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GUNNAR MINING LIMITED APPELLANT;

AND

THE MINISTER OF NATIONAL }
REVENUE } RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Mining company—New mine—Exemption for 3 years—Deduction of interest paid on debentures from interest received from investments—Whether interest on debentures to be considered in computation of depletion base—Income Tax Act, R.S.C. 1952, c. 148, ss. 11(1)(c), 12(1)(c), 83(5)—Income Tax Regulations, s. 1201(2), (4)(d).

In 1954, the appellant company borrowed \$19,500,000 by way of a debenture issue and used the money to develop its uranium mine. The 36-month taxation exemption period under s. 83(5) of the *Income Tax Act*, R.S.C. 1952, c. 148, commenced on March 1, 1956, and ended on February 28, 1959. During that period the income derived from the operation of its mine was not included in computing the appellant's income for tax purposes. By 1957, the appellant was able to accumulate profits from the production of the mine at such a rate that they exceeded the requirements for the payment of interest on the debentures as well as the requirements for repayment of the said debentures. The company decided then to invest its profits in short term investments. In assessing the appellant, the Minister added to the taxable income of the appellant the income received from the short term investments for the years 1958, 1959 and 1960. The appellant submitted that, in accordance with recognized accounting practice, the interest paid on the debentures should be deducted from the interest received on the short term investments so as to report only the net amount as income. It argued that during the tax exempt period, the interest paid could be regarded as a cost of earning the non-exempt income received from the short term investments. It argued further that, following the tax exempt period, the interest paid on the debentures should not be deducted in computing its depletion base under s. 1201(2) of the *Income Tax Regulations*. The Exchequer Court affirmed the Minister's assessment. The company appealed to this Court.

Held: The appeal should be dismissed.

The income from the short term investments was not income derived from the operation of the mine within the meaning of s. 83(5) of the *Income Tax Act*, but was income derived from the investment of the profits of the mine. That income could not be claimed as exempt under the Act.

The Minister rightly refused to allow a depletion allowance upon the income received from the short term investments. Such income could not be considered as profits for the taxation year reasonably attributable to the production of prime metal or industrial minerals, within the meaning of s. 1201(2) of the *Regulations*.

Revenu—Impôt sur le revenu—Compagnie minière—Nouvelle mine—Exemption pour 3 ans—Déduction des intérêts payés sur des titres d'obligations d'intérêts provenant d'investissements—L'intérêt sur les titres d'obligations doit-il être considéré dans le calcul de la base de déduction—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, arts. 11(1)(c), 12(1)(c), 83(5)—Règlements de l'impôt sur le revenu, art. 1201(2), (4)(d).

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En 1954, la compagnie appelante a emprunté \$19,500,000 sur émission de titres d'obligations et a utilisé cet argent pour développer une mine d'uranium lui appartenant. La période de 36 mois d'exemption de taxe sous l'art. 83(5) de la *Loi de l'impôt sur le revenu*, S.R.C. 1952, c. 148, a commencé le 1^{er} mars 1956 pour se terminer le 28 février 1959. Durant cette période le revenu provenant de l'exploitation de sa mine n'a pas été inclus dans le calcul du revenu de l'appelante pour fins de taxation. Dès l'année 1957, les profits provenant de la production de la mine s'accumulaient à un tel degré qu'ils excédaient les montants requis pour payer l'intérêt sur les titres d'obligations ainsi que pour faire les versements en vue du rachat de ces titres d'obligations. La compagnie a alors décidé d'investir ses profits dans des investissements à court terme. Dans la cotisation des revenus de l'appelante, le Ministre a ajouté au revenu taxable le revenu provenant des investissements à court terme pour les années 1958, 1959 et 1960. L'appelante soutient que selon la pratique reconnue en comptabilité, l'intérêt payé sur les titres d'obligations devait être déduit de l'intérêt provenant des investissements à court terme pour que seul le montant net soit déclaré comme revenu. Elle soutient que durant la période d'exemption de taxe, l'intérêt qu'elle payait pouvait être considéré comme étant une partie du coût requis pour gagner le revenu non exempt provenant des investissements à court terme. Elle soutient de plus qu'une fois la période d'exemption de taxe terminée, l'intérêt qu'elle payait sur les titres d'obligations ne devait pas être déduit dans le calcul de la base de déduction sous l'art. 1201(2) des *Règlements de l'impôt sur le revenu*. La Cour de l'Échiquier a confirmé la cotisation du Ministre. La compagnie en appela devant cette Cour.

