TAXATION DECISIONS AND RULINGS

The Credit Protectors (Alberta) Ltd.
v.
Minister of National Revenue[1]

This was an appeal from an assessment under the Excess Profits Tax Act, judgment in which was delivered by Cameron J. in the Exchequer Court of Canada on October 7th, 1946.

From the facts as stated in the judgment it appears that the appellant company, incorporated under the Companies Act of Alberta and carrying on business as a collection agency, had at all material times shareholders and holdings as follows:

Harold F. Alby	4 shares
Anna Frances Alby	70 shares
Roy E. Towns	1 share
J. Elva Towns	24 shares
Clifford Jones	1 share

Of the above shareholders, Roy E. Towns was employed by the appellant as secretary-treasurer and devoted his whole time to the interests of the Company. For his services he was paid in 1942 a total remuneration by way of salary and commission of $2,216.85.

The Company showed a profit of less than $5,000 for the year 1942. In making the assessment for that year the Minister added back to the profits of the Company the amount paid to the said Roy E. Towns, and as a result the profits then exceeded $5,000. The Company claimed exemption by virtue of section 7(A) of the Excess Profits Tax Act, which for the period involved read as follows:

> 7(A) The following profits shall not be liable to taxation under Section Three of this Act in accordance with the rates set out in the First and Second Parts of the Second Schedule to this Act:—
>
> The profits of a corporation or joint stock company which, in the taxation year, do not exceed the sum of five thousand dollars, or, where the taxation year of any corporation or joint stock company is less than twelve months, do not exceed the proportion of five thousand which the number of days in the taxation year of such corporation or joint stock company, bears to three hundred and sixty-five days, before providing for any payments to shareholders by way of salary, interest, dividends or otherwise.

[1] Not yet reported.

It may be noted here that the incidence of the Excess Profits Tax Act was upon all persons in Canada who derived income from the carrying-on of business. Where, however, the net income arising from such business was not in excess of $5,000 no tax was exigible. There is therefore, as pointed out by his Lordship, a liability to tax and any person claiming the exemption must clearly show that he comes within the exempting provisions. In this case the exemption was only to those companies whose profits in the taxation year did not exceed $5,000 "before providing for any payments to shareholders by way of salary, interest, dividends or otherwise". A contention on behalf of the appellant that the exemption should be interpreted in a generous fashion in order to give the benefit of the exemption to the appellant was rejected. His Lordship emphasizes the well-known principle of construction applied to taxing acts, to the effect that taxation is the rule and exemption is the exception and that any exempting clauses must be strictly construed.

The interest in this case lies in the fact that the shareholder whose salary was added back was the owner of only one share out of 100 issued. Following the principle established, it would follow that any widely-held corporation should add back to profits any salary paid to any shareholder who was employed by the company. In practice such a rule might be difficult to enforce and it would seem that the section is applied only in the case of closely-held companies. In this particular case it would appear from the evidence that a substantial number of shares was owned by the wife of the employee and this may have been the deciding factor in leading the tax authorities to apply strictly the provision of the section of the act quoted above.

Pure Spring Company Ltd. v. *Minister of National Revenue*[2]

On August 26th last Mr. Justice Thorson, President of the Exchequer Court, delivered judgment in the above case, an appeal against an assessment under the Income War Tax Act and the Excess Profits Tax Act in respect of the years 1940 and 1941. The subject matter of the appeal was the disallowance by the Minister of certain portions of salary and of the directors' fees paid by the appellant company to an employee and to its directors.

The judgment is commended as being an exhaustive discussion of discretionary powers of administrative officials under the particular section of the act and of numerous cases in connection therewith. It might be said to be a conclusive answer to the

[2] [1946] Ex. C.R. 471.

questions raised in two other recent appeals, *Nicholson Ltd.*, v. *Minister of National Revenue*[3] and *Wright's Canadian Ropes Ltd.*, v. *Minister of National Revenue*[4], which were discussed in vol. XXIII at p. 759 and in vol. XXIV at p. 241 of the Canadian Bar Review.

It is desirable to note certain facts in connection with the appellant company. Of the original 400 shares of the company, 397 were owned by Sadie Mirsky, and the business was managed by her husband, David Mirsky, who drew no salary for his services. The other 3 shares were in the name of Mrs. Mirsky's sons. Mrs. Mirsky occupied the office of, and received a salary as president. On her death in 1939 she left her shares to a son. Shortly after, in 1940, David Mirsky received one share and was made president and general manager at an annual salary of $7000 as from October 31st, 1939. The son who inherited the shares remained as vice-president with a salary increased from $2760 to $4000. Two other sons of Mrs. Mirsky remained as directors, holding one share each.

