of earning the profits of the trade: they are the application of those profits when made and not the less so that they are exacted by a dominion or foreign government. No clear distinction in point of principle was suggested to your Lordships between such taxes imposed by the United Kingdom government and those imposed by dominion or foreign governments.

Lord Radcliffe said at page 423:

> ...the question before us relates to a deduction of income and profit taxes paid in another country. But, once it is accepted that the criterion is the purpose for which the expenditure is made in relation to the trade of which the profits are being computed, I have been unable to find any material distinction between a payment made to meet such taxes abroad and a payment made to meet a similar tax at home.

[1] [1952] A.C. 401.

Upon the authority of the *Roenisch* case *(supra)* and the *Dowdall, O'Mahoney* case *(supra)* it is clear that a tax on profits imposed by a different or foreign jurisdiction is not an expenditure laid out to earn profit and is accordingly not deductible in determining taxable income. I do not think that the authority of the two foregoing cases is in any way impugned by the recent decision of the Supreme Court in *Premium Iron Ores Ltd. v. M.N.R.*[1] reversing a decision of this Court and which was delivered subsequent to the argument in the present appeals so that it was not available to counsel. One issue there involved was the deductibility of legal expenses incurred in disputing a claim for income taxes by a foreign jurisdiction. The majority of the Supreme Court held that the legal expenses so incurred were deductible since they were expended for the purpose of retaining or protecting revenue. In the *Premium Iron Ores* case *(supra)* the issue concerned the deductibility of legal expenses in disputing the imposition of income tax by a foreign jurisdiction, whereas in the *Roenisch* case (*supra*) and the *Dowdall, O'Mahoney* case (*supra*) the issues concerned the deductibility of a tax on income validly imposed by other jurisdictions.

Accordingly, I do not accept the point taken in paragraph 9 of the Quemont's Notice of Appeal that the duties paid by Quemont under the Quebec *Mining Act* were an outlay or expense incurred by it for the purpose of gaining or producing income from its business. It follows that the amount so paid is not deductible as being an exception to the prohibition in section 12(1)(*a*) of the *Income Tax Act*.

Having so concluded I now turn to the issue raised in paragraph 10 of Quemont's Notice of Appeal which is, as outlined above, (1) that the word "profits" as used in Regulation 1201 must mean the difference between receipts from the taxpayer's business and the expenditures laid out to earn those receipts and (2) that the taxes paid to the Province of Quebec was not an expenditure laid out to earn those receipts and therefore should not be deducted to determine Quemont's income under the *Income Tax Act* and if such is the case then the only way by which the amount paid for taxes to Quebec could be properly deducted would be by the inclusion of such item in the deduc-

[1] 66 DTC 5280.

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tions enumerated in subsection 4 of Regulation 1201 in which enumeration the tax allowable under section 11(1)(*p*) of the *Income Tax Act* is not included.

Counsel for the Minister, as I understood his argument, readily concedes that the taxes paid to the Province of Quebec were not laid out for the purpose of gaining the income and accordingly those taxes so paid are not a proper deduction from income under section 12(1)(*a*) of the *Income Tax Act*. However, he does not accept the premise of counsel for Quemont that the word "profits" used in Regulation 1201(2)(*a*) is synonymous with the word "income" or that it means the difference between receipts and expenditures laid out to earn those receipts. On the contrary he contends that the word "profits" is used in Regulation 1201(2)(*a*) in its popular and ordinary commercial sense and means net profits, or receipts which are left to the taxpayer after all accounts are paid.

I attach no particular significance to the circumstances that this is the first time this point has been raised by a taxpayer on an appeal to the courts from an assessment or that Quemont, in preparing its tax returns, deducted the amount which it calculated had been paid to the Province of Quebec as taxes on mining operations to compute the amount it was entitled to deduct under Regulation 1201(2)(*a*). The issue is not whether Quemont prepared its return correctly but rather whether the Minister assessed the taxpayer in accordance with the *Income Tax Act*, and the Regulations thereunder as it is his duty to do.

In support of his contention that the meaning to be attributed to the word "profits" is that used in common parlance counsel for the Minister referred to two cases which defined the word in contexts removed from income tax matters.

In *Bishop v. Smyrna and Cassaba Railway Co.*[1] Kekewich J. said at page 269:

> The word "profits", like many other words in the English language, and even some of a technical character, is capable of more than one meaning, and it is often, and properly, used in more than one sense; and it seems to me that the two different senses of the word "profits" afford the key to the solution of the difficulty which I have now to deal with. In ordinary parlance, among mercantile men and lawyers, "profits" mean that sum which periodically, at the end of the half-year, or year, or other time

[1] [1895] 2 Ch. 265.

fixed by agreement, is divisible among the partners—a term which, of course, includes members of a company—as income. It is sometimes called "net profits", only to distinguish it from what are called "gross profits". It is the sum which is ascertained by the taking of a proper account of what has been made by trading and is therefore distributable between the parties entitled.

Then in re *The Spanish Prospecting Company, Limited*[1] Fletcher Moulton L.J. said at page 98:

The word "profits" has in my opinion a well-defined legal meaning, and this meaning coincides with the fundamental conception of profits in general parlance, although in mercantile phraseology the word may at times bear meanings indicated by the special context which deviate in some respects from this fundamental signification. "Profits" implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates.

Section 2 of the *Income Tax Act* imposes a tax on the taxable income of every person resident in Canada. Section 3 provides that such income includes income from a business and by section 4 that income from a business is the profit therefrom for the year.

The basic concept of "profit" for income tax purposes has been well established. A recent statement of that basic concept is that of Viscount Simonds, in *M.N.R. v. Anaconda American Brass Ltd.*[2] in these words:

...The income tax law of Canada, as of the United Kingdom, is built upon the foundations described by Lord Clyde in *Whimster & Co. v Inland Revenue Commissioners* ((1925) 12 T.C 813, 823) in a passage cited by the Chief Justice which may be here repeated. "In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second place, the account of profit and loss to be made up for the purpose of ascertaining that difference must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income Tax Act, or of that Act as modified by the provisions and schedules of the Acts regulating Excess Profits Duty, as the case may be. For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the values of the stock-in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is the lower; although there is nothing about this in the taxing statutes."

This statement of the principle was cited with approval by Abbott J. in *M.N.R. v. Irwin*[3].

[1] [1911] 1 Ch. 92. [2] [1956] A.C. 85 at 100.
[3] [1964] S.C.R. 662.

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In *M.N.R. v. Imperial Oil Limited*[1] the Supreme Court considered Regulation 1201 in its earlier form. Judson J. delivered a judgment for three of the four members of the Court which constituted the majority. At pages 744 and 745 he said:

> ...I think that Regulation 1201 now requires the following procedure in determining the base for the allowance to be granted to a taxpayer who operates more than one oil or gas well:
>
> (1) Determine the profits or losses of each producing well in the normal manner by ascertaining the difference between the receipts reasonably attributable to the production of oil or gas from the well and the expenses of earning those receipts.
>
> . . .

It seems to me to be the clear inference from the language quoted above, Judson J. interpreted the word "profits" as it appeared in Regulation 1201 in its prior form as having the same meaning as that attributed to it by the Privy Council in the *Anaconda* case (*supra*) in the *Excess Profits Tax Act* and by the Supreme Court in the *Irwin* case (*supra*) as applied to the *Income Tax Act,* that is to say the difference between the receipts from a business for the year and the expenses laid out to earn those receipts.

The subsequent amendments to Regulation 1201 do not appear to me to affect the meaning attributed to the word "profits" by Judson J. in the *Imperial Oil* case (*supra*).

It is well recognized that Fletcher Moulton, L.J. when considering the meaning of the word "profits" in the *Spanish Prospecting* case (*supra*) was not dealing with that word in an income tax sense.

In *The Naval Colliery Co., Ltd. v. C.I.R.*[2] Lord Buckmaster commented on the *Spanish Prospecting* case at page 1047 as follows:

> . . ., the Appellants say that the proper method of taking accounts for purposes of determining the profit of the trade is to value everything at the beginning and the end of the accounting period and find the difference, and this view they base on Lord Justice Moulton's statement in Re *The Spanish Prospecting Co., Ltd.,* [1911] 1 Ch. 92. It is obvious that such a principle, which may have application in certain cases, cannot be universally applied and, indeed, it is admitted by Counsel that it needs material modification. Lord Moulton himself pointed out at page 101 that the rule ceases to apply where the Crown interferes. Nor can the rules

[1] [1960] S.C.R. 753.

[2] [1928] 12 T.C. 1017.

applicable to wise and prudent trading be used in this connection as was pointed out by Lord Cairns in 6 App. Cas., page 324 (*Coltness Iron Company v. Black,* 1 T.C. 287, at p. 312) where he says: "It may be proper for a trader, or for a trading company to perform in his or their books an operation of this kind every year, in order to judge of the sum that can in that year be safely taken out of the trade and spent as trade profits"; but it cannot be done when the question is the amount of profits received.

What these profits are for purposes of the Income Tax Acts was defined by Lord Herschell in *Russell v. Town and County Bank* (2 T.C. 321, at p. 327 13 App. Cas. 418 at page 424), in these words: "The profit of a trade or business is the surplus by which the receipts from the trade or business exceed the expenditure necessary for the purpose of earning those receipts", and as Mr. Justice Channell says in *Alianzo Co., Ltd., v. Bell* (5 T.C. 60), [1904] 2 K.B. 666, at p. 671: "He pays on what he gets less the current expenses for getting it", to which, of course, must be added the proper statutory allowances.

I can see no justifiable reason for construing the word "profits" as used in the Regulation in any sense different from the meaning attributed by authorities to that same word as used in the *Income Tax Act.*

It follows that, on this particular issue, the appeal of Quemont is allowed and the assessment is referred back to the Minister for reassessment and in order that the portion of the duties paid by Quemont under the Quebec *Mining Act* that the Minister allowed as a deduction in computing the income of Quemont under section 11(1)(*p*) of the *Income Tax Act* should not be deducted by the Minister and the profits of Quemont to which the allowance provided for by section 11(1)(*b*) of the Act and Regulation 1201 is applicable, might be computed accordingly.

With respect to the issue common to Quemont, Rio Algom and MacLeod-Cockshutt, that is to say, the determination of the proper method of calculating the deductions to which the taxpayers are entitled to under section 11(1)(*p*) of the *Income Tax Act* and Regulation 701 thereunder, in arriving at the proportion of provincial mining tax paid by them which is to be deductible, the appeal of Quemont is dismissed.

In paragraph 6A of the Minister's amended Reply to the Notice of Appeal it is pleaded:

6A. In computing the aggregate of the Appellant's profits for the 1960 taxation year reasonably attributable to the production of industrial minerals pursuant to subsection (2) of section 1201 of the Income Tax Regulation, the Respondent deducted only the sum of $122,558.81, being

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the amount properly allowable as a deduction in computing the income of the Appellant under paragraph (*p*) of subsection (1) of section 11 of the Income Tax Act. The Respondent says that in so doing, he deducted an insufficient amount in the computation of the said profits under subsection (2) of section 1201 of the Income Tax Regulations, and that whereas the deduction in computing the Appellant's income for the purposes of Part I of the Income Tax Act, of the taxes paid to the Province of Quebec in respect of the Appellant's income derived from mining operations in that province for the year in their entirety is prohibited by virtue of s. 12(1) (*a*) of the Income Tax Act, (an amount equal to such taxes, or a proportion thereof, being deductible solely by virtue of s. 11(1)(*p*) of the Income Tax Act and Reg. 701 of the Income Tax Regulations), proper commercial and accounting practice requires that there be deducted, in computing the Appellant's profits reasonably attributable to the production of industrial minerals for the purposes of subsection (2) of section 1201 of the Income Tax Regulations, the whole of the said taxes paid to the province, ($152,854.67).

In effect what the Minister is saying in paragraph 6A is that he disputes the deductibility of the sum of $122,558.81 from Quemont's acknowledged receipts in computing the base to which the percentage of 33% in Regulation 1201(2) applies and adds that the Minister erred in not deducting the greater sum of $152,854.67 being the whole of the taxes paid to the province.

This raises the question whether it is open to the Minister, where there is an appeal from an assessment, to ask the Court to increase the amount of the assessment. Because of the conclusion which I have reached it is not necessary for me to consider or decide that question.

In respect of the appeals of Rio Algom and MacLeod-Cockshutt, as indicated above, there will be judgment at this time dismissing the appeals with costs.

In respect of the appeal of Quemont, as success is divided, I propose to allow the parties an opportunity of speaking to the question of costs. For that reason there will be no judgment until such time as one of the parties brings a motion for judgment.

BETWEEN:

Ottawa 1966

Oct. 14

Oct. 22

HOVERCRAFT DEVELOPMENT LIMITED .... PLAINTIFF;

AND

THE DE HAVILLAND AIRCRAFT OF CANADA LIMITED .... DEFENDANT.

Patents—Conflict—Patent Act, R.S.C. 1952, c. 203, s. 45(8)—Relief sought that defendant not entitled to conflict claims—Jurisdiction.

Following the award by the Commissioner of Patents to defendant of certain claims in conflict plaintiff brought action for a declaration (1) that neither party was entitled to the claims (on the ground that they were inadequately described), and (2) that defendant was not entitled thereto (on the grounds that the claims were excessive and that defendant's inventors were not joint inventors), but there was no claim for the award of the claims to plaintiff. Defendant in its counterclaim alleged (1) that plaintiff's specification did not correctly describe the invention, and (2) that the claims were excessive.

Held, the Court has no jurisdiction to grant the relief sought by the statement of claim or by the counterclaim. Section 45 of the *Patent Act* was not intended to create a procedure for attacking a patent application before the issue of a patent.

ARGUMENT of question of law before trial.

David E. Hill for plaintiff.

Donald J. Wright for defendant.

JACKETT P.:—This is a Statement of Claim with reference to conflict proceedings under section 45 of the *Patent Act.* A question of law was set down for hearing before trial as to the jurisdiction of the Court to deal with the matters raised by the Statement of Claim and by the Counterclaim.

The Statement of Claim reads in part as follows:

3. The Plaintiff is the owner, by assignment, of an invention made by Christopher S. Cockerell entitled "Vehicles for Travelling Over Land and/or Water" for which an application for patent was filed in the Canadian Patent Office on December 12, 1956 under Serial No 719,851.

4. The Plaintiff has been advised by the Commissioner of Patents that the aforesaid application is in conflict with an application Serial No. 684,594 assigned to the Defendant and naming John Dubbury, J. C. M. Frost and T. D. Earl as inventors, such conflict arising by reason of the presence of claims identified as claims C1 to C5 inclusive in both the Plaintiff's and Defendant's applications.

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5. The Commissioner of Patents, by an official letter dated March 29, 1965, advised the Plaintiff of his determination that John Dubbury, J. C. M. Frost and T. D. Earl were the prior inventors of the subject matter of conflict claims C1 to C5 inclusive.

6. Neither of the parties is entitled to the issue of a patent containing any of claims C1 to C4 inclusive because:

(*a*) each of the said claims is obscure and ambiguous and fails to state distinctly the things or combinations which are regarded as new and in which an exclusive property or privilege is claimed,

and, alternatively, because

(*b*) each of the said claims extends to subject matter which is not useful,

(*c*) each of the said claims extends to subject matter which was not new having regard to the common knowledge in the art and the patents and publications referred to in Schedule I hereof, and

(*d*) each of the said claims extends to subject matter which was obvious having regard to the common knowledge in the art and the patents and publications referred to in Schedule I hereof.

7. The Defendant is not in any event entitled to the issue of a patent containing any of claims C1 to C4 inclusive because it has not, in the said application Serial No. 684,594, correctly and fully described any alleged invention distinctly claimed in any of the said claims and the operation or use of any such alleged invention as contemplated by the inventors named in the said application.

8. The Defendant is not in any event entitled to the issue of a patent containing any of claims C1 to C4 inclusive because the said claims claim more than the inventors named in the said application Serial No. 684,594 invented, if they invented anything.

9. The Defendant is not in any event entitled to the issue of a patent containing any of claims C1 to C5 inclusive because the inventors named in the Defendant's said application Serial No. 684,594 were not in fact joint inventors of

(*a*) any alleged invention distinctly claimed in any of conflict claims C1 to C4 inclusive

or

(*b*) the subject matter of claim C5.

10. The Plaintiff is entitled as against the Defendant to the issue of a patent including claim C5 because the Defendant has not, in the said application Serial No. 684,594, correctly and fully described the invention claimed in the said claim and the operation or use of the said invention as contemplated by the inventors named in the said application.

THE PLAINTIFF THEREFORE CLAIMS:

(*a*) A declaration that neither of the parties is entitled to the issue of a patent containing any of claims C1 to C4 inclusive;

(*b*) A declaration that the Defendant is not entitled to the issue of a patent including any of claims C1 to C4 inclusive;

(*c*) A declaration that the Plaintiff is entitled as against the Defendant to the issue of a patent including claim C5;

(*d*) Such further or other relief as the justice of the case requires;

(*e*) Costs.

Paragraph 5 of the Statement of Defence reads as follows:

5. In the alternative, the Defendant says that

(1) the specification of application Serial No. 684,594 does not correctly and fully describe said alleged invention, or the invention claimed in claims C1 to C5 inclusive, as required by subsection (1) of Section 36 of the Patent Act;

(2) If Christopher S. Cockerell invented anything (which is denied) claims C1 to C5 inclusive claim more than he invented.

By Notice of Motion dated October 5, 1966, an application was made that the following question of law be set down for hearing before trial:

(*a*) The questions relating to the jurisdiction of this Court raised by paragraph 4 of the Statement of Defence, and

(*b*) the question of whether or not this Court has jurisdiction to entertain in these proceedings the issues raised in paragraph 5 of the Statement of Defence or to give an Order relating thereto as asked for in the counter-claim.

This application was granted.

Having regard to recent decisions of this Court, counsel for the plaintiff did not put forward any argument as to the Court's jurisdiction to deal with the questions raised by subparagraphs (*b*), (*c*) and (*d*) of paragraph 6 or the matters dealt with in paragraphs 7 and 10 although he reserved the right to make submissions in support of them on an appeal. He recognized that, with regard to these parts of the Statement of Claim, there was no point in taking time to argue the matter in this Court. He did contend, however, that there was no previous decision with reference to the jurisdiction of the Court concerning paragraph 6(*a*), paragraph 8 and paragraph 9, and he submitted that the Court had jurisdiction to deal with the matters raised by those paragraphs.

The answer to the question depends upon the construction of section 45 of the *Patent Act* which reads as follows:

45. (1) Conflict between two or more pending applications exists

(*a*) when each of them contains one or more claims defining substantially the same invention, or

(*b*) when one or more claims of one application describe the invention disclosed in the other application.

(2) When the Commissioner has before him two or more such applications he shall notify each of the applicants of the apparent conflict and transmit to each of them a copy of the conflicting claims, together with a copy of this section; the Commissioner shall give to each applicant the opportunity of inserting the same or similar claims in his application within a specified time.

(3) Where each of two or more of such completed applications contains one or more claims describing as new, and claims an exclusive

property or privilege in, things or combinations so nearly identical that, in the opinion of the Commissioner, separate patents to different patentees should not be granted, the Commissioner shall forthwith notify each of the applicants to that effect.

(4) Each of the applicants, within a time to be fixed by the Commissioner, shall either avoid the conflict by the amendment or cancellation of the conflicting claim or claims, or, if unable to make such claims owing to knowledge of prior art, may submit to the Commissioner such prior art alleged to anticipate the claims; thereupon each application shall be re-examined with reference to such prior art, and the Commissioner shall decide if the subject matter of such claims is patentable.

(5) Where the subject matter is found to be patentable and the conflicting claims are retained in the applications, the Commissioner shall require each applicant to file in the Patent Office, in a sealed envelope duly endorsed, within a time specified by him, an affidavit of the record of the invention; the affidavit shall declare:

(*a*) the date at which the idea of the invention described in the conflicting claims was conceived;

(*b*) the date upon which the first drawing of the invention was made;

(*c*) the date when and the mode in which the first written or verbal disclosure of the invention was made; and

(*d*) the dates and nature of the successive steps subsequently taken by the inventor to develop and perfect the said invention from time to time up to the date of the filing of the application for patent.

(6) No envelope containing any such affidavit as aforesaid shall be opened, nor shall the affidavit be permitted to be inspected, unless there continues to be a conflict between two or more applicants, in which event all the envelopes shall be opened at the same time by the Commissioner in the presence of the Assistant Commissioner or an examiner as witness thereto, and the date of such opening shall be endorsed upon the affidavits.

(7) The Commissioner, after examining the facts stated in the affidavits, shall determine which of the applicants is the prior inventor to whom he will allow the claims in conflict and shall forward to each applicant a copy of his decision; a copy of each affidavit shall be transmitted to the several applicants.

(8) The claims in conflict shall be rejected or allowed accordingly unless within a time to be fixed by the Commissioner and notified to the several applicants one of them commences proceedings in the Exchequer Court for the determination of their respective rights, in which event the Commissioner shall suspend further action on the applications in conflict until in such action it has been determined either

(*a*) that there is in fact no conflict between the claims in question,

(*b*) that none of the applicants is entitled to the issue of a patent containing the claims in conflict as applied for by him,

(*c*) that a patent or patents, including substitute claims approved by the Court, may issue to one or more of the applicants, or

(*d*) that one of the applicants is entitled as against the others to the issue of a patent including the claims in conflict as applied for by him.

(9) The Commissioner shall, upon the request of any of the parties to a proceeding under this section, transmit to the Exchequer Court the papers on file in the Patent Office relating to the applications in conflict.

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There is no doubt that the purpose of section 45 is to solve a question that has arisen in the course of processing applications for patents as to which of two persons claiming separately the grant of a patent in respect of the same invention was the first inventor thereof. When the Commissioner has made an award in a particular conflict proceeding, under subsection (7) of section 45, that one of the applicants "is the prior inventor to whom he will allow the claims in conflict", it is open to the other applicant to commence proceedings in this Court "for the determination of their respective rights". There is no doubt in my mind that these latter words contemplate an action by an applicant who was unsuccessful before the Commissioner for a determination of the Court that he and not the applicant who was successful before the Commissioner is entitled "as against the others to the issue of a patent including the claims in conflict". See paragraph (*d*) of section 45(8).

In such an action, there might well be a proper allegation that the inventor or inventors named in the defendant's application is not the inventor of the invention as described in the conflict claim as the basis for a claim that the plaintiff should have such relief because the inventor named in its invention is the sole inventor of the invention described in the conflict claim. To the extent that paragraphs 8 and 9 of the Statement of Claim herein constitute such an allegation, I should not have been inclined to strike them out if they were part of an otherwise properly framed statement of claim.

My difficulty with the Statement of Claim in the present action is that it has not been framed with a view to having the Court reverse the Commissioner's finding that the defendant and not the plaintiff is entitled to a patent containing the conflict claims. The plaintiff has not put forward a claim, by his Statement of Claim, that it is entitled to the claims in its application that were put in conflict and then awarded to the defendant. The clear purpose of the Statement of Claim is to obtain a judgment of the Court that the claims in question should not be awarded to the defendant. In my view, section 45 was not intended to create a procedure for attacking a third party's application for an invention before the issuance of a patent.

What I have said with reference to the Statement of Claim applies equally to the Counterclaim.

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For the above reasons, the answer to the question of law is that the Exchequer Court of Canada has no jurisdiction to grant the relief sought by the Statement of Claim or by the Counterclaim.

Pursuant to the terms of the Order setting the question of law down for hearing before trial, before an application is made for judgment dismissing the Statement of Claim or for other consequential relief in accordance with my answer to the questions of law, the plaintiff will be given a reasonable opportunity of applying for leave to amend its Statement of Claim. One term of an order granting such leave may, of course, be that the defendant will have leave to amend its Statement of Defence.

Upon the application for judgment or other consequential relief, the question of the costs of this hearing and determination will be dealt with.

Toronto 1966 Oct. 18-20 — Ottawa Oct. 31

IN THE MATTER OF the *Trade Marks Act* (1–2 Elizabeth II, Chapter 49),

AND

IN THE MATTER OF an Opposition by the Rowntree Company Limited to application S.N. 264,951 covering the trade mark SMOOTHIES.

BETWEEN:

PAULIN CHAMBERS CO. LTD. (*Applicant*) .... APPELLANT;

AND

THE ROWNTREE COMPANY LIMITED (*Opponent*) .... RESPONDENT;

AND

THE REGISTRAR OF TRADE MARKS.

Trade marks—Trade Marks Act, S. of C. 1952-53 c. 49, Sections 6(2), (5), 12(1)(b), 37, 55—Appeal from the decision of the Registrar of Trade Marks—Whether confusion of trade marks—Information should be representative, unbiased, reliable and not hearsay—Mark widely known throughout Canada—Degree of resemblance—No probability of confusion within the meaning of Section 6 of the Act—Appeal allowed.

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PAULIN CHAMBERS CO. LTD. AND THE ROWNTREE CO LTD. AND THE REGISTRAR OF TRADE MARKS

This is an appeal pursuant to section 55 of the *Trade Marks Act*, from the decision of the Registrar of Trade Marks, upholding the opposition by the respondent to application by the appellant to register its word mark "Smoothies" as applied to candy.

The respondent has two prior registrations, namely the Trade mark "Smartie" for biscuits and candy, and the Trade mark "Smarties" for chocolate confection.

Since the date of the appellant's application to register was September 16, 1961 and the date of first use was August 9, 1961, there was no substantial contemporaneous use of the two marks, and therefore evidence of actual confusion was practically impossible to obtain. An attempt was made to obtain from a primary source statistical data to establish confusion. This was done by conducting a survey.

The survey evidence advanced by the respondent does not demonstrate how the information was obtained nor that it was representative, unbiased, reliable and adequate for the purpose of the survey.

"In coming to a decision as to whether or not these two marks are confusing, the concept of first impression must be employed. The marks must be considered in their totality, not in a detailed study. And the criterion that should be employed in considering the connection between the two marks should be real tangible danger of confusion and not a theoretical danger."

The survey evidence before the Registrar of Trade Marks and before this Court is no proof of confusion between the two marks. It is hearsay.

After considering the whole of the admissible evidence and particularly the circumstances detailed in section 6(5) of the *Trade Marks Act*, the Court made the following findings.

Held, That "there is an inherent distinctiveness in the trade mark 'Smarties' in that it is a strong trade mark; and that it has become widely known throughout Canada".

2. That "the trade mark 'Smarties' has been used for a very long time whereas the trade mark 'Smoothies' has been used a very insignificant period of time".

3 That "the wares sold under the marks of 'Smoothies' and 'Smarties' are similar, are cheap and are in the main purchased by or for children but that some reasonable degree of discrimination is exercised in their purchase".

4. That "the nature of the trade in which the wares 'Smoothies' and 'Smarties' are sold is the same, namely, the retail trade".

5. That "there is no resemblance between the trade marks in appearance, sound or in the idea suggested by them", nor "dispute between the parties that there is no appearance or sound resemblance but there was a dispute as to whether there was a degree of resemblance in the idea suggested by them."

6. That it is clear that the meaning of these words namely: "smart or smartie" "smoothy or smoothie" are entirely dissimilar.

7. That "there is no probability of confusion within the meaning of section 6 of the *Trade Marks Act* of 'Smoothies' with 'Smarties'."

8. That "the mark 'Smoothies' is not clearly descriptive or deceptively mis-descriptive of the character or quality of the wares within the meaning of section 12(1)(*b*) of the *Trade Marks Act*".

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PAULIN CHAMBERS CO. LTD. AND THE ROWNTREE CO. LTD. AND THE REGISTRAR OF TRADE MARKS

APPEAL from a decision of the Registrar of Trade Marks.

Norman R. Shapiro for the appellant.

Donald J. Wright for the respondent.

GIBSON J.:—This appeal, pursuant to section 55 of the *Trade Marks Act*[1], is from the decision of the Registrar of Trade Marks dated January 21, 1964, upholding the opposition by the respondent, The Rowntree Company Limited, to application S.N. 264,951, filed September 16, 1961 by the appellant, Paulin Chambers Co. Ltd., to register its word mark "Smoothies" as applied to candy.

The respondent has two prior registrations, namely the trade mark "Smartie" numbered 198/43453 as of March 6, 1928 for biscuits and candy, and the trade mark "Smarties" numbered 49/13008 as of March 7, 1940, for chocolate confection.

In compliance with Rule 36 of this Court, the Statement of Allegations of Fact Upon Which The Appellant Relies is as follows:

1. The Appellant, Paulin Chambers Co. Ltd., commenced to use the Trade Mark SMOOTHIES, in Canada, in association with candy as of August 9, 1961.

2. The Appellant, Paulin Chambers Co Ltd. through its duly authorized agent filed in the Canadian Trade Marks Office on September 16, 1961, an application for registration of the Trade Mark SMOOTHIES for use in association with candy based on use in Canada as of August 9, 1961, which application was given Serial Number 264,951 by the Canadian Trade Marks Office.

3. The Appellant, Paulin Chambers Co. Ltd. filed its application for registration of the Trade Mark SMOOTHIES for candy under Serial Number 264,951 in accordance with the provisions of Section 29 of the Canadian *Trade Marks Act* and that it is the person entitled to registration thereof in Canada in accordance with the provisions of Section 16(1) of the Canadian *Trade Marks Act* because at the date it first used the Trade Mark SMOOTHIES for candy, in Canada, it was not confusing with:

(*a*) A Trade Mark that had been previously used in Canada or made known in Canada by any other person;

(*b*) A Trade Mark in respect of which an application for registration had been previously filed in Canada by any other person; or

(*c*) A trade name that had been previously used in Canada by any other person.

4. The Trade Mark SMOOTHIES for candy claimed in said application Serial Number 264,951 is registrable as it is not confusing within the

[1] S. of C. 1952-53, c. 49.

meaning of Section 6(2) of the Canadian *Trade Marks Act* with the Trade Mark SMARTIE for biscuits and candy registered as of March 6, 1928 under Number 198/43453 in the Canadian Trade Marks Office and with the Trade Mark SMARTIES for a chocolate confection registered as of March 7, 1940, under Number 49 N.S./13008 in the Canadian Trade Marks Office, both registration Numbers 198/43453 and 49 N.S./13008 being owned by the Respondent, The Rowntree Company, Limited because:

(*a*) The use of the Trade Mark SMOOTHIES in association with candy and the use of the Trade Mark SMARTIE in association with biscuits and candy, in the same area does not and would not be likely to lead to the inference that the wares associated with such trade marks are manufactured, sold, leased or hired by the same person.

(*b*) The use of the Trade Mark SMOOTHIES in association with candy and the use of the Trade Mark SMARTIES in association with a chocolate confection, in the same area does not and would not be likely to lead to the inference that the wares associated with such Trade Marks are manufactured, sold, leased or hired by the same person.

Complying also with Rule 36 of this Court, the Statement of Allegations of Fact Upon Which The Respondent Relies is as follows:

1. The Rowntree Company, Limited is the registered owner of the Trade Mark "Smarties" registered in the Trade Mark Register No. 49, folio N S. 13008 on March 7, 1940. This Trade Mark registration was renewed on March 7, 1955, and is currently in force.

2. The respondent is and has been, since its incorporation, a wholly owned subsidiary of Rowntree & Co. Ltd. of the United Kingdom.

3. In addition to the respondent, Rowntree & Co. Ltd. has subsidiaries and factories in many other countries of the world and Rowntree & Co. Ltd. and all its subsidiaries carry on substantially the same business including, inter alia, the manufacture and/or sale of a chocolate confectionery in association with the Trade Mark "Smarties".

4. Rowntree & Co. Ltd. is the registered owner of the Trade Mark "Smarties" in the United Kingdom and its subsidiaries are registered as the owners of the Trade Mark "Smarties" in various other countries of the world.

5. The Trade Mark "Smarties" has been continuously and extensively used and advertised in Canada by the respondent since at least as early as February 19, 1940 in respect of goods which may be described as "candy-coated chocolate confectionery".

6. Similar candy-coated chocolate confectionery has for many years been manufactured by Rowntree & Co. Ltd. and its subsidiaries and sold throughout the world in association with the Trade Mark "Smarties".

7. A very large proportion of the purchasing public in Canada is familiar with the Trade Mark "Smarties" and associate this Trade Mark with a product of the respondent.

8. The appellant's application was advertised in the issue of the Trade Marks Journal dated February 14, 1962 and the respondent filed a statement of opposition to the said application dated the 13th day of June, 1962.

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9. A hearing was held in the office of the Registrar of Trade Marks on November 19, 1963 and by his decision dated January 21, 1964, the Registrar concluded that there was a strong possibility that the concurrent use of both marks would lead to the inference that the wares of the appellant and those of the respondent emanate from the same source and accordingly he refused the application pursuant to Section 37 of the *Trade Marks Act.*

10. The Trade Mark "Smoothies" is and has at all material times been confusing with the registered Trade Mark "Smarties" in that the use of the Trade Mark "Smoothies" would cause confusion with the registered Trade Mark "Smarties" in the manner and circumstances described in Section 6 of the *Trade Marks Act* and accordingly the Trade Mark "Smoothies" is not registrable.

11. On the date on which the appellant first used or made known the Trade Mark "Smoothies", it was confusing with the registered Trade Mark "Smarties" that had previously been used and been known in Canada by the respondent and accordingly the appellant is not the person entitled to registration of the Trade Mark "Smoothies".

12. The Trade Mark "Smoothies" is descriptive or deceptively misdescriptive of the character or quality of the wares in association with its use and accordingly the Trade Mark "Smoothies" is not registrable.

13. The respondent will refer to Exhibits "A" and "B" to the affidavit of Tom E. King sworn the 30th day of September, 1965, herein.

14. The sales of a product in association with the Trade Mark "Smoothies" in Canada, by the appellant, have been of a very small and localized nature.

Although this is an appeal from the decision of the Registrar of Trade Marks and not from his reasons, it is of interest to record here part of them, *viz:*

I have considered the evidence on file and also the representations of counsel for both parties at a Hearing held in my Office November 19, 1963. The nature of the wares and the nature of the trade in both cases is identical and the wares are distributed through the same channels of trade. Both marks are slang terms commonly used to describe a 'smart alec' or a 'smooth operator'. After carefully reviewing the evidence, I have arrived at the conclusion that there is a strong possibility that the concurrent use of both marks would lead to the inference that the wares of the applicant and those of the opponent emanate from the same source.

