DOMINION TELEGRAPH SECURITIES LIMITED ..... } APPELLANT;

AND

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

1946

* May 29
* Oct. 1

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Income tax—Revenue—Interest on bonds of company held by trustee of sinking fund to retire bonds—Income—Deductible expense—Redemption of bonds—Payment on account of capital—Income War Tax Act, section 6 (1) (b)—Whether "contingent" qualifies "sinking fund" in that section—Evidence—Admissibly—Hearsay—Statements made in course of duty by deceased party—Surrounding circumstances when construing instrument—Duty to be clearly established—Collateral matters—

*PRESENT:—Kerwin, Taschereau, Rand. Kellock and Estey JJ.

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Held: that, under its special terms, the contract, out of which the moneys arose which were claimed to be income, was a sale to the lessee of the reversion of plant and franchises of a telegraph undertaking and not a present sale of the undertaking involving a cancellation of the existing lease; that the supplementary arrangement, as between the vendor and the trustee for its bondholders to whom the bonds were issued in exchange for stock which they held as shareholders of the vendor, was that of a serial redemption; that the moneys assigned by the vendor to the trustee out of which interest and redemption payments were made, apart from a special sum, the nature of which was not in dispute, were the original continuing rents, and therefore gross income for the purposes of the *Income Tax Act*.

Per Kerwin and Rand JJ.:—The word "contingent" in the context of section 6 (1) (*b*) does not qualify the word "sinking fund" in that paragraph. Three distinct accounts are therein specified and "contingent account" is the description of one of them.

The appellant company tendered testimony of witnesses and sought through them to adduce in evidence statements made by the general manager of the Dominion Telegraph Company, who died before the trial, relative to negotiations conducted by him on behalf of the Company in support of its contention that the rentals were considered as capital payments to recoup the Company for the loss of its capital assets.

Per Kellock J.:—The contemporaneous written evidence does not support such a contention, and it is doubtful if the oral evidence, assuming it is admissible at all, goes that far. It is not necessary however, to decide that point as the documents in the case negative such a view of the actual settlement. While surrounding circumstances may be regarded for the purpose of construing an instrument, the true legal position arising upon the instrument so construed may not be ignored in favour of the supposed "substance."

Per Estey J.:—Statements made in the course of duty by a deceased party are admissible as an exception to the hearsay rule, but the duty must be clearly established and the statements must be made in the course of that duty and not in connection with collateral matters.

Judgment of the Exchequer Court of Canada ([1946] Ex. C.R. 338) aff.

APPEAL from the judgment of the Exchequer Court of Canada, O'Connor J. (1), dismissing the appeal of the appellant company to that Court from the affirmation by the respondent of assessments under the *Income War Tax Act* upon income tax returns filed by the appellant company for the years 1926 to 1929 inclusively.

(1) [1946] Ex. C.R. 338;
[1946] 2 D.L.R. 417.

The material facts of the case and the questions at issue are stated in the above head-note and are more fully related in the judgments now reported.

L. A. Landriau K.C. for the appellant.

F. P. Varcoe K.C., W. R. Jackett and *A. A. McGrory* for the respondent.

The judgment of Kerwin and Rand JJ. was delivered by:

RAND J.: The contention of the appellant is that in 1925 when it became known that the telegraph system leased in 1878 by the Dominion Telegraph Company had in large measure lost its identity through changes in location and absorption in a larger system, an agreement was made by which the lease came to an end and the rights of the lessor under the lease as well as all its title to whatever property remained to it, were sold for a capital sum equal to the annual rents for the then unexpired term of the lease plus $116,640 at that time paid in cash. The former rents would in amount continue as capital instalments and the latter sum be put out at interest. Together these payments would represent to the Dominion Telegraph Company the plant, works and business which under the lease were to be kept intact and returned as a modern telegraph system. The continuation of the annual payments of $62,500 from 1925 to 1978 would amount to something over $3,000,000, and the sum in cash was calculated at compound interest to produce during the same period over a million dollars. No specific value was placed on the property, but the evidence generally and indefinitely treats it as two, three, four or more million dollars.