Upon assessing the returns of the appellant it was notified that it was proposed, among other things, to reduce the salary of the president from $7000 to $5000 pursuant to authority contained in section 6, sub-section 2, of the Income War Tax Act:

> 6(2) The Minister may disallow any expense which he in his discretion may determine to be in excess of what is reasonable or normal for the business carried on by the taxpayer. . . . .

The directors' fees were also disallowed, to which reference will be made, but not under this section. The disallowance of the portion of the president's salary was dealt with first by Mr. Justice Thorson.

He points out that the scope of the power given to the Minister under the section is very wide. He says:

> No exception is made for any class or kind of expense and no distinction is drawn between items of expense that are within the control of the taxpayer and those that are not. The fact that the taxpayer has paid the expense under a contractual obligation does not remove it from the scope of the power; there is no such limitation in the section. The obligation to pay the expense results from the contract; the right to deduct it is quite a different thing, for it depends on whether the statutory power of disallowance is exercised; if the Minister disallows an expense within his statutory power to do so, then whatever right there might otherwise have been to deduct it no longer exists, for it has been extinguished pursuant to the Act.

[3] [1945] Ex. C.R. 191.
[4] [1945] Ex. C.R. 174; [1946] S.C.R. 139.

This statement of the learned President is in conformity with the judgment of Cameron D.J. in the *Wright's Canadian Ropes Ltd.* case *supra*. It is true that the judgment in this case was reversed in the Supreme Court of Canada; nevertheless, his Lordship points out that in his opinion it supports his contention that the section in question is exclusively a matter for the Minister, and that there is no right of appeal from the Minister's decision to the court, provided that he has exercised his power in a proper manner.

His Lordship then proceeds to discuss the nature of the power that Parliament has delegated to the Minister. In an interesting discussion of the many authorities, he concludes that under the section in question a decision of the Minister is not a judicial one but is rather an administrative act with quasi-legislative effect. In doing so, he does not overlook the effect of section 6(1)(a) of the act, which reads:

> 6(1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> (a) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income.

It has been said that this section is one of the most important in the Income War Tax Act. It is placed in the section of the act the heading of which reads, "Deductions from Income Not Allowed". It must therefore be presumed that all disbursements or expenses are to be disallowed except those "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income". According to a well-established rule, exempting clauses are to be strictly construed in the interpretation of taxing acts. This is even more true when the exemptions are certain exceptions carved out of a total prohibition. In the *Wright's Canadian Ropes Ltd.* case Kellock J. in the Supreme Court took the view that section 6 (1)(a) gave a statutory right to the deduction of expenses which were "wholly, exclusively and necessarily" expended. It was not denied that the salary here in question would come within the exception. However, the learned President contends that section 6(1)(a) must be read as being qualified by section 6, sub-s. (2), and that there will be allowed under the former section only that amount which is determined by the Minister under the latter section if he should decide to exercise his power to make a determination thereunder.

A contention of the appellant that the Minister's discretion extended only to the excess of what is reasonable and normal,

and that what is reasonable or normal is a question of fact and not within the power of the Minister to determine, was rejected. In doing so the learned President said (at p. 478):

> It is obvious that in a great many cases it would be very difficult, if not impossible, to determine as a matter of fact that a particular expense is in excess of what is reasonable or normal for the business carried on by the taxpayer. Parliament realized this fact and decided to meet it by entrusting the Minister with the power to determine in his discretion in each case the amount of expense to be disallowed as being excessive; it is the determination of the excessiveness of an expense that is left to his discretion. . . . . The test of the correctness of the disallowance of an expense is not whether it is in excess of what is reasonable or normal as a matter of fact but whether it is in excess of what the Minister determines in his discretion to be reasonable or normal. The standard of correctness is the opinion of the Minister; it is a subjective one belonging exclusively to him; the Court has no right, in the absence of specific statutory authority, to measure it by any standard of its own or by any objective standard such as that of the 'ideal reasonable man'.

The other point involved in this appeal was the disallowance by the Minister of certain directors' fees paid by the company. The directors were David Mirsky and his three sons and the fees paid them totalled $800. These were all disallowed.

In dealing with this point his Lordship finds that they were not disallowed by virtue of any exercise of discretionary power under section 6, sub-s. (2) of the act. On the contrary, he finds that they were disallowed as not coming within the exception in section 6(1)(a) of the act as having been "wholly, exclusively and necessarily expended for the purpose of earning the income". He does not dissent from the view that such fees may be excluded under this section and refers to two cases, *Copeman* v. *Flood (William Sons)*,[5] an English case where it was held that excessive remuneration was not necessarily a deductible expense. In a New Zealand case, *Aspro Limited* v. *Commissioner of Taxes*,[6] the Privy Council affirmed a judgment of the courts of that country to similar effect with respect to directors' fees. In the New Zealand case, however, only a portion of the fees was disallowed. In discussing the disallowance of the fees "in toto" his Lordship says:

> The Court may properly determine whether the Commissioner was right in his findings of fact. Under its appellate jurisdiction the Court may deal with questions of fact as well as of law and in respect of the Commissioner's finding of fact on which the disallowances were based, it may, on its own view of the evidence, come to the conclusion that such

[5] [1941] 1 K.B. 202.
[6] [1932] A.C. 683.