Since the date of the appellant's application to register was September 16, 1961 and the date of first use was August 9, 1961, there is no substantial contemporaneous use of the two marks, and therefore evidence of actual confusion is practically impossible to obtain (although the respondent did file certain survey evidence to attempt to establish confusion, which is commented upon later in these reasons).

Therefore, in coming to a decision as to whether or not these two marks are confusing, the concept of first impression must be employed. The marks must be considered in their totality, not in a detailed study. And the criterion that should be employed in considering the connection between the two marks should be real tangible danger of confusion and not a theoretical danger.

The evidence before the Registrar of Trade Marks and before this Court, consisted of certain survey evidence attached as Exhibit "A" to the affidavit of Tom E. King sworn on September 30, 1965 referred to in said paragraph 13 in the Statement of Allegations of Fact Upon Which The Respondent Relies; two affidavits of William J. Irvine, Assistant Secretary Treasurer of the appellant company; and the affidavit of Richard George Mitchell, Secretary Treasurer of the respondent company.

Regarding the survey evidence attached as Exhibit "A" to the affidavit of Tom E. King, it consists of a series of affidavits of persons who interviewed certain people in the Winnipeg and Vancouver area and asked them to answer certain predetermined questions; the form of which questions is attached as a schedule to the affidavit of such interviewers. From this survey evidence, the respondent seeks to establish that there is proof of some confusion between the two marks.

This so-called survey evidence is no proof of anything. It is hearsay. And, in any event, commenting generally on the same, it was an attempt to obtain from a primary source statistical data to establish confusion. In this, it completely failed, because, among other things, it did not show how the persons were chosen who were to be interviewed or the procedure followed in collecting the information nor does it demonstrate how the information obtained is representative, unbiased and reliable, and adequate for the purpose of the survey. To use statistics obtained without these precautions and without this critical attitude, especially if the results happen to be in accord with the purpose of the survey, does not prove anything and the results are meaningless.

After considering the whole of the other admissible evidence and all of the surrounding circumstances and making all proper inferences and considering particularly the circumstances detailed in section 6(5) of the *Trade Marks Act*, I make the following findings:

1. that there is an inherent distinctiveness in the trade mark "Smarties" in that it is a strong trade mark; and that it has become widely known throughout Canada;

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2. that the trade mark "Smarties" has been used for a very long time whereas the trade mark "Smoothies" has been used a very insignificant period of time;
3. that the wares sold under the marks of "Smoothies" and "Smarties" are similar, are cheap, and are in the main purchased by or for children but that some reasonable degree of discrimination is exercised in their purchase;
4. that the nature of the trade in which the wares "Smoothies" and "Smarties" are sold is the same, namely, the retail trade;
5. that there is no resemblance between the trade marks in appearance, sound or in the idea suggested by them. There was no dispute between the parties that there is no appearance or sound resemblance, but there was a dispute as to whether there was a degree of resemblance in the idea suggested by them. As to the latter, however, it is clear that the meanings of these words are entirely dissimilar. Webster's Third New International Dictionary defines "smarties" and "smoothies" as follows:

> *Smart or Smartie* ... one that tries in a callow fashion to be witty or clever: smart aleck
>
> *Smoothy or Smoothie* ... 1a: a person with polished manners b: one who behaves or performs with deftness, assurance, easy competence...

All of which, on balance, leads to the conclusion, in my view, that there is no probability of confusion within the meaning of section 6 of the *Trade Marks Act* of "Smoothies" with "Smarties".

I am also of the view that the mark "Smoothies" is not clearly descriptive or deceptively mis-descriptive of the character or quality of the wares within the meaning of section 12(1)(*b*) of the *Trade Marks Act*.

The appeal is allowed and the decision of the learned Registrar of Trade Marks is reversed and the trade mark application S.N. 264,951 is allowed.

The appellant is entitled to its costs.

BETWEEN:

BALSTONE FARMS LTD. .... APPELLANT;

Winnipeg 1966
Sept. 13-16

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Ottawa
Dec. 1

Income tax—Company incorporated to acquire lands from man and wife in contemplation of death—Whether subsequent sale of lands mere realization of assets or business transaction—Nature of profits, test for determining.

Appellant was incorporated in Manitoba by letters patent in May 1955 at the instance of L in contemplation of the deaths of himself and his wife. Appellant, whose letters patent stated its object as farming, forthwith purchased from L and his wife 1,052 acres, most of which had been acquired by them since 1944 and had been farmed by tenants, and also a 5 acre mink ranch from a company controlled by L. The price for the 1,052 acres was $144,000 which greatly exceeded its cost to L and his wife; this sum was charged on the land and payable on demand. Appellant gave a demand note for $41,700 for the mink ranch. Appellant continued to farm the farm lands through tenants but operation of the mink ranch was discontinued. Shares in appellant were issued to four trustees in trust for the children and grandchildren of L and his wife and for certain charities (these beneficiaries being also those of L's will). In May 1957 an option to purchase 277 acres granted by appellant expired and $15,000 paid therefor was forfeited to appellant. In December 1958 $5,000 was forfeited to appellant on the expiration of an option on 557 acres. In 1958 appellant became entitled to $5,000 in settlement of a claim for breach of a contract to purchase 171 acres. In January 1960 $10,000 was forfeited to appellant on the expiration of an option on 106 acres and in May 1960 a further $5,000 for an extension of the option was forfeited. In that month appellant sold 171 acres at a profit of $93,312.

Held, appellant was taxable on all of the above sums. While the lands were capital assets in the hands of L and his wife they were inventory in the hands of appellant which purchased them with a view to their resale. *Hudson's Bay Co. v. Stevens*, 5 T.C. 424, *C. H. Rand v. Alberni Land Co.*, 7 T.C. 629, *Glasgow Heritable Trust Ltd. v. C.I.R.*, 35 T.C. 196, distinguished; *Alabama Coal Iron, Land and Colonization Co. v. Mylam*, 11 T.C. 232, *Gas Lighting Improvement Co. v. C.I.R.*, [1923] A.C. 729, *C.I.R. v. Westleigh Estates Co.*, 12 T.C. 657 considered; *Salomon v. Salomon & Co.* [1897] A.C. 22, *Ashbury Rly. Carriage & Iron Co. v. Riche* [1875] L.R. 7 H.L. 653, *Ruhamah Property Co. v. Federal Comm'r. of Taxation* (1928) 41 C.L.R. 148, referred to.

The nature of the profits made by a company depends on the nature of its operations and not on the purpose which led to its incorporation. *C.I.R. v. Melbourne Trust Ltd.* [1914] A.C. 1001.

The fact that a transaction falls within the objects declared in a company's letters patent is merely a *prima facie* indication that a profit therefrom is derived from the business of the company. *Anderson Logging Co. v. The King* [1925] S.C.R. 45; [1926] A.C. 140. The question is what did the company do? *Institution Mechanical Engineers v. Cane* [1960] 3 A.E.R. 715.

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INCOME TAX APPEALS.

Stuart D. Thom, Q.C. for appellant.

C. Gordon Dilts and *R. S. Saunders* for respondent.

CATTANACH J.:—These are appeals by the appellant herein against its assessments to income tax for the taxation years 1957, 1958, 1959 and 1960, by reason of the inclusion by the Minister in the appellant's taxable income of the sums of

(1) $15,000 for the 1957 taxation year as a forfeited consideration for an option to buy land from the appellant,
(2) $10,000 for the 1958 taxation year also as forfeited considerations for an option to buy land from the appellant,
(3) $15,000 for the 1960 taxation year as a forfeited consideration for an option to buy land, and $93,312.88 as a profit realized from a sale of land by the appellant in the same taxation year,
(4) For the taxation year 1959 the Minister added the sum of $4,793.55, which had been paid for legal fees respecting the land transactions, to the deductible business expenses of the appellant rather than permitting them to be charged against the amounts realized by the appellant which the appellant had done on the assumption that the amounts so realized were capital gains.

The foregoing figures are not in dispute but rather the dispute is as to the taxability thereof. The rival contentions of the parties hereto on this question can be stated quite succinctly. On behalf of the Minister it is contended that the appellant, being a trading company, realized the above mentioned sums as profits from acts done in what was truly the carrying on of a business or an adventure in the nature of trade. On behalf of the appellant it is contended that it was not a trading company but a realization company, that certain lands acquired by the appellant were not so acquired as inventory of a venture in the nature of trade but as a capital asset to be liquidated in an orderly manner and that, until such liquidation, the farming operations, as previously carried on by the former owners of the land, were to be continued so long as practicable. The principle of law involved is that profits derived from a business or an adventure or concern in the nature of trade are assessable to income tax while the proceeds from a mere realization of or from an enhancement of capital are not income and accordingly not assessable to income tax.

The appellant is a joint stock company incorporated pursuant to the laws of the Province of Manitoba by Letters Patent dated May 9, 1955 with an authorized capital stock of 40,000 shares of no par value which might be issued for a consideration not exceeding in the aggregate the sum of $400,000. The purposes and objects of the company are set out in the Letters Patent as follows:

> To carry on in any capacity the business of farming and the raising of animals for any purpose.

Forthwith upon its incorporation the appellant purchased from Mr. J. T. LePage and Mrs. J. T. LePage approximately 1,030 acres of farm land which they had acquired during the period between 1944 to 1953 and which lands had been continuously farmed on a crop share basis by tenants from the dates of their acquisition by Mr. and Mrs. LePage. In addition the appellant also assumed an obligation of Mrs. LePage to purchase 4 lots comprising 22 acres which gave access to a larger parcel owned by her. Of the total 1,052 acres purchased by the appellant, 663 acres were purchased from Mr. LePage and the remaining 389 acres were purchased from Mrs. LePage. The lands comprised four separate parcels in two different areas. Three of such parcels are in the Rural Municipality of Assiniboia and the fourth is in the Rural Municipality of North Kildonan. Mrs. LePage owned two parcels in Assiniboia. One parcel was river lots 100 and 101 in St. Charles Parish containing approximately 149 acres plus the four lots containing approximately 22 acres which she had contracted to purchase and which afforded access to this particular parcel. The other parcel was river lots 90 and 91 also in St. Charles Parish containing approximately 218 acres. These two parcels were purchased by Mrs. LePage on May 9, 1945 and August 13, 1953 at a cost of approximately $44.50 and $68.50 per acre respectively.

The lands owned by Mr. LePage were also in two parcels. One parcel was also in the Rural Municipality of Assiniboia

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being river lots 97 and 98 containing 106 acres which was purchased by Mr. LePage on June 9, 1944, at a cost of approximately $42.00 per acre. The other parcel owned by Mr. LePage was situate in the Rural Municipality of North Kildonan and consisted of 557 acres which were purchased in two transactions, the first of which was the purchase of 154 acres on December 14, 1944, at an approximate cost of $19.40 per acre and the second was the purchase of 403 acres on November 19, 1950 at a cost of $32 per acre.

All four parcels were farm land and used as such but because of their location on the fringe of the residential and industrial development area of Greater Winnipeg the particular location of each parcel had a direct bearing on its market value.

The Rural Municipality of Assiniboia, in which three of the parcels of land are located, is on the Western outskirts of Greater Winnipeg and North of the Assiniboine River. The parcels are about nine miles west of the corner of Portage and Main which is the business and geographic centre of the City of Winnipeg. The Municipality is not a part of the Greater Winnipeg Water District, nor the Greater Winnipeg Sanitary District and lacked the facilities provided by the Boards of such districts. While water was purchased from the Water District, sewage facilities were not available and would be expensive to install. However the City of Winnipeg had been expanding rapidly particularly in the western suburban Municipality of St. James which lies between Assiniboia and Winnipeg City proper.

The Rural Municipality of North Kildonan, in which the fourth parcel of land is situated, like Assiniboia, is not part of the Greater Winnipeg Water or Sanitary district and likewise lacks the facilities provided for such districts. The property is approximately 5 miles east of the corner of Portage and Main but borders on the town of Transcona which has a population of approximately 7,000. While the greatest growth and development in the Winnipeg area has been westerly, nevertheless, the town of Transcona has experienced some development but to a lesser degree.

In May 1955, the date the appellant acquired the lands in question, Mr. LePage was 76 years of age and his wife was two years older. In 1947, when he was 68 years of age, Mr. LePage was advised by his physician to restrict his business activities and physical exertion because at that time he had a coronary ischaemia with angina pectoris. Later in 1951 his condition worsened and he was advised by his physician to stop work entirely or to restrict his activities most drastically. However, despite his physical afflictions and advancing years, he was mentally alert at all material times. The state of Mrs. LePage's health was much more critical than that of her husband. She was suffering from a variety of ailments in 1954 which caused mental confusion. In 1957 her condition worsened to such a point that she required constant care and attention. She died on March 9, 1959 and Mr. LePage died in 1961.

Prior to 1955 Mr. LePage was acutely aware of the state of his own health and that of his wife. During his actual business life, in addition to his farming operations on the lands above described, he was also engaged in the business of a lumber broker carried on by a joint stock company of which he was the president and majority shareholder. The lumber company owned a five acre plot of land some twenty miles from the City of Winnipeg upon which a mink ranch was operated with variable and uncertain success. However, the bulk of his estate and that of his wife consisted of the 1,052 acres of farm land. About 1955 Mr. LePage optimistically valued this land at $1,000 an acre. There is no question that the land had appreciated in value subsequent to the original purchases and there was every reasonable expectation that the value of the land would increase still further. Because of the imminent possibility of the death of himself or his wife, Mr. LePage, who recognized the inevitability of succession duties which could only be paid from a sale of the land or a portion thereof under circumstances disadvantageous to the vendor, sought professional advice respecting the planning of his own and his wife's estates. He consulted Archie W. Bell, the Manager of the Winnipeg Branch of the Canada Trust Company, James W. Abbott, a chartered accountant who had acted as auditor in Mr. LePage's enterprises and Walter C. Newman, Q.C. his solicitor. Mr. LePage obtained the advice of these three persons individually without consultation among them. All three persons recommended the incorporation of a company to acquire the farm lands but with variations in share ownership and like differences. Mr. Newman, on becoming aware of Mr. LePage's habit of

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obtaining proposals from each of his advisers independently and then seeking advice of the others on any proposal so made, suggested a meeting of all three advisers with Mr. LePage to pool their suggestions and resolve upon an acceptable solution. A meeting took place in 1954, the outcome of which was that a concerted plan was decided upon and was subsequently implemented.

First, two appraisals were obtained from two independent appraisers of the value of the farm lands. One appraiser valued the land at $132,000 and the other at $143,000. The appellant company was then incorporated and four shares were subscribed and paid for by the applicants for incorporation. Of the authorized capital stock 100 shares were issued, 34 shares in the name of A. W. Bell as trustee for Inez Marguerite Fidler, a daughter of Mr. and Mrs. LePage and her children, 50 shares in the name of Leroy Francis Findlay, a son-in-law of Mr. and Mrs. LePage of which 34 were held in trust by him for his wife, Minnie Evelyn Findlay and her children and 16 shares were held in trust for the Missionary Fund of the United Church, 8 shares in the name of James W. Abbott as trustee for the Pension Fund of the United Church and 8 shares in the name of Walter C. Newman also as trustee for the Pension Fund of the United Church. Each of the four shareholders executed a unilateral irrevocable declaration of trust acknowledging that the shares in question were held on behalf of the above named beneficiaries, that the beneficiaries were entitled to all dividends and capital proceeds of the shares, that the Trustee should exercise the voting rights in the shares held by him in his absolute discretion and provision was made that in the event of any interference of the beneficiary with the Trustee's absolute voting discretion the beneficial interest in the shares would cease and the interest would then be held for the other beneficiaries. Provision was also made for the appointment of a new trustee by the surviving trustees in the event of the death of a trustee as well as for the disposition of the funds in the event any beneficiary should be a minor. The shareholders paid no consideration for the shares issued to them. None of the trustees, who were also the shareholders and who also became the directors of the appellant, communicated the purport of the declarations of trust entered into by them to the beneficiaries named therein until the lands were eventually disposed of or in one instance upon the death of Mrs. LePage. The beneficiaries named in the declarations of trust were also the beneficiaries under the Last Will and Testament of Mr. LePage and in the same proportions.

The lands were transferred to the appellant at a valuation of $144,000, that is at the amount of the higher of the two independent appraisals received of $143,000 plus $1,000.

No cash was paid by the appellant for the farm lands but the lands were charged with a trust deed upon the basis of which debentures were issued to Mr. and Mrs. LePage in the amounts of $80,000 and $60,000 respectively payable upon demand with interest at 5 percent to begin six months after demand having been made. In addition the appellant gave a promissory note to Mrs. LePage in the amount of $1,000 and three promissory notes to Mr. LePage in the total amount of $3,000. No personal guarantees or other security was given with respect to the acquisition of the lands by the appellant.

It was common ground that if demand were made for payment of the debentures then the appellant would be obliged to sell the lands or a portion thereof to meet that demand because the land was the only asset it possessed.

In May 1955 the appellant also purchased the mink ranch which had been operated by the lumber company which was owned and controlled by Mr. LePage at a cost of $41,727.45 being the book value of the assets. The appellant gave Mr. LePage a promissory note for that amount.

The farm lands continued to be farmed by the appellant on a crop share basis which provided funds to meet current expenses but yielded no substantial profits. The operation of the mink ranch, which had in some of the previous years yielded a profit and which the directors considered as a possible source of income, was discontinued because of a disaster which struck the mink and because of the hazardous nature of the undertaking and the land was thereafter held by the appellant merely as land.

On March 15, 1956 the appellant was approached by Sarah Diamond with an offer to purchase 277 acres of the farm lands in the Rural Municipality of Assiniboia at $1,250 an acre and requested an option for a period of one year. The directors of the appellant, conscious of their

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obligations as trustees, considered it expedient to ascertain if any other persons were interested in purchasing the lands at a higher price, inserted a small advertisement in the classified section in one issue of a local newspaper which resulted in two enquiries.

The advertisement read as follows:

> Balstone Farms Ltd. must sell all or part of two large blocks of farm acreage. Kirkfield Park district, 496 acres, Transcona district, 557 acres more or less. Details of land and buildings can be obtained at 401 Somerset Bldg. Options will be considered.

Having received the request from Sarah Diamond for an option on a portion of the lands, Mr. Bell, on the letterhead of The Canada Trust Company and as manager thereof wrote to Mr. and Mrs. LePage advising them that it would be in their best interests to make a demand upon the appellant for payment of the debentures held by them. Mr. and Mrs. LePage both did so on March 26, 1956. The other directors were aware of Mr. Bell's letter to Mr. and Mrs. LePage and had, in fact, concurred in the advice conveyed and delegated Mr. Bell to convey it.

On April 13, 1956 the appellant entered into an option with Sarah Diamond the consideration therefor being $15,000. The option expired on May 1, 1957 without being exercised. In accordance with the terms of the option the consideration therefor of $15,000 became forfeit to the appellant and was taken into its books of account as a surplus item and not as income. However, in assessing the appellant for its 1957 taxation year the Minister brought this amount into the appellant's income for that year which gives rise to the first item in the present appeals.

On January 3, 1957 the appellant executed an option on the 557 acres in Transcona and in the Rural Municipality of Kildonan in consideration of $5,000 at a price of $1,250 an acre to Model Homes Limited for a period of two years. Model Homes Limited was a reputable company possessed of the resources necessary to conduct a subdivision and housing development operation. An option for two years was an inordinately long period, the usual period of options in accordance with the custom of the trade in Winnipeg being normally six months. The option agreement represented the best terms obtainable after considerable negotiation. The option expired on December 1, 1958, without being exercised and the consideration therefor of $5,000 became forfeit to the appellant which amount was taken into its accounts as surplus. In reassessing the appellant for its 1958 taxation year the Minister added the amount of $5,000 to the appellant's income.

On June 25, 1958, the appellant entered into an agreement for the sale of 171 acres situated in the Rural Municipality of Assiniboia (part of the land previously under option to Sarah Diamond) to Philip Ricci. A deposit of $5,000 was made. Apparently Ricci and his associates attempted to sell lots illegally and before a subdivision of the lands had been approved. The appellant, therefore, began a court action to set aside the agreement for sale. During the currency of this litigation an option was asked for by and given by the appellant to Metro Subdivisions Limited dated July 15, 1959, on the lands which were the subject matter of the litigation at $2,100 an acre. A settlement of the action against Ricci was effected whereby the deposit of $5,000 was retained by the appellant which the Minister added to the appellant's income for its 1958 taxation year.

The foregoing two amounts totalling $10,000 constitute the second item in the present appeals.

On June 30, 1959 the appellant gave an option to Urban Home Builders Land Development Limited to purchase 106 acres in the Rural Municipality of Assiniboia (which land was also part of the lands which were previously under option to Sarah Diamond) at a price of $2,000 an acre for a consideration of $10,000. The option expired on January 2, 1960. An extension of that option was granted by the appellant to May 30, 1960 for a consideration of $5,000. A further extension was requested and refused. Accordingly the considerations for the option and for the extension thereof were forfeited to the appellant.

On May 24, 1960, Metro Subdivisions Limited exercised its option dated July 15, 1959, to purchase 171 acres as a result of which sale the appellant realized a profit in the amount of $93,312.88.

In assessing the appellant for its 1960 taxation year the Minister added to the appellant's income the considerations for the option and extension thereof, in the total amount of $15,000 which were forfeited to the appellant and the

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amount of $93,312.88 as profit realized on the sale to Metro Subdivision Limited. These amounts constitute the third item in the present appeals.

The proceeds of the sale to Metro Subdivision Limited were used by the appellant to pay off the balance owing on the debentures held by Mr. LePage and the estate of Mrs. LePage, Mrs. LePage having died on March 9, 1959. The debentures were paid off in June 1961 having been in default since the demand for payment made on March 26, 1956.

Subsequent to the taxation years now under review because the appellant could not farm the remaining lands on a profitable basis due to increased taxes and similar reasons all the lands were sold on July 25, 1961, to LePage Foundation Land Development Co., Limited which was incorporated for the express purpose of buying the said lands and disposing of them.

In assessing the appellant as he did the Minister did so on the assumption that the appellant acquired the lands owned by Mr. and Mrs. LePage in 1955 with a view to trading in, dealing with, or otherwise turning it to account at a profit. If the Minister's assumption is correct it follows that the appellant realized a profit of $93,312.88 from the sale of a portion of the lands in 1960 to Metro Subdivision Limited which profit would be taxable as income from a business within the meaning of the *Income Tax Act*. If the view of the Minister is correct in this respect, I would then be of the opinion that the amounts of $15,000, $10,000 and $15,000 received by the appellant in its 1957, 1958 and 1960 taxation years from the options forfeited in those years would likewise constitute taxable income as profits from a business.

However the appellant, as has been previously mentioned, challenges the basic assumptions of the Minister upon which the assessments were made and contends that the lands in question were acquired as a capital asset for the ultimate purpose of orderly, and I might add advantageous, liquidation in accordance with a carefully preconceived plan.

There is no question whatsoever in my mind that the lands in the hands of Mr. and Mrs. LePage were capital assets and if sold by them any gain which might have been made would be a realization of an enhancement in value. It would not be a gain made in an operation of business in carrying out a scheme of profit making and accordingly not subject to income tax.

But Mr. and Mrs. LePage are not the appellants herein. They sold the lands to a company, which is the appellant, in consideration for debentures, secured by a trust deed, and promissory notes. They were not shareholders in the company and were entirely devoid of any voice in its affairs.

It is not uncommon to hear it said that a company is only the alter ego or the agent of an individual and that its activities are so coloured by his interests and directions and intentions. This was the root of the unsuccessful argument in *Salomon v. Salomon & Co.*[1] which established the legal nature of a company. Lord Halsbury L.C. said at page 30:

> ....it seems to me to be essential to the artificial creation that the law should recognise only that artificial existence—quite apart from the motives or conduct of individual corporators...short of such proof (that is that the company had no real existence) it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.

(The words in brackets are mine)

In *Commissioner of Taxes v. The Melbourne Trust, Limited*[2] three Australian banks went into liquidation. Their respective assets were transferred to three asset companies, each of which issued debentures and shares to the creditors of the bank concerned. These companies realized their assets to an extent sufficient to redeem the debentures. Melbourne Trust Limited was then formed to take over and dispose of the remaining assets of the three companies. An assessment to income tax was made in respect of the surplus realized. A special case was referred to the Full Court of the Supreme Court of Victoria. The Court (Hood and a'Beckett JJ., Madden C.J. dissenting) held that the respondent was incorporated with the object of selling the assets acquired and if possible making a profit for the benefit of the shareholders; that it was immaterial that the creditors of the banks could never be paid in full; that,

[1] [1897] A.C. 22.

[2] [1914] A.C. 1001.

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under these circumstances, the surplus realized was liable to income tax as profits earned. Madden C.J., in dissenting, was of opinion that the three vendor companies were a mere agency or device for realizing the assets for the benefit of the banks' customers, and that the respondent was the amalgamation of the three companies, standing in the same positions as they did, and that there could be no profits liable to income tax until the shareholders had received an amount equal to the indebtedness of the banks to their creditors.

On appeal Griffith C.J. and Barton J. took a similar view to that held by Madden C.J. while Isaacs J. concurred with the view of Hood J. and a'Beckett J. In a broad sense the majority took the view that the respondent was doing practically what a liquidator would have done.

However the Privy Council, looked upon the transactions in the same light as Isaacs J. in his dissenting judgment in the Court below.

Lord Dunedin said, "... the whole object of the company was to hold and nurse the securities it held, and to sell them at a profit when convenient occasion presented itself". The main question was, as I see it, whether the nature of the profits made by a company in the ordinary course of its business is to be determined by the purpose which led to its incorporation. The decision of the Privy Council rested on the principle that the nature of a company's profits depends on the nature of its operations. The legal position of the company and its shareholders could not be affected by circumstances which took place prior to the company's incorporation.

However one is not entitled to infer from the circumstance that a company has been incorporated for trading purposes that a particular transaction in which it engages necessarily constitutes a part of the company's trading operations. The fact that a particular transaction falls within the objects contemplated by the Letters Patent is merely a *prima facie* indication that a profit so derived is a profit derived from the business of the company; see *Anderson Logging Co. v. The King*[1].

The question to be determined is what did the company do and whether what it did was a business.

[1] [1925] S.C.R. 45; [1926] A.C. 140.

In the circumstances of the present appeals it is of no consequence that the objects and purposes stated in the Letters Patent incorporating the appellant are far removed from what the appellant actually did.

In *Institution Mechanical Engineers v. Cane*[1], Lord Denning took the view that in cases of a body incorporated by charter and an unincorporated body, regard must be had to what purposes the corporation or society actually carries on regardless of those stated in its constating instruments. He said at page 728, "I do not think that this question is to be solved by looking at the royal charter alone and construing it as if you were sitting aloft in an ivory tower, oblivious of the purposes which the institution has, in fact, pursued".

If you are considering a statutory limited liability company incorporated by memorandum of association and articles of agreement you know that the purposes are determined exclusively by its memorandum of association. No fresh purpose can, in law, be pursued, even with the consent of all the shareholders; see *Ashbury Railway Carriage & Iron Co. v. Riche*[2]. But when you are dealing with a limited liability company incorporated by the exercise of the Royal prerogative delegated to a Minister of the Crown either in the right of Canada or one of the Provinces, as in the case of a company incorporated by Letters Patent, the doctrine of *ultra vires* has no place.

The appellant was so incorporated pursuant to the laws of the Province of Manitoba.

Such a company has in law the self-same capacity as a natural person. The "divers clauses", as Lord Coke said, "are not of necessity, but only declaratory, and might well have been left out"; see *Sutton Hospital* case[3]. If it should pursue purposes other than those set out in its Letters Patent, its activities are perfectly valid. It is true (at common law and in many instances in the statutes governing the incorporation of companies by Letters Patent) that any shareholder or person who is injured by a violation of the Letters Patent can take proceedings in the name of the Crown to revoke the Letters Patent (see *Attorney-General of Canada v. Hellenic Colonization Association*)[4]. But if

[1] [1960] 3 A.E.R. 715.
[2] [1875] L.R. 7 H.L. 653.
[3] (1612) 10 Co. Rep. at p. 306.
[4] [1946] 3 D.L.R. 840.

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the Crown takes no such steps, it does not lie in the mouth of the company to say that the purposes which it in fact pursues are *ultra vires* or beyond its powers; see Blackburn J. in *Riche v. Ashburn Railway Carriage & Iron Co.*[1]

Isaacs J. in his dissenting opinion in *Ruhamah Property Co. Ltd. v. Federal Commissioner of Taxation*[2], said at page 165, "It seems to be thought, and this in my opinion is one of the fallacies in the appellant's contention, that once established that there is a realization or change of investment and there is an end of the matter. That is not so: it may be all that and something more. If a company does that, and what is done is also 'an act done in what is truly the carrying on, or carrying out of a business' (*Commissioner of Taxes v. Melbourne Trust Ltd.,*) then the profits resulting are proceeds liable to income tax as proceeds of a business".

Here what the appellant did was to acquire real property and turned it to account by disposing of it to advantage, which was its avowed purpose and in my view, applying the foregoing authorities, those acts amount to the conduct of a business.

Counsel for the appellant, during his argument cited, and placed great reliance on, *Hudson's Bay Co. v. Stevens*[3], *C. H. Rand v. Alberni Land Co.*[4], and *Glasgow Heritable Trust, Ltd. v. C.I.R.*[5], as well as other cases.

He also pointed out that the desired end sought to be achieved by the financial and legal advisers of Mr. and Mrs. LePage, by the incorporation of the appellant and the sale of land to it, was to secure for them an immediate accretion in the value of their land, to fix the value thereof for succession duties, to facilitate the disposition of a particular parcel to pay succession duties in the event of the death of either Mr. or Mrs. LePage and to ensure that the beneficiaries under the last will of Mr. LePage would receive any further appreciation in the value of the lands. The mink ranch, owned by a company which Mr. LePage controlled, was included in the land acquired by the appellant, I believe, as a convenience and as an afterthought. I accept the foregoing objectives as being the motives which

[1] (1874) L.R. 9 Exch. at pp. 263, 264.
[2] (1928) 41 C.L R. 148.
[3] 5 T.C. 424.
[4] 7 T.C. 629.
[5] 35 T.C. 196.

actuated the advisers of Mr. and Mrs. LePage to advise them as they did and which advice was accepted and acted upon by them.

The plan as outlined above was conceived by the solicitor for Mr. and Mrs. LePage with the full knowledge of the decisions in the cases cited immediately above and with the incidence of income tax also in mind. There is no impediment to a taxpayer so ordering his affairs as to escape or reduce tax but the substance of a transaction must be determined from the legal rights which flow therefrom ascertained upon ordinary legal principles; see *Duke of Westminster's* case[1].

I have concluded from the authorities before mentioned that the motives which led to the incorporation of the appellant and the purposes and objects set out in its letters patent are to be disregarded and what must be looked at is the nature of its operations.

It is incontrovertible that in cases of this nature the question to be decided is one of fact.

In the three cases above cited the Court found, in each instance, that on their respective facts there was no evidence that the companies there involved were engaged in trading.

In the *Hudson's Bay* case (*supra*) the property sold had not been acquired in trade, but as part of a consideration for the surrender, by the company, of all their rights and territories within Rupert's Land. It was not the case of a purchase with a view to resale, the property was an "inheritance", and, when disposed of it was in law simply a "patrimony" turned into cash. The facts of the *Hudson's Bay* case are distinguishable from those in the present case in that there was no purchase of land with a view to resale as there was here.

In *C. H. Rand v. Alberni Land Co. (supra)* Rowlatt J. based his decision on the fact that all the company had done was to provide machinery for carrying out the projects of other people.

Subsequently in *Alabama Coal Iron, Land and Colonization Company, Limited v. Mylam*[2], Rowlatt J. said at page 256, and I think correctly, that the *Hudson's Bay* case was "a very special case, owing to the antecedents of the land for one thing, and that the *Alberni* case, was

[1] [1936] A.C. 1.

[2] 11 T.C. 232.

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again a very special case". He also said of the appellant in the *Alabama Coal* case at page 255, "but on the whole I think they have conducted a trading concern, as opposed to mere realization, which prescribes a very special state of facts in the case of a company".

I do not think that the basis of the decision in the *Alberni* case can survive the criticism of Lord Sumner in *Gas Lighting Improvement Company, Limited v. Commissioners of Inland Revenue*[1] where he said at page 741, "Assuming, of course, that the company is duly formed and is not a sham (of which there is no suggestion here), the idea that it is mere machinery for effecting the purposes of the shareholders is a layman's fallacy.", nor that Warrington L.J. who said in *The Commissioners of Inland Revenue v. The Westleigh Estates Co., Ltd.*[2]:

> It was contended that the company was merely in the position of an ordinary landowner dealing with his land and granting leases thereof and so receiving rents and profits. But, assuming that in the case of an individual to do such things would not be to carry on a trade or business, it does not at all follow that the conclusion would be the same in the case of a company the end and object of whose being is to transact the business in question.

In my view the *Glasgow Heritable Trust Ltd.* case (*supra*) is also a very special case. A company was formed to acquire tenement properties previously owned by a partnership of speculative builders. The shares of the company were taken by the former partners or members of their families. Sales of flats took place to sitting tenants or when flats became vacant. The question was whether the company was engaged in trade or merely realized some of its capital assets.

The Court of Session, after two remits to the Commissioners, found that the purpose which "informed" the partnership was to carry on for profit a speculative builder's business in tenements. The purpose which "informed" the company was to salve something from the wreck of a type of trading enterprise which had ended.

The Lord President (Cooper) outlined the basic underlying facts at page 213 as follows:

> The findings disclose that prior to 1909 the now defunct firm of Duncanson & Henderson were engaged in the trade or business of speculative builders, constructing in Glasgow tenements of flatted houses for sale. They had been doing so since the early 1890's and it is common knowledge that in those days the enterprise was a familiar one, for "stone and lime" was then regarded as a favoured investment. The legislation of

[1] [1923] A.C. 723. [2] 12 T.C. 657.