Now, that is a conceivable mode of dealing with a rather mixed up subject-matter; but if the parties intended the arrangement between them to be in that form it is unfortunate they did not so express it. The lease remained unaffected except the release of the covenants to keep the system in good working order and to deliver up the property in that condition when the lease terminated. And the consideration for the payment of $116,640 is dealt with in these words:

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Rand J.

Upon the expiration of the said lease on the 30th day of June, 1978, or upon its earlier termination as therein provided for, the Dominion Company and the Securities Company for the aforesaid sum of $116,640 hereby agree to transfer, quit claim and assign unto the Great Northwestern all of the Dominion Company's and the Securities Company's right, title and interest in and to all of the lines, telegraph system and properties conveyed by the said lease * * * provided however that the provision of the said lease with respect to the payment of rentals shall have been in all respects fully complied with.

And finally:

All future rents payable during the currency of the said indenture of lease and amounting to the sum of $62,500 per annum payable quarterly on the 1st days of January, April, July and October in each and every year during the currency of the said lease, shall be paid to the Securities Company which has acquired by purchase all the assets and goodwill of the Dominion Company subject to the terms and conditions of this agreement.

Moreover the appellant has shown the $62,500 on its tax return as income and a deduction of bond interest paid to the holders of the bonds has been allowed; and it is only in respect of the portion of the rents referrable to the bonds placed in the "sinking fund" so-called that the question of tax arises.

The "sinking fund" was provided by the form of the transaction as carried out between the shareholders of the Dominion Company and the Securities Company which was this: the latter, the purchaser, issued bonds for $1,000,000 carrying interest at 5½% per annum, which were distributed *pro rata* among the shareholders: the $116,640 was used in the first instance to buy in that value of those bonds and these were held by a trust company in the "sinking fund". The rent to the extent of $55,500 was paid quarterly to the trust company which disbursed the interest payable to the bondholders; but that portion representing interest on the bonds in the "sinking fund", in turn was used to redeem or buy in further bonds. The sum of $116,640 was more than necessary to bring about that redemption, and provision was made for the issue of 2,000 interest certificates likewise distributed among the shareholders to absorb the surplus. In the result, at the end of the lease all of the bonds would have been redeemed, the rents exhausted, the property divested, and the object of the Securities Company fulfilled.

It was an arrangement for a serial redemption of bonds, but that does not mean that the redemption moneys must be treated as capital; it is their character when and as received that determines their liability for income tax and not their subsequent application.

It is further contended that even on the other view the transfer of the moneys to the sinking fund, a fund here not "contingent", is outside of the provisions of section 6 (1) (*d*) which reads:

> Amounts transferred or credited to a reserve, contingent account or sinking fund, except such an amount for bad debts as the Minister may allow and except as otherwise provided in this Act;

and that the amounts are deductible from income. But the answer is twofold: there was no sinking fund properly so-called; and the word "contingent" in the context of the paragraph does not qualify "sinking fund"; three distinct accounts are specified and "contingent account" is the description of one of them.

The appeal should be dismissed with costs.

TASCHEREAU J.: I am of opinion that this appeal should be dismissed with costs.

KELLOCK J.: This is an appeal from the judgment of the Exchequer Court of Canada, O'Connor J., dated December 29, 1945, dismissing certain appeals by the appellant from assessments made under the provisions of the *Income War Tax Act* in respect of the years 1926 to 1929, inclusive. These assessments arose out of the following facts:

The appellant is the purchaser of the assets of Dominion Telegraph Company (which, for convenience, I shall refer to as the original company) under an agreement dated 12th January, 1925. It describes itself and the nature of its business in the income tax returns here in question as "owners of telegraph leases".

By an instrument dated 12th June, 1879, the original company demised to The American Union Telegraph Company, a New York corporation, "all the telegraph lines and the entire telegraphic system and plant" in Canada of that company for a term of ninety-nine years, commencing July 1, 1879, at a rental of $52,500 per annum,

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Kellock J.

with provision for an increased rental in certain circumstances. The lease included a covenant on the part of the lessee to keep the lines, system and plant in good working order and to pay all costs of renewals and all expenses of working and carrying on the same, including municipal taxes. The lease contained a further covenant on the part of the lessee to yield up the demised premises at the expiration of the term in good working order and repair.