Arrêt: L'appel doit être rejeté.

Le revenu provenant des investissements à court terme n'était pas un revenu provenant de l'exploitation de la mine dans le sens de l'art. 83(5) de la *Loi de l'impôt sur le revenu*, mais était un revenu provenant de l'investissement des profits de la mine. On ne peut pas dire que ce revenu était exempté sous la loi.

C'est avec raison que le Ministre a refusé de permettre une déduction sur le revenu provenant des investissements à court terme. Un tel revenu ne pouvait pas être considéré comme étant un profit pour l'année de taxation raisonnablement imputable à la production du métal brut ou de minéraux industriels dans le sens de l'art. 1201(2) des *Règlements*.

APPEL d'un jugement du Juge Gibson de la Cour de l'Échiquier du Canada¹, en matière d'impôt sur le revenu. Appel rejeté.

¹ [1966] Ex. C.R. 310, [1965] C.T.C. 387, 65 D.T.C. 5241.

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APPEAL from a judgment of Gibson J. of the Exchequer Court of Canada¹, in an income tax matter. Appeal dismissed.

R. M. Sedgewick, Q.C., and J. A. Langford, for the appellant.

D. G. H. Bowman and Paul Dioguardi, for the respondent.

The judgment of the Court was delivered by

SPENCE J.:—This is an appeal from the judgment of the Exchequer Court¹ delivered on September 30, 1965, which dismissed the appeal from the decision of the Tax Appeal Board delivered on September 24, 1963. By that decision the Tax Appeal Board had confirmed the assessment of the Minister as to the 1958, 1959 and 1960 income tax payable by the appellant.

The Minister in his assessment had added to the taxable income of the appellant income from short term investments received in each of the said years. The following were the circumstances.

The appellant, or perhaps one might more correctly say the appellant's predecessor Gunnar Mines Limited, was developing a very large uranium ore open pit mine at Beaver Lodge in the Lake Athabasca area of Saskatchewan. The ore had been sold to Eldorado Mining & Refining Limited under a contract providing for total payments of nearly \$77,000,000. Gunnar Mines Limited determined to borrow on debenture a capital sum of \$19,500,000 and for such purposes issued 5 per cent debentures in that sum. The Canada Permanent Trust Company was the trustee for the debenture holders and as such received the net proceeds of the sale of the debentures in the sum of \$18,700,000. The said proceeds were held by the said trust company and paid out to Gunnar Mines Limited from time to time upon the latter's certificates as to the payment of the costs of construction of the proposed mine. Those parts of the proceeds of the debentures issued which were not immediately required by Gunnar Mines Limited for the purpose of expenditure upon the construction of the mine

¹ [1966] Ex. C.R. 310, [1965] C.T.C. 387, 65 D.T.C. 5241.

were kept invested by the trustee in short term securities and the income therefrom in the amount of \$104,000 was used by Gunnar for construction purposes. That item of \$104,000 was charged against the 5 per cent interest payable on the outstanding debentures. In making its 1954 and 1955 income tax returns, Gunnar divided the sum of \$104,000 between these two taxation years and deducted the two amounts from the interest paid on the 5 per cent sinking fund debenture. That process was permitted by the Minister in the two years mentioned.

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The mine was completed in October 1955 and all the proceeds of the debentures were paid out by the trustee to Gunnar on or before that time. The income tax authorities agreed to consider the period between October 1955 and February 28, 1956, as a run-in period and to take the following day, i.e., March 1, 1956, as the first day upon which production of the mine commenced. This was for the purpose of applying the 36-month taxation exemption under s. 83(5) of the *Income Tax Act* to which reference shall be made hereafter.