1909 paralysed this form of enterprise, which received its death blow from the outbreak of war in 1914 and the subsequent introduction of rent restriction. As is evident from many successive statutes and the Bill now before Parliament, most tenements in Glasgow and certain other centres have long ceased to be marketable as tenements and the unfortunate owners of such properties have in many instances found their assets transformed into ruinous liabilities. The letting market for individual houses in the tenements survived and survives (subject to rent restriction), and sales of individual houses could sometimes be effected with vacant possession or to sitting tenants: but it is hardly too much to say that during the First War tenements as such became *extra commercium*, as they still are forty years later and are likely to remain for an indefinite time to come...

Previously he had said at page 210:

...Under the old regime the trade consisted of the erection of tenements and the sale of these tenements at a profit. Under the new regime the position has been transformed as a result of changed conditions which have notoriously resulted in making tenement dwelling-house property in Glasgow all but *extra commercium*, and in extinguishing the business of the speculative builder of such property. The Company took over 46 tenements each burdened with a bond, the bonds aggregating over £100,000, and the 46 bonds were until 1937 real burdens on each of 46 tenements. The only way in which this large capital debt could be paid off was, we are told, by realising assets: but the Company never were able to sell whole tenements and, so far as appears, never even tried to do so, but contrived, as opportunity offered, to dispose of single flats in some of the tenements, each sale reducing the security for the bond over the whole tenement and exposing the debtor to the necessity of making a fresh bargain with the creditor in the bond. It is found that no profits from such sales were ever distributed, and that no entry is found in the profit and loss accounts as respects the sales of the flats. It appears to me that this was correct accounting, the sales being truly transactions on capital account and the proceeds not being profits available for dividend. After 1937 the outstanding bonds were combined in a single omnibus bond for £70,000 of which £23,500 was still outstanding at the close of the relevant accounting periods. Until at any rate the whole of the heritable debt was paid off, the proceeds of the successive sales of flats properly fell to be treated as receipts on capital account and not as profits. To put the matter in another way, the tenements were stock-in-trade in the hands of the partnership but they were capital assets in the hands of the Company, to be held as investments or fractionally realised, as circumstances might dictate. In point of fact, the Company has been holding these assets, so far as not realised by sales of flats, as revenue-earning investments for upwards of 35 years.

As I understand the above quoted passages, the Court is saying that in the hands of the partnership the tenements were its stock-in-trade. The partnership built tenements with the view to their sale. Because of the circumstances referred to in the above extracts that business came to an end. The properties came into the hands of the Company as revenue earning assets. The revenue, by way of rentals received, was applied in the reduction of the outstanding liabilities. As such the tenements were capital assets in the

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hands of the Company and any subsequent dispositions, when circumstances permitted, were, therefore, the disposition of a capital asset and incidental to the Company's principal purpose of receiving rental income.

The facts in the *Glasgow Heritable Trust* case, (*supra*) in my opinion differ radically from those in the present appeals. Here the lands were purchased by the appellant with the view to their resale and any income received during the interval prior to their sale was incidental to that principal and acknowledged purpose. The lands in the hands of the appellant were its inventory rather than capital assets which is the direct opposite to the facts as found in the *Glasgow Heritable Trust* case.

As was stated by Rowlatt J. in the *Alabama Coal* case *(supra)* a mere realization prescribes a very special state of facts in the case of a company which state I do not think prevails in these appeals.

The only way in which I could accede to the appellant's contention would be to treat the appellant company as mere machinery for the purposes of those instrumental in securing its incorporation which, on the authorities above quoted, I am not entitled to do. Neither can I treat the appellant as a sham as that is not in accordance with the facts. Accepting the principle that the nature of the appellant's gains depend on the nature of its operations, it follows that the activities of the appellant amount to the conduct of a business and the profits so derived are profits from a business and so subject to income tax in accordance with sections 3 and 4 of the *Income Tax Act.*

In my opinion the Minister was, therefore, right in assessing the appellant as he did from which it follows that the appeals are dismissed with costs.

Quebec 1966 Nov. 18, 19 — Ottawa 1967 Feb. 15

QUEBEC ADMIRALTY DISTRICT

BETWEEN:

CANADA STEAMSHIP LINES LIMITED .... PLAINTIFF;

AND

JEAN-PAUL DESGAGNÉ .... DEFENDANT.

Shipping—Verbal voyage charter—No bill of lading issued covering cargo loaded—Verbal arrangements—"Due diligence"—Responsibility of carrier—Water Carriage of Goods Act, R.S.C. 1952, c. 291, art. III, ss. 1(a), 3—Goods on board (ship)—Damages $33,099.93.

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This is an action in damages to recover the value of steel plates stowed on deck and interlocked across the deck of the M/V *Fort Carillon* owned by the defendant.

While *en route* from Montreal to Lauzon, P.Q., the rudder of the vessel failed to function, the vessel listed to starboard and 148 of the steel plates stowed on deck fell over the side of the vessel and were lost.

Under the verbal charter arrangements between the plaintiff and the defendant, charter hire was to be and was paid by the charterer to the owner of the goods, on the basis of the quantity of the cargo shipped on board the vessel. The cargo was to be loaded and stowed by plaintiff under the supervision of the master of the ship, namely the defendant. The cargo was loaded partly under deck and 152 steel plates on deck. No bill of lading was issued covering cargo loaded on the vessel.

The plaintiff was obliged to pay and did pay to Davie Shipbuilding, as owner of the steel plates, the sum claimed, namely $34,533.51, the value of the steel plates lost overboard.

Subsequently, plaintiff recovered the sum of $1,283.58, representing the net salvage. Then the net loss sustained by the plaintiff amounts to $33,249 93 from which however must be deducted the sum of $150.00 for the cargo lost freight, forming a total loss of $33,099 93.

Held, The loss overboard of the steel plates resulted from the unseaworthiness of the vessel due to her being overloaded and poorly stowed having regard to her stability which were matters within the special knowledge and responsibility of the master of the vessel. The defendant, as master and owner of the ship, failed to exercise "due diligence" to make the vessel seaworthy.

2. That the *Water Carriage of Goods Act*, R.S.C. 1952, c. 291 and its rules, do not apply to the instant case, as the verbal contract of carriage between the plaintiff and the defendant was not covered by a bill of lading as required by the Act.

3. That as there was no bill of lading herein and none contemplated, the defendant cannot avail himself of the clause in his specimen bill of lading which provides that cargo carried on deck was at shipper's risk.

4. That as the charter arrangements were verbal and the cargo was to be loaded and stowed under the supervision of the master of the vessel, namely the defendant, the latter, as captain and owner of the ship acted imprudently and did not exercise "due diligence" required in ensuring the seaworthiness of his vessel, prior and at the beginning of the voyage.

5. As the *Water Carriage of Goods Act* cannot apply to the present contract of carriage of goods, the defendant cannot benefit from the modification of his common law absolute warranty or the duties he has under section 1675 of the Quebec Civil Code where it appears that the burden of the defendant is as great as the common law obligations arising in virtue of the warranty of seaworthiness.

6. That in the Court's view, the vessel in question was overloaded with reference to its freeboard and plimsoll marks. This was contrary to the *Canada Shipping Act* and the rules of elementary prudence and does not indicate "due diligence". Having not obtained the weight of the steel plates and of the general cargo in the hold of his vessel, the defendant, as captain, master and owner of the ship, should not have allowed the plaintiff to load the plates on board his vessel.

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7. That the participation of the employees of the plaintiff in the loading and stowing of the cargo cannot be "une fin de non-recevoir", as it cannot be construed to imply an agreement, the effect of which would be to release the shipowner, namely the defendant.

8. That it was sufficient that the unseaworthiness of the vessel existed at the end of the loading stage to involve the owner's liability.

9. Judgment for the plaintiff in the sum of $33,099 93.

ACTION for damages pursuant to loss of goods stowed and loaded on the deck of a vessel.

Peter D. Walsh for plaintiff.

Raynold Langlois for defendant.

NOËL J.:—This is an action flowing from the loss during transportation on board the M/V *Fort Carillon,* under a verbal voyage charter to plaintiff from defendant, Jean-Paul Desgagné, the owner as well as the master of the said vessel, of 152 steel plates, the property of Davie Shipbuilding. These steel plates were delivered to plaintiff as carriers in the latter part of August 1961, as part of shipments made respectively by the Algoma Steel Corporation, at Sault Ste-Marie, Ontario, in each case for carriage to Lauzon, P.Q., consigned to Davie Shipbuilding in accordance with the terms and conditions of bills of lading issued by plaintiff and produced as Exhibit 1 herein.

The plaintiff alleges that under the charter arrangements between plaintiff and defendant, charter hire was to be and was paid by charterer to the owner on the basis of the quantity of the cargo shipped on board the vessel, said cargo to be loaded and stowed by plaintiff under the supervision of the master of the vessel.

The plaintiff maintains that pursuant to the charter arrangements, the cargo loaded on board the vessel for the voyage in question, on September 12, 1961, between 7:00 a.m. and 10:00 p.m., consisted of 180 tons of general cargo which was stowed in the hold and 152 steel plates which were placed on the deck of the vessel; that the general cargo was loaded by stevedores in the hold under the supervision and to the knowledge of the master or mate and that the stevedores requested the master or mate as to the manner in which the 152 steel plates should be loaded as they measured between 30 to 49 feet in length, were between 3 and 5 feet in width between $\frac{1}{4}$ inch and $1\frac{1}{2}$ inches thick and weighed a total of approximately 235 tons; that because of their size they had to be loaded on the deck of the vessel and the stevedores were advised by the master that it would be in order for them to load on deck the total of the 152 steel plates.

The plaintiff states that the steel plates were stowed on deck and interlocked across the deck without lashing and in the manner indicated by the master or mate of the vessel.

While *en route* from Montreal to Lauzon, P.Q. in the vicinity of Contrecoeur, P.Q., on the night of September 12 and 13, 1961, the rudder of the vessel failed to function, the vessel listed to starboard and 148 of the steel plates fell over the side of the vessel and were lost. The weather at the time was excellent, with good visibility, light wind and no sea. After this mishap, the steering gear was tested and found to be in good order and no further difficulty was experienced during the remainder of the voyage to Lauzon where the vessel arrived on September 13, 1961 and discharged the four remaining plates.

Davie Shipbuilding, as owner of the steel plates, claimed the sum of $34,533.51 from plaintiff, the value of the steel plates lost overboard and under the terms of the bills of lading and the conditions of carriage, plaintiff was obliged to pay, and did pay, this amount to Davie Shipbuilding.

Plaintiff subsequently recovered an amount of $1,283.58, representing the net salvage payable to it in respect of recovery of part of the steel plates lost so that the net loss sustained by plaintiff amounts to $33,249.93.

The plaintiff alleges that the listing of the vessel and the loss overboard of the steel plates resulted from the unseaworthiness of the vessel due to her being overloaded and/or poorly stowed having regard to her stability, which plaintiff claims were matters within the special knowledge and responsibility of the master and mate and of the failure of defendant, as master and owner to exercise due diligence to make the vessel seaworthy.

The defendant, on the other hand, takes the position that the cargo, including the steel plates, were loaded under a verbal charter but that under the terms of this charter the cargo was to be loaded and, in fact, was loaded, partly under deck and partly on deck, stowed, secured and discharged by plaintiff free of all risk and expenses to defendant which, however, is denied by plaintiff; the defendant claims that during the loading and stowing operations at

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Montreal, plaintiff and all its agents or servants informed defendant that the on deck cargo totalled between 140 and 160 tons, which distribution of cargo, as between under deck and on deck, insured a good stability of defendant's vessel.

The defendant claims that when the vessel sailed at 20:55 hours on September 12, 1961, on her voyage to Lauzon, the vessel was then staunch, strong, well-manned, seaworthy and in every respect fit for the intended voyage and that if the vessel listed and lost the plates it was due to the fact that the said plates weighed 235 tons (which plaintiff realized only after the vessel's arrival in Lauzon) instead of the 140 to 160 tons mentioned by plaintiff prior to the voyage.

Defendant further states that since plaintiff, its agents, or its servants had informed and represented to defendant that the on deck cargo weighed 140 to 160 tons only and since they had failed to supply defendant with loading receipts in Montreal, the latter had to rely on the tonnage reported as loaded on deck by plaintiff, its agents or servants and that the vessel was rendered unstable prior to her departure from Montreal because of the sole negligence, carelessness and fault of plaintiff, its agents and servants who misled defendant in misrepresenting the weight of the cargo loaded on deck.

The defendant finally alleges that although no bill of lading was issued covering cargo loaded on the *Fort Carillon*, the terms and conditions of defendant's regular bill of lading (a specimen of which is filed as Exhibit D-1) should apply to the cargo carried on the voyage and this bill of lading provides *inter alia* that cargo carried on deck was at shipper's risk in any event as it contains the following paragraph:

> CARGAISON EN PONTÉ.—Les marchandises couvertes par ce connaissement peuvent être arrimées sur ou sous le pont à la discrétion du voiturier; et lorsqu'elles sont chargées en pontée elles sont, en vertu de cette disposition, censées être déclarées comme étant ainsi chargées en pontée, et ceci même si aucune mention spécifique à cet effet n'appert à la face de ce connaissement. Relativement à cette cargaison en pontée, le voiturier n'assume aucune responsabilité quant aux pertes, avaries ou aux retards résultant de toutes causes que ce soit, y compris la négligence ou le mauvais état de navigabilité au départ ou à n'importe quel moment du voyage.

The defendant is a member of a cooperative called les Cabotteurs Unis de Québec (The Quebec United Coasters)

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and act as shipping agents for a number of ships, whose manager in the province of Quebec is a Captain Philippe Byers. The latter established that not only was there no written contract in this case but that bills of lading were never prepared for use with Canada Steamship Lines in charters of this nature. Captain Byers stated that arrangements were made with the plaintiff company, a shipping firm through its traffic manager Rosario J. Paquin in 1961 to carry the cargo handled by the plaintiff from Montreal down river. The agreement was that the Cooperative would provide the plaintiff with a vessel or vessels on reasonable notice for a minimum quantity per voyage of 400 tons and if the cargo exceeded 400 tons, the Cooperative would provide a larger vessel. The vessel would be paid on a tonnage basis, the loading wharfage and discharging of cargo to be paid by the plaintiff and to be carried out by the latter's stevedores. Captain Byers admitted that the stevedores usually place cargo on board ship under the instructions of the master of the ship and that in general, it falls to the master of the ship and chief officer to indicate where certain types of cargo should go. He added that if the stevedores place or distribute badly, the master should and would interfere. Captain Byers also pointed out that although it is customary to load cargo on deck, it is important to ensure that a proper ratio of cargo is placed in the hold and on deck. He also stated that before it is possible to load a ship, it is virtually essential that whoever is in charge of loading and stowing speak to the master and mate who must be fully aware of the nature of the cargo to be placed on board. Indeed at the beginning of loading, there is usually a conference with the captain or his representative in order to determine where the cargo is to be placed and he then knows the nature of the cargo within limits. In order to enable the stevedores to do this, the booking agent must, however, give him information and he should have in hand documents which give him some detail of the cargo. According to Captain Byers, these documents are usually summarized and placed on a piece of paper, distributed to those concerned and given to the vessel at the pre-loading meeting where everyone has a copy. On the other hand, although plaintiff was entitled to be given a bill of lading by the master of the vessel, none was asked for, Captain Byers adding, however, that had one been required the Quebec United Coasters' long form (specimen Exhibit D-1) would have been supplied and used. Captain Byers received the information with respect to the weight of the cargo carried by the *Fort Carillon* only after the loss of the plates, i.e. the day following the departure of the vessel from Montreal. He added that his agreement with Rosario J. Paquin, traffic manager for the plaintiff in 1961, was based on recognized terms and conditions which govern all of the transportation carried out by its members and that there was never any doubt in his mind as to the terms of the agreement which were the same as those which had obtained in the past for transportation effected for the plaintiff by the ships of the Cooperative. He also stated that under "shippers load and count", which was one of the terms of the agreement between the plaintiff and the Cooperative, the shippers had to provide figures to establish charges as the vessel being paid on this basis, the captain must know what weight goes on board. The captain would normally obtain this information from the stevedores or the shipper's agent or agents.

Prior to the instant voyage, Captain Byers states that he was informed by telephone that between 430 to 435 tons would be loaded adding, however, that the initial quantity only took care of the minimum quantity, the charterer having the right to use the ship to its capacity.

Rosario J. Paquin, plaintiff's freight manager in 1961, stated that the agreement with the Quebec United Coasters was that the plaintiff would supply the men to load the vessel and this is what was done, its stevedores taking the cargo from the wharf and placing it on board the vessel according to the instructions of the crew. He admitted that the plaintiff company is a shipper which loads and unloads vessels and places cargo in the hull or on the deck of vessels by means of a competent personnel on the wharf with a manager, an assistant manager, six or eight foremen and a large number of stevedores (they had 350 men in 1961) which it employs and pays. Eleven of the plaintiff's men loaded the *Fort Carillon* but he does not know whether the captain of the *Fort Carillon* had given them instructions or not as to where the cargo was to be placed on the vessel on September 12, 1961.

Paquin stated that he would ordinarily get the weight of the cargo to be shipped from freight bills through one of the plaintiff's employees, Vadeboncoeur, but that after a phone call to the Quebec United Coasters for a vessel the weight could change as more freight would come in.

Paquin was on the dock when the loading of the *Fort Carillon* started but was not there all the time as there were other ships to load and he would move from ship to ship supervising the operations. J. W. Wood, as general agent of the plaintiff in 1961 also supervised the loading and unloading of ships. He states that he had occasion to speak to Captain Desgagné, master and owner of the *Fort Carillon* about placing some cargo in the ship and other cargo on the deck, but he is not sure whether he spoke to the captain of the different weights of the cargo. He adds that he ordinarily would check weights to decide where to place the cargo after conferring with the captain and he would then tell his foreman about it. He stated that bills of lading were never issued to the captain and that the only way the latter could find out the weight of the merchandise would be to ask the foreman or the clerks.

Wood stated also that when the cargo to be shipped on the *Fort Carillon* was determined in the morning, the captain did not know if he could load all of the steel plates and he was told that when he would tell the plaintiff's employees to stop they would stop loading. The greater part of these steel plates could not be stowed in the hold of the ship as they were too long and had to be placed on deck and in answer to counsel for the defendant's question as to whether he had any objection to these plates being carried on deck, or to the manner they were stowed thereon, stated that he had none. He also does not remember whether he had indicated to the captain the weight of the general cargo or of the steel plates.

Captain Desgagné, the owner and master of the vessel, stated that he tried to obtain the quantity and weight of the cargo from Leroux, one of the plaintiff's foremen, but the latter could not tell him. He adds that he did not have any contact with the plaintiff's employees (which he calls "les boss") because they spoke English only. He requested information from some of the plaintiff's employees, a checker, who told him that a bill indicating the weight

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would be sent to Quebec the next day. He then asked for an estimate and the man could not give him one. Although someone told him they would try to get this information, he obtained none. He then adds that he heard of the quantity and tonnage on board his ship only when he reached the Davie Shipyards in Lauzon the next day. He was not able to support the allegation in his defence that employees of the plaintiff had guaranteed that there were 140 to 160 tons of cargo on deck.

Captain Bouchard, the second mate, looked after the loading and the dunnage on September 12, 1961 and according to Wood, at one stage, stopped the use of dunnage on deck while Captain Desgagné went around the ship asking questions and checking from time to time the stowing of the cargo.

The evidence clearly discloses that no representations were, at any time, made by the plaintiff's employees to defendant that the deck cargo totalled between 140 to 160 tons as alleged by defendant in its written plea and this allegation must be disregarded.

The evidence also establishes that under the charter arrangements between the parties herein, the cargo was to be loaded and stowed by plaintiff under the supervision of the master of the vessel and the limitation of liability claimed by defendant for cargo on deck would apply only if the Court came to the conclusion that the proper inference to be drawn from the facts of this case was that the agreement was for the carriage to be made under the terms of a bill of lading, that that bill of lading was that of the defendant and that its terms applied to the circumstances of the present case; otherwise, the terms would be those implied by law only.

Counsel for the plaintiff in argument took the position that the *Water Carriage of Goods Act* (R.S.C. 1952, chapter 291) and its rules do not apply to the present case as the verbal contract of carriage between the plaintiff and defendant was not covered by a bill of lading as required by article 1 of the schedule thereof, whereas counsel for the defendant argued that the Act applied. Should the Act apply it would reduce the defendant's obligation of an absolute warranty of seaworthiness to that of one of "due diligence" only under Article IV, section 1 of the schedule of the Act.

The "due diligence" provision is contained in Article III of the Rules which provides that,

1. The carrier shall be bound, before and at the beginning of the voyage, to exercise due diligence to,

(*a*) make the ship seaworthy;

. . .

and in paragraph 3 of the Act which states that:

3. There shall not be implied in any contract for the carriage of goods by water to which the Rules apply any absolute undertaking by the carrier of the goods to provide a seaworthy ship.

In view of the fact that not only was there no written contract of any nature in this case but that bills of lading were never prepared for use with the plaintiff in charters of this nature generally and that arrangements were always verbal, continued from year to year over a long period of time between the Cooperative for its members and the plaintiff, it is hard to see how one can reach the conclusion that the *Water Carriage of Goods Act* could apply even in the light of *Pyrene Co. Ltd. v. Scindia Navigation Co. Ltd.*[1] where, although no bill of lading was issued, it was at least contemplated by the parties that one would issue or even in the light of *Anticosti Shipping Company v. Viateur St-Amand*[2] where also, although no bill of lading was issued, Rand J. at page 374 concluded from the evidence that "the shipping clerk's authority was to accept articles for transportation on the basis only of the Company's bill of lading following which he proceeded to fill out the standard form with the required matter" or finally in the light of *Great Lakes Paper Co. v. Paterson Steamships Ltd.*[3] where, although goods on board ship were damaged before the bill of lading was issued, the defendant's rights were held to fall to be determined as if a bill of lading had been issued, as the loading of the cargo contemplated the issuance of a bill of lading.

In the instant case, there was not only no bill of lading issued, nor any at any time contemplated, nor was there any similar document of title; there was not even, as already mentioned, a written contract of any nature.

It follows, of course, that as there was no bill of lading herein, and none contemplated, the defendant cannot avail

[1] [1954] 2 Q B 402. [2] [1959] S C R. 372.
[3] [1951] Ex. C.R. 183.

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himself of the clause in his specimen bill of lading form (Exhibit D-1) which provides that cargo carried on deck is at shipper's risk. The decision of the House of Lords in *McCutcheon v. David MacBrayne Ltd.*[1] aptly applies to this situation in holding that a mere oral contract of carriage did not incorporate the respondent's ordinary written conditions excluding liability contained in its contract form although such conditions were referred to in the invoice on which the receipt was written. I should add that I do have considerable doubt that such a clause would, in any event, cover damage to cargo or loss thereof caused by the unseaworthiness of the vessel where due diligence could not be established. I must, therefore, conclude that the terms governing this particular carriage of goods contract are those implied by law only.

As the *Water Carriage of Goods Act* cannot apply to the present contract of carriage of goods, it also follows that the defendant cannot, therefore, benefit from the modification of his common law absolute warranty or the duties he has under section 1675 of the *Quebec Civil Code*[2] where it appears to me that the burden of the defendant is as great as the common law obligations arising in virtue of the warranty of seaworthiness. I should add, however, that the result of the present action would be no different even if the *Water Carriage of Goods Act* applied to this case because I must, from the evidence, conclude that the captain of the vessel, who also is its owner, did not here demonstrate (as I will enlarge upon later) the due diligence required in ensuring the seaworthiness of his vessel necessary to allow him to claim the benefit of the statute when the ship departed on September 12, 1961, from Montreal with its cargo of steel plates and although she may have been seaworthy before loading, she no longer was seaworthy, as admitted by defendant in his plea, when she departed from the wharf in Montreal on her trip to Lauzon, P.Q.

It is indeed sufficient that the unseaworthiness of the vessel existed at the end of the loading stage to involve the

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[1] [1964] 1 All E.R. p. 430.

[2] 1675 They (carriers) are liable for the loss of things entrusted to them, unless they can prove that such loss or damage was caused by a fortuitous event or irresistible force, or has arisen from a defect in the thing itself.

owner's liability as clearly indicated in *A. E. Reed and Company, Limited v. Page, Son and East, Limited, et al*[1] at p. 749:

> ...I think, inasmuch as wrong loading, excessive loading, can amount to unseaworthiness, and constitute unseaworthiness, if the vessel is at the end of the loading stage so overloaded as to be a danger to herself and her cargo, that then there is a breach of the warranty which I find exists, that she shall be fit to complete or enter upon and carry out the next stage of the contract.

Lord Sumner in *F. O. Bradley and Son Limited v. Federal Steam Navigation Co. Limited*[2] points out the relativity of the obligation of diligence in the transportation of cargo by sea when at p. 268 he states that:

> In the law of carriage by sea neither seaworthiness nor due diligence is absolute. Both are relative, among other things, to the state of knowledge and the standard prevailing at the material time.

There is no question from the evidence that the *Fort Carillon,* although seaworthy before loading, was rendered unseaworthy in being so loaded as to become top heavy at the beginning of the voyage with the result that the vessel listed in clear weather, the steel plates slid off the deck and were lost because of the instability of the vessel and the only thing that could protect the defendant under the *Water Carriage of Goods Act* would be that the owner of the vessel or his agents and employees had showed due diligence in making the vessel seaworthy at the beginning of the voyage. That, as already mentioned, the defendant has not been able to establish such due diligence here will appear from an examination of the manner in which the overloading on deck of the *Fort Carillon* took place. I should, however, before going into this matter, determine what the words "due diligence" mean. In *Grain Growers Export Co. v. Canada Steamship Lines Limited*[3] at pp. 344-345 Hodgins J.A. stated that:

> ...The ship-owner warrants the seaworthiness, and the seaworthiness is a necessary condition of the carriage. Its absence, as has already been pointed out, increases the danger from the perils mentioned in sec. 6, and I read "exercises due diligence to make the ship in all respects seaworthy" as meaning not merely a praiseworthy or sincere, though unsuccessful, effort, but such an intelligent and efficient attempt as shall make it so, as far as diligence can secure it.

[1] [1927] 1 K.B. 743.
[2] (1927) 137 L.T. 266.
[3] 43 O.L.R. 330.

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The obligation on the carrier to use due diligence to make the ship seaworthy must be not only by the shipowner but also by all its servants and agents. (Cf. *Dominion Glass Company Limited v. The Ship Anglo Indian*[1])

In *Re Unus Shipping Co.*[2] Ross J. clearly sets down the requirements of due diligence when he states:

> ...As I read the authorities the obligation to use due diligence to make a ship seaworthy is not confined to the owners as such, but extends to those persons employed by the owners to see that the ship is seaworthy, and any lack of due diligence on the part of such persons will be imputed to the shipowner.

In *Smith, Hogg and Company, Limited v. Black Sea and Baltic General Insurance Company, Limited*[3] the House of Lords decided that a shipowner was liable for loss or damage to goods, however caused, if his ship was not in a seaworthy condition when she commenced her voyage and if the loss would not have arisen but for that unseaworthiness. Lord Wright, at p. 1001 of the above decision, went so far as to state that:

> ...The unseaworthiness, constituted as it was by loading an excessive deck cargo, was obviously only consistent with want of due diligence on the part of the shipowner to make her seaworthy.

Under article IV of the schedule to the *Water Carriage of Goods Act,* whenever loss or damage has resulted from unseaworthiness, the burden of proving the exercise of due diligence is on the carrier and the question is whether Captain Desgagné has discharged that burden. I am afraid that from the evidence I cannot arrive at a conclusion that he has. The vessel, indeed, was overloaded with reference to its freeboard and plimsoll marks. On this point James Linton Thacker, a marine surveyor, was heard on behalf of the plaintiff. This witness stated that two days after the sailing he was given figures by Captain Desgagné which indicated that the vessel was overloaded beyond its freeboard and plimsoll marks. Captain Desgagné testified differently at the trial, but this was five years after the event and in view of the manner in which he checked the freeboard and plimsoll marks of his vessel by merely peering over the side thereof employing a flashlight, this evidence is not too convincing. There is no question in my mind that

[1] [1944] S.C.R. 409 at 421. [2] [1937] 2 D.L.R. 239 at 254.
[3] [1940] A.C. 997.

the vessel sailed when it was overloaded, having regard to its freeboard, contrary to the *Canada Shipping Act* and elementary prudence and this does not indicate due diligence, although it should be stated that the overloading of a vessel *per se* will not necessarily and always make a ship unstable or unseaworthy even though in some cases it will; the instability here, however, was not caused by overloading but by loading cargo on deck which was too heavy compared to the cargo in the hold, thus rendering the ship tender as far as its stability was concerned, and it may well be here that the settling down of the ship in the water due to it being merely overloaded did not cause the loss.

Captain Desgagné took the position at the trial that it was not possible for him to know the ratio of the weight of the cargo on deck and in the hold and that although the plaintiff should have told him this, and he had asked for this information, he was not able to obtain it. He admitted he had been advised by Captain Byers, of the Cooperative, that he would get a load of approximately 450 tons (in fact 436 tons were loaded of which 239 tons of steel plates on deck and 197 tons in the hold) and that two weeks previously he had carried 354 tons of steel of approximately the same dimensions and bundled in the same position. I believe that he should, under the circumstances, by merely looking at the steel plates, have realized that he was faced here with a situation which required his personal attention and positive diligence. He indeed is the one to determine whether the stability of his vessel will be affected by a stowage of cargo which, to all intents and purposes, should have appeared to him as being not only bulky but extremely heavy. He stated that he attempted to get its weight but was unsuccessful. It is not, in my view, sufficient for him to have merely asked, in order to discharge his burden of due diligence herein and he should have here made it his business to obtain an answer from someone who could have given it. Now, although he did not receive from the plaintiff's employees all the cooperation they could and should have given him herein, I still cannot reach the conclusion that his attempts to get the information are sufficient to indicate that he has discharged here his obligation of due diligence because his actions herein are far short of the standard of conduct required in the circumstances from a captain of a vessel whose admitted responsibility with

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regard to the stability of his vessel is his alone. He, in my view, should have obtained the weight of the steel plates and of the general cargo in the hold of his vessel and if he could not get such weight, he should not have allowed the plaintiff to load the plates on board his vessel.

The evidence of Captain Thacker, and even of Captain Byers, suggests that the defendant herein acted imprudently and did not use due diligence.

Captain Thacker stated, and he was endorsed on this point by Captain Byers, that a safe stability formula for the on deck and the in the hold loading of cargo would be one third on deck and two thirds below. Here, of course, the proportion of cargo, as already mentioned, was way off this ratio with 239 tons on deck and 196 tons in the hold and that the deck cargo was indeed excessive appears from the fact that it took but a very slight movement to unbalance the vessel.

Captain Byers who admitted that it falls on the master and chief officer of the vessel to indicate where certain types of cargo should go, stated that in the circumstances of the present case, he would have insisted and endeavoured to obtain the weight of the cargo.

Asked whether he would have conducted stability tests before sailing had he captained the vessel, he answered (not having the transcript of the evidence, the following are from my notes at the trial and may not be verbatim):

> No, not some form of stability tests. There would be circumstances where a test should be made. This may have caused some doubt into my mind (the 249 tons on deck and 187 in the hold). Under the circumstances, I might have done the same as the captain did and sailed. I would have taken a chance.

He then added later that someone working for himself, such as Captain Desgagné, who owned the vessel, is prepared to take greater risks than if employed by the owner. Here again I cannot hold that the captain of this vessel was discharging his obligation of "due diligence" if he was, as indicated by the witness, "taking a chance".

There is some evidence here to indicate that Captain Desgagné took a further chance at the end of the loading operations when, according to J. W. Wood, he finally decided, after some hesitation, to take the balance of the steel as cargo. Indeed, not long before the termination of loading, Wood stated that he enquired as to whether the loading should cease and heard the captain say he would take the balance of the steel as cargo which, of course, he did. This would indicate a momentary consideration at least of the situation and (in view of the obvious considerable weight and bulk of the steel plates, and his ignorance of their weight) what I would call a heedless recklessness in accepting the balance of the cargo. This, again, I must say is also far from the "due diligence" required of a captain of a vessel.

There is, however, here a strong suggestion that Captain Desgagné did know the approximate weight of the steel plates on the deck of his vessel and, of course, if such is the case, he cannot, in any way, be held to have discharged the burden of having shown due diligence in providing a seaworthy vessel for the voyage. The protest made by the captain on September 14, 1961 (i.e., two days after the loss) before Percy Flynn, a commissioner of the Superior Court, contains a description of the events which led to the loss of the steel plates. Counsel for the defendant objected to the production of this document on the basis that it was not signed by the captain, nor were its contents couched in the language (French) in which the captain had expressed his protest. In view of the manner in which this document is made, I would have been prepared to disregard it entirely were it not for the fact that Captain Desgagné admitted that he had given to Mr. Flynn the facts as disclosed in the protest and that for all intents and purposes, it contained the information he had expressed in French including the pertinent information that "approximately 230 tons of steel" has fallen overboard. It therefore appears that around noon on September 14, 1961, the captain knew within nine tons the weight of the cargo on the deck of his vessel prior to the mishap.

When examined, Captain Desgagné stated that he had obtained the above information from a clerk or "Receveur" at the Davie Shipyards, in Lauzon, when he delivered the remaining four plates but he was not able to identify this clerk. From the evidence of Frank Findlay, the plaintiff's general agent in Quebec City, as well as Maurice Conway, the plaintiff's purchasing agent and Alphonse Desjardins, a foreman at the Davie Shipyards, in Lauzon, it would appear that Captain Desgagné could not have obtained the information of 230 tons of on deck cargo from the ship-

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yards because there was no one at Davie Shipyards at that time who knew or could possibly determine the actual or approximate weight of his deck cargo, and the only inference the Court can draw from the evidence is that the captain knew all along the approximate weight of the on deck cargo and, therefore, no defence of due diligence is possible here.