By a further instrument, dated July 11, 1881, the above named lessee assigned the lease, with the consent of the original company, to The Western Union Telegraph Company, with the provision that the assignee might sublet such part of the lines, system and property to another company, namely, the Great North Western Telegraph Company of Canada, as it might deem proper; in which event the Western Union was to pay an additional rental of $10,000 per annum.

This last mentioned indenture was followed on the 26th August, 1881, by a further instrument by which The Western Union sublet to the Great North Western all the lines, system and property acquired from the original company west of the province of New Brunswick, the rent being increased to $62,500.

During the year 1922, and subsequent years, negotiations took place between the original company, the other companies mentioned and the Canadian National Railways, which had acquired the assets of the Great North Western Company, and it is said that it was discovered by the officers of the original company that all the wires and poles of the demised system had been removed from their original position on public highways and absorbed into the systems of one or other of the lessee companies and that the municipal franchises had become forfeited. Ultimately a settlement was arrived at and it is the nature of this settlement which gives rise to the controversy between the parties.

To carry out the settlement an agreement dated 15th January, 1925, between the original company, The American Union, The Western Union, the Great North Western and the appellant was executed. This document acknowledges receipt by the original company of the sum of $116,640 and in consideration therefor that company and the appel-

lant released the other parties from all claims in respect of the covenants in the indenture of the 12th June, 1879, to keep the telegraph lines, system and plant in good working order and to yield them up in the same condition. The agreement also contains the following provisions:

3. Upon the expiration of the said lease on the 30th day of June, 1978, or upon its earlier termination as therein provided for, the Dominion Company and the Securities Company for the aforesaid sum of one hundred and sixteen thousand six hundred and forty dollars ($116,640) hereby agree to sell, transfer, quitclaim and assign unto the Great North Western all of the Dominion Company's and the Securities Company's right, title and interest in and to all of the lines, telegraph system and properties conveyed by the said lease existing and being west of the province of New Brunswick in the Dominion of Canada and elsewhere west of the province of New Brunswick and the Dominion Company and the Securities Company hereby agree to sell, transfer, quitclaim and assign unto the Western Union all the Dominion Company's and the Securities Company's right, title and interest in and to all of the other lines, telegraph system and properties conveyed by the said lease; provided, however, that the provision of the said lease with respect to the payment of rental shall have been in all respects fully complied with.

4. The indenture of lease hereunto annexed as schedule "A" hereto and all the covenants, provisos, conditions, powers, matters and things whatsoever contained therein shall enure to the benefit of and be binding upon the successors and assigns of each of the corporate parties hereto and shall continue in full force and effect save and except as hereby expressly amended.

5. All future rents payable during the whole of the currency of the said indenture of lease and amounting to the sum of sixty-two thousand five hundred dollars ($62,500) per annum payable quarter-yearly on the 1st days of January, April, July and October in each and every year during the currency of the said lease, shall be paid to the Securities Company which has acquired by purchase all the assets and good will of the Dominion Company subject to the terms and conditions of this agreement.

It is the contention of the appellant that not only the sum of $116,640 but the continued payment of the rent of $62,500 were capital, both together being the consideration for the settlement of the claims by the original company in respect of the demised telegraph system and property.