Production of uranium from the mine was so successful that the taxpayer was able to accumulate profits therefrom at such a rate that they exceeded the requirements for the payment of interest on the debentures and also the requirements for repayment in instalments of the said debentures. Under the trust deed, those debentures were to be redeemed as follows:

October 1, 1956	\$ 2,500,000
October 1, 1957	4,250,000
October 1, 1958	4,250,000
October 1, 1959	4,250,000
October 1, 1960	4,250,000
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Total	\$19,500,000

The company, therefore, had to determine its course. It could use these funds to redeem the sinking fund debentures prior to their due date or the company could go out into the market and purchase for cancellation the said sinking fund debentures or it could invest its profits in such short term securities as would permit it to redeem the sinking fund debentures in accordance with the terms of

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the trust deed. Had the company called the sinking fund debentures for redemption prior to their due date it would have been required to pay a premium. It was informed by its financial advisers that if it sought to go into the market to purchase the said sinking fund debentures for cancellation the market would immediately react so that the price would increase to equal the premium for redemption prior to the due date and the company therefore determined to invest its profits in short term securities.

In the three years under consideration, i.e., 1958, 1959 and 1960, this resulted in the taxpayer receiving an income from the said short term securities as follows:

1958	\$231,197.94
1959	412,852.85
1960	504,763.64 (as adjusted by the Minister in his reassessment)

During the same years, the liability for interest upon the 5 per cent sinking fund debentures of the taxpayer was in these amounts:

1958	\$485,878.00
1959	263,092.00
1960	114,603.00

The 36-month exemption period allowed by s. 83(5) to which I have referred above having commenced on March 1, 1956, ended on that day in 1959, and therefore the 1959 figures must be divided so that the first two months showed an income from short term investments of \$68,922.28 and the remaining ten months in the next exemption period showed an income from such short term investments of \$343,930.57, while the interest payable on the 5 per cent sinking fund debentures in the first two months was \$60,152 and in the remaining ten months, i.e., the non-exempt period, was \$175,940. That the financial advisers' opinion was a sound one is demonstrated by the fact that during those three years the interest payable on the 5 per cent sinking fund debentures totalled \$836,572.90 while the income received on the short term investments made by the company out of its profits in the same three years totalled \$1,148,814.20, a credit of \$312,241.30.

Mr. Richard M. Parkinson, a chartered accountant, described before Gibson J. in the Exchequer Court the method used by the company in its accounting. His evidence is summarized by the learned Exchequer Court Judge as follows:

The evidence of Mr. Parkinson in brief was that it was proper from a commercial and business point of view for the Appellant, or indeed for any business, to differentiate in its statement of income and expenditures between what he refers to as "operating items" and "non-operating items".

The figure obtained by considering only operating items, this witness said, results in arriving at a figure of "operating income". This is done by first obtaining the figure of gross sales less returns, allowances, etc., and subtracting from that sum the cost of sales to arrive at a figure for gross profit. From this figure is then deducted selling expenses and general and administrative expenses from which the figure of operating income is obtained.

Then this witness said it is proper to consider the non-operating items in the business.

These non-operating items the witness said are categorized as "other income", and include interest and dividends and miscellaneous items on the receipt side and also on the disbursement side; and from which there is computed the figure of income before federal and other taxes. Then the witness said that it is proper to make a computation of federal and other taxes and subtract the figure so found from the figure of income above referred to, in order to obtain the figure of "net income" of the business for the fiscal year.

The learned Exchequer Court Judge in his reasons said:

I accept Mr. Parkinson's evidence in so far as it describes a method currently recommended as good practice and employed by many accountants in determining the profit or loss of a company from its business operations including miscellaneous revenues of investments of surplus cash. His method no doubt is not only good accounting practice, but is also acceptable as a method of determining the company's income for the purpose of the *Income Tax Act* for a fiscal year (when the company is taxable on its income from all sources) in that it is not contrary to any particular statutory direction.

In the matter under appeal, however, what is being considered is not income for the year from all sources but income from a source other than the company's mining business, namely, the income from its short term investments.