I now come to the defendant's last argument which is that the plaintiff here is not the owner of the goods but the shipper and an experienced loader and stower. Although the loading and stowing was under the supervision of the master of the vessel, it was carried out by the plaintiff's employees. The latter's participation in the operations, according to the defendant, would prevent the plaintiff from now complaining of the stowage and the securing of the cargo on the deck of the vessel and from claiming payment of the value of the steel plates lost in the voyage.

The defence herein contains no specific allegation that the plaintiff's participation in the stowing and loading would preclude him from complaining of the defective stowage and from claiming reimbursement of the amount paid by the plaintiff to the consignee of the plates, the defendant having merely stated *inter alia* at paragraph 2 of its defence that the cargo

...was under the terms of said verbal charter, to be loaded and in fact was loaded, partly under deck and partly on deck, stowed, secured and discharged by plaintiff free of all risks and expenses to defendant.

This, of course, is a somewhat different argument from the one voiced by counsel for the defendant in argument, when he dealt with the effect of the shipper's or charterer's participation in the loading and stowing of cargo.

In view of the power of the Court to allow, or even to order the amendment of the pleadings herein under section 73 of the *General Rules and Orders of the Admiralty Act,* the matter could even at this late date, be raised in the pleadings and I would do so if I felt that some useful purpose could be served by so doing.

In view of the conclusion to which I must, however, arrive at, no useful purpose could be served by doing this here because the participation of the employees of the plaintiff in the loading and stowing of the cargo herein cannot be "une fin de non-recevoir" as it cannot be construed to imply an agreement, the effect of which would be to release the shipowner, who here happens also to be the captain of the vessel, from his obligation not only to supervise the proper and safe stowage of the cargo but also to see that its weight on deck and below is distributed according to a ratio which would ensure the stability of the vessel for the voyage and, thereby, its seaworthiness. I cannot indeed find here that the plaintiff or its employees or representatives knew and appreciated the risk to which the cargo was exposed by reason of the manner in which it was stowed and that with such knowledge had agreed to accept such risk and release the defendant from the above mentioned obligations.

I cannot do so because here the sole person qualified in navigation to establish the stability of the vessel and the manner in which the cargo should be loaded to ensure this stability is Captain Desgagné himself who has a specific duty in this regard.

I do not believe that the defendant can even find any assistance in the view expressed by Smith J.A. in *Mannix Ltd. v. N. M. Paterson & Sons Ltd.*[1] where, in dealing with a loss of cargo on deck breaking loose in heavy weather, the shipper having participated in the stowage of the cargo, he stated:

> It may well be that there are cases in which the shipper, who has participated in or approved the stowage and securing of the cargo, is precluded from later complaining of such stowage. For example, when the shipper is fully aware, or it is patent, that stowage of a particular type of cargo in a particular manner or place will expose that cargo to damage, e.g., contamination, and nevertheless participates in and approves stowage in that manner, such shipper may be precluded from claiming in respect of damage to cargo due to said stowage.

I fully agree with what Smith J.A. says here but I do not believe that it can assist the defendant in any manner because once again the loss here was not caused by merely bad stowage but by excessive stowage on deck affecting the stability of the vessel which is, as already mentioned, a matter of navigation within the province of the captain of the vessel of which the plaintiff, or its employees, would be ignorant of. In *Canadian Transport Company, Limited v. Court Line, Limited*[2] where by the terms of a charter party the charterers were to "load, stow and trim the cargo at their expense under the supervision of the captain," (which is similar to the agreement in the present case) Lord Atkin

[1] [1965] 2 Ex. C.R. 107 at p. 113. [2] [1940] A.C. 934.

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clearly sets down the obligation of the captain to ensure the seaworthiness of his vessel during loading operations when at pp. 937-938 he said:

> . . .The supervision of the stowage by the captain is in any case a matter of course; he has in any event to protect his ship from being made unseaworthy; and in other respects no doubt he has the right to interfere if he considers that the proposed stowage is likely to impose a liability upon his owners.

I cannot, therefore, under the circumstances of the present case reach the conclusion that the conduct of the shipper as to stowage here was such that it would support a plea of leave and licence by the shipper and this argument must, therefore, fail.

The value of the steel plates lost herein after deduction of the amount recovered through salvage is $33,249.93 from which, however, must be deducted (as agreed to by the parties at trial) the amount of $150 for the cargo lost freight; this forms a sum of $33,099.93 and to this sum the defendant must be condemned.

The defendant will be entitled to the costs of the amendment of plaintiff's action whereby paragraph 15 was added to its statement of claim which the Court fixes in the sum of $100 and there will be judgment for the plaintiff in the sum of $33,099.93 with interest dated from the service of the action and costs.

Toronto — Apr. 11

BETWEEN:

CHATEAU-GAI WINES LIMITED ....APPLICANT;

AND

LE GOUVERNEMENT DE LA RÉPUBLIQUE FRANÇAISE .. } RESPONDENT.

Trade Marks—Jurisdiction—Foreign sovereign state not submitting to court—Originating notice to strike out entry in trade mark register—Whether service valid—Trade Marks Act, S. of C. 1952-53, c. 49, s. 56(1)—Amendment.

This Court has no jurisdiction to entertain an action against a foreign sovereign state which does not submit to its jurisdiction. (*The Christina,* [1938] 1 All E.R. 719). Hence purported service of an originating notice of motion on the Government of France to strike out as null its registered trade mark will be set aside. The Exchequer Court of Canada has however jurisdiction under s. 56 of the *Trade Marks Act* to strike out an inaccurate entry from the Trade Marks register and the court may authorize amendment of the originating notice so that it neither is nor appears to be a proceeding against the Government of France. Proceedings so amended should not be served except pursuant to a special order of the court. It is not likely that such a direction would be given but the court would probably direct that the Registrar of the court bring the proceedings to the attention of the Deputy Attorney General of Canada with the suggestion that the Secretary of State for External Affairs consider whether they should be brought to the attention of the Government of France as a matter of courtesy.

APPLICATION.

Harold G. Fox, Q.C. for applicant.

C. W. Robinson, Q.C. for respondent.

JACKETT P. (*orally*):—This is an application for an order setting aside the originating Notice of Motion whereby these proceedings were instituted, and the service of that originating Notice of Motion, on the ground that the named respondent is a foreign sovereign state and, declining to submit to the jurisdiction of this Court or to accept service of the proceedings, is not liable to be impleaded in this Court.

The originating Notice of Motion was filed in this Court on March 23, 1967 and reads as follows:

COURT NO. B1367

IN THE EXCHEQUER COURT OF CANADA

BETWEEN:

CHATEAU-GAI WINES LIMITED ....APPLICANT;

AND

LE GOUVERNEMENT DE LA RÉPUBLIQUE FRANÇAISE .... } RESPONDENT.

ORIGINATING NOTICE OF MOTION
(Filed this 23rd day of March, A.D. 1967)

TAKE NOTICE that pursuant to section 56 of the Trade Marks Act a motion will be made on behalf of the Applicant herein before this Court at a time and place to be fixed by a judge thereof;

FOR AN ORDER directing that the whole of the entry in the Trade Mark Register maintained pursuant to the Trade Marks Act and relating to Registration No. N.S. 2709, Register 7, registered June 10th, 1933, by the Respondent herein be struck out for the reasons and on the grounds and facts set out in the Statement of Facts delivered herewith.

Dated at Toronto, Ontario, this 22nd day of March, 1967.

McCarthy & McCarthy
330 University Avenue
Toronto, Ontario
Solicitors for the Applicant.

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As appears from the Statement of Facts referred to in the originating Notice of Motion, the position taken is that the registered trade mark in question is wholly invalid.

I have no doubt that the originating Notice of Motion cannot be entertained in the form in which it has been filed unless the Government of the Republic of France submits to the jurisdiction of this Court for that purpose. The law on the point, as I understand it, is well settled and not open to doubt. It is expressed by Lord Maugham in *The Christina*[1] where he says

> My Lords, it is not in doubt that an action *in personam* against a foreign government will not be entertained in our courts unless that government submits to the jurisdiction. The rule was founded on the independence and dignity of the foreign government or sovereign, or, to use the language of the future Lord Esher, M.R., delivering judgment in the great case of *The Parlement Belge (1880) 5 P.D. 197, at p. 207*:
>
> > . . . the real principle on which the exemption of every sovereign from the jurisdiction of every court has been deduced is that the exercise of such jurisdiction would be incompatible with his regal dignity—that is to say, with his absolute independence of every superior authority
>
> This immunity, be it noted, has been admitted in all civilised countries, on similar principles, and with nearly the same limits.

Fortunately, these proceedings do not raise the question concerning which there has been so much debate, and which all the judges of the Supreme Court of Canada in *Flota Maritima Browning de Cuba S.A. v. The Republic of Cuba*[2] held to be still undecided, as to whether the additional rule that property of a foreign power cannot be impleaded, seized or detained applies to property held by the foreign sovereign power for commercial purposes as well as to property held by it for public purposes. The contrast between the two rules is to be found near the end of the judgment of Locke and Judson JJ. in the latter case at page 609, which reads, in part,

> In my opinion, the law applicable in these circumstances is as it is stated in *Compania Naviera Vascongado v. S.S. Cristina, (1938) A.C. 485 at p. 490,* in the following terms:
>
> > The foundation for the application to set aside the writ and arrest of the ship is to be found in two propositions of international law engrafted into our domestic law which seem to me to be well established and to be beyond dispute. The first is that the courts of a country will not implead a foreign sovereign, that is, they will not by their process make him against his will a party to legal proceedings whether the proceedings involve process against his person or seek to recover from him specific property or damages.

[1] [1938] 1 A.E.R. 719 at p. 737. [2] [1962] S.C.R. 598.

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> The second is that they will not by their process, whether the sovereign is a party to the proceedings or not, seize or detain property which is his or of which he is in possession or control.

In *Rahimtoola v. Nizam of Hyderabad, (1958) A.C. 379 at p. 394,* Viscount Simonds adopted that statement as accurately stating these proceedings of international law.

The question as to whether the law extends to property only used for the commercial purposes of the sovereign does not arise in the present matter and I express no opinion as to it.

In this case it has been made to appear to the Court that the named respondent does not submit to the jurisdiction of this Court in respect of this matter. The matter cannot therefore be permitted to proceed as a matter in which, in form at least, relief is being sought, or might appear to be sought, as against the Government of the Republic of France.

That is not, however, the end of the matter. The question as to what is the essential nature of the matter remains to be considered. The relief sought is neither a judgment that the applicant is entitled to any relief from the Government of the Republic of France nor a judgment that would in any way affect any property that belongs to or is in the possession of that Government or in which that Government has any interest. The relief sought is relief that this Court has jurisdiction to give under section 56 of the *Trade Marks Act,*[1] which reads in part:

> 56. (1) The Exchequer Court of Canada has exclusive original jurisdiction, on the application of the Registrar or of any person interested, to order that an entry in the register be struck out or amended on the ground that at the date of such application the entry as it appears on the register does not accurately express or define the existing rights of the person appearing to be the registered owner of the mark.

This must be read with section 2(*n*) which defines "register" to mean the register kept under section 26, which reads in part:

> 26. (1) There shall be kept under the supervision of the Registrar a register of trade marks and of transfers, disclaimers, amendments, judgments and orders relating to, and of registered users of, each registered trade mark.

What we have then is an application to this Court to exercise its statutory jurisdiction to order that an entry be struck out of this domestic trade mark register on the basis that there is no "existing rights" in the person appearing to be the registered owner.

[1] S. of C 1952-53, c. 49.

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In my view, the Court's jurisdiction to police the Trade Mark Register cannot be dependent upon its having jurisdiction over all persons who have, or might be suggested to have, some interest in the maintenance of the register in a particular form. Certainly, the Registrar must be able to apply under section 56 where he is of the view that there is an entry that is invalid. What the Registrar can do, under section 56, "any person interested" can do. The authority extends to them in the same terms.

The order will therefore be that the originating Notice of Motion be set aside ten days from this date unless, within that time, an order be obtained from the Court amending the originating Notice of Motion and the Statement of Facts to change their form so that they neither are, nor have the appearance of being, a proceeding against the Government of the Republic of France.

As the proceeding in its present form is, apparently, if not actually, a proceeding *in personam* against a foreign government, and as such a proceeding is not only contrary to both international law and domestic law but is unauthorized by the Rules of this Court, any act that may have been effected as a purported service of such proceeding is hereby declared to be a nullity and set aside.

In the event that the proceedings are amended so as to be unobjectionable as to form, there should, in my view, be no further attempt at service of them unless it is made pursuant to a special order of the Court which, in my view, it is not likely that the Court would be inclined to grant. I should myself be inclined, if the proceedings are so amended, to order that the Registrar bring them to the attention of the Deputy Attorney General of Canada with the suggestion that the Secretary of State for External Affairs may desire to consider whether they should be brought to the attention of the Government of the Republic of France, in some appropriate way, as a matter of courtesy, and an indication that there will be a reasonable delay in the carrying on of the proceedings in this Court to provide the Government of the Republic of France with an opportunity of deciding whether it desires to take any action with regard thereto.

As the Government of the Republic of France has not submitted to the jurisdiction of the Court, there will be no order as to costs.

BETWEEN: | Calgary 1966 Nov. 15-16 | Ottawa 1967 Jan 6

LARS WILLUMSEN ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ....RESPONDENT.

Income tax—Building built and sold at profit—Whether trading profit or capital gain—Intention of builder.

Appellant, a building contractor who also was involved in many other enterprises, purchased a leasehold in Banff in 1954 to house persons employed by him in a restaurant. He sold the restaurant in 1958 and then erected a 14-suite apartment building on the property at a cost of approximately $95,000. He was unable to obtain permission from the National Parks authority to rent the suites on a daily basis at high rents, as he had hoped, and the suites were accordingly rented on a monthly basis at lower rents from October 1959 until June 1961 when appellant sold the building for $115,000. He was assessed to income tax on the profit and appealed contending that he erected the building for revenue and sold it because of his dire need for cash in his construction business.

Held, affirming the assessment, appellant had not discharged the onus of disproving the Minister's assumption that the profit was a trading profit. The evidence did not establish a balance of probability that appellant had erected the building for the purpose of deriving rentals therefrom to the exclusion of any purpose for its disposition at a profit.

APPEAL from Tax Appeal Board.

E. David D. Tavender for appellant.

S. A. Hynes for respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1] dated July 8, 1965 dismissing the appeal from an assessment to income tax for the appellant's 1961 taxation year on the ground that a profit realized upon the sale of an apartment building constituted a profit from an adventure or concern in the nature of trade within the meaning of sections 3, 4 and 139(1)(*e*) of the

[1] (1965) 39 Tax A.B.C. 70.

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Income Tax Act[1], R.S.C. 1952, Chapter 148, and accordingly was properly included in the appellant's income for that year.

The appellant contends that the assessment by the Minister was in error. The contention was that, upon the evidence which he adduced, the building which the appellant constructed had been created by him as a capital asset for revenue producing purposes and accordingly the gain realized upon the subsequent sale was a mere enhancement of value rather than a gain made in carrying out a scheme of profit making.

The question to be determined is whether the purpose for which the appellant constructed the apartment building was to derive rental income therefrom. If that was the exclusive purpose of the appellant at the time that he acquired the building, as contended by him, then the gain realized from the sale of that building would not be profit from a business or an adventure or concern in the nature of trade. If that was not his exclusive purpose at that time, there can, in the circumstances, be no doubt that the appellant, in erecting the apartment building, had for his purpose or one of his possible purposes the subsequent disposition at a profit, in which event, the resulting profit would be clearly taxable, as is contended by the Minister.

The apartment building was built by the appellant in the City of Banff, in the Province of Alberta. Most, if not all property, in the particular area is owned by the Crown which leases parcels of land for periods of 21 years with an option of renewal. The appellant held such a lease on the

[1] 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

139. (1) In this Act,

. . .

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

. . .

property upon which he built the apartment building. It was agreed between counsel that the matter might be considered as though the appellant held the land in fee simple and there was no dispute between them as to the amount of the gain realized by the appellant. The sole dispute is as to the taxability thereof.

The appellant was a man with multitudinous interests, most of which were carried on in Banff, but his principal business was that of a building contractor, that is, he built on behalf of others and did not engage in speculative building. He came to Canada from Denmark in 1925 and worked as a foreman in the construction of the Banff Springs Hotel. The next year he entered the general contracting business in association with another man with offices in Calgary, Alberta. Most of the construction work was done in Banff on behalf of the Canadian Pacific Railway. He moved to Banff in 1932 in order to better supervise the construction work in which he and his partner were engaged.

In 1943 he continued in the business of a general contractor but on his own behalf under the firm name and style of Larwill Construction Company in which capacity he undertook the construction of several notable buildings, among those mentioned by him in evidence being a ten storey Mobile Oil Building, the Banff School of Fine Arts, an Auditorium in Banff, additional wings to existing Calgary Hospitals, additions to the King Edward and Mount Royal Hotels in Banff and the Greyhound Bus Depot in Banff.

The many other enterprises in which the appellant engaged at various times include the Chuck Wagon Restaurant which was conducted in rented premises in the Greyhound Bus Depot in Banff and a curio and gift shop on the same premises. The restaurant business was acquired by the appellant in 1946 and was sold in 1958 from which sale he obtained between $5,000 and $10,000 in cash. The curio and gift shop was also acquired by the appellant in 1946. He testified that he attempted to sell this business in 1960 and again in 1961 without success. The appellant also owned and operated the Wigwam, a coffee shop and milk bar in Okotoks, Alberta, a town with a population of about 1,000, between Calgary and Banff where he had a home on a farm operated by his sons in addition to his residence in Banff. The appellant had

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apparently acquired the farm land to transfer to his sons as a means for their livelihood and did transfer that land to them retaining for a time a quarter section for himself. He acquired the Wigwam Restaurant in 1945, and sold it later, but was obliged to take it back about a month after its sale obviously because the purchaser did not comply with the terms of the contract of sale. The appellant also operated a coffee shop called either the Wellington or Willingdon, I think in Banff, which business was begun in late 1950 and which was subsequently sold at an unspecified date from which sale he obtained between $4,000 and $5,000 in cash.

He also constructed and participated in the operation of the Timberline Hotel in Banff. The building was constructed by the appellant in his capacity as a general contractor for a joint stock company in which two shares of capital stock were issued, one of which was owned by the appellant and the other share by another person. The value of this building was estimated at between $600,000 and $800,000.

The appellant also owned 70,000 shares without nominal or par value in the capital stock of Mechanical Pin Resetter Company, Limited. The authorized capital stock consisted of 810,000 shares of which the appellant testified about 400,000 shares were issued and outstanding as fully paid. The appellant was the largest shareholder in and president of the Company. The Company was incorporated with a private status. The appellant testified that he acquired the shares he held at varying prices averaging about one dollar per share. During the year 1961 this Company was contemplating converting its status from that of a private to a public company and offering its share for public subscription. This step was taken, after the times material to the present appeal, and the shares then commanded a market price ranging between $2.25 and $2.75 per share. Further in 1961 the Company also had available a substantial undistributed surplus.

The appellant acquired the lease to the property upon which the apartment was built in 1954. He acquired this leasehold as an adjunct to the operation of the Chuck Wagon Restaurant. There was an old building on the land which was used by the appellant to house employees of the restaurant during the peak of the tourist season when approximately forty persons were employed, twenty of whom were accommodated in the building. The appellant derived a benefit from the accommodation so provided his employees by way of an adjustment to their salaries to the extent permitted by the labour laws of the Province of Alberta. The building was so used from 1954 to 1958. In 1958 the appellant disposed of the restaurant because it was losing money but he retained his lease of the property which had been acquired by him as employees quarters. At that time the building was condemned by the appropriate authority, who ordered that it be demolished.

From his years of business experience in this particular community, the appellant concluded that the leasehold he possessed could be best and most profitably utilized as the site of an apartment. Accordingly the construction of a fourteen (14) suite brick and frame building was begun by the appellant and was completed on October 1, 1959 at a cost of $95,234.33. This building was the first of its kind in Banff and the appellant foresaw very lucrative returns. He sought a first mortgage of $85,000, which was his estimate of construction costs, but was successful in obtaining a mortgage for $75,000 at 7 percent, a firm commitment for which was given prior to the commencement of construction. The mortgage was repayable in monthly instalments of principal and interest of $625.30. The appellant's equity in the building at the outset was approximately $10,000 but, upon completion of the building, stood at approximately $20,000 due to increased construction costs. However, the ultimate cost of $95,000 was far less than could have been achieved by a person other than the appellant. He was his own general contractor and because of his years in the trade he obtained and benefitted from concessions from his architect and sub-tradesmen. He, therefore, ended up with a building costing $95,000 but with a normal construction cost in excess of that amount and a market value also in excess of that amount.

In addition to the repayment of the mortgage the appellant also arranged with the Hudson's Bay Company to supply furniture and other necessary equipment for the suites under a conditional sales agreement repayable at $675 monthly.

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The appellant also made an estimate of other fixed charges such as heating, insurance, maintenance, taxes and the like. Subsequent events proved his estimates to be accurate with the exception of taxes.

He estimated an annual cash "flow" of $25,000 from rental income which would result in a net income of between $11,000 and $12,000.

However, the appellant's estimate of an annual cash flow of $25,000 was predicated upon the suites being rented upon a daily basis for which permission was required from the National Park authority. Upon enquiry to that body, the appellant was informed, as a matter of policy, rental of the premises on a daily basis was prohibited but it was suggested that he make formal application to do so. This the appellant did, and periodically made representations, but authorization was not forthcoming until two years after the original application and then at a time when the appellant no longer owned the building. During the period of the appellant's ownership the suites were rented on a monthly basis at $125.

For the period October 1, 1959 to December 31, 1959 gross rentals of $4,403 were received.

For the year 1960, $18,056.33 in rentals were received with expenses amounting to $9,267 thereby yielding a net income of $9,350.33.

For the three month period from January 1, 1961 until June 26, 1961, the gross rentals were $6,521.98, the expenses were $4,277.80 with a resultant net of $2,244.18. By the operation of the apartment on a monthly rental basis the appellant was able to meet the expenses and make the profits above indicated.

The appellant sold the apartment building to Mechanical Pin Resetter Company, Limited on June 26, 1961, that is some twenty-one months after its completion on October 1, 1959. The sale was effected at a price of $115,000 for the building and $30,000 for the furnishings. (The suggestion that the Company should purchase the apartment building was made to the appellant by two of its directors because the Company had an undistributed surplus which it could use for that purpose and it had just previously purchased a bowling alley adjacent to the apartment.) The profit so realized gives rise to the present appeal.

The appellant had reached his decision to sell the apartment building prior to the date of the actual sale because some eight months before that date he had listed the property with one or more real estate agents and had done considerable newspaper advertising himself. At least one offer was received by him at a price some $10,000 in excess of the eventual sale price to Mechanical Pin Resetter Company, Limited. The appellant did not accept that offer because, he testified, the cash he would receive would be $20,000 whereas his immediate need was for cash in a greater amount.

Accordingly the appellant made a comparatively quick decision to sell the apartment after its completion, and the sale which resulted in the profit now in question was consummated shortly after that decision was made.

That decision to sell, made shortly after completion of the building, followed by a sale and resulting profit, if unexplained, would give rise to the inference that the transaction was "an adventure or concern in the nature of trade" within the meaning of those words as used in the definition of the word "business" in the *Income Tax Act.*

As I conceive it the correct approach to the solution of a problem of this kind of case in any given set of circumstances is first to examine the taxpayer's acts and operations objectively, bearing in mind that the question is one of fact in each particular case and that the appellant's statement at the trial is only part of the evidence and must be considered along with all the objective facts. If, after consideration of these facts, it should be concluded that the inference to be drawn is one of "trading", then the matter must be considered to ascertain if there is some satisfactory explanation, consistent with the facts as found, which would negative that *prima facie* inference. If from the facts that are proved it appears to the satisfaction of the Court that, at the time of acquisition, the purpose of the operation was exclusively to provide the taxpayer with a satisfactory investment and that there was not in contemplation at that time the possibility of sale, then the inference of trading would be rebutted.

The onus of disproving the Minister's assumption, in assessing the appellant as he did falls on the appellant.

My next task is, therefore, to consider the appellant's explanation as to the circumstances which prompted his

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decision to sell the apartment building and to determine whether, on the balances of probabilities, that explanation is a more acceptable explanation of what has happened than the assumption of the minister.

The explanation proferred by the appellant was that he was in dire need of cash to salvage Larwill Construction Company, which was his principal activity, which circumstance necessitated the sale of the apartment building. He intimated that up to the year 1959 the general contracting business carried on had been reasonably good but in the three next ensuing years that business had deteriorated to the point where the accounts payable exceeded the accounts receivable and that the subtradesmen were pressing for the payment of overdue accounts.

The appellant had dealt with the same bank for a period of twenty years. As is common in businesses of this type, the appellant financed his general construction business by means of a bank loan and overdrafts.

Up to 1958 the bank loan remained fairly static at $75,000. On March 23, 1959 the loan had been reduced to $55,000 but on March 26, 1959 two loans of $10,000 each were obtained by the appellant from his bank, which raised this loan indebtedness again to $75,000. The amount of the loan remained at that figure until March 1961 when the loan was raised to $95,000. The appellant's balance remained at that figure until the loan was paid in full in 1964. It would appear that the bank, in March 1961, transferred the amount of the appellant's then overdraft to a loan account secured by promissory notes.

The appellant conducted and financed his current business by means of bank overdrafts. From 1958 to 1959 the amount of his overdrafts varied little. Overdrafts were frequent and the appellant's account was more often red than black. There was no perceptible change from 1959 to 1961.

On September 15, 1960, the bank obtained security for the indebtedness of the appellant to it by way of a general assignment of book debts and the deposit of the appellant's shares in Mechanical Pin Resetter Limited, as well as other shares and rights to royalties owned by him. The bank did not realize on any of the securities it held.

The appellant attributed his financial predicament to three factors, *viz*: (1) the decline in his general construction business, which resulted in the position where the accounts payable exceeded his accounts receivable; (2) a claim for income tax for previous years in an amount of $14,000 and (3) a sharp curtailment of his overdrafts by his bank and its refusal to extend him further credit.

He stated that his cash position was at nil and that if he had not sold the apartment building he was close to bankruptcy.

Apparently the appellant considered the apartment to have been his most readily liquable asset. The Chuck Wagon Restaurant had been sold in 1958. The curio and gift shop was not readily saleable because the appellant's continuous efforts to sell it had been unsuccessful. The Wigwam Restaurant had been sold but that sale proved abortive. His other principal assets upon which monies might have been realized were, in addition to the apartment building, his half interest in the Timberline Hotel, which was free of all encumbrances and had a conservative value of $600,000, and the 70,000 shares owned by him in Mechanical Pin Resetter Company, Limited.

The Timberline Hotel was not prospering. One of the accounts receivable in the appellant's construction business was an advance to the Timberline Hotel of $150,000 which had been outstanding for a long period of time without any payments being made thereon. The appellant testified that his efforts to raise funds by way of a first mortgage on the Timberline Hotel were unsuccessful, although in 1964 subsequent to the period under review, a mortgage of $375,000 was placed on those premises. This the appellant attributed to the vagaries of the mortgage market.

At the time of the appellant's need for cash in a substantial amount, Mechanical Pin Resetter Company, Limited was a private company but the directors had in contemplation a change in its status to that of a public company and a public offering of its shares. In the appellant's view a disposition of any of his shares, bearing in mind that he was its president and largest shareholder, would destroy public confidence and depress the market value of the shares. For this reason he refrained from realizing on this asset. At this point I might refer to a discrepancy in the appellant's testimony. He testified that the bank held no security whereas, in fact, the appellant's shares in this Company had been deposited with the Bank as security for

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his indebtedness on September 15, 1960. It may have been that the appellant was referring to a time prior to September 15, 1960, but in any event the shares were not available to him for some time after that date.

The financial predicament which the appellant faced was not a sudden emergency. Upon an examination of the balance sheets of Larwill Construction Company for the years December 31, 1956 to December 31, 1961 I have observed that, with the exception of December 31, 1959 and December 31, 1961, the accounts payable were in excess of the accounts receivable. I have extracted the following figures from the financial statements above referred to:

	Accounts receivable	*Accounts payable*
December 31, 1956	$112,808.20	$260,552.80
December 31, 1957	159,761.85	236,041.12
December 31, 1958	120,184.66	177,485.93
December 31, 1959	180,413.26	179,944.92
December 31, 1960	69,749.24	119,434.76
December 31, 1961	241,280.25	109,798.93

I do not consider the fact that the appellant was obliged to pay arrears of income tax to have had a vital bearing upon his decision to sell the apartment building because the tax was paid before the building was sold, although this pressing claim may well have accentuated his already precarious financial position.

Despite the fact that the appellant was admittedly short of cash, nevertheless, for the years 1955 to 1962, but excluding the year 1961, he made the maximum gifts permitted without attracting tax to members of his family. These gifts, the appellant sought to explain as being merely book entries. I fail to follow such explanation, nor can I follow how such gifts could not have had the effect of further reducing the appellant's assets.

Neither can I perceive there to have been any radical change in the appellant's loan or overdraft position with his bank over the span of years from the records for those years which I have had the opportunity to review.

While the only formal demand for payment made by the bank upon the appellant is contained in a letter dated December 16, 1963, nevertheless I accept the appellant's evidence that he had received frequent verbal demands from the bank to improve his debit position and that the bank did rigidly curtail and supervise his credit.

However, the appellant was an extremely experienced business man and it is inconceivable to me that, when he saw his general contracting business deteriorating, he did not also foresee the possibility of being required to dispose of some of his other assets and further it seems probable that this possibility was present to his mind at the time construction of the apartment building was begun.

The appellant was a man of many business interests and his history indicates that he was not adverse to disposing of any one of his business enterprises when it was expedient to do so.

At the time when it became necessary for the appellant to realize upon some one or other of his assets it is quite apparent from his evidence that he was well aware that the apartment building was the most readily saleable. Since I have concluded that there was no radical change in the appellant's financial position from the time the apartment building was built until it was sold, it follows that the appellant's awareness must relate back to that prior time.

Further the appellant's equity in the apartment building was not particularly great. Because of his experience and advantages as a builder he acquired the building at a much lesser cost than the market value thereof.

I do not have any doubt whatsoever that the appellant from his wealth of experience in the Banff business community correctly forecast that an apartment would yield lucrative rental returns but his more optimistic forecast was based upon suites being rented on a daily basis. The authority so to rent was not forthcoming during the appellant's ownership of the building and while the rentals he received on a monthly basis were adequate to carry the project, nevertheless, that income was more modest than he had anticipated.

Admittedly the appellant was not a speculative builder, but he was a builder and as such he would have some knowledge of the closely allied field of building for sale.

As stated at the outset the onus of disproving the assumption that the profit realized by the appellant was a profit from a business or an adventure in the nature of trade that was made by the Minister in assessing the appellant as he did, falls on the appellant. In my view he has failed to discharge that onus.

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The question of fact as to what was the appellant's purpose in acquiring the apartment building is one that must be decided after considering all the evidence. The appellant's evidence at the trial that his purpose was to derive rental income from the apartment building is only part of the evidence.

After having given careful attention to all the evidence, I am not satisfied that there is a balance of probability that the appellant erected the apartment building for the purpose of deriving rental income from it to the exclusion of any purpose of its disposition at a profit.

Accordingly, it cannot be said that the assumption of the Minister in assessing the appellant as he did was not warranted.

The appeal is, therefore, dismissed with costs.

Ottawa 1967 Jan. 12

BETWEEN:

THE MINISTER OF NATIONAL REVENUE .... APPELLANT;

AND

DORILA TROTTIER .... RESPONDENT.

Income tax—Deductions—Husband and wife—Separation agreement—Mortgage of hotel to wife—Monthly payments—Whether periodic payments of alimony or maintenance—Income Tax Act, s. 11(1)(l).

T was owner of a hotel which he operated for a number of years with the active help of his wife until they separated in 1958. They then agreed that the wife was entitled to half the value of the hotel, estimated at about $90,000. In August 1958 they accordingly signed a document agreeing to sign a separation agreement when $12,000 was paid to the wife under a first mortgage of the hotel and stating that such agreement should include a second mortgage of the hotel for $45,000 to the wife who would sign a bar of dower. The second mortgage for $45,000 which *T* gave his wife provided for payment of $12,000 from the proceeds of a first mortgage and the balance by monthly instalments of $350 inclusive of interest at 5% on the outstanding balance, authorized prepayment without notice or bonus, and provided that the rights thereunder were assignable and should pass to the mortgagee's heirs, executors, administrators or successors. A separation agreement executed on October 23rd 1958 declared that the wife accepted the second mortgage in full settlement of all claims for an allowance for herself from her husband provided the mortgage covenants were observed.

Held, the monthly payments made by *T* to his wife were made pursuant to the second mortgage and not pursuant to the separation agreement and accordingly were not deductible in computing *T's* income under s. 11(1)(*l*) of the *Income Tax Act*. In order to qualify under s. 11(1)(*l*) a payment must fall precisely within its terms.

Unlike payments of alimony or maintenance the monthly payments by *T* to his wife were assignable, interest-bearing, and the obligation to pay them was absolute regardless of any change in the financial or marital status of the wife and whether she lived or died. Further, in case of default she was not restricted to proceeding under the mortgage but could elect to sue for maintenance.

APPEAL from Tax Appeal Board.

Bruce Verchere for appellant.

F. L. Gratton, Q.C. for respondent.

CATTANACH J.:—This is an appeal by the Minister from a decision of the Tax Appeal Board[1] dated October 21, 1964 in which it was held that certain monthly payments made by the respondent to his wife, Yvonne Trottier, in the total amount of $3,150 were properly deductible by the respondent in determining his taxable income for his 1961 taxation year as an amount paid by him in that year pursuant to a written agreement, as alimony or other allowance payable on a periodic basis for the maintenance of his wife from whom he was living apart pursuant to a written separation agreement in accordance with the provisions of section 11(1)(*l*) of the *Income Tax Act*[2].