The appellant put in evidence the minutes of a special general meeting of shareholders of the original company held on the 2nd April, 1924, called to consider a resolution approving the settlement, passed on the previous 18th of February by the directors. The resolution itself was not put in evidence. At this meeting the shareholders approved the resolution and authorized the officers of the company to execute a formal agreement. This became the agree-

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Kellock J.

ment of the 15th January, 1925. The minutes include a statement by Mr. Macrae, the secretary, to the shareholders explaining the negotiations. This includes a statement that the cash payment was arrived at on the basis of the then present value of the sum of $1,000,000 at the expiration of the term of the lease. As Mr. Macrae said

> "the sum of $1,000,000 was the goal because it was the value of the property when the lease was made and was also the amount of our stock. After still further discussions we were asked to name a figure and we offered to accept the sum of approximately $115,660, which, on a 4% basis instead of 5%, would realize $1,000,000 at the end of the term. The final exact figures will be adjusted by the actuaries of the Imperial Life and the Canada Life. This offer was accepted and passed by the board of the Canadian National Railways and the amount was approved by this board and a settlement authorized subject to the approval of the shareholders."

The $116,660 became $116,640.

Mr. Macrae does not refer at all to the continued payment of the rents but the president of the company, in his statement to the meeting, said:

> "The amount was arrived at as a sum which would, invested at 4% and interest compounded for the remainder of the term, produce a sum of not less than $1,000,000 which would pay to the shareholders the par value of their stock, $50 per share, *and in the meantime the rentals would continue to pay the dividends as heretofore.*"

The appellant tendered evidence of witnesses who testified to conversations with Mr. Macrae in support of its contention that the rentals were considered by those who negotiated the settlement as capital payments to recoup the company for the loss of its capital assets.

It is not argued as a matter of law that the lessees could, by destroying the demised telegraph system, put an end to their liability for the payment of rent. The argument is that by agreement the compensation for the lost assets was fixed at an immediate cash payment of $116,640 and instalment payments of $62,500 per annum, which, although formerly paid and received as rent, ceased to be such. I find no support in the contemporaneous written evidence for such a view and it is doubtful if the oral evidence, assuming it is admissible at all, goes that far. Certainly Mr. Hodgetts does not say so. It is not necessary however to decide this point as I think the documents negative such a view of the actual settlement. While surrounding circumstances may be regarded for the purpose of construing an

instrument, the true legal position arising upon the instrument so construed may not be ignored in favour of the supposed "substance"; *Inland Revenue Commissioners* v. *Westminster (Duke)* (1). No doubt the claims of the original company might have been settled in accord with what the appellant now contends. I do not think they were, but that the rent continued as rent and, accordingly, as revenue, and not capital. The agreement of January 12, 1925, is quite irrelevant in the determination of this question as it formed no part of the settlement. That agreement provided for the issue by the appellant, *pro rata,* to the shareholders of the original company of bonds of a par value of $1,000,000, to be secured by a mortgage of its assets to the Royal Trust Company, as well as certain "certificates of interest", the bonds and certificates ultimately to be retired by means of a "sinking fund" to be initiated by the "purchase" by the appellant of bonds of a par value of $109,000, using part of the $116,640 cash payment for that purpose. Provision was made for payment of the interest on the bonds by assigning to the trustee $55,000 out of the $62,500 annual rental. The bonds bore interest at 5½%. No dispute exists with respect to so much of the rentals as was required to pay the interest on any bonds other than the bonds held by this "sinking fund". It is the amounts claimed to have been paid as "interest" on these last mentioned bonds which are here in question.

In its argument the appellant says that:

> The appellant submits that on the evidence it is clearly established that what was to be received by the shareholders of the Company was $1,000,000, and, in addition, the recovery of rentals, dealt with below, and that, by the nature and character of the settlement, no part of the funds which were to represent $1,000,000 by a present settlement in 1924 can be held to be income subject to tax under the *Income War Tax Act* as an item of annual gain or profit to the appellant.

It may be said at once that no question arises on this appeal with respect to any taxation upon any

> part of the funds which were to represent $1,000,000 by a present settlement in 1924.

The fund which was to represent that particular $1,000,000 was the sum of $116,640. That was capital and was

(1) [1936] A.C. 1.

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Kellock J.

not and is not taxed. The above contention serves only to confuse the issue. Quoting again from the appellant's factum:

> The appellant submits that on the evidence the nature or character of the transaction was that $1,000,000 capital, and the continued payment of rentals, was to be available to the shareholders of the appellant's predecessor, The Dominion Telegraph Company.
>
> The respondent in assessing annually accumulations of interest received in sinking fund on such of the bonds of the issue of $1,000,000 principal amount issued to shareholders of The Dominion Telegraph Company as are held in sinking funds from time to time, has wrongly treated as taxable income the portions of the said $1,000,000 represented by such accumulations.