(The underlining is my own).

I am in agreement with that comment.

Section 83(5) of the *Income Tax Act* provides:

83. (5) Subject to prescribed conditions, there shall not be included in computing the income of a corporation income derived from the operation of a mine during the period of 36 months commencing with the day on which the mine came into production.

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Section 11(1)(c) of the said *Income Tax Act* provides:

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:

- (c) an amount paid in the year or payable in respect of the year (depending upon the method regularly followed by the taxpayer in computing his income), pursuant to a legal obligation to pay interest on
 - (i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt),
 - (ii) an amount payable for property acquired for the purpose of gaining or producing income therefrom or for the purpose of gaining or producing income from a business (other than property the income from which would be exempt), or
 - (iii) an amount paid to the taxpayer under . . .

The appellant, therefore, was entitled under s. 11 of the *Income Tax Act* to deduct from its income the interest which it would be required by law to pay on the 5 per cent sinking fund debentures. That amount in the year 1958 was \$485,878, in the year 1959 was \$236,092, and in the year 1960 was \$114,603.

The appellant did not deduct those amounts from its taxable income but in each year a smaller amount which resulted from crediting against that interest payable the income received from its short term investments. In fact in 1959 and 1960 that income far exceeded the interest payable. The result in the tax exempt period which covers the whole of the year 1958 and the first two months of 1959 was that those amounts of income from short term investments were thrown into the income from the operation of the mine and therefore claimed as exempt under s. 83(5) of the *Income Tax Act*. What is exempt under the latter section is "income derived from the operation of a mine". The income from the short term investments was not income derived from the operation of the mine but was income derived from the investment of the profits of the mine. This income from the short term investments cannot be regarded as incidental income in the operation of the mine any more than any other income gained from use of the profits of the mine could be so considered.

As the learned member of the Tax Appeal Board noted in his reasons:

Even if Gunnar had held the surplus revenue from its mine on deposit, the bank interest could not be said to be derived from the operation of its mine.

Counsel of the appellant stressed the circumstance that in the tax exempt period the corporation also showed as incidental income rental which it received from the letting of certain houses at the mine property and argued that the income from the short term securities was just another form of income incidental to the mining operation. I do not think that the argument can be accepted. Those houses were built by the company so that its workers at the mine might reside therein. Certainly their construction and letting, and the receipt of rental therefrom, was incidental to the operation of the mine. To put it perhaps colloquially, during the tax exempt period the appellant was operating two businesses—firstly, a mining business, and secondly, an investment business, and the fact that its purpose in operating the second business was so that it might accumulate funds in a readily realizable form with which it could pay off the 5 per cent sinking fund debentures if they became due makes it nonetheless the operation of a second business.

In my view, this is sufficient to dispose of the appellant's appeal in reference to the tax exempt period ending on February 28, 1959.

The appellant's appeal as to the non-exempt period being the last ten months of the year 1959 and the last eleven months of the year 1960 (the fiscal year having been altered to end on November 30) deals with the Minister's refusal to allow the quantum of the depletion allowance claimed by the appellant as authorized by regulation 1201(2) made under the *Income Tax Act*. The said regulation provides:

1201. (2) Where a taxpayer operates one or more resources, the deduction allowed is 33½% 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 of the resources operated by him

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The appellant claimed a depletion allowance upon its total income including income from these short term investments. As the learned Exchequer Court Judge remarked:

In the matter under appeal, however, what is being considered is not income for the year from all sources but income from a source other than the company's mining business, namely, the income from its short term investments.

It would seem that the income from such short term investments could not possibly be considered as "profits for the taxation year reasonably attributable to the production of . . . prime metal or industrial minerals . . .". I am, therefore, of the opinion, that the Minister's limitation on the depletion allowance as confirmed by the Income Tax Appeal Board and the Exchequer Court was a proper one.

For these reasons, I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Miller, Thomson, Hicks, Sedgewick, Lewis & Healey, Toronto.

Solicitor for the respondent: D. S. Maxwell, Ottawa.