Prior to trial the parties agreed upon a statement of issues, admitted facts and facts which were in dispute in the following terms:

I ISSUES

1. Were the payments in issue made by the Respondent to his wife pursuant to a charge by way of mortgage dated 7 August 1958 or pursuant to a written agreement dated 7 August 1958 as alimony or other allowance payable on a periodic basis for the maintenance of his wife, his child, or both of them?

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[1] (1964) 36 Tax A.B.C. 413.

[2] (1) an amount paid by the taxpayer in the year, pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written agreement, as alimony or other allowance payable on a periodic basis for the maintenance of the recipient thereof, children of the marriage, or both the recipient and children of the marriage, if he was living apart from, and was separated pursuant to a divorce, judicial separation or written separation agreement from, his spouse or former spouse to whom he was required to make the payment at the time the payment was made and throughout the remainder of the year;

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2. Were the payments in issue made by the Respondent to his wife as part of a property settlement or for the maintenance of his wife, his child, or both of them?

3. Were the payments in issue made by the Respondent as a partial or entire discharge of all obligations, present or future, to his wife whether of an alimentary nature or of any other nature?

II FACTS ADMITTED

1. During the period from 1947 to 1958 the Respondent owned a hotel known as the Algoma Hotel in Chelmsford, Ontario. The Respondent and his brother purchased the hotel in 1944 for $15,500 and operated it as a partnership until 1947 when the Respondent purchased his brother's interest for $7,000.

2. On 7 August 1958 the Respondent and his wife, in the presence of J. L. McMahon, the wife's solicitor, signed a memorandum of agreement, a copy of which is attached hereto as Schedule A.

3. On 7 August 1958 the Respondent mortgaged the Algoma Hotel to the Canada Permanent Mortgage Corporation for $21,000 repayable in five years.

4. On 7 August 1958 the Respondent entered into a mortgage agreement, a copy of which is attached hereto as Schedule B.

5. On 7 August 1958 the Respondent executed a direction to the Canada Permanent Mortgage Corporation and to Messrs. Hawkins & Gratton, Barristers and Solicitors, a copy of which direction is attached hereto as Schedule C.

6. On 7 August 1958 the Respondent and his wife, Yvonne Trottier, entered into a separation agreement, a copy of which is attached hereto as Schedule D.

7. In 1958 the Algoma Hotel was valued by the Respondent at approximately $100,000.

8 During the years 1944, 1945, 1946 and 1947:

(a) the Respondent and his brother attended to and operated the beverage rooms in the Algoma Hotel,

(b) the Respondent's wife, Yvonne Trottier, operated the kitchen and dining room in the Algoma Hotel and kept the books of account of the hotel business, and

(c) the Respondent's sister-in-law, that is, his partner's wife, attended to and was responsible for the rental of the bedrooms in the Algoma Hotel.

9. After 1947, and until 1957, the Respondent's wife continued to keep the books of account of the hotel business, to operate the kitchen and dining room and also attend to the rental of the bedrooms in the Algoma Hotel. The profit from operating the kitchen, dining room and bedrooms was kept in a separate bank account by the Respondent's wife.

10. During their married life, and until 1947, the Respondent and his wife maintained a joint bank account in Sudbury.

III FACTS WHICH ARE IN DISPUTE

1. Were the Respondent and his wife, in the period from 1947 to 1958, engaged, with regard to the Algoma Hotel business, in a joint enterprise to which each contributed work and money earned from other sources?

2. If the Respondent and his wife were engaged in such a joint enterprise, what approximately were their respective contributions to the business or enterprise?

3. Was the agreement entered into by the Respondent and his wife on or about 7 August, 1958 an agreement providing for alimony or other allowance payable on a periodic basis to the Respondent's wife for her maintenance or was it an agreement which provided for a property settlement?

Attached to such document are Schedules A, B, C, and D.

Schedule A referred to in paragraph (2) under the heading II Facts Admitted, is a photostatic copy of a memorandum of agreement dated August 7, 1958 between the respondent and his wife stating that the parties agree to sign a separation agreement when payment of $12,000 on a first mortgage is made to the wife, that the separation agreement should include a second mortgage given by the respondent to his wife securing an amount of $45,000, and that the wife would sign a permanent bar of dower.

Schedule B, referred to in paragraph (3) of the aforesaid heading is a copy of a mortgage dated August 7, 1958 between the respondent as mortgagor and his wife as mortgagee charging the Algoma Hotel, which is therein described by its legal description, as security for payment of the principal sum of $45,000.

Schedule C, referred to in paragraph (5), is a copy of a direction by the respondent dated August 7, 1958 to the first mortgagee to pay the sum of $12,165 from the proceeds of the mortgage loan to his wife and is stated to be in consideration of her barring her dower and other considerations.

Schedule D, referred to in paragraph (6), is a copy of the separation agreement between the respondent and his wife, which is dated August 9, 1958, and was executed by the parties thereto on October 23, 1958.

Mr. and Mrs. Trottier were married in 1929 and separated some 29 years later in 1958. The respondent, prior to his marriage and during the initial years thereof, had been engaged in a variety of jobs, but his principal occupation had been that of a bartender. He earned about $100 a month. His wife had been a school teacher earning a like monthly amount.

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In 1944 the respondent purchased the Algoma Hotel in the circumstances outlined in the Statement of Facts admitted and the hotel was operated, as is also therein outlined, during the period indicated.

The basic arrangement between the respondent and his wife appears to have been that she would assume the responsibility of operating the kitchen and dining room facilities of the hotel and later assumed the responsibility for the rental of rooms. The respondent, on his part, assumed the responsibility of operating the beverage room or tavern. Mrs. Trottier kept the books of account for the entire combined enterprise. These two areas of responsibility appear to have been somewhat segregated. When acquired, the hotel was in a run-down condition, the kitchen and dining room equipment was inadequate and the bedrooms were in constant need of refurbishing. Mrs. Trottier purchased new equipment and effected repairs, the cost of which was paid from the income received by her from the operation of that portion of the hotel enterprise and when there was not sufficient income from that source, she returned to teaching to supplement her resources. The proceeds from her part of the hotel operation and teaching were kept by Mrs. Trottier in a separate bank account maintained in her name. Counsel for the respondent introduced in evidence the statements from Mrs. Trottier's savings account ledger from 1950 to 1966 but I did not have the benefit of any explanation thereof or any particular item therein. The account shows a modest credit balance over the years varying between $2,000 and $500 with equally modest withdrawals and deposits. She testified that on occasion she paid accounts incurred in the operation of the tavern, although no cash was turned over to the respondent, her husband. The respondent, in giving evidence, sought to emphasize the complete independence of the operation of the beverage room by himself and the remainder of the hotel by his wife. He testified that he paid the taxes, lighting and heating costs, and like expenses from the revenue received from the beverage room. However, he acknowledged that his wife worked very hard, that she expended monies for improvements and repairs, that she engaged and paid staff, but he did state that any revenue received by her was her own. The respondent did not deny that some accounts incurred in the beverage room were paid by his wife and admitted that when he left he owed his wife $1,000 which he subsequently paid.

I am convinced, from the evidence, that while there was a considerable degree of separation in those portions of the hotel business conducted by the respondent and his wife respectively, nevertheless, I am also convinced that there was a considerable mingling of funds. From the very nature of the operation and the relationship of husband and wife, it could not have been otherwise. The hotel was originally purchased for $15,500 and in 1958 it had appreciated in value to $100,000. I am equally convinced that Mrs. Trottier by her industry over the years contributed substantially to that appreciation in value, but I am unable to assess with any exactitude the respective contributions in effort and monies from sources other than from the operation of the combined business to that enterprise because of the imprecise nature of the evidence with respect thereto.

The couple occupied space in the hotel which served as the matrimonial home. In 1957 the respondent left to live elsewhere under circumstances which were understandably intolerable to his wife. He continued to operate the beverage room. On being approached by his wife to ascertain if he intended to resume his domestic relationship with her, the respondent informed her that he did not. Mrs. Trottier thereupon told the respondent she could no longer continue to live in the hotel or to operate her part of the hotel business and that financial arrangements must be made to facilitate their separation.

In her view, her contribution of effort and money to the development of the hotel business morally entitled her to one-half the value thereof at that time. She neither pressed for nor claimed any interest in the respondent's other assets which included an apartment building of unestablished, but likely negligible, value.

The respondent readily and amicably agreed to his wife's demands. It was also agreed between them that the reasonable value of the hotel was $90,000 after taking into account the expenses and possible diminution in price consequent upon a precipitate sale.

The respondent did not have $45,000 readily available in cash to pay to his wife. He, therefore, undertook to raise

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funds by placing a first mortgage on the hotel premises from the proceeds of which $12,000 would be forthwith paid to his wife, as he stated in evidence, in order that she might build or purchase an adequate home for herself and their daughter. For the balance of $33,000 he undertook to give his wife a second mortgage repayable in monthly instalments inclusive of interest at five percent to be payable upon a maximum sum of $21,000. While the respondent was quite willing to pay his wife the sum of $45,000, there was some negotiation between them on the question of whether interest should be paid and if so at what rate. The wife felt that she was entitled to interest on any unpaid balance, but the respondent did not and accordingly the compromise above outlined was agreed upon. As the respondent explained the matter, it was his hope that the foregoing arrangement would enable his wife to live out the remainder of her life in comfort and without working and that he gave her the second mortgage on the hotel premises to ensure her "protection". The respondent also agreed to give his wife the sum of $50 monthly for the maintenance and education of their daughter for a period of two years or until her education was completed.

The matter of the total of the $50 monthly payments paid in the taxation year for the maintenance and education of the respondent's daughter and the initial lump sum payment of $12,000 is not in dispute. The dispute is restricted to the deductibility of the total amount of $3,150 paid by the respondent in computing his income for his 1961 taxation year.

The respondent contends that the amount is deductible as payments made pursuant to a separation agreement on a periodic basis in strict accordance with the provisions of section 11(1)(*l*) of the *Income Tax Act.*

On behalf of the Minister it is contended that the payments were not made pursuant to a separation agreement but rather were made pursuant to the second mortgage which had been accepted by her in full settlement of all her claims against the respondent. The argument on behalf of the Minister was extended to submit that on the true interpretation of the arrangement between the respondent and his wife it was, in effect, a division or distribution of their property and that it was, in effect, an agreement whereby the respondent was discharged from his liabilities present or future to his wife whether of an alimentary nature or of any other nature, e.g. her forebearance to claim for a division of the hotel property whether the claim was meritorious or not.

The arrangement as outlined above was discussed and finally agreed upon between the respondent and his wife without prior legal advice. It was their own independent solution of the predicament in which they found themselves.

Having so decided they attended, during July 1958, at the office of a solicitor acting on behalf of Mrs. Trottier for the purpose of having him prepare the necessary documentation to implement the foregoing plan agreed upon by the respondent and his wife. This the solicitor did by preparing the documents annexed to the agreed statement of issues, admitted and disputed facts as Schedules A to D inclusive.

As recited in Schedule A, the parties agreed to separate, and that a separation agreement would be entered into by them when an initial payment of $12,000 was paid to Mrs. Trottier. Because of the respondent's financial position this payment could be made by him only when he had received the proceeds of a first mortgage on the hotel premises. To facilitate the placing of the first mortgage Mrs. Trottier undertook to sign a permanent bar of dower.

Schedule B is the second mortgage given by the respondent to his wife. It recites that "In consideration of the sum of $45,000 paid to me" he charges the land therein after described. The principal sum of $45,000 is made repayable as follows:

> The sum of Twelve Thousand Dollars ($12,000.00) shall be paid when the proceeds of a first mortgage loan to Canada Permanent Mortgage Corporation dated July 29, 1958, are available, or within one month from the date of execution of the Charge, which ever is the sooner. The balance of Thirty-Three Thousand ($33,000 00) Dollars shall be paid in equal consecutive monthly instalments of Three Hundred and Fifty ($350 00) Dollars, including interest, commencing on the 1st day of October, 1958, and on the 1st day of each and every month thereafter until all arrears of principal and interest monies hereby secured are fully paid and satisfied. The interest at the rate of Five per cent (5%) per annum shall be calculated half yearly, not in advance, on the unpaid balance of principal outstanding. Not withstanding, anything written above the interest shall not be calculated at any time on a principal sum greater than Twenty-One Thousand ($21,000.00) Dollars. Such monthly instalments when received by the mortgagee shall be applied firstly on

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account of interest and interest in arrears, if any, and secondly upon the unpaid balance of the Principal The interest payable shall be calculated from the 1st day of September, 1958

In addition to the usual covenants there was also inserted a clause permitting the respondent as mortgagor to pay the whole or any part of the mortgage money without notice or bonus. It is also stated that the rights thereunder are assignable and shall pass to the mortgagee's heirs, executors, administrators or successors as the case may be.

The separation agreement, Schedule D, which is stated to have been made on August 7, 1958 but which was not executed until October 23, 1958 when Mrs. Trottier was assured of the receipt of the initial payment of $12,000, in addition to the usual mutual covenants in an agreement of this nature, provides in paragraph 2 as follows:

2. The wife accepts in full settlement a second mortgage upon the property known as Lot Number (2) TWO, in the Fourth concession in the Township of Balfour, for the sum of Forty-Five Thousand ($45,000 00) Dollars in full settlement of all claims for an allowance for herself from her husband. This is provided the covenants in the mortgage are observed.

There is no question whatsoever in my mind that the respondent recognized his legal obligation and duty to maintain and provide for his wife and that he was quite prepared to discharge that obligation and duty which he did in the manner above described. I am also certain that in agreeing to pay his wife the total sum of $45,000, (which I have roughly estimated as being payable over a period of eleven years pursuant to the instruments executed to effect the arrangement between them, and ending when the wife would have attained her 63rd year,) the respondent was guided, in reaching that quantum, by the yardstick of one half of the then mutually accepted value of the combined hotel business operated by his wife and himself. I am equally certain that Mrs. Trottier did not regard the sum of $45,000 to be paid to her as being payment for her maintenance but rather that she regarded it as being her share of the hotel business to which she had contributed her efforts and some of her monies to establish.

Because of the conclusion which I have reached upon the first contention on behalf of the Minister that the payments here in issue were made by the respondent to his wife pursuant to the second mortgage and not pursuant to a written agreement as an allowance payable on a periodic basis for her maintenance, it is not necessary for me to decide the two alternative contentions raised by the Minister, i.e. that the agreement between the respondent and his wife was, in effect, a division of property between them or that it was a general obligation whereby the respondent would be relieved of all liabilities to his wife whether of an alimentary nature or otherwise.

Prior to the enactment of section 11(1)(*l*) and its analogous predecessor sections, payments made on account of alimony or pursuant to separation agreements were not deductible by a taxpayer in determining his taxable income on the basic principle that personal or domestic expenses are not deductible or the principle that when income was received it is chargeable at that moment no matter what subsequent disposition was made of it. Alimony or maintenance whether or not paid out of the husband's income was considered as something to which the wife was entitled.

Section 11(1)(*l*) permits deduction in the computation of taxable income of:

> an amount paid by the taxpayer in the year...pursuant to a written agreement, as alimony or other allowance payable on a periodic basis for the maintenance of the recipient thereof. . . .

In order to qualify as a deduction from his income the payments made by the respondent to his wife must fall precisely within those express terms.

With such considerations in mind a reference to paragraph 2 of the separation agreement, Schedule D, discloses that Mrs. Trottier accepted a second mortgage on the hotel property for the sum of $45,000 "in full settlement of all claims for an allowance for herself from her husband". While the value of the second mortgage might not be $45,000, nevertheless in my view, the language of the paragraph indicates that what Mrs. Trottier got from her husband in exchange for her right to maintenance was an incorporeal property of value.

It was submitted on behalf of the respondent that the separation agreement, Schedule D, and the second mortgage, Schedule B, must be read together and that payment of $33,000 in equal consecutive monthly instalments of $350 inclusive of interest were periodic payments for the maintenance of the recipient pursuant to a written agree-

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ment which is contained in the two documents. I do not accept that submission. In my view the second mortgage stands in exactly the same position as a promissory note or a parcel of real property which the respondent might have given to his wife in satisfaction of his obligation to provide for her. The real property, if such had been given, rather than the second mortgage, could have been disposed of by the wife, or if a promissory note had been given the note could have been discounted by her. So too could the second mortgage have been negotiated by Mrs. Trottier, either at a discount or a bonus dependent on the state of the second mortgage market if any such market existed. In short I construe paragraph 2 of the separation agreement as being an executory provision.

Alimony or maintenance continues through the joint lives of the husband and wife but terminates upon the death of either. If Mrs. Trottier had died during the currency of the second mortgage the payments under the second mortgage would continue to be payable to her assignee, if she had assigned it, and otherwise to her heirs, executors or administrators in accordance with a covenant in the indenture to that effect. It follows that the periodic payments cannot be classified as payments for maintenance.

Further maintenance is payable for the support of the wife and as such is not assignable by her and neither do such payments, from their very nature, bear interest. The payments here under consideration are both assignable and interest bearing under the terms of the second mortgage.

The result might be different if paragraph 2 of the separation agreement, Schedule D, were a specific covenant by the respondent to pay to his wife a sum certain by way of periodic instalments during her lifetime and the second mortgage had been given to Mrs. Trottier as collateral security for those payments. But such is not the case. The second mortgage was not given by way of collateral security but rather in discharge of the respondent's obligation to support his wife.

Further paragraph 2 of the separation agreement provides that the acceptance by the wife of the second mortgage in full settlement of her claim for an allowance is dependent on the covenants in the mortgage being observed. If there had been default under the second mortgage Mrs. Trottier's remedy would not be restricted to taking proceedings to foreclose the mortgage. If she did not elect to proceed under the mortgage she would be free to institute an action for maintenance.

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Furthermore, there was an absolute obligation upon the respondent to pay the sum of $45,000 pursuant to the terms of the second mortgage regardless of any changes in the financial or marital status of his wife and whether she lived or died. This is quite inconsistent with the payments being for maintenance.

Therefore, in my opinion, it cannot be properly said that the payments here in question were made, in the words of section 11(1)(*l*), as an amount paid by the taxpayer in the year pursuant to a written agreement, as alimony or other allowance payable upon a periodic basis for the maintenance of the recipient thereof.

Therefore, there will be judgment allowing the appeal with costs against the respondent in favour of the Minister to be taxed in the usual manner.

BETWEEN:

Toronto
1967
Feb. 21-22
Ottawa
Apr. 21

NEIL FRANCIS GIBNEY, FREDERICK JOHN MARTIN and HERBERT G. HASKINS of the City of Vancouver in the Province of British Columbia and DONALD S. ANDERSON of the City of Honolulu, Hawaii, of the United States of America, carrying on business under the firm name and style of PROGEN DISTRIBUTORS .... PLAINTIFFS;

AND

FORD MOTOR COMPANY OF CANADA LIMITED .... DEFENDANT.

Patents—Infringement—Makeshift device to protect car generator from contaminants—Placement by filling station operator in customer's car—Whether "public use"—Patent Act, R.S.C. 1952, c. 203, s. 28(1)(c)—Lack of subject matter.

In 1951 the operator of a filling station in Vancouver wired a piece of stove-pipe to the generator of a customer's car and flared out a portion of the stove-pipe in order to protect the generator from oil splashes and fumes and other contaminants whilst permitting the flow of air. It was common knowledge at the time that water, dirt and oil injuriously affected generators. The operator did not caution the

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customer to keep the device secret and did not see him again until early in April 1952 when he discovered that the device had worked well. He then had similar devices manufactured and commenced selling them in June 1952. He applied for a patent on April 23rd 1954 and a patent issued in March 1957. Subsequently defendant sold generators which infringed the patent.

Held, dismissing an action for infringement, the alleged invention was in public use in Canada more than two years before the application for a patent, which was therefore invalid under s. 28(1)(*c*) of the *Patent Act,* and furthermore the device lacked inventive ingenuity.

It suffices that one person saw the invention (*cf. Carpenter v. Smith,* (1841) 1 Web. Pat. Cas. 530) to make it known in a public manner, which is the test (and not use by the public) if the plaintiff fails to establish that he was experimenting. A common sense view should be taken in dealing with the means taken by an inventor in experimenting to perfect his invention. The small man is entitled to an invention as well as the large corporation and providing that what he is doing is experimenting he should be able to use whatever means are available to him.

In re Stahlwerk Becker Aktiengesellschaft (1919) 36 R.P.C. 13; In re Taylor's Patent (1896) 13 R.P.C. 482; Conway v. The Ottawa Electric Rly Co, 8 Ex. C.R. 432; *Boyce v. Morris Motors Ltd,* (1927) 44 R.P.C. 105; *Westley v. Tolley, Sons &c,* (1894) 11 *R.P.C. 602; Croysdale v. Fisher,* (1884) 1 R.P.C. 17; *Elias v. Grovesend Tinplate Co.,* (1890) 7 R.P.C. 455, referred to.

ACTION for infringement of a patent.

Gordon F. Henderson, Q.C. and *Edwin A. Foster* for plaintiff.

Donald F. Sim, Q.C. and *Weldon Green* for defendant.

NOËL J.:—This is an action for infringement of patent No. 538,561 issued March 26, 1957, to Donald S. Anderson one of the plaintiffs herein. The plaintiffs are partners who carry on business under the firm name and style of Progen Distributors, in the City of Vancouver, in the Province of British Columbia.

The defendant is a corporation duly incorporated and organized under the laws of Canada and has its head office and chief place of business in Toronto, Ontario.

A large number of defences were raised in the Statement of Defence and in the Particulars of Objections, but as a result of the new rules of this Court the parties herein were able to produce, prior to trial, an "Agreement on facts and on issues in controversy", which narrows the issues herein to two specific matters only, namely, that (1)

Donald S. Anderson in whose name the patent in suit was issued, placed the invention into public use more than two years prior to the date of his application for a patent in Canada with the result that the patent is invalid by virtue of section 28 (1)(*c*) of the *Patent Act* and (2) in any event, it did not require inventive ingenuity to conceive the subject matter of the patent, a shield for the protection of generators in automobiles.

On the other hand, the plaintiffs' position concerning the attack on the validity of their patent is that (1) any use or sale of these shields or protectors more than two years before the filing date of the application was experimental and that (2) the invention did require inventive ingenuity.

The parties' "Agreement on facts and on issues in controversy" is set out hereunder:

AGREEMENT ON FACTS AND ON ISSUES
IN CONTROVERSY

Upon the parties agreeing that:

1 The Plaintiffs are partners under the firm name and style of Progen Distributors, being located in the City of Vancouver, in the Province of British Columbia.

2. The Plaintiffs do not carry on business as alleged in paragraph 1 of the Statement of Claim.

3. The Defendant is a company duly incorporated and organized under the laws of Canada, having its head office in the City of Toronto, in the Province of Ontario.

4. The Plaintiffs are the owners of Canadian Letters Patent No. 538,561 which issued on March 26, 1957 for an invention of Donald S. Anderson entitled "Protector for Electric Rotary Machines".

5. (*a*) The Defendant has infringed the rights of the Plaintiffs under claims 1, 4, 5 and 6 of the said Letters Patent after the issue of the said Letters Patent, and, before and after the 31st day of May, 1961:

(i) by the use of protectors for electric rotary machines in motor vehicles sold by the Defendant.

(ii) by the sale of protectors for use with electric rotary machines.

(*b*) The Defendant threatens to continue the infringement referred to in paragraph 5(*a*) hereof.

(*c*) All of the generator protectors used or sold by the Defendant from March 25, 1957 to the date hereof infringe the aforesaid claims, and for the purposes of this trial can be taken to be identified as Exhibits 1

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and 3 to the Examination for Discovery of J. M. Lambert who is an officer of the Defendant company. The infringement extends to the use or sale of all such units by the Defendant.

(*d*) The only Ford generators upon which generator protectors have been used by the Defendant or for which they have been sold by the Defendant are of the type shown with reference to page 270 of the 1962 Ford Passenger Car Parts and Accessories Catalogue. The Ford unit in question is identified in this diagram as No. 10170. The generator to which it is applied is No. 10002. The end plate fastened to the engine block is identified as No. 10139 and has openings which are not visible in the diagram due to the adjacent fan which is identified as No. 10130. Air is drawn by the fan mounted on the generator shaft in through the rear ventilating holes of the generator forward over the armature and field coils of the generator and is expelled radially at the front. Air also passed from front to rear over the outside frame of the generator due to the action of the radiator fan and the forward motion of the vehicle.

(*e*) The Ford unit assists in preventing water splash, dirt and oil from entering the rear openings of the generator. The unit does not increase nor assist air flow or generator performance except in so assisting in preventing water splash, dirt, oil from so entering the generator.

6. As of the date of invention and for several years prior thereto, it was common general knowledge in the art to which this patent is directed that water, dirt and oil were injurious to the proper operation of a generator and that it was, therefore, desirable to prevent the ingress of water, dirt and oil into a generator housing.

7. Claims 2 and 3 of the said Letters Patent are withdrawn from the action.

8. In the event that claims 1, 4, 5 and 6 of the said Letters Patent are held to be valid, the amount of damages or profits will be determined upon a reference made to the Registrar of this Honourable Court.

Notwithstanding the issues raised by the pleadings, the parties agree that, excepting the issue of damages or profits, the only issue between them is the Defendant's allegation that claims 1, 4, 5 and 6 of the said Letters Patent are void and invalid.

More specifically, the Defendant defines the issue of invalidity as follows:

1. The alleged invention described and claimed was not inventive nor an invention in that (*a*) the alleged invention described in the patent and claimed in the claims in issue did not in fact and in law involve any inventive step, and (*b*) the alleged invention described in the patent and claimed in the said patent was and is not an invention, but was and is, at best merely the result of mechanical skill. The Defendant relies upon the following:

> U S. Patents 1,133,184, 1,439,990, 1,816,183, 1,883,288, 1,972,315, 1,982,139, 1,998,087, 2,057,637, 2,093,082, 2,240,664, 2,294,586;
>
> British Patent 290,043;
> German Patent 632,663;

the common general knowledge in the art and the public use and/or sale of metal protectors more than two years prior to the filing date of the application for the said Letters Patent. In respect of the allegation of public use and/or sale, the Defendant relies only upon the admissions made during the course of the Examination for Discovery of Donald S. Anderson relating to the development, use and sale of metal protectors.

2. The alleged invention described and claimed in the said Letters Patent was not new but was known before Anderson invented it, if he did invent it, by the persons named in the patents identified in paragraph 1 hereof, and was diclosed by such persons in such a manner that it had become available to the public by reason of the publication of the patent set forth in paragraph 1 hereof before the date of application for the said Letters Patent. The Defendant will also rely upon the common general knowledge in the art as of the date of invention.

3. The alleged invention described and claimed in the said Letters Patent was described in patents published more than two years prior to the application for filing the said Letters Patent, as identified in paragraph 1 hereof.

4. The device described and claimed in the said Letters Patent was in public use or on sale in Canada for more than two years prior to the application in Canada. The Defendant relies only upon the admissions made in the examination for discovery of Anderson as to the development, use and sale of metal protectors.

The Plaintiffs' position concerning the issue of invalidity as defined by the Defendant is as follows:

1. The Plaintiffs join issue with the Defendant on paragraphs 1, 2, 3 and 4. The Plaintiffs allege that any use or sale of metal protectors more than two years before the filing date of the application for the said Letters Patent was experimental.

DATED at Ottawa this 10th day of November A.D. 1966

(sgd) Gowling, MacTavish, Osborne & Henderson
Gowling, MacTavish, Osborne & Henderson—Solicitors for the Plaintiffs

(sgd) McCarthy & McCarthy
McCarthy & McCarthy
Solicitors for the Defendant

It therefore appears from the above document that the matter of infringement by defendant of the plaintiffs' patent is admitted and I should add that counsel for the defendant in his opening address at the trial stated that on the question of lack of invention or inventive ingenuity, the prior art on which defendant would rely was limited to two prior patents only, namely: (1) U.S. patent 2,057,637 by W. G. Schneider, a "cooling system for dynamo-electric machines" and (2) German patent No. 632,663, a "Device for cooling the driving motor of a propeller blower for delivering hot gases" (a translation of which agreed to by the parties was attached to a photographic copy thereof). Counsel for the defendant further stated that he is not claiming that the Anderson invention was anticipated by any of the two patents he is relying on nor by any others and it therefore follows that what the patentee did must be taken to have been new.

The invention in suit relates to a protector for electric rotary machines, i.e., a generator and according to the patent, it is a "device for protecting the ventilating holes in an electric rotary machine and for increasing the rate of flow of cooling air passing within the outer casing of the rotary machine".

The only Ford generators upon which a shield or protector has been used by the defendant or for which they have been sold by the defendant are of a type shown at p. 275 of the 1962 Ford passenger car parts and accessories catalogue which page was produced as Ex. 2 herein. This generator appears on this page under No. 10002 and a physical embodiment thereof was produced as Ex. 3. A generator in an automobile is a secondary source of electrical power, the battery being the primary source. The electrical current generated by the armature revolving in the generator must have some place to go and brushes mounted on the back plate are fitted to ride on a commutator and these brushes pick up the current and take it wherever it is needed. These brushes are in a holder and rub on the commutator. When contamination gets on the commutator and lifts the brushes away, it is like turning off a switch and breaking the connection and there is no longer any flow of current. Contamination can also get into the brush holder and when there is also contamination on the commutator, the brush will stick in an upward position away from the commutator and the generator will no longer operate. In some cases, the brushes freeze together. According to Rodak, one of defendant's witnesses, the main point of failure in generators was the parting of the field coil wire which energizes the field windings and which establishes the magnetic fields within the generator. The wire staked on to the terminal (the one connecting the field terminal on the case generator) would part and create an open circuit. As a result thereof, there would be no flux generated and the generator would be rendered inoperative. According to Rodak, this was due to the entrance of a saline solution or road salt and water into the interior of the generator which would attack the bare wire at the terminal part. I should add that all of the generator protectors used or sold by the defendant from March 25, 1957, to the date hereof and which infringe claims 1, 4, 5 and 6 of the Anderson patent (claims 2 and 3 having been withdrawn by the plaintiffs from the action) are identified as Exs. 2 and 4 herein.

Plaintiffs' shield or protector (Ex. 5) can be described as having a portion (which the patentee calls an annular band) which fits on to the rear part of the generator and another portion which extends outwardly and rearwardly over the ventilating holes situated around the rear end of the casing containing the generator thereby preventing the direct entry of splash, fumes, oil or other contaminants and because it extends outwardly or flares out, it does not block these holes out.

A generator converts mechanical power to electrical power. In some of Ford's vehicles it has a projecting shaft at its forward end on which a pulley and centrifugal impeller are mounted which pulley is linked up to the shaft of the motor fan which drives the generator's impeller and, of course, the faster the motor of the automobile is driven the faster the centrifugal impeller of the generator revolves. This impeller draws air from right to left (i.e., in the same direction as the method of travel of the vehicle) through the holes at the rear of the casing and expels this air out the front holes situated near the impeller. If in the process of converting mechanical power to electrical power the generator is not cooled it will burn out and if in the process of drawing air inside the casing of the generator contaminants are allowed to get in the generator or to block the holes through which the cooling air can enter, then the brushes of the generator can be burnt out or worn out or the insulation or the soldering may become dissolved and the generator may then cease to function.

Donald S. Anderson, the patentee of the patent in suit completed, in 1930-1932, two courses in motor mechanics and electricity and then from 1932 to 1933 worked in a Ford dealership in Calgary called Macklin Motors. He moved to Vancouver in 1933 and in 1936 became a journeyman mechanic. From 1939 to 1941 he worked in Vancouver in his own garage and service station. During the

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last war he left the service station and worked as a welder at Burrard Shipyards in Vancouver, B.C. From 1943 to 1945 he was an airman in the R.C.A.F. In 1945 he worked for Carmichael Motors in Vancouver for a year as shop foreman where his work then was in the service shop as a mechanic. In 1947 he again opened his own business in Vancouver which he called Anderson Motors Limited and which he operated until 1952. He was then a lessee of the Texaco Oil Company and on the rear of the property he had his own property on which he had a garage. From 1952 to 1954 he sought to promote his progen unit (the generator shield). From 1954 to 1957 he was employed by the Bowell McLean Motor Car Company in Vancouver. From 1957 to 1959 he had his own business again, selling, however, used cars. He then left for Honolulu where from 1957 to 1965 he was still in the automobile business. In 1965 he returned to Vancouver where he continued to work in the automobile business until January 1967 when he became the manager of a furniture business.

Anderson stated that in the fall of 1953 Ford changed the location of the generator on its 8-cylinder models from on top of the motor to the bottom thereof. Anderson's experience was that, prior to 1953, when the generator was mounted on top of the motor, oil fumes from the oil filler cap (which accumulated in the crank case) located at the rear end of the generator (and this applied particularly when the motor was idling) would be drawn in the rear openings of the generator and would contaminate the brushes and the commutator. Sometimes, according to this witness, the openings on the generator closest to the side of the filler cap would actually have more than an oil film on it and it could almost be scraped off with a knife. It would not be sufficient to block the apertures in the casing, but it would be sufficient to fill up between the brush holder and the brush and cause the brush to stick in the generator and prevent it from functioning. In the case of worn out motors, the problem of the fumes entering the generator became, according to Anderson, real serious. Several remedies were tried to correct the situation such as placing masking tape over the openings closest to the filler pipe or discarding the filler cap and installing a flexible tube in the filler cap which extended rearward and downward and which would take the fumes out and away from the generator. When the generator on the 8-cylinder Ford models was moved down from the top of the motor (where the generator on the 6-cylinder model had always been) a further problem (according to Anderson) developed when the oil in the rocker arm which works the valves would leak and drip directly down on the generator. Located down close to the road, the generator was also subject to water entering it through splashing.

Although, as already mentioned, Rodak, a Ford employee and witness, stated that the field wire was the main source of the problem, Anderson's experience was that very seldom did the field wire give any trouble and that he was always finding the commutator and the brushes fouled up or the generator overheated.

In cross-examination, Anderson admitted that his pro-gen unit did not prevent oil fumes going into the generator but restricted them and that, although some fumes go in, it is not near as much a problem as without his shield. He added that he had never realized the salt problem was as great as it was until he made the trip to Toronto for the present trial. He agreed that the oil dripping into the generator from the valves in the engine was about as isolated a cause of generator failure as he said the field terminal would cause trouble through contamination.