It is apparent that the appellant is here confusing two separate things. The first is the $116,640 received on the basis of its being the present value in 1924 of $1,000,000 payable in 1978 on a 4% basis. The second thing is the rental. On the documents already referred to this was income and no part of it ceased to be income merely because the appellant employed it at 5½% (the bond rate) to pay interest on outstanding bonds of an issue created by it.

If, then, the rental was never capital but revenue, on what basis does it become exempt from income tax? The appellant itself in its returns showed the $62,500 as "Rents received from Canadian National Telegraphs". It is said this was merely bookkeeping. I do not think that a sufficient answer. It is next said that $55,000 out of the rents was assigned to the trustee to meet the interest on the bonds and that the bonds in the "sinking fund" were just as much outstanding as those in any other hands. I think that is not so. In my opinion the bonds, when acquired by the sinking fund, ceased to be outstanding obligations of the appellant and payment of "interest" was impossible. The acquisition was simply redemption and it is interesting to observe that this is the word used in the bond mortgage itself. We have been referred to no provision of the law by which revenue becomes exempt from taxation because used by the tax payer for redemption of an outstanding capital obligation.

I would dismiss the appeal.

ESTEY J.: The issue in this appeal arises out of an agreement dated the 15th day of January, 1925, and made between the parties to a lease dated the 12th day of June, 1879, for a period of 99 years. The appellant contends that the agreement was a settlement of all matters under the lease. That it effected a cancellation of the lease and the sums payable thereunder are damages payable in lieu of a capital asset and as such not subject to income tax. The respondent contends that the agreement was a settlement of certain covenants only, that otherwise the lease continued in full force and effect. That of the two sums payable thereunder that of $116,640 payable forthwith was a settlement of these covenants and for income tax purposes treated as capital, but the other, $62,500 payable in each year thereafter, remained a payment of rent and was income and as such, subject to certain deductions, was taxable under the *Income War Tax Act,* 1917 (1927, R.S.C., ch. 97). The returns in this appeal were filed for the years 1926 to 1929 inclusive. In the Exchequer Court of Canada, Mr. Justice O'Connor, sitting in appeal from the decision of the Minister of National Revenue, found in favour of the respondent and dismissed the appeal.

Under date of June 12, 1879, The Dominion Telegraph Company leased to The American Union Telegraph Company for 99 years "all the telegraph lines and the entire telegraphic system and plant" "for and in consideration of the rents and covenants and agreements" therein specified. The rent, at first $52,500, subsequently was raised to $62,500, and at all times material to this litigation, was at the latter figure. This lease contained a covenant that the lessee would throughout the term "keep said telegraph lines, system and plant in good working order", and at its termination surrender

> the said demised premises and property in good working order and repair, with an adequate supply of instruments and plant of the most improved character * * *

The American Union Telegraph Company assigned this lease to The Western Union Telegraph Company, which company assigned it to The Great North Western Telegraph Company and after the Canadian National Railway System

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Estey J.

was formed it became as of April 2, 1924, the property of that system and was known as Canadian National Telegraphs.

About this time the directors of The Dominion Telegraph Company discovered that, whereas the rent had been regularly paid by the successive lessees, they had not maintained the line as the lease provided but had made alterations and so far merged it into the larger system that it would now be difficult if not impossible to carry out either of the covenants, to maintain or to surrender at the termination of the lease.