> findings cannot be supported, and substitute its own findings with the result that the assessments must be amended accordingly; it need not refer the matter back to the Commissioner.

Reference was also made to the Australian case of *Robert G. Nale Ltd.* v. *Federal Commissioner of Taxation*,[7] where a portion of salary paid was disallowed as being excessive under legislation similar to that contained in section 6(1)(a) of the Income War Tax Act.

It may have no significance, but in dealing with this point his Lordship refers to the *Commissioner's* findings, apparently referring to the Commissioner of Income Tax, an office existent at the time the assessments were made. However, the assessments are, under the statute, made by the Minister and any findings, or the exercise of discretion, while in practice made by the Commissioner (or, as at present, by the Deputy Minister), must be deemed to be those of the Minister. It is not suggested, nor would it be reasonable to assume, that there is any distinction intended.

His Lordship says (at p. 527), after finding that meetings of the directors were actually held:

> It may fairly be inferred that such meetings were necessary for the proper conduct of the appellant's business and that the services of the directors in shaping and directing its policies were rendered for the purposes of contributing to its success; as such they were part of the process of profit making and directly connected with the earning of the income from the business. That being so, it seems to me that unless it is shown that the directors' fees were unreasonable or disproportionate to the value of the services rendered they should be regarded as an expenditure for the purpose of earning the income.

In the result the court ordered that the fees be allowed, except those paid to one of the directors, who had gone overseas with the armed forces, but who had nevertheless been paid the usual fees during his absence.

The importance of this case arises in the indication by his Lordship that expenses ordinarily allowed under the exceptions in section 6(1)(a) of the act may nevertheless be reduced for the same reason and to the same extent that they may be disallowed by the Minister under the exercise of the discretionary power in section 6, sub-s. (2). If this is so, it is difficult to understand why it was necessary to introduce section 6, sub-s. (2), into the act. While the matter is presently under judicial consideration, the trend of thought has been towards the idea that it is not necessary

[7] (1937), 4 Australian T.D. 335.

to give reasons for any disallowance under section 6(2). If however an expense, either in whole or in part, is disallowed under section 6(1)(a), it is purely an administrative action and must be supported by reasons. It would seem therefore that the objections raised by taxpayers as to their inability to have the taxing authorities disclose reasons for disallowances could be met by using the powers inherent in section 6(1)(a). Such power, his Lordship states, is as ample as that given in section 6(2), but is exercised upon a different basis. Consequently it would be subject to consideration and review by the courts, something which they have consistently refused to do in respect of findings properly made under section 6(2).

Bond v. *Minister of National Revenue*[8]
Rutherford v. *Minister of National Revenue*[9]

Judgment in the above appeals against assessments under the Income War Tax Act was delivered by Mr. Justice Thorson, President of the Exchequer Court, on October 31st. The cases were heard separately, but the facts in both were essentially the same.

Both appellants are duly qualified and practising members of the Manitoba Bar. Mr. G. F. D. Bond is employed as Counsel to the Corporation of the City of Winnipeg and receives a salary for his services. As part of his duties he is actively engaged in litigation on behalf of his employer and is required to appear and conduct proceedings in court and to do other and related work in his capacity as a qualified barrister and solicitor.

Mr. G. S. Rutherford is Legislative Counsel for the Province of Manitoba and Deputy Superintendent of Insurance. He is called upon to do work which can only be done by a person having a knowledge of law and its practice and, as found by his Lordship, he performs duties that only a lawyer could discharge.

Both appeals were from the disallowance by the Minister of the annual fees paid by the appellants to the Law Society of Manitoba, which they were required to pay if they were to retain their standing as qualified barristers and solicitors. The disallowance was based upon the dictum of Audette J. in *In re Salary of Lieutenant Governors*,[10] where it was said:

> But it is otherwise in the case where a person received an annual salary from any office or employment which is duly ascertained and capable of computation, and which constitutes of itself a net income.

[8] Not yet reported.
[9] Not yet reported.
[10] [1931] Ex. C.R. 232.

The judgment in which the above comment was made was delivered in 1924 and since then has been the basis upon which the income tax authorities have refused to recognize any deduction (other than those given by statute, such as charitable donations, medical expenses and superannuation contributions) against a fixed salary.