Charles George Ashdown, a warrant officer with the Royal Electrical and Mechanical Engineers, Ottawa, was heard on behalf of the plaintiffs. He is technical assistant to a staff officer who covers problems of maintenance and supply of spare parts due to maintenance problems. This witness has had considerable experience with the problem of contaminants in generators for a great number of years on military as well as on commercial vehicles.

Ashdown stated that during the time he was a craftsman and later when he was in charge of a repair shop, he saw generators when mounted on top of the engine become contaminated around the opening with a sort of black dust which he said was an outside sign. The commutators would become discoloured, would eventually cease to conduct and an amalgam of dust and oil would have to be cleaned off. Depending on the type of use the vehicle and the generator was put to, where it was driven, Ashdown saw generators become inoperative after as little as one hundred miles, some after two or three months and others after several thousands of miles.

This witness became aware of this problem when he started to work on a great number of generators in 1944 adding that the problem continued up until the time he ceased to run a repair section which was around 1956 or 1957. Brushes would stick mostly up in the brush holder and generators failed and burnt out due, apparently, to the ventilating holes being partially blocked by contaminants.

The witness stated that as on the Canadian military pattern vehicles made by General Motors, the ventilating holes were in the end plate or the brush plate and not in the casing, the trucks were fitted with filters. The filter, however, had problems too, some operators discarded them because the generator would overheat and over a period of time the filter would become clogged and if it was not serviced or replaced, the generator would not get the proper supply of air.

He had less trouble with generators on passenger cars than on trucks but stated that he definitely had enough difficulty with the generators of automobiles to say that this was a major problem in the period. Ashdown experienced problems with generators from November 1944 to the year 1956 in varying degrees on Ford vehicles in Great Britain, India, Malaya, Northwest Europe and, finally, in Canada. He agreed that it was a greater problem in the tropical areas because of the higher ambient temperatures.

John Charles Hastings, of Toronto, a mechanical engineer, and defendant's expert witness, stated that he has always been aware and that it is fundamental knowledge that contaminants in the cooling air can cause damage to or impair the operation of an electric generator or motor. That water with salt or water alone to a lesser degree if it enters the generator casing, can corrode the generator parts and is extremely injurious to the varnishes used on the electrical wire rings of the generator and to the faces of the commutator and brushes. He added that oil and fumes, if present in the cooling air, can act as a solvent for certain types of insulation and can also enhance the collection of certain types of dirt and thus reduce the efficiency of the electrical unit.

He pointed out that design requirements dictate that the generator be as small as possible and it follows that the smaller the generator, the more the heat builds up because these generators are permitted to operate at as high a temperature as possible in getting the maximum output for their size. This requires larger circulation of cooling air and increases the chance for contamination.

He was of the view, however, that although these facts have been well known for years, generator failure in automobiles due to the presence of contaminants in the cooling air was not a significant factor prior to about 1959 when in the 1958 Mercury and Monarch the generator was mounted low on the engine block and splash was entering the generator air inlet slots to a greater degree and when in the 1960 Falcon, the generator was located on the right side of the engine block at the front about 14 inches below and slightly behind the oil filler. During the filling of the engine, oil sometimes would drip onto the generator and in some cases oil fumes emitted from the breather vent would follow a path towards the rear of the generator and would be sucked into the generator casing. The low mounting of the generator in these vehicles also increased the possibility of water being splashed directly into the slots.

In cross-examination, Hastings asked whether he was aware that trouble with generators due to contaminants was a problem for many years prior to 1959, answered (at p. 41 of the transcript) that it had happened from time to time, adding that "It has not been a serious problem but it has happened".

He admitted that filters had been used to solve the problem and that in the case of Cadillacs the generator was even enclosed entirely in a casing and a flexible or blast tube was used as a separate source of cool air. He agreed that there is a tendency for hot fumes from the crank case to come out of the breather and form part of the ambient air, particularly if an engine is worn out, but added however that such a situation would not exist while in motion. He also admitted that there is always a tendency for leakage to develop with an overhead valve engine and that this

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area of potential leakage bore a relationship to the position of the generator in some models where the generator was mounted below and alongside the block and the area below the area of attachment of the cover to the head proper.

Hastings was then re-examined by counsel for the defendant and to the following questions, at pp. 84, 85 and 86, gave the following answers:

RE-EXAMINATION BY MR. GREEN:

Q. I have some questions in reply, my lord. Now, Mr. Hastings, you will recall you told my learned friend this morning that generator failure due to contaminants of one sort or another in the cooling air had occurred for many years. Do you recall that portion of your evidence?

A. Yes.

Q. Mr. Hastings, will you tell the court when and for how long prior to the introduction of the Ford shield, Exhibit 2, such failure was a general problem in the automotive field.

A. Well, it wasn't a general problem for any significant time prior to that, as I pointed out.

. . .

A. Yes, sir. Based on my experience you can't say that there was a specific time when a situation became a problem, and that prior to that time there was no problem. As has been stated before, there have been periodic failures of generators and indeed virtually every other component of a motor car since the device was first designed.

However, as I have pointed out in paragraph 15 of my affidavit, I think there have been a series of events since the second World War which have gradually worked together and pyramided and it was somewhere around the late '50s that this began to manifest itself as a significant problem.

From the whole of the evidence, it appears that although the question of contaminants entering the generator was not a great problem, it was a problem which existed long before 1959 when the defendant, through Hastings, submitted it became one. As a matter of fact, paragraph 6 of the Agreement on Facts clearly establishes that prior to the progen unit which came into existence sometime between 1951 and 1952, the contamination of generators by water, dirt and oil was known and it was felt desirable to prevent these contaminants from entering it. Paragraph 6 of the Agreement on Facts reads as follows:

6. As of the date of invention and for several years prior thereto it was common general knowledge in the art to which this patent is directed that water, dirt and oil were injurious to the proper operation of a generator and that it was, therefore desirable to prevent the ingress of water, dirt and oil into a generator housing.

The evidence of Ashdown during the period 1944 to around 1956 or 1957 who encountered problems with Ford generators in many countries including Canada and the problems with contaminants in generators encountered by Anderson in British Columbia sufficiently establish not only that there existed long before the year 1959 a problem or problems due to the entry of contaminants in Ford generators, but also that prior to the patentee's device, a number of attempts were made to correct the situation. Masking tape was in some cases placed over the holes close to the oil breather, which one witness said was like "slitting one's throat to stop a nose bleed" and which was unsatisfactory because although it prevented the entry of fumes, it did not allow sufficient air to cool the generator. Filters were also used. They, however, were not entirely satisfactory either as they would get clogged and in many cases the operators of the vehicles would remove them; at one time, a hose from the oil filter cap was used and in the case of Cadillacs, a hose from the rear vent was used; Schneider's solution (an American patent produced (Ex. 7) as part of the prior art on which the defendant relies to establish lack of inventive ingenuity) was to put holes in the end plate and the size of these holes was changed from time to time.

It was sometime in the spring of 1951 when Anderson, the patentee in suit, was operating a filling station (as a lessee of Texaco Oil Company) and a garage in Vancouver, B.C., that an unidentified customer (whom the patentee saw twice and has not seen since) came to his shop with a defective generator and asked him to check it for him. Anderson states that there was masking tape covering two of the openings of the generator on the side closest to the filter cap. The generator had overheated and burnt out. He installed a new armature and brushes and then charged the battery and repaired it. Anderson states that this customer was very perturbed about his generator and told him that he had had this same generator repaired three months prior thereto and had been having periodic trouble with it. He then asked him whether he would not try to do something to stop it. Anderson then took a piece of stove-pipe he had in the garage, wrapped it around the generator, wired the back end, cut out a portion for the terminals and used a tool to flare out the front portion which overlapped

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so that it would cover the openings without, however, restricting the entry of air. This was a very makeshift installation.

Anderson then states that he charged this customer for the generator repair (between $18 and $20) but did not charge him for the stove pipe. He then added that he asked him "if it did improve anything to let him know".

Anderson had been examined on discovery in October, 1963, and in cross-examination he was asked by counsel for defendant why he had not told him then that he had asked the customer to let him know if it did him any good and he answered, at p. 227 of the transcript as follows:

> Q. You didn't tell me about this when we talked about this matter in Vancouver three years ago?
>
> . . .
>
> A. I didn't apparently, no.

He was then referred to his examination in 1963, question 128, p. 18, where he gave the following answer:

> A. When he came in to pick up his car I billed him for the generator repairs and told him I wasn't charging him for this apparatus I put on there but I hoped it would help him. That was the last I saw of him for almost a year and one day this car drove in the service station and the owner requested that I go out and service the car. I gave him gasoline and I looked under his hood to check the oil and I saw this piece of stovepipe that I had put on there. And that, then I recognized that it had been the one, the customer that had been in before.

Asked again by counsel for the defendant why he did not state in 1963 that he had told the customer if it worked to come back and tell him about it, he stated that although he knew in 1963 that he had told the customer to come back, he had not mentioned it because he only realized today that counsel for the defendant felt it was important adding also (at p. 231 of the transcript):

> A. Probably, other than the fact I was just as nervous at that time as I am now.

Anderson explained that this customer was not a regular customer and he did not ask his name nor write down his licence number. Nor did he caution him to keep the device confidential, and this appears from his answers at p. 232 of the transcript:

> Q. Did you ask him to keep this device that you fitted to his car, secret or confidential?
>
> A. No, Sir.

Q. You didn't caution him not to show it to nobody else?
A. No.
Q. You didn't ask him to bring it over to you for service in the future until you found out whether it worked or not?
A. No, at this particular time, I didn't know whether it would work or not. I placed it on there in the hope it would help him.

and at p. 236 of the transcript:

Q. In any event you put it on for the purpose of helping this problem of contaminated air entering the generator apertures?
A. I put it on there hoping it would help the situation.
Q. And for that reason only. And as it turned out it did do the job?
A. Yes, Sir.
Q. But you didn't find this out until a year later?
A. That is correct.

This same customer returned to Anderson's garage in the spring of 1952 when one of the attendants told Anderson a customer wanted him and would not allow anyone else to service him. Anderson states at p. 204 of the transcript:

A. ... I went out and served him. And when I checked the oil I saw this piece of stove pipe. And he got quite a kick out of my surprise, because over the period of time I hadn't expected him back. He told me I could take anything off his car but that. He had no trouble during the time he was away.

As a matter of fact, when the customer came back, it appears from Anderson's evidence that nothing had to be done to the unit on the generator at the time as it had functioned well since the spring of the preceding year and this appears at p. 238 of the transcript:

Q. When the unit came back in 1952, when you saw it again for the second time, did the customer indicate he had to do something to it in the meantime?
A. No, it was a pretty rigid piece of metal. The stove pipe isn't flimsy. I wired it on. The generator was stationary and so was the piece of metal.

Shortly thereafter, Anderson contacted a tinsmith, Collingwood Sheet Metal, gave them the dimensions of the generator and requested a sample that could be tried out. These samples, however, were not satisfactory; they would not fit properly to the generator and stay in place and he was afraid they would come in contact with the terminals. He, however, used the aluminum model to make a design for a plastic one and then ordered plastic progens from Listo Plastic Company, in Vancouver, which he started to sell on June 22, 1952.

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He first contacted the franchised Ford dealers in the Vancouver area and made sales in every case. He then called on independent service stations and garage operators and was successful here also. He called on all the Ford dealers in southern British Columbia and in Alberta as far north as Edmonton and each one of them placed an order for "progens". He also advertised the device. He sold approximately 6,000 units from 1952 up through the year 1953 and 3,000 others were sold after that.

It was in the fall of 1952 that he received from the defendant corporation a letter signed by a Mr. C. M. Lossing stating that Ford's Parts and Accessories Division in Windsor, Ontario, were interested in handling Anderson's progen product in their line and asking him to submit a quotation on this item as soon as possible. Anderson proceeded to Windsor around November 1, 1952, where he met Lossing and discussed with him the possibility of Ford handling his progen device as a genuine Ford accessory. Before departing, he left six progen units with Lossing and Anderson says it was agreed that the latter would get in touch with him later. Lossing had given him the name of a Ford employee in the River Rouge plant at Detroit where he proceeded and where he was given a conducted tour through the Ford operations. He then obtained information as to who he should see in order to try to sell his device to the Ford Motor Company in the United States. He saw three individuals at Ford at the Detroit plant and left three progen units with each of them.

He however did not devote all of his time to the selling of progens in subsequent years, because money was a problem in promoting the item and also because he became involved in a combines case which took up most of his time. The promotion of his device was further affected by the fact that he had been using the Ford letter as a selling argument suggesting that it would soon be a Ford accessory when one day in the Engine Motor Parts Department, in Vancouver, when discussing the sale of some progens with the parts manager, a Ford representative by the name of Les Woodbridge came in and gave instructions to take his progen units off the shelf and not display them as they were not genuine Ford accessories.

It is against the above background that counsel for the defendant maintains that Anderson has placed the invention in public use more than two years prior to the date of his application for a patent in Canada, (i.e. April 23, 1954) contrary to section 28(1)(*c*) of the *Patent Act* which provides that:

> 28. (1) Subject to the subsequent provisions of this section, any inventor or legal representative of an inventor of an invention that was
>
> . . .
>
> (*c*) not in public use or on sale in Canada for more than two years prior to his application in Canada
>
> may, on presentation to the Commissioner of a petition setting forth the facts (in this Act termed the filing of the application) and on compliance with all other requirements of this Act, obtain a patent granting to him an exclusive property in such invention.

An inventor may, therefore, get a patent providing he applies for it within two years of the time in which he first puts his invention in public use or on sale in Canada. Were it not for the above section, an inventor could market an invention for any number of years and apply for a patent only when someone else decided to duplicate his invention. He would then, instead of obtaining a 17-year monopoly, obtain one covering a longer period of time. It is, therefore, in the public interest that an inventor apply within two years of the first public use or the placing on sale of his invention or forfeit his right to obtain a patent.

Counsel for the defendant urges that more than two years before the date of application for the patent, the conduct of Anderson by supplying the unidentified customer with a makeshift shield for his generator, without cautioning him to keep the matter confidential and secret, did something which amounted to public use of his invention in Canada and that such public use was beyond the two year period provided in section 28(1)(*c*) of the *Patent Act*.

The difficulty here is that the Act does not define public use and recourse, therefore, must be had to the decided cases as to its meaning.

In *Conway v. The Ottawa Electric Railway Company*[1] this Court (Burbidge J.) held that:

> The use of an invention by the inventor or by other persons under his direction, by way of experiment, and in order to bring the invention to perfection is not such a public use as, under the statute, defeats his right to a patent. But such use of the invention must be experimental, and what is done in that way must be reasonable and necessary, and done

[1] 8 Ex. C.R. 432.

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in good faith for the purpose of perfecting the device or testing the merits of the invention; otherwise, the use in public of the device or invention for a time longer than the statute prescribes will be a dedication of it to the public; and when that happens, the inventor cannot recall the gift.

In *Boyce v. Morris Motors Ltd.*[1] Astbury J. stated:

> It is a question of fact in each case whether a prior use alleged has been proved to have been complete. An incomplete experimental use which led only to partial success, even in the subsequent patentee's field would not amount to a disclosure of the subsequent perfected invention.

In *Westley v. Tolley, Sons and Bostock and the same v. W. H. Richards & Co.*[2] Charles J. had this to say on the question of experimental use:

> ...it is perfectly true supposing the Defendants had applied for a patent for this invention, which they undoubtedly use in their factory, they might have been met by one of you saying, "You cannot apply for a patent, you have given this thing"—I will not use the word dedicated —"but you have given this thing to the public years and years ago, and anybody who went into your factory at Darlaston might, if he had taken the trouble to look about him, have seen that this thing was being used". It may be that that would be an answer, and that the Crown would say: "Very well, you shall not have a patent at all because there has been a public use of this invention already". Equally is it true that the Defendants might answer, "True it is we have been using it, but we have only been using it to try whether it is a good thing or not", and if that were the opinion of the authorities, then the Defendants would get their patent, even although they had used it in their own factory.

Fletcher Moulton on Patents at p. 68 suggests as good law:

> ...that a prior user in order to defeat a patent must have been a user as a manufacturer and not a mere fortuitous user of the subsequent invention in which the person using it gained no knowledge of the advantages of the invention and which would not have led to its further use.

In *In re Stahlwerk Becker Aktiengesellschaft*[3] the House of Lords, through Lord Finlay L.C., at p. 19 dealt with the matter of prior user as follows:

> ...The law as to prior user seems to be this, that, if the article has been manufactured and sold, that gives the means of knowledge to the purchaser, and that that is enough to establish prior user.

And lower down on the same page he added:

> When an article is manufactured and sold, and from an inspection of it it is possible for the vendee to ascertain its component elements, or the main principles of its construction, then, in my opinion, there has been publication by prior user.

[1] (1927) 44 R.P.C. 105 at 135. [2] (1894) 11 R.P.C. 602 at 607.
[3] (1919) 36 R.P.C. 13.

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The principle applied as to what is public use by the inventor such as here, as distinct from use by another inventor or person, was clearly enunciated by Pollock B. in *Croysdale v. Fisher*[1] as follows:

...When it is said that a process has been disclosed or an invention has been disclosed by means of user, it is not necessary that such user should be a user by the public proper, provided only there is a user in public, that is to say, in such a way as contra-distinguished from a mere experimental user with a view of patenting a thing which may or may not be existing.

In *Elias v. Grovesend Tinplate Co.*[2] the Master of the Rolls elaborated on the principle of experimental use as follows:

...that so long as you are experimenting upon the thing in the hands of people who ought not to disclose it—you must have people to assist you, and you cannot do everything yourself in your own private room —but so long as you are only doing it with people who are to assist you, and who ought not to tell, that is experimenting, and it is no publication; it does not make it public property. But if you go on with all that you have been in doubt about, to erect or make your patent—if it is a machine, to make your machine—if all that is over, and you put it up in a public workshop or in a place where other people would come who are not bound by any rule of secrecy or faith—who are not bound to keep the secret—if you put it up in a place which they are to frequent and where they can see it, you have published it, and if you have published it, it becomes public property—it becomes the property of all the world immediately. If you put it up in a public workshop—not to go on experimenting about it in the sense in which I have said, to see whether your machine is complete or not—but to use it as the completed thing, as here, (for that is the way in which it was put up) in his factory as part of his plant, and in respect of the user of which it is obvious, if it turned out a failure, he would have to pay for the plates—then it is commercial user as well. If that is done it is no longer experimental; it is a publication.

I would indeed think that a common sense view should be taken in dealing with the means taken by an inventor to complete and perfect his invention and thereby ensure that a half baked device is not patented and providing he is experimenting, the means employed should not be too important.

Indeed, the small man, in my view, is entitled to an invention as well as the large corporation and whether he is or not a dedicated or professional inventor, he should still be entitled to what he invents. He will not have all the advantages of a laboratory or a testing ground and the assistance of a large staff but that should not place him in a position different from those who have such advantages

[1] (1884) 1 R.P.C. 17 at 21.

[2] (1890) 7 R.P.C. 455 at 466.

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and he should be able to use whatever means of testing are available to him even if such means are, as here, a customer and his automobile, providing always, however, that what he is doing is experimenting.

Reverting, however, to the facts disclosed in the present case, it is most difficult, under the circumstances involved here, to find that the patentee was merely experimenting when he placed his stove-pipe shield on the customer's generator even if it was a makeshift contraption and, in any event, it is not possible to hold that such was the case after this customer's return in the beginning of April 1952 (which was still, even then, more than two years prior to his application for the patent in suit) when he was so happy with the stove-pipe shield he had been using for a year that he told Anderson he could take anything else off but that he should leave the shield on and which, of course, he did.

Experimentation here is further denied by the placing of the shield on this unknown man's generator without any restriction on his use of it or without any injunction for secrecy and in the absence of the customer, whom Anderson could not identify and who, therefore, could not be questioned as to how many people saw the invention, and also because of the public manner in which the device was used, I am irresistably led to the inference that it is most likely that other people saw it or heard of it. Quite apart, however, from the number of people that may have seen the patentee's device, the authorities clearly establish that it is sufficient that one person alone sees the invention (cf. *Carpenter v. Smith*[1]) to make it known in a public manner, which is the test (and not use by the public) if, on the other hand, the plaintiff was not able to establish that what he was doing was experimenting.

It was again held that one use alone is sufficient to establish public use in *Taylor's Patent* case[2] which dealt with a grate in a fireplace, although there was no sale and only one prior use and it was in a private house. In this connection Romer J. expressed himself as follows:

> There is one point which, in my opinion, is fatal to this patent, and certainly the Specification as at present drawn, and that is this—the very thing that the Patentee claimed as his invention was in use in Mr. Bowes'

[1] (1841) 1 Web. Pat. Cas. 530 at 535.
[2] (1896) 13 R.P.C. 482 at 487.

hall for several months prior to the date of the Respondent's patent... This grate in the hall, which, as I have said, is, for all practical purposes, the Patentee's, was originally put up and used only by way of experiment, and used by way of experiment up to November 1893. After that time the necessity of keeping it in any way secret and only using it experimentally ceased so far as Mr. Bowes was concerned, but for several months, from November 1893 down to the 2nd of April 1894, the date of the Respondent's patent, this grate of Mr Bowes was publicly used—used in his house, openly, seen by a hundred visitors at least, explained to them, and in no way kept secret....It was an open user, and for the purposes which I am now considering a public user.

In *Stahlwerk Becker Aktiengesellschaft*[1] the House of Lords decided that if an invention were available to even one member of the public, that was sufficient. Indeed, Lord Finlay stated at p. 19:

> I think it would be very dangerous to introduce the doctrine which your Lordships are now invited to introduce, either that it must be actually shown that the knowledge had been acquired by some individual, or that there is a high probability that it had in fact been acquired. The law as to prior user seems to be this, that, if the article has been manufactured and sold, that gives the means of knowledge to the purchaser, and that that is enough to establish prior user.

And lower down he added:

> When an article is manufactured and sold, and from an inspection of it it is possible for the vendee to ascertain its component elements, or the main principles of its construction, then, in my opinion, there has been publication by prior user.

In the present case, as soon as the unidentified customer drove out without any injunction or restriction placed upon him, it then became available to anyone who wanted to lift up the hood and look at it.

In *Birtwhistle v. Sumner Engineering Co. Ld.*[2] one unit only of a timing device for bookmakers was not even sold but merely carried around by a bookmaker when he went on his rounds for the purpose of trying it out and yet this was held to be prior public use.

As a public use has been established here, it was, I believe, incumbent upon the plaintiffs to bring themselves within the exception and establish that such use was experimental only and nothing else. Anyone who claims he is exempted from the provisions of the statute by reason of experiment must, I should think, establish clearly that it is an experiment. The plaintiffs have not, in my view, succeeded in establishing an experimental use here.

[1] (1919) 36 R.P.C. 13. [2] (1929) 46 R.P.C. 59 at 71.

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The fact that Anderson said to the unknown customer, "I hope this will help you" is, in my view, a long way from establishing that the placing of the makeshift device on his automobile was experimental. It merely establishes that there was some doubt in his mind as to whether the device would be successful or not and nothing else. There is also no question that it was placed there for the purpose of solving the problem the man had had with his generator and it did, in fact, exactly that. I should also add that had Anderson really been an experimenter, he would have tried it on other cars, yet he did not do it, nor did he, according to the evidence, at any time think of doing it.

Furthermore, the evidence of Anderson on this matter is not too satisfactory in that on discovery in October 1963, he merely stated that he had told the customer "I hope this will help you" and it was only at the trial that he stated he had said to the customer ". . . if it did any good, I told him to come back and see me". This is not, in my view, sufficiently cogent and convincing evidence on which to establish an experimental use.

How indeed can it be held that this was experimental when Anderson failed to take even the most elementary precautions to guarantee or ensure the placing of the device on the customer's car as experimental.

In any event, whatever was in Anderson's mind, if this was experimental, it was not experimental in the mind of the unidentified customer as he was under no restriction or injunction to secrecy when he first came to the patentee in 1951, nor was he under any such restriction when he came back and left at the end of March or beginning of April 1952, which was still more than two years prior to Anderson's application for his patent which was filed on April 23, 1954.

It therefore follows that even if it could be said that whatever took place in 1951 prior to the customer's return in the spring of 1952 was experimental, it definitely ceased to be experimental when he came back and said "I used it for a year and it worked fine". At that time there was no further experiment involved.

The patentee did go through the process of first causing aluminum units to be made which were not satisfactory. They were unsatisfactory, however, not because Anderson had not perfected his device at this stage, and was experimenting, but merely because there was some difficulty in that they did not fit the generator properly and stay in place and he was also afraid that they would come into contact with the terminals. He had no such trouble with the stove-pipe contrivance which was also made out of metal and which remained as a permanent fixture and a satisfactory solution to the customer's generator problem.

Under the above circumstances, it is not possible to hold that the use here was experimental and it therefore follows that the device described and claimed in the patent in suit was in public use in Canada for more than two years prior to the application in Canada for the said letters patent.

I now come to the second attack made on the patent in suit in that it lacks the attribute of inventive ingenuity necessary to make it a patentable device. The evidence has shown, as already mentioned, that although there was not too serious a problem and that the long felt want for a solution was not overwhelming, (the Ford Company could have, in 1952, used the Anderson device without infringement as it was not patented at the time, yet it did not) the problem with Ford generators was still sufficiently important to the defendant company to cause it to have a look at Anderson's device as early as 1952, to use such devices on some of their vehicles prior to 1963 and to eventually apply their infringing shield devices on all of their cars from the year 1963. I also believe that it can be said that Anderson's device was one that was simple, low cost and relatively maintenance free.

The only matter remaining is whether Anderson's invention required inventive ingenuity or was merely the result of workshop improvement. Under section 48 of the *Patent Act* the onus was on the defendant to establish that there had not been an inventive concept. In order to determine this matter, it is necessary for the Court to place itself in the context in which the competent workman started to address himself to the problem around the year 1951. This problem at the time was a rather simple one in that the generator had holes around the top or the end through which air should penetrate in order to cool the armature and the brushes but through which also, in some cases, oil leakage, oil fumes and particles of dirt could either block these apertures or penetrate into the generator and the solution, in my view, was obvious and consisted in merely applying an attachment to that part of the generator over the holes to cover them and shield them from the direct entry of oil from above and of splash from beneath or particles of dirt or fumes from the ambient air without, at the same time, blocking them off and preventing the ingress of air into the holes. It was then also, in my view, a simple matter to place a band around this generator and flare it out outwardly and rearwardly over the ventilating holes.

That such was the obvious manner to deal with the problem and that it could be simply executed, appears from the evidence which discloses that the solution to the problem followed very quickly as soon as either Anderson or Rodak directed their efforts to it. It indeed required, in my opinion, nothing more than the application of workshop skill.

Reverting to the evidence herein, it appears from Anderson's testimony that all he did to solve the unidentified customer's generator problem was to go into his shed, pick up a piece of old stove-pipe, mold it to go around the generator and then flare out the rearward portion thereof in order to ensure that the holes would be protected or shielded from direct splashes or that oil could not directly fall in, or that oil fumes and particles in the ambient air would be restricted somewhat in being drawn in by the impeller into the air cooling stream of the generator.

The patentee's shield turned out eventually to have a number of other minor advantages to which, however, I am convinced neither Anderson nor for that matter, even Rodak, gave any thought at the time of their respective inventions, such as the aerodynamic effect of the flared portion (which, however, applied only when the automobile was in movement) which provided a number of sharp turns for the air entering the generator slots thus making it more difficult for particles of dirt to enter the ventilating holes by creating what one of the witnesses called a labyrinthine path and a sharp radial turn (with the protector, indeed, the air has to make one turn to go downwards, another turn to go underneath the lip and, finally, another turn to go into the holes) and finally by causing the flaring of dirt particles away from the air intake portion in the rear of the generator thus preventing some of the particles of dirt or contaminants from entering the generator casing by centrifugal gravity (although if the vehicle is in movement there will still be a separation of dust particles from the air intake due to the specific gravity of the particles and the velocity component even without the flaring out feature) and, finally, by creating a somewhat depressed area in the air intake portion in the rear of the generator thus facilitating the passage of air from front to back in the case where the impeller would not function and thereby ensuring proper cooling of the generator armature and parts even in the event of a breakdown of the impeller.

I should add that whether the inventor realized that he was getting these advantages or not by making his device as he did, he would still be entitled to the benefit of such advantages if his invention, as defined in his claim or claims, encompasses such advantages. However, when considering the question of obviousness or inventiveness or inventive ingenuity such unsuspected and unimportant advantages are not too helpful in determining whether a device has the inventiveness required to establish a valid patent.

Quite apart, however, from the prior art submitted by the defendant and merely looking at the problem to be solved, how it could be solved and how the patentee solved it, it appears to me evident that the solution of an outwardly flared band attached to the generator would have been obvious.

Should I, however, go to the prior art, i.e., the Schneider and the German patent, both of which were public knowledge long before the date of invention and with which the skilled workman in the art at the date of invention in the present case is held to have knowledge of, the obviousness of the invention in suit here becomes still clearer, even if one should consider the unexpected aerodynamic properties or advantages which flow from the flared out rearward position of the Anderson shield. Indeed, the Schneider patent (Exhibit 7) deals with a cooling system for dynamo-electric machines with aerodynamic properties which, in my view, solve the problem in a very similar manner to the patentee's device. At page 3, column 1, line 37 *et seq.* of the Schneider patent it is stated that:

> ...The rapid change in direction of the air currents will serve to separate the dust particles from the air, due to the specific gravity of the particles and velocity component.

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The drawings of the Schneider patent indicate how the air travels across the top of the unit and then turns 180 degrees from the rear and, of course, this is very similar to the labyrinthine path mentioned by Robinson, the plaintiffs' expert witness, when dealing with the aerodynamic effects of the Anderson unit.

At page 2, column 2, line 40 *et seq.* of the Schneider patent, this sharp turn of the direction of the air is dealt with as follows:

> ...due to the greater specific gravity and component of inertia of dust or other foreign matter, the same can not follow the sharp turn taken by the air currents, the air entering the generator housing being free from dust or foreign matter without the use of filtering or cleaning devices such as wire screens of knitted fabric for retaining dust particles which interfere with proper circulation of air and obstruct its ingress into the generator housing, a factor which decreases efficiency and increases manufacturing cost.

The only thing not shown by Schneider is the outwardly flared portion which with the progen unit gives to the air an outward radial velocity component. From the evidence of Hastings (at p. 56 of the transcript) this flared portion, however, would not seem to be of considerable use in that as put by the witness and as already pointed out above:

> ...When you have a significant velocity of air, the tendency for foreign particles and dirt and so on to enter these holes even without the shield is at a minimum.

It appears also that the radius on the progen unit is slightly less than on the Schneider unit. The sharper radius at the end of the flange of the progen unit resulting in a sharper turn of the air at this corner making it more difficult for particles of dirt to enter the apertures of the generator than in the Schneider unit, does not seem from the evidence, however, to be too significant.

The German patent (Exhibit 8) on the other hand is a cooling device for the driving motor of a propeller blower which delivers hot gases. It is a quite different application from the patentee in suit's device in that its object is to separate two regions of clean gas, one hot and one cold. It also has a separate source of cooling air, whereas the generator on which Anderson's shield applies must use the ambient contaminated air for cooling.

The phenomenon of hot gases arriving in the presence of cooler ones is a particular feature of the German patent. It is, therefore, concerned with low velocity gases in which inertia effects are negligible and here also the outwardly flared flange is neither necessary nor disclosed. The German patent, however, covers a motor mounted in a special casing and although it does not appear to be of great use in determining the inventiveness of the patent in suit, it would appear from an answer given by Mr. Hastings, the plaintiffs' expert, in cross-examination, that the rearward projection of the casing E would shield the rear entry holes from the entry of water and contamination.

From this I must conclude that a competent workman at the date of the invention, knowing that a rearward extension of the casing would shield the rearward holes from the entry of contaminants, with the knowledge also of the teaching of Schneider, that if one makes the air undergo a change in direction an aerodynamic principle of reduction of particles, of contaminants going into the generator will be realized, would have easily come up with a unit such as the progen unit and, therefore, I have here further reason to hold that the patentee's unit was a perfectly obvious, logical and reasonable solution to whatever problem existed at the time and, finally, that there was no invention in so doing.

I should, before parting with this case, deal with Canadian patent No. 650,112 by Joseph J. Rodak, Dearborn, Michigan, U.S.A., an employee of the American Ford Motor Company, which patent was granted to Ford Motor Company of Canada, Limited, Oakville, Ontario, the defendant herein. The shields covered by the above patent are those (Exhibits 2 and 4) which the defendant admits as infringing the Anderson patent.

It was possible for Rodak and the defendant corporation to obtain the above patent because of the rather broad manner in which the Anderson claims are framed. From a reading of them it appears that Anderson's invention purports to cover any device attached to a generator which extends rearwardly and over the rear ventilating holes to protect them without blocking them and the claims are not limited to any material, nor to any specific construction.

Because of the broadness of these claims, it was possible for Rodak and the defendant corporation to obtain a patent for what must have been considered by the Patent Office to be invention over the Anderson invention, otherwise, it would not have allowed the patent.

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The differences between the Ford patent and the device covered by the Anderson patent, reside firstly, in the selection of the material which in the Ford patent is elastomer, i.e., of an elastic nature, secondly, the placing of ribs inside the shield to keep the elastic band away from the ventilating holes and, thirdly, the placing of a number of lugs on the ribs to prevent the shield from moving and keep it in place.

The priority date for the Rodak patent is December 26, 1958, and it was, therefore, applied for subsequent to the Anderson patent which was issued March 26, 1957. Rodak was heard as a witness and stated that he was not familiar with the Anderson patent when he applied for a patent for his shield and that he had not even heard of it until the eve of the present trial in Toronto. He agreed that it was possible, however, that the American or Canadian Ford employees who deal with patents could have heard of it.

From what either Rodak or the Ford Motor Company did in obtaining its patent, from what was said in this patent, from what Rodak stated in evidence relating to what he considered was inventive and finally from the fact that they used the subject matter of the Anderson patent, counsel for the plaintiffs submitted that one should conclude that the Anderson patent was inventive. He urged that one may look to the conduct of the defendant with a view to determining whether it treated the subject matter of the Anderson invention as inventive and as an admission against interest.

