THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

GOLDSMITH BROS. SMELTING AND REFINING COMPANY LIMITED ..... RESPONDENT.

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

THE L. D. CAULK COMPANY OF CANADA LIMITED ..... RESPONDENT.

1953
*Oct. 8, 9

1954
*Jan. 26

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Whether legal expenses incurred in making representations to the Commisisoner under the Combines Investigation Act and in *successfully defending charge under Criminal Code* regarding operation *of alleged illegal combine, are deductible under s. 6(1)(a) of the Income War Tax Act, R.S.C. 1927, c. 97 as amended.*

The legal expenses incurred by the respondent companies in connection with an investigation into an alleged illegal combine and in successfully defending a charge under s. 498 of the *Criminal Code* regarding the operation of such alleged illegal combine, were deductible in ascertaining taxable income as they were "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within the meaning of s. 6(1)(*a*) of the *Income War Tax Act,* R.S.C. 1927, c. 97. (*Minister of National Revenue v. The Kellogg Company of Canada Ltd.* [1943] S.C.R. 58 followed).

*PRESENT: Rinfret C.J. and Kerwin, Rand, Kellock, Estey, Locke and Fauteux JJ.

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APPEALS from the judgment of the Exchequer Court of Canada (1), Cameron J., affirming the decision of the Income Tax Appeal Board and holding that certain legal expenses incurred by the respondents were deductible under the *Income War Tax Act* in ascertaining their taxable income.

F. P. Varcoe Q.C. and K. E. Eaton for the appellant.

J. Sedgwick Q.C. and Stuart Thom for the respondent Goldsmith Bros. Smelting and Refining Co. Ltd.

J. D. Pickup Q.C. for the respondent L. D. Caulk Company of Canada Limited.

The judgment of the Chief Justice and Rand, J. was delivered by:—

RAND J.:—The question here is whether expenses incurred by the respondent company in defending itself against charges of violating the criminal law by combining with others to prevent or lessen unduly competition in the commercial distribution of dental supplies, are deductible in ascertaining taxable income. The agreement or arrangement alleged to have been unlawful purported to regulate day to day practices in the conduct of the respondent's business. It formed no part of the permanent establishment of the business; it was a scheme to govern operations rather than to create a capital asset; and the payment to defend the usages under it was a beneficial outlay to preserve what helped to produce the income. These expenses included legal fees both for appearing before the Commissioner under the *Combines Investigation Act* and at the trial which resulted in acquittal.

The provisions of the *Income Tax Act* are imposed on the settled practices of commercial accounting, but they create in effect a statutory mode of determining taxable income. Deductions from revenue must have been "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income". Each word of this requirement is significant, and decisions based on different statutory language are strictly of limited assistance.

(1) [1952] Ex. C.R. 49.

The payment arose from what were considered the necessity of the practices to the earning of the income. The case is then governed by *The Minister v. Kellogg* (1). Proceedings there had been brought against the company to restrain it from using certain ordinary descriptive words in connection with the sale of its products and the expenses had been incurred in successfully resisting them. That use was likewise part of the day to day usage in marketing the company's products and the expenses were held to be deductible.

The word "necessarily" was urged by Mr. Varcoe as being unsatisfied by the facts. This term is not found in the English Act and it cannot be taken in a literal or absolute sense. Fire insurance, for instance, is admittedly a deductible expense, and yet how can it be said to be necessary when thousands of business houses have gone through generations of trade without loss from fire? The word must be taken as it was in *Kellogg* in the commercial sense of necessity.

The judgment of this Court in *The Minister v. Dominion Natural Gas* (2), is clearly distinguishable as having been a case of expenses to preserve a capital asset in a capital aspect.

I would therefore dismiss the appeal with costs.

The judgment of Kerwin and Fauteux, JJ. was delivered by:—

KERWIN J.:—The facts are set forth in the reasons for judgment of Mr. Justice Cameron (3) and, on those facts, as to which there is no contradiction, these appeals are covered by the decision of this Court in *Minister of National Revenue* v. *The Kellogg Company of Canada Ltd.* (1). There the previous decision in *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (2), was distinguished, as it is distinguishable here, since in that case the Court was concerned with money paid to preserve a capital asset. The legal fees paid by each of the respondents were necessary in a commercial sense and were wholly and exclusively laid out or expended for the purpose of earning

(1) [1943] S.C.R. 58. (2) [1941] S.C.R. 19.
(3) [1952] Ex. C.R. 49.

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the income (*Riedle Brewery Ltd.* v. *Minister of National Revenue* (1) and, therefore, do not fall within the prohibition contained in section 6(1)(*a*) of the *Income War Tax Act*, 1927, c. 97, as amended.