It seems difficult to understand the reason for the tax authorities proceeding with such appeals as these in view of the very definite conclusions reached by his Lordship in the appeal of *Samson* v. *Minister of National Revenue*.[11] In this judgment, which was not appealed, his Lordship stated that in his opinion the dictum of Audette J. quoted above was *obiter* and that a salary, wage or other fixed amount was not necessarily a "net" income.

His Lordship found that the appellants in the two cases under discussion were required by law to pay certain annual fees if they were to retain their standing at the Bar. He further found that such a standing was necessary in the performance of their duties and the earning of the salary in connection therewith. As a result he had no difficulty in allowing the appeals and in deciding that such fees were a proper deduction in determining the taxable income of the appellant.

Questions regarding certain other expenses which employees pay out in the course of their employment may well arise as a result of these judgments. One of these expenses is dues paid by a member of a union employed in what is known as a "closed shop". Such a payment is, however, readily distinguishable from those in question in these appeals. Union dues are not an obligation imposed by statute. They are voluntary contributions and are paid, not so as to maintain a status, but rather to obtain the benefits and advantages which can be gained through a union for personal benefit. A carpenter is employed not because he is a member of a union, but rather because he is skilled in carpentry, and he may perform the work incidental thereto without joining the union. There is no legal obstacle to him doing so, such as is the case with a solicitor, who is prohibited from performing the duties of a barrister or solicitor if he is not in good standing with the Law Society.

There are also other societies, clubs and associations to which employees belong and which may be useful and valuable to him in his work. However, the joining of such societies or organizations is purely voluntary and is not a necessary, though it may be a

[11] [1943] Ex. C.R. 17.

desirable thing to do in the performance of his duties. Such fees would not, therefore, be regarded as an allowable expense against salary income.

Alberta Pacific Consolidated Oils Limited

v.

Minister of National Revenue[12]

Judgment in the above appeal, taken under the provisions of the Income War Tax Act, was delivered by Mr. Justice Cameron of the Exchequer Court on the 2nd of October last. The assessment appealed against was in respect of the year 1940.

The contention of the appellant was that it was a corporation exempt from taxation by reason of the fact that it qualified under the provisions of section 4, paragraph (k), of the act, generally designated as a 4(k) company. The pertinent provision of the act reads:

> (4) The following incomes shall not be liable to taxation hereunder:
>
> (k) The income of incorporated companies (except personal corporations),
>
> (i) whose business operations are of an industrial, mining, commercial, public utility or public service nature, and are carried on entirely outside of Canada, either directly or through subsidiary or affiliated companies, and whose assets (except securities acquired by the investment of accumulated income and such bank deposits as may be held in Canada) are situate entirely outside of Canada, including wholly owned subsidiary companies which are solely engaged in the prosecution of the business outside of Canada of the parent company.

In discussing this provision his Lordship pointed out that there are three points which must be present before the company could claim the exemption:

(1) the company must be carrying on business of an industrial, mining, commercial, utility or public service nature;
(2) the operations of the company must be carried on entirely outside of Canada;
(3) all the assets of the company except securities and bank deposits must be outside of Canada.

On an agreed statement of facts it was shown that the company during the year 1940 carried out exploratory and drilling operations in Alberta. Such operations were one of the purposes

[12] Not yet reported.

and objects of the company and were in accordance with its charter. His Lordship held therefore that they were business operations. The contention of the appellant, however, was that no profit or gain was derived from such operations, in as much as they were unsuccessful. This contention his Lordship was unable to accept. He said that he was being asked to assume that there should be included in the act after the words "business operations" the words "which resulted in a profit", and he stated that he was unable to do so. His Lordship then goes on to point out that certain other operations of the company could be described as a business operation. These consisted of the sub-letting of a portion of its business office, from which it received a small rent.

With regard to the question whether the assets of the company were situated outside of Canada, the facts show that the company was the holder of certain leases, royalties and surface rights, all situated in the Province of Alberta and having a value of over a million dollars. The company also had a warehouse in Turner Valley, which was carried at nominal value, but in this warehouse there were certain stocks having a value in excess of a thousand dollars. Other assets were also mentioned. His Lordship pointed out that it might be that a company otherwise qualified under the section could have assets such as office furniture in Canada, and he was not disposed to disagree that it would be a fair interpretation of the act that they were not disqualified by having such assets. As he points out, the act "goes on the assumption that the company to be taxed is in Canada and it must of necessity have the essential requirements with which to carry on business but not necessarily assets which result in income or productive assets".

Further the company held certain assets in the way of shares having a value of $100. Nevertheless, as his Lordship points out, while the amount is small, it is definitely an asset and not acquired by the investment of accumulated income. Having also stated that in his opinion the company carried on activities of an industrial, mining or commercial nature, it was held that the appeal must be dismissed.

J. S. FORSYTH

Ottawa