In the Rodak patent reference is made in the first paragraph to the invention as follows:

> This invention relates to a dynamo-electric machine and more particularly to a protective cover for such a machine which has a portion thereof fitting in spaced relationship over slots provided for the passage of cooling and ventilating air.

The above, of course, is equally applicable to the Anderson unit (Exhibit 5).

The patent then continues and describes the application of its device and the problems that it solves without, however, any acknowledgement whatsoever of the Anderson shield and one reading the Rodak patent would believe that the protector or shield was here discovered for the first time.

The patent also describes that the shield protects without impeding the air and this is what Mr. Rodak stated he considered as significant in the invention adding in his testimony that the shield also deflects the air. What the plaintiffs are saying here is that as the defendant corporation took Anderson's invention and its advantages, it cannot in this case now be heard to say that it is not inventive and that this is cogent evidence that what they did is evidence of invention.

Now, whether the Ford patent covers the Anderson invention or not is a matter that does not require a solution here. It appears, however, that the Anderson patent is broad enough to read on the Ford construction and, of course, that is why the defendant admitted that its shield infringed the Anderson patent. It may well be that the Rodak patent is an improvement on the Anderson patent and he could well be entitled to a patent for an improvement under section 34 of the *Patent Act* although it would take some considerable effort for me to arrive at such a conclusion in view of the conclusion I have arrived at, that the device covered by the Anderson patent is not inventive. I would, indeed, think that there would be more reason to find inventiveness in the Anderson patent than in the Rodak one.

It, however, appears to me that whatever Rodak, or the Ford Corporation, thought of its device or of the inventiveness or inventive ingenuity involved can have no bearing on the present decision as to whether on the facts, evidence and prior art produced in this case, the Anderson device has the attribute of inventiveness necessary to make it a valid patent. Having determined that it has not, no admissions made by either party can, in my view, inject a patent with such an attribute if it does not have it.

As I have reached the conclusion that the patent in suit was placed in public use in Canada more than two years prior to the patentee's application in Canada contrary to section 28(1)(*c*) of the Act and that it also lacks the attribute of inventiveness necessary to make it a valid patent, the action fails.

There will, therefore, be judgment for the defendant with costs.

Winnipeg 1967 Mar. 30 — Ottawa Apr. 20

BETWEEN:

ADMIRAL INVESTMENTS LIMITED ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Company incorporated to invest—Purchase and sale of second mortgages—Subsequent purchase and sale of corporate shares —Whether trading transactions.

Appellant was incorporated in Manitoba in 1954 as an investment company, all of its share capital being held beneficially by Mrs. M whose husband guided the company's affairs. During the years 1955 to 1964 appellant purchased and sold second mortgages and agreements for sale of land and reported the income therefrom. In 1958 it also made a profit on the sale of land which it reported as income. In 1954 it purchased corporate securities and sold all but a few in 1956 and 1958 No further purchases of securities were made until 1961 and 1962 In 1956 appellant reported dividend income of $1,600 but had little dividend income subsequently until 1962. In 1963 appellant made $700 on the sale of shares purchased in 1956 and reported this sum as income In 1964 it suffered a loss of $13,304 on the sale of securities. The Minister refused to include the profit made in 1963 and disallowed the loss incurred in 1964 in computing appellant's taxable income for those years.

Held, appellant's appeal must be allowed. Its dealings in securities were part of its business. The testimony of Mrs. M's husband that his intentions (which must be attributed to appellant), *viz* to buy and sell securities in order to make a gain from an increase in their market price, was confirmed by appellant's course of conduct. Further, appellant's acts, though they were not those of a trader in securities, as e.g. an underwriter with a seat on the stock exchange, were the ordinary acts of a person who deals in shares. *I.R.C. v. Livingston*, 11 T.C. 538 referred to.

APPEAL from Tax Appeal Board.

Alan Sweatman, Q.C. and *T. G. Mathers* for appellant.

Bruce Verchere for respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1] dated July 25, 1966, whereby appeals by the taxpayer against its assessments to income tax for its taxation years ending September 30, 1961 to 1964 inclusive were dismissed.

At the outset of the trial counsel for the appellant announced that the appeal with respect to the appellant's

[1] (1966) 41 Tax A.B.C. 409

1961 and 1962 taxation years was abandoned. In those taxation years the appellant had claimed as deductions from its income the amounts of $8,159.57 and $16,365 respectively, being losses sustained by it on the sales of Dominion of Canada Bonds in the years in question and which deductions were disallowed by the Minister.

Accordingly, only the assessments to income tax for the appellant's 1963 and 1964 taxation years remain in issue.

In the taxation year 1963 the appellant included in its income a profit of $700.22 realized upon the sale of 100 shares of Dallas Transit Limited which had been purchased by it in 1956.

However, in computing its income for its 1964 taxation year the appellant claimed a loss of $13,304.04 arising from the sale of securities. The foregoing loss was computed in the following manner:

	Date of Purchase	Date of Sale	Profit	Loss
100 shares—Bristol-Meyers Company	Sept. 28/61	Mar. 16/64	$ 5,181.38	
300 shares—Manufacturers & Traders Trust Co. of Buffalo	Nov. 21/61	Mar. 16/64		$ 3,102.51
208 shares—Atlas Credit Corporation	Dec. 1/61	Mar. 19/64		3,188.06
200 shares—Marrud, Inc.	Dec. 1/61	Mar. 19/64		1,783.92
300 shares—Harvest Brand, Inc.	Dec. 1/61	Mar 19/64		3,050.25
204 shares—Monroe Auto Equipment	Dec. 6/61	Mar. 19/64		3,470.19
100 shares—Inter-State Vending Co.	Dec. 8/61	Mar. 19/64		3,963.75
100 shares—American Cyrogenics Inc.	Mar. 23/62	Mar. 19/64		475.29
4% Minneapolis-St. Paul Soo Line Railway Bonds	Apr. 10/62	Mar. 19/64	426.60	
100 shares—Celanese Corp. of America	Nov. 29/63	July 21/64	2,013.29	
2,000 shares—Forty-Four Mines Ltd.	Acquisitions July 1962	Feb. 24/64		1,606.00
2,000 shares—San Antonio Gold Mines	June 13/63	Feb. 24/64		285.34
			$ 7,621 27	$20,925.31
				7,621.27
				$13,304.04

The Minister refused to include the profit of $700.22 realized by the appellant from the sale of shares in Dallas Transit Limited in computing the appellant's income for its 1963 taxation year on the ground that the appellant was not in the business of trading in securities within the meaning of the word "business" as defined in section

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139(1)(*e*) of the *Income Tax Act* and accordingly the profit so realized was not profit from a business within the meaning of sections 3 and 4 of the Act.

The Minister also disallowed the amount of $13,304.04 claimed by the appellant as a deduction from income for its 1964 taxation year on the ground that the losses incurred by it were capital losses within the meaning of section 12(1)(*b*) of the Act.

The pertinent sections of the *Income Tax Act* read as follows:

> 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all
>
> (*a*) businesses,
>
> (*b*) property, and
>
> (*c*) offices and employment.
>
> 4 Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.
>
> . . .
>
> 139. (1) In this Act,
>
> . . .
>
> (*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;
>
> . . .
>
> 12. (1) In computing income, no deduction shall be made in respect of
>
> . . .
>
> (*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,
>
> . . .

Prior to trial the Minister served notice on the appellant to admit facts as therein specified with which the appellant readily agreed subject to four minor corrections. The Statement of Facts so admitted is comprised of forty-eight paragraphs some of which are divided into sub-paragraphs. The Minister also served notice on the appellant to admit documents referred to in the Notice to Admit Facts. The appellant also agreed to this notification. The documents so admitted are the financial statements of the appellant for its 1956 to 1964 fiscal years and a schedule which accurately and completely sets forth the appellant's transactions in stocks and bonds for the period October 1, 1954 to September 30, 1965.

The relevant facts may be summarized as follows.

The appellant is a joint stock company incorporated pursuant to the laws of the Province of Manitoba by Letters Patent dated August 19, 1954 with an authorized capital stock of 900 non-cumulative redeemable preference shares of the par value of $100 each and 100 common shares without nominal or par value for the following purposes and objects:

(a) To carry on the business of an investment company and to invest in shares, stocks, bonds, debentures, mortgages, agreements for sale, and other evidences of indebtedness and obligations with or without guarantee by any person, firm, corporation or public authority;

(b) To promote, organize, manage or develop investment, enterprise or undertakings;

(c) To purchase or otherwise acquire and hold, or otherwise deal in real and personal property and rights in particular lands, buildings, business or individual concerns and undertakings, mortgages, contracts, franchises, patents, licenses, securities, book debts and any interest in real or personal property, any claims against such property or against any personal company and any privileges and choses in action of all kinds;

(d) To act as insurance brokers or agents.

In 1954 Mrs. Sidonia Maibach, the wife of Jack Maibach, purchased all of the authorized preference shares of the appellant. Three common shares, of which Mrs. Maibach was the beneficial owner, were issued to members of the legal firm of Sokolov and Wolinsky who became the directors and officers of the appellant. In addition to the $90,000 paid for the preference shares, Mrs. Maibach also advanced monies to the appellant by way of loan. In 1954 the sum loaned by Mrs. Maibach to the appellant was $6,777.75, in 1955, $5,713.82 and in each of the years 1956 to 1964, $6,669.33.

Mr. and Mrs. Maibach are citizens of the United States and divide their period of residence in each year between that country and Canada. Mrs. Maibach had inherited money from her father and because of the state of her husband's health (Mr. Maibach is afflicted with a heart ailment) they were both anxious that Mrs. Maibach's resources should be increased and made productive of income.

Mr. Maibach, therefore instructed the legal firm of Sokolov and Wolinsky to incorporate the appellant company. Mr. Hyman Sokolov of that firm, in addition to being

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the Maibachs' legal adviser, was a personal friend and proffered financial advice. At the outset the appellant was primarily interested in acquiring second mortgages and agreements for sale, either at a discount or bonus, which were either sold or held to maturity. The number of mortgages and agreements for sale acquired by the appellant is tabulated in paragraph 28 of the Notice to Admit Facts as follows:

	Number Owned	*Acquired in Year*	*Matured or Sold in Year*
1955	7	7	0
1956	13	6	0
1957	21	11	3
1958	22	4	3
1959	22	9	9
1960	21	4	5
1961	16	2	7
1962	14	4	6
1963	12	3	5
1964	11	2	3

As satisfactory mortgages were not readily available, the appellant, in October 1954, bought Government of Canada Bonds at a premium to the face value of $80,000 and bearing 3½% interest. The bonds were left at the appellant's banks as collateral security against which the appellant could borrow at favourable rates of interest to purchase mortgages as they became available. By this method there would be no idle funds at any time. The appellant followed this course until 1961. The amounts of the appellant's bank loans were as follows:

1956 — $67,500.00
1957 — $50,000 00
1958 — $58,000 00
1959 — $59,500 00
1960 — $49,000 00
1961 — $32,500.00
1962 — nil

On November 24, 1961 the appellant sold the Government of Canada bonds at a loss of $16,365.00 because of the low interest yield and an anticipated further decline in their market value.

With the release of funds consequent upon the sale of the Government bonds the appellant substantially increased its purchases of stocks in late 1961 and 1962.

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In paragraph 29 of the Notice to Admit Facts the allocation of the appellant's capital during its fiscal years 1955 to 1964 is tabulated as follows:

Year	*Mortgages Receivable*	*Cash*	*Stocks*	*Bonds*	*Total Capital*
1955	$ 29,493.07	$11,021.56	$36,240 42	$86,025 00	$162,780 05
1956	47,878.10	13,248 84	29,607 93	86,025.00	176,759 87
1957	67,844.19	11,757.97	589 28	86,025.00	166,216 44
1958	103,105.99	1,730.21	589 28	86,025 00	191,450 48
1959	113,977.19	1,625.77	589 28	86,025 00	202,217 24
1960	109,743.66	1,887.28	589 28	86,025 00	198,245 22
1961	91,161 78	1,463.88	9,096 77	86,025.00	187,747 43
1962	84,447 67	5,480.21	50,117 76	2,842 15	142,887 79
1963	66,830 79	31,746 88	50,143.48	2,842 15	151,563 30
1964	58,383.97	69,643.22	15,717.44	Nil	143,744 63

During its fiscal years 1955 to 1964 inclusive, the appellant received income from the following sources:

Year	*Mortgages:— Interest & Bonus*	*Bank Interest*	*Dividends*	*Bonds*
1955	$ 2,724 38	—	$ 127 50	$ 812 60
1956	4,355.39	—	1,600 65	4,777 40
1957	4,808.68	—	56 30	2,795 00
1958	6,109 82	—	25 82	2,795 00
1959	9,711 23	—	29 76	2,795.00
1960	10,147.42	—	29 76	2,795 00
1961	9,784.80	—	37.17	2,795 00
1962	8,180.86	—	447.09	459 45
1963	8,796.63	—	692 41	Nil
1964	7,078.41	479.64	734 80	Nil
	$71,697.62	$479 64	$3,781.26	$20,024.45

It is common ground between the parties that Jack Maibach was the guiding force in all transactions of the appellant. It was he who gave instructions for the incorporation of the appellant and it was he who decided what mortgages would be acquired by the appellant and the decisions to purchase or sell any shares and bonds by the appellant were made by him in every instance. When Mr. Maibach made the decision to acquire a mortgage or shares Sokolov and Wolinsky as solicitors for, and officers of the appellant would implement his instructions.

A schedule of the appellant's transactions in shares and bonds from October 1, 1954 to September 30, 1965 is appended to the appellant's Notice of Appeal and to the Notice to Admit Facts.

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In 1955 the appellant used funds borrowed from its bankers on the security of the Government of Canada bonds which had been purchased by it in 1954, to purchase shares in Canadian Breweries Ltd., Pantapac Oil Co., Ltd., United States Steel Corporation and Anglo Canadian Oils Ltd. at a total cost of approximately $36,000 in addition to mortgages at a total cost of approximately $29,000. Later in the same year the appellant bought shares in the Royal Bank of Canada at a cost of $16,157.50 which were sold in 1956 at a profit.

In 1958, the appellant sold all shares acquired prior thereto except 100 shares in Dallas Transit Company, Limited acquired in 1956, the profit of $700.22 from the sale of which in 1963 gives rise to the first issue in the present appeal.

In 1958 the appellant realized a profit in the purchase and sale of real estate which it included in its income.

The appellant did not have any transactions in securities in 1959 or 1960.

In 1961 the appellant purchased 100 shares in Bristol Myers Company at a cost of $8,507.49.

In 1962, as previously indicated, the appellant sold its Government of Canada bonds and purchased shares in Manufacturers & Traders Trust Co. of Buffalo, Atlas Credit Corporation, Marrud, Inc., Harvest Brand, Inc., Monroe Auto Equipment, Inter-State Vending Co., American Cyrogenics, Inc. and Forty-four Mines Ltd. at an aggregate cost of $41,020.99 as well as $5,000 principal amount, bonds in Minneapolis St. Paul Soo Line Railway bearing interest at 4% at a cost of $2,842.15.

In 1963 the appellant sold its shares in Dallas Transit Company Ltd. and in that year bought 2,000 shares in San Antonio Gold Mines Limited at a cost of $615.

In 1964 the appellant sold all the stocks and bonds in its possession (except 210 shares in American Telephone and Telegraph acquired during the year at a cost of $15,717.44) resulting in a net loss for the year of $13,304.04 computed as previously indicated above. This loss gives rise to the second issue in the present appeal.

Further, purchases of stocks were made by the appellant in 1965.

Paragraph 48 of the Notice to Admit Facts contains a recapitulation of the dividend yield per share of twenty-one companies in which the appellant owned shares in the years 1954 to 1965. A cursory examination of the information therein contained would appear to indicate an average dividend yield between $3\frac{1}{2}$ and 4 percent.

From its inception the appellant, in making its tax returns, invariably declared in its income amounts received from bond and mortgage interest, bonuses or discounts realized on the purchase of mortgages and agreements for sale, dividends, and gains or losses on the purchase and sale of shares as well as the one real estate transaction in 1958.

In previous taxation years the Minister included any profit made on the sale of securities in the appellant's income and any losses incurred by the appellant in such transactions were allowed by the Minister as deductions from income.

All of the securities purchased and sold by the appellant are listed and traded on one or more recognized stock exchanges. The appellant purchased the shares outright and never on margin, through Winnipeg investment dealers for the most part, but on occasion from a dealer in New York who was either known to or related to Mr. Maibach. Most of the shares purchased by the appellant appear to be of the "blue chip" variety in that they were dividend producing, although in some instances Mr. Maibach testified he was willing to take a "flyer" in a stock which might be termed as "speculative".

Mr. Maibach's decisions to cause the appellant to purchase the shares it did were based on tips from persons whose information he considered reliable, such as his physician, a relative who was a dentist and a customer's man for a New York brokerage firm. He further testified that his intention in having the appellant purchase shares was that it might reap an appreciation in the market price, rather than to look for a dividend return and he conceded (as subsequent events proved that he must) that in some instances his tipsters were wrong in their recommendations.

The appellant was not assessed as a "personal Corporation" as defined in section 68(1) of the *Income*

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Tax Act[1] from which it might be assumed that the appellant therefore carried on "an active financial, commercial or industrial business" within section 68(1)(*c*). However, a consideration of the facts discloses that such an assumption is not warranted. Paragraph 30 of the Notice to Admit Facts shows that in the taxation years 1963 to 1964, as well as in the years 1955 to 1964, with the exception of 1956, the appellant derived far in excess of one-quarter of its income from ownership of or trading or dealing in mortgages. It was common ground between the parties that the appellant's income from its transactions in second mortgages was income from a business and on the facts disclosed in evidence and on the basis of the authorities applicable to those facts, I have no doubt whatsoever that this is so. (See *M.N.R. v. Spencer*[2], *Scott v. M.N.R.*[3] affirmed by the Supreme Court of Canada[4] and *M.N.R. v. MacInnes*[5].)

Therefore, while conceding that the appellant was engaged in a mortgage business, the Minister does not concede that the appellant's transactions in shares constituted the business of dealing therein or adventures or concerns in the nature of trade.

On the contrary, as I understood the submissions by counsel for the Minister they were that the business of the appellant was that of dealing in mortgages, rather than

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[1] 68. (1) In this Act, a "personal corporation" means a corporation that, during the whole of the taxation year in respect of which the expression is being applied,

(*a*) was controlled, whether through holding a majority of the shares of the corporation or in any other manner whatsoever, by an individual resident in Canada, by such an individual and one or more members of his family who were resident in Canada or by any other person on his or their behalf;

(*b*) derived at least one-quarter of its income from

(i) ownership of or trading or dealing in bonds, shares, debentures, mortgages, hypothecs, bills, notes or other similar property or an interest therein,

(ii) lending money with or without securities,

(iii) rents, hire of chattels, charterparty fees or remunerations, annuities, royalties, interest or dividends, or

(iv) estates or trusts; and

(*c*) did not carry on an active financial, commercial or industrial business.

[2] [1961] C.T.C. 109.

[3] [1963] C.T.C. 176

[4] [1963] S.C.R. 223.

[5] [1963] S.C.R. 299.

that of trading in shares and bonds and that the purchase of shares and bonds by the appellant was from its funds surplus to or not devoted to its mortgage business as investments rather than a speculation and accordingly any resultant gains or losses would be gains or losses of capital.

In support of the foregoing contentions, it was submitted by counsel for the Minister that (1) the nature and quantity of the shares and bonds sold by the appellant in the two taxation years under appeal, were not such as to indicate the carrying on of a business or adventures in the nature of trade and (2) the transactions engaged in by the appellant were not of the same kind or carried on in the same manner as those characteristic of ordinary trading.

On the other hand, the appellant contends that the profit realized by it from the sale of shares in 1963 and the net loss it sustained as the result of its transactions in 1964 were not merely the realizations of the enhanced value of the shares or changes in investments, but were gains made or losses suffered in the operation of a business in carrying out a scheme of profit making, it being the appellant's intention to make profits from a rise in the market price of the shares held by it.

I do not attach any particular significance to the fact that the Minister, in the appellant's previous taxation years, included profits made on the sale of shares in the appellant's income and that he allowed losses incurred in those years as deductions from income.

It is well settled that while a decision reached by the Minister in one taxation year may be a cogent factor in the determination of a similar point in a following year, the fact that a concession may have been made to a taxpayer in one year, does not, in the absence of any statutory provisions to the contrary, preclude the Minister from taking a different view of the facts in a later year when he has more complete data on the subject matter. There is nothing inconsistent with the Minister altering his decision according to the facts as he finds them from time to time. An assessment is conclusive as between the parties only in relation to the assessment for the year in which it was made. (See *M.N.R. v. British and American Motors Toronto, Limited*[1].)

[1] [1953] Ex C.R. 153.

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The only significance that can be attached to the appellant invariably declaring in its tax returns any gains or losses on its purchase and sale of shares is that it is illustrative of its consistent treatment of such gains or losses as gains or losses from a business.

The narrow issue for determination is whether the gains made or losses incurred by the appellant in the circumstances above outlined were made or incurred by it in the conduct of a business as is contended by the appellant or whether they were enhancements in value or losses sustained upon the realization of or changes in investments as contended by the Minister.

In *Sutton Lumber & Trading Company Limited v. M.N.R.*[1] Locke J. said at page 83:

> The question to be decided is not as to what business or trade the company might have carried on under its memorandum, but rather what was in truth the business it did engage in. To determine this, it is necessary to examine the facts with care.

Mr. Maibach, whose intentions both parties acknowledge to have been the intentions of the appellant, testified that the shares were bought and sold speculatively in order to make a gain from an increase in their market price. While I am conscious of the often repeated admonition that a taxpayer's *ex post facto* declaration of his intention should be scrutinized with care, nevertheless, I have no reason to disbelieve Mr. Maibach's testimony. On the contrary, I think that his expression of his intention, which was also that of the appellant, is confirmed by the appellant's course of conduct and what it actually did.

From its inception in 1954 the appellant in its tax returns reported dividends received as income and gains or losses on the purchase and sale of shares as income or deductions from income respectively which indicates to me a consistent course of conduct and a consistent attitude by the appellant to its transactions.

Certainly Mr. Maibach was not looking to a safe and modest return by way of dividends. The Government of Canada bonds were sold because of their low interest yield and the proceeds of that sale were placed, as Mr. Maibach put it, where the "action" was. While he was not adverse

[1] [1953] 2 S.C.R. 77.

to accepting dividends when paid, it is obvious that he was looking for a much greater and quicker return based on the vagaries of the stock market. His selection of shares purchased was not based on any thorough analysis of the companies whose shares were purchased but reliance was placed on tips received from persons whom he considered knowledgeable but which subsequent events proved not to be invariably so.

While shares may be the subject matter of investment, they are equally susceptible of being the subject matter of trade. Whether they fall into one category or the other, is dependant upon the particular facts of the case. The evidence above recited leads me to the conclusion that the purchase and sale of shares here involved was done in the course of business.

What must be looked at is what was done by the appellant with a view to asking the question in Lord President Clyde's words in *C.I.R. v. Livingston et al*[1]:

> ...whether the operations involved (in the transactions of the company) are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.

While the appellant was not a trader in securities in the sense of that term that it was an underwriter and held a seat on a stock exchange, but rather made its purchases and sales through a stock exchange in the usual manner, nevertheless, the acts of the appellant were just the ordinary transactions of a person who deals in shares.

In my opinion the transactions in question were acts done in carrying on a business from which it follows that tax is payable on the profit realized on the sale of shares in its 1963 taxation year and that the appellant is entitled to deduct the loss that it incurred in its 1964 taxation year.

The appeal is, therefore, allowed with costs.

[1] 11 T.C. 538 at p. 542.

Ottawa 1967

Apr. 12

Apr. 28

BETWEEN:

CENTRAL ELECTRIC WIRE LIMITED ..APPELLANT;

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE FOR CUSTOMS AND EXCISE .... RESPONDENT.

Customs duty—Appeal from Tariff Board—Classification of imported steel rods for use in manufacture of wire—Customs Tariff, R.S.C. 1952, c. 60, am. 1958, c. 27, Items 379b, c.

In November 1964 appellant imported coils of hot-rolled lead-coated stainless steel wire rods .217 inches in diameter for converting into wire in its factory. The majority of the Tariff Board held that the rods were properly classified under Tariff Item 379*b* as " . . . rods of . . . steel . . . further processed than hot- or cold-rolled, . . .". Appellant appealed on the ground that they were properly classifiable under Item 379*c* as "rods of steel, in the coil, not more than .375 inches in diameter, when imported by manufacturers of wire for use in the manufacture of wire . . .".

Held, allowing the appeal, the rods fell precisely within the language of Item 379*c* which was designed, by way of exception from the three preceding items, to cover these very circumstances.

APPEAL from Tariff Board.

John J. Urie, Q.C. for appellant.

L. R. Olsson for respondent.

CATTANACH J.:—This is an appeal, pursuant to section 45 of the *Customs Act,* R.S.C. 1952, chapter 58 as amended by Statutes of Canada, 1958, chapter 26, from a majority decision of the Tariff Board dated December 2, 1966 whereby coils of hot-rolled lead coated stainless steel wire rod imported from the United States of America, but originally manufactured in Japan, at the Port of Perth, in the Province of Ontario, under Customs Entry No. 1471 on November 25, 1964, were declared to be properly classified under Tariff Item 379*b* (now Tariff Item 37910-1) R.S.C. 1952, chapter 60 as amended by Statutes of Canada, 1958, chapter 27.

The appellant, in the Statement of Facts in its Notice of Appeal alleges the following:

1. The Appellant is a body corporate and politic carrying on the business of a manufacturer of electric wire and cable at the Town of Perth in the Province of Ontario.

2. The Appellant imports coils of hot-rolled, stainless steel wire rods .217 inches in diameter which is imported by the Appellant from the United States through the Port of Perth.

3. The goods in issue were entered under customs Entry No. 1471 on November 25th, 1964 under Tariff Item 37910-1, then Tariff Item numbered 379*b*.

4. The Appellant requested that the goods be classified under Tariff Item 37915-1 (then No. 379*c*), but the request was denied by a Dominion Customs Appraiser who ruled that the goods were properly classified under Tariff Item 37910-1 and so notified the Appellant by notification dated January 25, 1965, which decision was affirmed by the Deputy Minister of National Revenue on June 16, 1965.

5. The coils of wire in issue are made of hot-rolled stainless steel which has been immersed in a bath of molten lead so that a lead coating adheres to the rod. The purpose of the coating is to facilitate the drawing process, acting as a lubricant, which process takes place in the Appellant's factory in the course of its manufacture of electric wire. All of the lead must be completely removed before the manufacturing process is completed.

The respondent in his reply admits the foregoing facts alleged by the appellant, but relies upon the further following facts, with respect to which there is no dispute between the parties, adduced in evidence before the Tariff Board:

. . .

3. The goods were described in the customs invoice accompanying the entry as "hot-rolled lead-coated stainless steel wire rods". The Appellant in ordering stainless steel rods specifies a diameter of 0 217 inches, pickled, annealed and lead-coated. In the rod manufacturer's factory the rods are formed by a hot-rolling process applied to the steel and are annealed and pickled and coiled into large coils weighing about 400 pounds. These coils are then dipped into a molten lead bath and when the steel and lead reach the same temperature the lead adheres to the steel and forms a coating around the rod. The coils are then refrigerated to solidify the coating. The lead coating is approximately 3% of the cross section of the coated rod and it adheres to the steel very firmly.

4. In the Appellant's factory, wire is made from rod by a drawing process wherein the diameter of the rod is greatly reduced in the conversion to wire. The lead coating acts as a lubricant carrier in the drawing process. The Appellant uses a dry soap powder containing 7% lead in its lubricant box and this powder is picked up by the lead coating and carried into the drawing die to act as a lubricant. When the cross section of the rod has been reduced 85% in area by drawing, the lead coating is removed by the application of nitric acid, and the final 15% draw is completed with oil as a lubricant.

5. Stainless steel rods for drawing wire may also be coated with other coatings such as copper, cadmium, lime or various branded coating. Other steel rods may be drawn without any coating at all.

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For purposes of convenience and consistency I shall refer to the tariff items by the numbers which were applicable when this cause arose.

Under section 45 of the *Customs Act* a party to an appeal from a decision of the Deputy Minister has an appeal, as of right, to this Court upon any question of law. The right of appeal so conferred by section 45 is, therefore, limited to a question of law.

The question to be decided is whether the majority of the Tariff Board erred as a matter of law in holding that the imported wares were properly classified under Tariff Item 379*b* as contended by the Deputy Minister rather than under Tariff Item 379*c* as contended by the appellant.

Section 3(1) of the *Customs Tariff* provides:

> 3. (1) Subject to the provisions of this Act and of the *Customs Act*, there shall be levied, collected and paid upon all goods enumerated, or referred to as not enumerated, in Schedule A, when such goods are imported into Canada or taken out of warehouse for consumption therein, the several rates of duties of Customs, if any, set opposite to each item respectively or charged on goods as not enumerated, in the column of the tariff applicable to the goods, subject to the conditions specified in this section.

The relevant tariff items in the present appeal appear in Schedule "A" as follows:

GOODS SUBJECT TO DUTY AND DUTY FREE GOODS

Tariff Item		British Preferential Tariff	Most-Favoured-Nation Tariff	General Tariff
	GROUP VIII Metals, and Manufactures Thereof.			
379	Bars or rods of iron or steel, hot-rolled, plain or deformed, namely. rounds half-rounds, ovals, half-ovals, squares, round-cornered squares, hexagons, octagons or other multisided bars or rods, flats, 13/64 inch or more in thickness and eight inches or less in width	5 p.c.	10 p.c.	20 p c.
379*a*	Bars or rods of iron or steel, as described in tariff item 379, cold-rolled or cold-drawn .	5 p.c.	15 p.c.	25 p.c.
379*b*	Bars or rods of iron or steel, as described in tariff item 379, further processed than hot-or-cold-rolled or cold-drawn, or otherwise processed.	5 p.c.	15 p.c.	25 p.c.
379*c*	Rods of iron or steel, in the coil, not more than 0.375 inch in diameter, when imported by manufacturers of wire for use in the manufacture of wire, in their own factories per ton	Free	$3.00	$5.00

Counsel for the appellant submits that the words of Tariff Item 379*c* are clear and unambiguous and that the wares imported fall precisely within those words as a consequence of which there is no necessity and it is an error in law in such circumstances to consider other tariff items as an aid to the interpretation of those words. He contends that the imported wares are (1) rods of steel, (2) in the coil, (3) not more than the prescribed diameter, (4) the appellant is a manufacturer of wire and (5) the wares are for use in the manufacture of wire in the appellant's factory. There is no dispute whatsoever that the last four qualifications in Tariff Item 379*c* are met by the appellant. However, counsel for the appellant further contends that the "rods of steel" which were imported, fall within the meaning of those words in Tariff Item 379*c* whether the rods were "coated" with lead or not so "coated".

On the other hand counsel for the Deputy Minister contends that for the purpose of construing any enactment it is proper to find the legislative intent from the statute as a whole. On this premise he concludes that the legislative scheme is clear from the many references to "coating" in other items and that where a tariff item, such as Tariff Item 379*c* makes no reference to "coating" then the item must be interpreted as not including coated metals and that there is no error in law on the part of the majority of the Board in having referred to other items in the *Customs Tariff* to so conclude. He then contends that Tariff Item 379*b* is applicable. Tariff Item 379*b* imports the description of the wares outlined in Item 379, that is to say hot-rolled rods of steel. The hot-rolled rods of steel have been further processed as contemplated in Tariff Item 379*b* by the application of a lead coating by the original manufacturer.

There is no doubt in my mind that the imported wares were "further processed", beyond being hot-rolled, by the application of a lead coating. The word "process" contemplates the wares being subjected to a treatment designed to effect a particular result. This is what the Tariff Board found and in my view correctly so.

The appellant specifically required, in placing its order for the wares, that they should be lead coated. It did so for the express purpose of facilitating its own manufacturing process of reducing the rods of steel to electrical wire. To

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the appellant the lead coating was temporary in the sense that it would be ultimately removed and the sole purpose of the lead coating was to serve as a lubricant carrier.

However, section 43 of the *Customs Act* as amended by Statutes of Canada 1955, chapter 32, appears to say clearly that the time for determining tariff classification is at the time of the entry into Canada of the goods subject to duty. (See Hall J. in *D.M.N.R. v. MacMillan & Bloedel (Alberni) Ltd.*[1]). I think it is also clearly inferred in the above section that the state of goods for tariff classification is the state of the goods at the time of entry.

The narrow issue for determination is, therefore, whether the language of Tariff Item 379*c* is properly construed as including rods of steel coated with lead, although no reference to "coating" is contained therein and if not, whether the wares in question fall within the language of Tariff Item 379*b*.

I am unable to obtain any real assistance in construing the words of Tariff Item 379*c* from a perusal of the many items in the Customs Tariff to which Counsel for the Deputy Minister referred me, wherein words such as "coated or not", "not coated", "coated", "coated with metal", "whether or not coated" or "uncoated" appear. All such items are ranged under Group VIII of Schedule "A" headed "Metals, and Manufactures Thereof". Some of such items refer to basic metal formations and others appear to be end products. It is not clear whether the coatings therein referred to are permanent or temporary. There are many other items which do not refer to coatings. I can discern no consistent scheme and can only assume that when such description occurs in a specific item it must be taken as referring only to that item, *ex abundanti cautela,* and cannot be taken to serve as a guide to assist in the interpretation of another item.