The appeals should be dismissed with costs.

The judgment of Kellock and Locke, JJ. was delivered by:—

KELLOCK J.:—The question involved in these appeals, which were argued together, arises under section 6(1)(*a*) of the *Income War Tax Act*. In 1947, the respondents, both of whom carry on the business of manufacturing dental supplies, were, along with others, invited by the Commissioner under the *Combines Investigation Act*, R.S.C., 1927, c. 26, then conducting an investigation into an alleged combine in Canada in the manufacture and sale of the above materials, to make representations before him. The respondents did so and for this purpose employed solicitors. Subsequently, in 1948, a charge was laid against the respondents and others under the provisions of section 498(1)(*d*) of the *Criminal Code*. The respondents were acquitted and their acquittal was affirmed on appeal. In making their returns of taxable income, the respondents sought to deduct from gross profits the legal expenses thus incurred in the respective years. The Minister refused to admit the deductions but his ruling was reversed by the Income Tax Appeal Board, whose decision was, in turn, affirmed by Cameron J., in the Exchequer Court (2). These appeals now result.

The proper construction of the statute has already been considered by this court more than once. In *Minister of National Revenue* v. *The Dominion Natural Gas Company Limited* (3), Duff C.J.C., in delivering the judgment of himself and Davis J., said at page 22:

> First, in order to fall within the category "disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning the income", expenses must, I think, be working expenses; that is to say, expenses incurred in the process of earning "the income".

The judgments of the other members of the court are to the same effect. It was held that the legal expenses of the then respondent in defending an action brought against it

(1) [1939] S.C.R. 253.
(2) [1952] Ex. C.R. 49.
(3) [1941] S.C.R. 19.

to restrain it from selling gas in a certain portion of the City of Hamilton, alleged by the appellant to be the subject of an exclusive franchise held by the latter, were not deductible.

In *Minister of National Revenue* v. *The Kellogg Company of Canada, Limited* (1), the respondent company had incurred legal expenses in defending a suit brought against it for an injunction to restrain the alleged infringement of certain registered trade marks of the appellant by the respondent in the use by the latter of certain words in connection with the sale of some of its products. These trade marks were, however, held invalid. The respondent subsequently sought to deduct the expense of these proceedings in ascertaining its taxable income, and it was held it was entitled so to do. In delivering the judgment of this court, the Chief Justice pointed out that, in the ordinary course, legal expenses are simply current expenditures and deductible as such and, in referring to the decision in the *Dominion Natural Gas Company,* said at p. 60:

> It was held by this Court that the payment of these costs was not an expenditure "laid out as part of the process of profit earning" but was an expenditure made "with a view of preserving an asset or advantage for the enduring benefit of the trade", and, therefore, capital expenditure.

In the case then before the court it was held that the respondents were not relying upon "a right of property or an exclusive right of any description" as in the *Natural Gas* case, but "the right (in common with all other members of the public) to describe their goods in the manner in which they were describing them."

In my view the principle of these decisions has been correctly applied by the learned trial judge in the circumstances here present. In *Kellogg's* case the taxpayer was challenged as to his right to use a certain trade description in the selling of his goods, while in the case at bar the taxpayer was challenged as to his right to employ a certain trade practice. In each case the expense incurred in defending the challenge was, in my view, "working expenses", that is to say "expenses incurred in the process of earning the income". The income was earned in the one case by the employment of the trade description and in the other, by

(1) [1943] S.C.R. 58.

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the employment of the trade practice. In my opinion it makes no difference that in the one case the challenge was by a private party, while in the other it was by the Crown.

It must be assumed in the case at bar, by reason of the acquittal, that the trade practices involved were not illegal, and, as pointed out by Cameron J., it is not necessary to consider the situation had the contrary been the case. The difference for present purposes is substantial.

On the argument we were referred to a number of other authorities but I do not find it necessary to refer to any of them. They are but applications of the principle in other circumstances. In my view the expenses with which we are here concerned were not merely indirectly related to earning the income in question but were "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within the meaning of section 6(1)(*a*).

I would dismiss the appeals with costs.

ESTEY J.:—I concur in the dismissal of the appeals with costs.

Appeals dismissed with costs.

Solicitor for the appellant: *A. L. DeWolf.*

Solicitors for the respondent: Goldsmith Bros. Smelting and Refining Co.: *Smith, Rae, Greer, Sedgwick, Watson & Thom.*

Solicitors for the respondent: The L. D. Caulk Co.: *Fasken, Robertson, Aitchison, Pickup & Calvin.*