Negotiations consequent upon this discovery led to an agreement in writing dated the 15th of January, 1925, to which The Dominion Telegraph Company, The American Union Telegraph Company, The Western Union Telegraph Company, The Great North Western Telegraph Company and Dominion Telegraph Securities, Limited, were all parties. (Although negotiations were concluded with the officials of the Canadian National Railways, they were not made a party to this agreement. It is, however, admitted that The Great North Western Telegraph Company was taken over by the Canadian National Railways.) This agreement contained an acknowledgment of "the due execution and validity" of the original lease and the successive assignments thereof. It then provided that in consideration of the payment of $116,640 The Dominion Telegraph Company and Dominion Telegraph Securities, Limited, released the other parties thereto from the covenants in the lease,

which are to the following effect:

Firstly, that the lessee in the said indenture of the 12th of June, 1879, should, during the demised term, keep the said telegraph lines, system and plant in good working order and should pay all costs of renewals thereof and all expenses of carrying on the same, and

Secondly, that on the last day of the said term, or on the sooner determination of the estate thereby granted, the lessee should peaceably and quietly leave, surrender and yield up unto the Dominion Company all and singular the said demised premises and property in good working order and repair with an adequate supply of instruments and plant of the most improved character then in use on telegraph lines in America.

It then provided that upon the termination of the lease the lessors would

for the aforesaid sum of one hundred and sixteen thousand six hundred and forty dollars ($116,640) * * * sell, transfer, quitclaim and assign unto the Great North Western

the property leased (except as to a territory not material to this litigation), and the paragraph concluded:

Provided, however, that the provision of the said lease with respect to the payment of rentals shall have been in all respects fully complied with.

This agreement also contained the following paragraph:

4. The indenture of lease hereunto annexed as schedule "A" hereto and all the covenants, provisos, conditions, powers, matters and things whatsoever contained therein shall enure to the benefit of and be binding upon the successors and assigns of each of the corporate parties hereto and shall continue in full force and effect save and except as hereby expressly amended.

In the result this agreement released the lessees and their assigns from any covenant to maintain and to surrender all the telegraph lines and the telegraph system and plant at the expiration of the lease but that otherwise this lease shall remain "in full force and effect."

The rent remained at $62,500 per annum. The Dominion Telegraph Company therefore under this agreement had at its disposal the sum of $116,640 in cash and an income of $62,500 per year up to 1978. It was decided to wind up The Dominion Telegraph Company and to form another company known as Dominion Telegraph Securities, Limited. The latter company was incorporated under the laws of the province of Ontario and by an agreement in writing dated the 12th day of January, 1925, it purchased the entire assets, subject to the liabilities, of The Dominion Telegraph Company.

The Dominion Telegraph Securities, Limited, then entered into two agreements with The Royal Trust Company under the terms of which fifty-three year 5½% mortgage bonds in the sum of $1,000,000 were issued, as well as certificates of interest valued at that time at the sum of $5.25. As collateral Dominion Telegraph Securities, Limited, assigned the rent under the aforementioned lease in the sum of $62,500, payable quarterly commencing with the instalment dated 30th of April, 1925. These bonds and certificates of interest were delivered to the individual shareholders of The Dominion Telegraph Company in exchange for their shares.

The $62,500 was applied as received in each year $55,000 to pay the interest on the $1,000,000 5½% fifty-three year mortgage bonds and the balance for operating expenses of

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Estey J.

Dominion Telegraph Securities, Limited. The $116,640 was expended $56,500 to buy a block of these bonds, and another sum of $52,500 to purchase another block of these bonds, and all of these bonds as purchased were delivered to The Trust Company to be placed in a sinking fund. They were not to be then cancelled but were merely to be marked "Not negotiable, property of the sinking fund". The balance of the $116,640 was used as expenses. In every year interest was paid out of the $62,500 to The Royal Trust Company on these bonds in the sinking fund and as this interest was received it was expended in purchasing further of the outstanding bonds from the bondholders. These bonds as purchased were in each year placed in the sinking fund and marked "Not negotiable, property of the sinking fund".

The $56,500 capitalized at 5½% would realize at the end of the fifty-three year period $1,000,000. In fact the trustee in the first year received interest at the rate of 5½% upon the two amounts of $56,500 and $52,500 with which to purchase further bonds. It follows from this procedure that they would have in each successive year a larger amount with which to purchase additional bonds and at some time prior to the termination of the fifty-three year period all the bonds would be purchased, while the $62,500 per year would be collected up to the expiration of the lease in 1978. The trustee would have, therefore, a fund not required to redeem the bonds. This fact was realized at the outset and led to the issue by The Royal Trust Company, as trustee, of the certificates of interest.