Therefore, recourse must be had to the language of specific Tariff Items above quoted, that is, 379, 379*a*, 379*b* and 379*c*. It is apparent that Tariff Item 379 is a general item and attracts a lesser rate of customs duty than either 379*a* or 379*b* under the Most Favoured Nation Tariff and the General Tariff. (I assume that the wares here in question fall under the Most Favoured Nation Tariff). Tariff Item

[1] [1965] S C R 366 at p. 371

379*a* covers bars or rods of iron or steel described in Item 379, but which have been "cold-rolled" or "cold-drawn" upon the importation of which a slightly higher customs duty is imposed. Tariff Item 379*b* covers bars or rods or iron or steel described as in Tariff Item 379, but further processed than "hot-rolled", which is defined in section 2(1)(*c*) of the Customs Tariff, or "cold-rolled", which is also defined in section 2(1)(*c*), or "cold-drawn". The Customs duties under Items 379*a* and 379*b* are identical.

However, Tariff Item 379*c* is obviously an exception to the three immediately preceding Tariff Items 379, 379*a* and 379*b*. It is directed to a very limited class of importer who imports "rods of iron or steel" of a limited diameter and "in the coil", who has the particular status of being a manufacturer of wire and who imports the wares for use in the manufacture of wire in his own factory. For such a very limited case, a lesser duty is imposed under Item 379*c*. If duty were imposed under the Most Favoured Nation Tariff under Item 379*b* the amount would be $3,145.20, whereas under the same tariff under Item 379*c* the duty would be $46.80.

As intimated before, the appellant meets precisely all the qualifications so imposed by Tariff Item 379*c* with the possible exception of the first. The only question which requires resolution therefore is whether the imported goods were "rods of steel" within the meaning of those words as they appear in Item 379*c*. That question comes to this: Is the application of a very thin coating of lead, (constituting 3% of the cross-section of the rod) sufficient to convert the imported wares from the category of "rods of steel" to one of rods composed of steel and lead?

While no evidence was adduced as to any trade acceptance of the meaning, or other definition, of the words "rods of steel", nevertheless, the majority of the Tariff Board declared the wares "to be properly classifiable under Tariff Item 379*b*". It follows from this that the Tariff Board must have found the ware to have been "rods of steel" within the meaning of those words as they appear in Tariff Item 379*b*. This is essentially a question of fact once the meaning of the words is ascertained.

I can see no reason for attributing a different meaning to those identical words where they appear in Tariff Item 379*c* from that which they have in Tariff Item 379*b*. It

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follows that the wares imported by the appellant fall precisely within each and every requirement of Tariff Item 379*c*.

No argument was addressed to me as to the consequences which would flow from the circumstance that the wares might be properly classified under both Tariff Items 379*b* and 379*c*. Counsel for the Deputy Minister made passing reference to that possibility from which he contended that Item 379*c* was ambiguous and resort might then be had to the Statute as a whole to resolve that ambiguity. However, in his argument, as I understood it, he was adamant that the wares fell within Tariff Item 379*b* and not within Item 379*c*.

Counsel for the appellant, during the course of his argument, made reference to this possibility in a back-handed or negative manner, that is to say, that if the wares did not fall within Item 379*c* or if Item 379*c* was not in the Customs Tariff, then it was a possibility that they did not fall within Item 379*b*.

In my view, for the reasons expressed above, the wares fall within Tariff Item 379*c* which was designed to cover the circumstance in which the present appellant finds itself. Accordingly the wares should be so classified because, in my view, Tariff Item 379*c* constitutes an exception from the more general Items 379 and 379*b*.

I am, therefore, of the opinion that the majority of the Tariff Board erred as a matter of law in declaring that the imported wares were properly classifiable under Tariff Item 379*b* and not under Tariff Item 379*c*.

The appeal is allowed with costs and it is declared that the goods in question are classified under Tariff Item 379*c*.

Vancouver 1967 Apr. 28, May 1

BETWEEN:

GATEWAY LODGE LIMITED .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income tax—Capital cost allowances—Terminal allowance—Recapture—Lodge operated on leasehold—Surrender of leasehold to Crown—Basis of valuing assets—Ascertainment of "undepreciated capital cost"—Income Tax Act, ss. 20(1), 20(5)(b),(c),(d).(e), 30(6)(g)—Income Tax Regulations s. 1100(1) and (2).

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In 1949 appellant acquired a lodge on land leased from the Crown in Kootenay National Park and up to 1962 incurred a capital cost of $52,129 on the buildings and $37,936 on the contents and was allowed capital cost allowances of $29,689 on the buildings and $28,911 on the contents. In April 1962 it surrendered to the Crown its lease (which was perpetually renewable) together with the buildings and contents for $155,000 and claimed a terminal allowance of the undepreciated capital cost of the buildings and contents under s. 1100(2) of the *Income Tax Regulations*. The Minister disallowed this claim and assessed appellant under s. 20(1) of the *Income Tax Act* on the footing that the capital cost allowances previously allowed had been recaptured. Appellant appealed. The parties agreed for the purposes of the appeal that to a prospective purchaser entitled to continue the existing business the buildings had a value of not less than $52,129 and the contents not less than $9,025.

Held, affirming the assessment (1) appellant was not entitled to the terminal allowance claimed on either the buildings (class 13 assets) or the contents (class 8 assets) since on application of the formula in s 20(5)(*e*) of the *Income Tax Act,* and valuing the assets as those of a going concern, there was no undepreciated capital cost for either class; and (2) $52,129 of the $155,000 received on the surrender could, valuing the assets as those of a going concern, reasonably be regarded (see s 20(6)(*g*) of the *Income Tax Act*) as consideration for the leasehold property, which in any event was assumed by the Minister and not disputed, and accordingly the recapture provisions applied.

APPEAL from Tax Appeal Board.

David A. Freeman for appellant.

L. R. Olsson and *S. A. Hynes* for respondent.

JACKETT P. (orally):—This is an appeal from a decision of the Tax Appeal Board dismissing the appellant's appeal from its income tax assessment for the 1962 taxation year. The appeal involves a question as to whether, by virtue of subsection (1) of section 20 of the *Income Tax Act,* an amount has to be included in computing the appellant's income for the year by way of what is commonly referred to as recapture of capital cost allowance. It also involves a question as to whether certain amounts are deductible in computing the appellant's income for the year, by virtue of subsection (2) of section 1100 of the *Income Tax Regulations,* as what is commonly referred to as terminal allowances.

At all material times, Rinaldo A. Wassman was the sole beneficial shareholder and managing director of the appellant.

In 1949 Wassman personally agreed to purchase from one Williams a property known as Gateway Lodge at

Radium Hot Springs in Kootenay National Park in the Province of British Columbia. At that time, the property consisted of a hotel or lodge building and two smaller buildings, all of which were furnished and equipped, and were located on land in the Park that was held under lease from the Crown in right of Canada. Two features of the leases of some importance are (a) that the rent was nominal but subject to adjustment on stated occasions by reference only to the bare land value of the demised property; and (b) that the lease was renewable from time to time in perpetuity at the option of the tenant. Wassman agreed to pay Williams for the property $65,000 plus the value of stock in trade on hand at the time of purchase.

Wassman assigned to the appellant his interest under the purchase agreement with Williams.

In its books of account, the appellant allocated, of the purchase price, $40,000 as being the capital cost of "buildings" and $25,000 as being the capital cost of "equipment".

Upon payment of the purchase price, Williams assigned the leases to the appellant. The appellant then surrendered the leases to the Crown and received new leases dated August 25, 1955 in lieu thereof.

During the period prior to 1962, the appellant expended, in addition to the aforesaid $40,000, which it had allocated to buildings, an additional $12,129.83 by way of capital improvements or additions to the buildings in question, making a total capital cost to it of such interest as it had in the buildings of $52,129.83. In the same period, the appellant claimed capital cost allowances with respect thereto in amounts totalling $29,689.64. These amounts were allowed by the Minister by his assessments for the various taxation years in the period. There was, therefore, at the beginning of the 1962 taxation year, on the appellant's books, a capital cost in respect of these buildings in respect of which no capital cost allowance had been made under the *Income Tax Act* of $22,440.19.

With reference to the furniture and equipment in the buildings, there was a parallel situation. The appellant, as already indicated, had allocated, of the original cost of the total property, $25,000 to the contents. It had made capital improvements and additions to the contents during the period prior to 1962, according to its books, of

$12,936.60. It had claimed, and been allowed, under the *Income Tax Act,* in respect of the furniture and equipment constituting the contents, capital cost allowance in amounts aggregating $28,911.39. There was therefore on the appellant's books, at the beginning of the 1962 taxation year, capital cost in respect of such furniture and equipment in respect of which no capital cost allowance had been made under the *Income Tax Act* of $9,025.21.

In 1960, the Department of Northern Affairs and National Resources advised the appellant that they required the land upon which his hotel was located for road and related purposes. The Crown therefore negotiated with the appellant for a surrender of his leases with a view to removing the buildings as well as their contents. It seems clear that neither the buildings nor the contents had any value except where they were and as an integral part of the appellant's hotel business on that location as a going concern.

The appellant fixed its original asking price for the surrender of its leasehold property on the basis of the profits it had been making in recent years from the carrying on of its business and ultimately entered into an agreement pursuant to which it accepted a somewhat lower amount—$155,000—therefor. There is no information as to the basis upon which the departmental officials justified seeking authority to pay that amount for a surrender to the Crown of the appellant's leases. There is a copy of an appraisal report made for the Department in evidence, but no evidence as to whether it was accepted by the Minister.

It is established that the departmental officials indicated that they were prepared to recommend a settlement on the basis of the appellant being entitled to remove and use or sell both the buildings and their contents; but the appellant refused to bargain except on the basis that the Crown would accept a surrender of the leasehold land with the buildings on it and their contents in them.

The actual agreement is contained in an offer made by the appellant to the Minister of Northern Affairs and National Resources by a document dated October 2, 1961, and reading as follows:

> I, the Lessee of Villa Lots 6, 7 and 7A in Radium Hot Springs Townsite, in Kootenay National Park, in the Province of British Columbia,

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agree to sell to Her Majesty the Queen in right of Canada, free from all encumbrances, my interest in the said lots, including buildings and contents, and improvements thereon, for the sum of One Hundred and Fifty-five thousand dollars ($155,000.00).

This agreement was implemented in part by formal surrender documents dated April 2, 1962, whereby the appellant surrendered to the Crown the lands comprised in the leases "to the intent that" the unexpired terms "may be merged and extinguished in the reversion and inheritance of the said lands" and whereby the appellant also granted, conveyed, released etc., to the Crown "all its right, title and interest in the building and improvements" situate on such lands. It was also implemented in part by the execution by the appellant in favour of the Crown of a bill of sale of the contents bearing date April 2, 1962.

By its 1962 Income Tax Return, the appellant claimed terminal allowance under subsection (2) of section 1100 of the *Income Tax Regulations* in the sum of $31,465.40, which was, apparently, made up as follows:

Buildings	$22,440 19
Furniture and equipment	9,025 21
	$31,465 40

By the re-assessment that is the subject matter of this appeal, the respondent disallowed this claim. By the same re-assessment, the respondent added to the appellant's declared income an amount of "Capital cost allowance recaptured" in the sum of $29,689.64.

By this appeal the appellant maintains its right to the terminal allowance so disallowed in the sum of $31,465.40 and attacks the assessment by the respondent in so far as it adds the amount of $29,689.64, or any amount, to his income for 1962 by way of capital cost allowance recaptured.

It is well to bear in mind, in considering capital cost allowance problems under the *Income Tax Act,* that, while the general rule in computing profit from a business for the purposes of Part I of the Act is that it is to be computed in accordance with business or commercial principles, section 12(1)(*a*) of the Act expressly excludes any deduction in respect of depreciation or obsolescence. In place of any such allowance, there is what is provided for by section 11(1)(*a*) when it authorizes as a deduction, in computing the income of a taxpayer for a taxation year, "such part of the capital cost to the taxpayer of property . . ., if any, as is allowed by regulation". What we have to deal with is therefore a purely statutory scheme of deductions and not a businessman's concept of an allowance for depreciation.

While the statute leaves to regulations the actual definition of the amounts that may be deducted, there is to be found in subsection (5) of section 20 of the statute a series of definitions of arbitrarily selected concepts that are to be used in the Regulations as well as the statute.[1] So we

[1] Subsection (5) of section 20 reads as follows.

(5) In this section and regulations made under paragraph (*a*) of subsection (1) of section 11,

(*a*) "depreciable property" of a taxpayer as of any time in a taxation year means property in respect of which the taxpayer has been allowed, or is entitled to, a deduction under regulations made under paragraph (*a*) of subsection (1) of section 11 in computing income for that or a previous taxation year;

(*b*) "disposition of property" includes any transaction or event entitling a taxpayer to proceeds of disposition of property;

(*c*) "proceeds of disposition" of property include
 (i) the sale price of property that has been sold,
 (ii) compensation for property damaged, destroyed, taken or injuriously affected, either lawfully or unlawfully, or under statutory authority or otherwise,
 (iii) an amount payable under a policy of insurance in respect of loss or destruction of property, and
 (iv) an amount payable under a policy of insurance in respect of damage to property except to the extent that the amount has, within a reasonable time after the damage, been expended on repairing the damage,

(*d*) "total depreciation" allowed to a taxpayer before any time for property of a prescribed class means the aggregate of all amounts allowed to the taxpayer in respect of property of that class under regulations made under paragraph (*a*) of subsection (1) of section 11 in computing income for taxation years before that time; and

(*e*) "undepreciated capital cost" to a taxpayer of depreciable property of a prescribed class as of any time means the capital cost to the taxpayer of depreciable property of that class acquired before that time minus the aggregate of
 (i) the total depreciation allowed to the taxpayer for property of that class before that time,
 (ii) for each disposition before that time of property of the taxpayer of that class, the least of
  (A) the proceeds of disposition thereof,
  (B) the capital cost to him thereof, or
  (C) the undepreciated capital cost to him of property of that class immediately before the disposition, and
 (iii) each amount by which the undepreciated capital cost to the taxpayer of depreciable property of that class as of the end of a previous year was reduced by virtue of subsection (2).

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find that, in this context "depreciable property" means property in respect of which the taxpayer has been allowed, or is entitled to, a deduction under regulations made under section 11(1)(*a*); and we find that "proceeds of disposition" include such things as the price of property that has been sold, the compensation for property that has been expropriated, and the insurance monies for property lost or destroyed; and further that "disposition of property" includes any transaction or event entitling a taxpayer to "proceeds of disposition" in this enlarged sense. Furthermore, by virtue of these arbitrary definitions, we find that "total depreciation" allowed to a taxpayer for property of a class means all the amounts allowed under the section 11(1)(*a*) regulations (commonly called capital cost allowance) in respect of property of that class, and that the expression "undepreciated capital cost" of property of a particular class is defined in very detailed and precise terms.

The overall scheme of capital cost allowances is to be found on the one hand in the regulations made under section 11(1)(*a*) of the Act, which provide for the deductions that may be made, and, on the other hand, in section 20(1) of the Act, which provides for the "recapture" of allowances previously made when it turns out that the actual overall capital cost of property to the taxpayer was less than the total of the allowances that were made under section 11(1)(*a*) in the years during which the property was held for income-earning purposes.

The parts of the Regulations that are relevant here include the following:

> 1100. (1) Under paragraph (*a*) of subsection (1) of section 11 of the Act, there is hereby allowed to a taxpayer, in computing his income from a business or property, as the case may be, deductions for each taxation year equal to
>
> (*a*) such amounts as he may claim in respect of property of each of the following classes in Schedule B not exceeding in respect of property
>
> * * *
>
> (vi) of class 6, 10%
>
> * * *
>
> (viii) of class 8, 20%
>
> * * *
>
> of the undepreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;

(b) where a taxpayer has property of class 13 in Schedule B which was acquired by him for the purpose of gaining or producing income, such amount as he may claim not exceeding, in respect of each item of the capital cost thereof to him, the lesser of

(i) one-fifth of the capital cost thereof to him, or

(ii) the amount for the year obtained by apportioning the capital cost thereof to him equally over the period of the lease unexpired at the time the cost was incurred,

but the total of the amounts allowed under this paragraph shall not exceed the undepreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;[1]

The parts of section 1100(1) of the Regulations to which I have just referred must be read with the definitions of Class 6, Class 8 and Class 13 as set out in Schedule B to the Regulations. These classes are defined, so far as is relevant for present purposes, as follows:

Class 6 (10%)

Property, not included in any other class that is

(a) a building of

(i) frame,

* * *

Class 8 (20%)

Property that is a tangible asset that is not included in any other class in this Schedule except . . .

Class 13

Property that is a leasehold interest except . . .

The only other part of the Regulations to which I should refer is section 1100(2), which provides for terminal allowances as follows:

(2) Where, in a taxation year, otherwise than on death, all property of a prescribed class that had not previously been disposed of or transferred to another class has been disposed of or transferred to another class and the taxpayer has no property of that class at the end of the taxation year, the taxpayer is hereby allowed a deduction for the year equal to the amount that would otherwise be the undepreciated capital cost to him of property of that class at the expiration of the taxation year.

As already indicated, the other part of the capital cost allowance scheme is the recapture provision which is to be found in section 20(1) of the *Income Tax Act,* which reads as follows:

20. (1) Where depreciable property of a taxpayer of a prescribed class has, in a taxation year, been disposed of and the proceeds of disposition

[1] I have set out in this judgment the Regulations as they were for the 1962 taxation year as nearly as I can ascertain them.

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exceed the undepreciated capital cost to him of depreciable property of that class immediately before the disposition, the lesser of

(a) the amount of the excess, or

(b) the amount that the excess would be if the property had been disposed of for the capital cost thereof to the taxpayer,

shall be included in computing his income for the year.

I propose to consider first the two questions that arise in respect of the "buildings".

In the first place, having regard to the definition of the relevant classes, it seems clear that the appellant's leasehold interest in the land, of which the buildings formed, in the view of the law, a part, falls within prescribed class 13 and not within prescribed class 6. Class 6 extends only to property "not included in any other class" that is a building and the appellant's leasehold interest clearly falls within class 13.

Coming then to the appellant's right to deduct a terminal allowance in respect of "buildings", the requirement that it must have fulfilled to be entitled to an allowance under section 1100(2) of the Regulations is that all of its class 13 leasehold property had been disposed of (or transferred to another class) in the 1962 taxation year and that it had no property of that class at the end of that year. This requirement appears to have been met.

The further question is, however, as to the amount of the deduction to which it was entitled. The subsection defines that to be "the amount that would otherwise be the undepreciated capital cost to him of property of that class at the expiration of the taxation year". This brings me to the definition of "undepreciated capital cost" to a taxpayer of depreciable property of a prescribed class as of any time, which, as I have already indicated, is to be found in section 20(5) of the *Income Tax Act,* paragraph (*e*) of which reads, in part:

(*e*) "undepreciated capital cost" to a taxpayer of depreciable property of a prescribed class as of any time means the capital cost to the taxpayer of depreciable property of that class acquired before that time minus the aggregate of

(i) the total depreciation allowed to the taxpayer for property of that class before that time,

(ii) for each disposition before that time of property of the taxpayer of that class, the least of

(A) the proceeds of disposition thereof,

(B) the capital cost to him thereof, or

(C) the undepreciated capital cost to him of property of that class immediately before the disposition, and

* * *

What we have to ascertain in order to determine the deduction permitted by section 1100(2) of the Regulations is what would "otherwise be the undepreciated capital cost" to the appellant of class 13 leaseholds as of the end of its 1962 taxation year. As I read the definition in section 20(5)(*e*), this would be

(*a*) the capital cost to the appellant of its leasehold interests,

minus the total of

(*b*) the total depreciation allowed to the appellant for class 13 leasehold interest property before that time, and

(*c*) for the sole disposition of leasehold interests, being that in 1962, the least of

(A) the proceeds of disposition,

(B) the capital cost of the property disposed of, or

(C) the undepreciated capital cost to the appellant of class 13 leaseholds immediately before the disposition.

As far as the evidence reveals, the only capital cost that can be attributed to the appellant's class 13 leasehold interests is what is shown on its books for "buildings", namely, $52,129.83.

Coming to the amounts that must be deducted from that capital cost of $52,129.83 to get the permitted terminal allowance, the "depreciation allowed" for class 13 leasehold property before the 1962 taxation year seems to me to be clearly the amount that was claimed and allowed for "buildings". Such amount could only validly be allowed as a class 13 allowance. I know that it was allowed; and I have nothing before me to show that it was allowed in any

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way that compels me to treat it as having been unlawfully allowed as a class 6 allowance. The amount so allowed was $29,689.64.

With reference to the 1962 "proceeds of disposition" of leasehold interests, it is necessary to turn to section 20(5)(*c*), which defines "proceeds of disposition" to include, *inter alia,*

> (i) the sale price of property that has been sold,
>
> (ii) compensation for property damaged, destroyed, taken or injuriously affected, either lawfully or unlawfully, or under statutory authority or otherwise,
>
> * * *

and to section 20(5)(*b*) which defines "disposition of property" to include any transaction or event entitling the taxpayer to proceeds of disposition of property.

I should have no doubt myself that a transaction whereby a lessee, for a consideration, surrenders his leasehold interest so that it merges in the landlord's reversion and is entirely lost to him falls within the ordinary meaning of the expression "disposition of property". Indeed, the only basis upon which the appellant can bring itself within section 1100(2) in order to claim a terminal allowance is that it had "disposed of" all property in the prescribed class. If it disposed of its class 13 leaseholds so as to be in the position of claiming a terminal allowance, the same disposition must be treated as a disposition for the purpose of determining the amount of the allowance. It follows that the "consideration" for the surrender is "proceeds of disposition" within the meaning of that expression as defined for the purpose of the statute. If, however, the facts of this case are open to the view that the department concerned, or the Crown, by their acts or decisions, either wrongfully or legally, took or injuriously affected the appellant's leasehold interests, then the compensation for such act, which is clearly contained in the $155,000 paid by the Crown to the appellant, is equally proceeds of disposition of leasehold interests within the definition of the expression "proceeds of disposition" to which I have just referred. On the admitted facts, the amount thereof must be regarded as being much more than the total capital cost of class 13 leaseholds, which is only $52,129.83.

My reason for reaching the latter conclusion is that the appellant received $155,000 for its leasehold interests (including buildings) and for the contents. Section 20(6)(*g*)[1] provides, in effect, that, where an amount can reasonably be regarded as being in part consideration for disposition of depreciable property of a prescribed class and as being in part consideration for something else, "the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property of that class". Paragraph 15 of the agreement as to facts (Exhibit 1) reads:

> 15. For the purposes of this appeal the parties admit that to a prospective purchaser entitled to continue the existing business the buildings had a value of not less than $52,129.83, the furniture and equipment a value of not less than $9,025.21, and the lessee's interest in the said leases, Exhibits A-7 and A-8, a value (excluding buildings and improvements) of not more than $93,845.04. The parties also admit that the buildings had no value to a purchaser required to remove them from Lots 6, 7, and 7A.

There is no doubt in my mind that what the appellant was bargaining about was the surrender of a leasehold interest in property that had a value as part of his business enterprise. That is what he was selling. He had a right to continue operating the business indefinitely. It was a profitable business. He valued his leasehold interest on that basis and it was because that was the nature of the asset that he had and that the Crown wanted that the Crown paid him $155,000. Had there been nothing but bare land, he could not have claimed, and the Crown could not have paid, any such amount. Once it is accepted that that was the subject matter of the bargain, then there can be no doubt on the above facts that more than $52,129.83

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[1] Section 20(6)(*g*) reads:

(6) For the purpose of this section and regulations made under paragraph (*a*) of subsection (1) of section 11, the following rules apply:

* * *

(*g*) where an amount can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property of that class irrespective of the form or legal effect of the contract or agreement; and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount;

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out of the $155,000 can reasonably be regarded as being consideration for the leasehold interest. In any event, this fact was assumed by the respondent and has not been disproved. The decision of this Court in *Minister of National Revenue v. Steen Realty Limited*[1] was on quite different facts and has no application to the facts of this case. In that case, the highest and best use of the land, and the basis on which it was bought and sold, was as land with the buildings removed.

As, however, the undepreciated capital cost of the leasehold interests is, by definition, equal to or less than the capital cost thereof, it is the amount that, with the total depreciation allowed, must be deducted from capital cost to obtain the amount of the terminal allowance. The result is as follows:

Capital cost		$52,129.83
Depreciation allowed	$29,689.64	
Plus undepreciated capital cost immediately before the disposition[2]	22,440.19	52,129.83
Terminal allowance for buildings or for class XIII leaseholds		NIL

I turn now to the amount added by the respondent to the appellant's income for 1962 by way of recapture under section 20(1) of the Act. That subsection reads as follows:

20.(1) Where depreciable property of a taxpayer of a prescribed class has, in a taxation year, been disposed of and the proceeds of disposition exceed the undepreciated capital cost to him of depreciable property of that class immediately before the disposition, the lesser of

(*a*) the amount of the excess, or

(*b*) the amount that the excess would be if the property had been disposed of for the capital cost thereof to the taxpayer,

shall be included in computing his income for the year.

I have already reached the conclusion that the appellant's class 13 leaseholds had been "disposed of" in the 1962 taxation year and that the proceeds of that disposition exceed the capital cost of the property of that class, within the meaning of those concepts in the statute. It

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[1] [1964] Ex. C R. 543.

[2] This amount is found by an application of section 20(5)(*e*) immediately before the surrender of the leases to be: capital cost minus depreciation previously allowed, or $52,129 83 minus $29,689.64, equals $22,440 19.

follows that the proceeds of disposition exceed the undepreciated capital cost immediately before the disposition because undepreciated capital cost must always be less than capital cost if any capital cost allowance has been taken. The subsection therefore applies to the facts of this case. The remaining question is as to the amount that must be included in computing the appellant's income for the 1962 taxation year by virtue of that subsection.

As I read the subsection, this amount is, on the facts of this case,

(*a*) the capital cost of the class 13 leaseholds to the appellant, which was $52,129.83,[1]

minus

(*b*) the undepreciated capital cost to the appellant of class 13 leaseholds immediately before the disposition, which was $22,440.19,[2]

which is $52,129.83 minus $22,440.19, or $29,689.64. This is the amount added to the appellant's income for the 1962 taxation year by the respondent. It follows that I have reached the conclusion that the appellant fails in its appeal as far as the recapture question is concerned.

The final question is as to the right of the appellant to deduct a terminal allowance in respect of "furniture and equipment" for the 1962 taxation year.

The requirement that it must have fulfilled to be entitled to an allowance under section 1100(2) is that all of its class 8 property had been disposed of (or transferred to another class) in the 1962 taxation year, and that it had no property of that class at the end of that year. This requirement appears to have been met.

The further question is as to the amount of the deduction to which it was entitled. As noted above, the subsection defines the amount to be "the amount that would otherwise be the undepreciated capital cost to him of property of that class at the expiration of the taxation year". Applying the definition of "undepreciated capital cost" to a taxpayer of depreciable property of a prescribed

[1] This is so because paragraph (*b*) of section 20(1) applies on the facts of this case as being less than paragraph (*a*).

[2] See footnote on page 18.

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class as of any time to be found in section 20(5)(*e*), which I have already discussed, what we have to find is the amount by which

(*a*) the capital cost to the taxpayer of the furniture and equipment, which was $37,936.60,

exceeds

(*b*) the total depreciation allowed for property of that class, which was $28,911.39,

plus

(*c*) for the sole disposition of assets of that class, being that in 1962, the least of

(A) the proceeds of disposition thereof, (which amount is in dispute),

(B) the capital cost thereof ($37,936.60), or

(C) the undepreciated capital cost of property of that class immediately before that disposition which, on the facts, was capital cost minus total depreciation previously allowed or $37,936.60 minus $28,911.39, being $9,025.21.

It follows that, unless the proceeds of disposition of the furniture and equipment was less than $9,025.21, the allowance is

Capital cost		$37,936 60
less		
total depreciation	$28,911.39	
plus		
undepreciated capital cost just before the disposition	9,025 21	
	$37,936.60	$37,936.60
		NIL

That raises the question as to whether the proceeds of disposition of the furniture and equipment in 1962 was less than $9,025.21. As appears from the paragraph from the Agreed Facts quoted above, to "a prospective purchaser entitled to continue the existing business" the furniture and equipment had a value of not less than $9,025.21. For the reasons already given, I am of opinion that the

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proper approach to the application of section 20(6)(g) to the facts of this case is to view the property sold as property whose value existed in its being the assets of a business as a going concern. That being so, it seems clear that at least $9,025.21 of the $155,000 can reasonably be regarded as being consideration for the disposition of the furniture and equipment.

Even if I am wrong in reaching this conclusion on the evidence before me, just as I indicated with reference to "buildings", this fact was assumed by the respondent in making the assessment appealed from and I am satisfied that it has not been disproved by the evidence before me.

That being so, by virtue of paragraph (g) of section 20(6), at least that amount is deemed to be the proceeds of disposition of the appellant's class 8 property (the furniture and equipment; and, as indicated above, the terminal allowance under section 1100(2) of the Regulations for furniture and equipment is nil.

The appeal is dismissed with costs.

BETWEEN:

Ottawa 1967 May 11

GREGORY FASTENERS LIMITED ....PLAINTIFF;

AND

CONTACT SHEETING INC. ....DEFENDANT.

Patents—Abandonment of earlier patent application in favour of subsequent—Whether later application entitled to filing date of earlier —Patent Act, s. 28(1)(b)—Motion to strike out allegation in statement of defence—Costs.

Plaintiff sued for a declaration that defendant's patent was invalid because the invention was described in a publication of June 1958, more than two years before the date of defendant's application for the patent on March 20th 1961. The statement of defence contained an allegation that in a patent application filed on April 22nd 1959 defendant disclosed the essential features of the invention, that it abandoned this application after the application of March 20th 1961 was filed, concluding that the later application was entitled to the filing date of the earlier application. Plaintiff applied to strike out such allegation.

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Held: (1) In view of the clear language of s. 28(1)(*b*) of the *Patent Act* it was not fairly arguable that defendant's allegation disclosed any defence to the action.

(2) Defendant's allegation should however not be struck out in order that it might be raised at the trial and thus be dealt with by the Supreme Court of Canada in the event of an appeal thereto.

(3) Plaintiff was entitled to the costs of the application in any event of the cause unless the defendant succeeded on that defence in this court, in which event they should be costs in the cause.

MOTION.

James D. Kokonis for plaintiff.

J. G. Fogo for defendant.

JACKETT P.:—Re: Motion (Notice dated May 4, 1967) made before me this morning for an order striking out paragraph 5 of the Statement of Defence. (Mr. Kokonis for the plaintiff and Mr. Fogo for the defendant.)

The action is for a declaration that the defendant's patent is invalid on the ground, *inter alia*, that the invention described therein was described in a publication published in June 1958 "more than two years before the date of the actual filing of the application for that patent".

There is a reference in the Particulars of Objection to section 29(2) of the *Patent Act* but it would seem to me that the reference should be to section 28(1)(*b*), which has the effect of excluding any invention that was "described . . . in any publication . . . more than two years before presentation of the petition" for a patent, from the class of inventions in respect of which patents may be granted under the Act. The operation of section 28(1)(*b*) may be modified by section 29 (Convention rights) and section 38 (divisional applications), but it is not suggested that either of those provisions have any application here.

The paragraph in the Statement of Defence that is the subject matter of this motion alleges

(a) that the defendant filed in the Patent Office on April 22, 1959, a patent application "disclosing the essential features of the invention" that is the subject matter of the patent that is being attacked,

(b) that the defendant filed in the Patent Office on March 20, 1961, the patent application pursuant to which the patent that is being attacked was ultimately issued, and

(c) that, subsequent to the filing of the March 20, 1961, application, the defendant abandoned the April 22, 1959, application, and concludes that "the second application . . . , as a continuing application", is entitled to an effective filing date of April 22, 1959.

It is clear from Mr. Fogo's argument that he proposes to contend at trial that, by virtue of some doctrine of abandonment that is subject to an exception in respect of continuing applications, which doctrine has been developed by United States jurisprudence under United States legislation and has received some rather indefinite recognition in the course of the administration of the United Kingdom and Canadian statutes of earlier times and by text book writers dealing with problems arising in another context, section 28(1)(*b*) must be read as though it referred to a description of the invention in a publication printed more than two years before an earlier abandoned petition instead of the petition pursuant to which the patent under attack was granted.

In my view, there is no room for argument as to the meaning of section 28(1)(*b*) as far as this problem is concerned. It clearly refers to a publication printed more than two years before the presentation of the "petition" "on presentation . . . of" which the "patent" attacked was "obtained". I can see no possible basis, and Mr. Fogo has referred me to no basis, for applying the doctrine upon which he relies to drastically alter the clearly expressed effect of the provision.

My conclusion is therefore that it is not fairly arguable that paragraph 5 of the Statement of Defence, either by itself or in conjunction with any of the remainder of the Statement of Defence, discloses any defence to the action.

The further question arises as to whether I should exercise my discretion and strike the paragraph out.

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I accept it that the defendant is advised that paragraph 5 of the Statement of Defence constitutes a fairly arguable defence and proposes, regardless of the outcome of this motion, to have the question passed upon, on appeal, if it is decided against it. I must, of course, recognize that events may show that, contrary to the view that I have formed, paragraph 5 raises a defence that is not only arguably valid, but is actually valid. It furthermore appears that the defence raised by paragraph 5 would require very little evidence in addition to that which would otherwise be required at the trial of the action, although it is evident that the argument in support of such defence will undoubtedly substantially prolong the argument that would otherwise be required. Finally, it is clear that, if I strike paragraph 5 out of the Statement of Defence, and if the defendant is to be in a position to rely upon it, it will have to appeal from my decision before the case comes to trial.

In all the circumstances, I have come to the conclusion that I ought not to strike paragraph 5 out of the Statement of Defence but that I should allow the defence raised thereby to be raised at the trial of the action, so that, in the event that there is to be an appeal to the Supreme Court of Canada, that question can be dealt with at the same time as any other question arising out of the case.

Nevertheless, I am of opinion that the plaintiff pursued a proper course in moving for an order to strike paragraph 5 out of the Statement of Defence and that the plaintiff ought, therefore, to have costs of the application in any event of the cause unless the defendant succeeds in obtaining a favourable judgment of this Court on the defence raised by paragraph 5, in which event the costs of this application are to be costs in the cause. It is, of course, a matter for the trial judge as to whether there should be any special disposition of other costs arising out of the defence raised by paragraph 5.

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