These certificates of interest were provided for by a second agreement dated the 2nd day of February, 1925. Under that agreement these certificates entitled

the holder thereof to an interest in a fund which shall be in the possession of the trustee on the second day of February, 1978.

At the date of their issue they had a value of $5.25 which under this plan would increase in each year. A schedule attached to the certificate indicated from year to year its value, which in February 1978 would be $93.12.

These certificates were not transferable but could only be surrendered for cancellation with an assignment thereof.

After all the outstanding bonds have been purchased and placed in the sinking fund, but not before the 2nd of February, 1965, the trustee

shall proceed to redeem certificates at the value thereof as indicated by the schedule endorsed upon the said certificates.

But unlike the bonds, as purchased these certificates

shall forthwith after payment therefor by the trustee be cancelled by the trustee * * *

In filing its income tax return in each year the appellant disclosed the $62,500 as income and claimed as a deductible expense the $55,000. The taxing authorities varied this by allowing only those amounts of interest paid to the holders (other than the trustee) of the bonds, or in other words disallowing the amounts of $55,000 paid to the trustee in each year as interest on the bonds in the sinking fund.

The appellant submits that the agreement dated the 15th day of January, 1925, was in fact a settlement of all matters under the lease and in effect terminated the lease and the rights of the parties were thereafter determined only by that agreement of January 15, 1925. That it was made because the lessees had not carried out their covenants to maintain and would not be in a position to surrender the property leased at the expiration of the term. That the lessees were not in a position to pay a lump sum in an amount which the lessors would accept as compensation and therefore it was agreed that they would pay in cash the sum of $116,640 and the sum of $62,500 annually to the time when the lease would expire. That as a settlement these amounts were in their nature and character damages paid for the loss of a capital asset and should therefore be treated as capital and ought not to be subject to income tax.

The outstanding share capital of The Dominion Telegraph Company was $1,000,000 and the $116,640 capitalized at 4% would at the end of 53 years yield $1,000,000.

In support of its contention the appellant tenders an extract from the minute book of The Dominion Telegraph

1946

DOMINION TELEGRAPH SECURITIES LIMITED
v.
THE MINISTER OF NATIONAL REVENUE

Estey J.

Company under date of April 2, 1924. This minute indicates the negotiations leading up to the settlement and includes the following:

> He (the president) stated that the directors had then instructed Mr. Macrae to negotiate with the other lessees, the Great North Western Telegraph Company, now the Canadian National Telegraphs, and that the negotiations had been successful, and an offer had recently been made by the Great North Western Company to pay the sum of $115,660 for a release by this Company of the covenants in the lease above mentioned. The amount was arrived at as a sum which would, invested at 4%, and interest compounded for the remainder of the term, produce the sum of not less than $1,000,000, which would pay to the shareholders the par value of their stock, $50 per share, and in the meantime the rentals would continue to pay the dividends as heretofore.

Further on in the minutes the following appears:

> After still further discussions, we were asked to name a figure and we offered to accept the sum of approximately $115,660, which on a 4% basis instead of a 5% would realize $1,000,000 at the end of the term.
>
> The final exact figures will be adjusted by the actuaries of the Imperial Life and the Canada Life. This offer was accepted and passed by the board of the Canadian National Railways, and the amount was approved by this board, and the settlement authorized, subject to the approval of the shareholders.
>
> * * *
>
> We ask you to confirm the resolution passed by the board of directors and authorize the release of the covenants mentioned.

The sum of $115,660 mentioned in these minutes when adjusted by the actuaries was fixed at $116,640.

The words "for a release by this company of the covenants in the lease above mentioned" in the foregoing minutes refer to the covenants in the lease to maintain and repair. They are the only covenants mentioned prior thereto in the minutes and indeed throughout the minutes. It will be further observed that "the rentals would continue to pay the dividends as heretofore". That they were effecting a settlement for a breach of the two covenants to maintain and surrender the telegraph lines, system and plant is emphasized in these minutes by the last paragraph above quoted:

> We ask you to confirm * * * and authorize the release of the covenants mentioned.

The negotiations on behalf of the Dominion Telegraph Company were conducted by the late Mr. H. H. Macrae, secretary-treasurer and general manager of that company. A few years later Mr. Macrae died. The appellant called

two witnesses and sought through them to adduce in evidence statements made by the late Mr. Macrae relative to these negotiations to establish "the reason for and the extent of the settlement arrived at" and

the full facts explaining the nature and character of the settlement with Canadian National Railways.

That the statements made to the witnesses by the late Mr. Macrae were hearsay was not contested but it was contended that these statements were made in the course of duty to the witnesses by the late Mr. Macrae and therefore admissible in evidence. So far as the first witness is concerned, he was not associated with the company nor with Mr. Macrae at the times material and no evidence of any duty on the part of the late Mr. Macrae to make the statements to this witness was established. The other witness was a solicitor who was consulted by the late Mr. Macrae and who deposed as follows:

Q. Did you take any instructions from Mr. Macrae?

A. Yes, he gave me all my instructions.

Q. Instructions in relation to what?

A. He informed me what the settlement was with the Canadian National Railways and he consulted me as to the method of making a distribution of the proceeds of that settlement among the shareholders of Dominion Telegraph Company. I carried out those instructions.

Q. And those instructions were given to you when?

A. In 1924 and 1925.

Q. Approximately at the time of the settlement?

A. About the time of the settlement and before the money was paid over by the Canadian National Railways to Dominion Telegraph Company.

It will be observed that the solicitor was consulted after the settlement with Canadian National Railways and then as to the method of making a distribution of the proceeds of that settlement.

That statements made in the course of duty by a deceased party are admissible as an exception to the hearsay rule is clear, but the duty must be clearly established and the statements made in the course of that duty. In this instance any statements made by the late Mr. Macrae as to the negotiations and reason for the settlement would not be part of the instructions given to the solicitor with respect to the disposition of the proceeds but would only be collateral thereto and under the authorities not admissible.

1946

DOMINION TELEGRAPH SECURITIES LIMITED v. THE MINISTER OF NATIONAL REVENUE

Estey J.

Then it is said, if not a statement against interest, the letter is admissible as a memorandum made in the course of business and in the discharge of a duty to Barker's principals. But the rule as to the admission of such evidence is confined strictly to the entry of the particular thing which it is the duty of the person to do, and, unlike a statement against interest, does not extend to collateral matters, however closely connected with that thing.

Blackburn J., *Smith* v. *Blakey* (1). *O'Connor* v. *Dunn* (2).

> Then does it come within another exception, which is an entry made by a deceased person of something in the discharge of his duty? * * * the principle has never been questioned in any case, and it is this, that it must be an entry, not of something that was said, not of something that was learned, not of something that was ascertained, by the person making the entry, but an entry of a business transaction done by him or to him, and of which he makes a contemporaneous entry. For nothing else was it admissible, and it was received only because it was the person's duty to make that entry at the time when the transaction took place. The exception is entirely confined to that.

James L. J., *Polini* v. *Gray*, (3).

Quoted with approval by Bowen L. J. in *Lyell* v. *Kennedy* (4). See also *Regina* v. *Buckley* (5) and Phipson on Evidence, 8th ed., 282.

The express language of the agreement dated January 15, 1925, which relieved the lessees and their assigns from their obligations to maintain and to surrender "all the telegraph lines and the entire telegraphic system and plant"; that the sale and transfer of the leased property would take place only at the termination of the lease and then only:

> Provided, however, that the provision of the said lease with respect to the payment of rentals shall have been in all respects fully complied with.

that in all other respects the lease should continue in full force and effect; the extract from the minutes; and the practice of the Dominion Telegraph Securities, Limited, in preparing their income tax returns in each year disclosing the $62,500 as income all clearly indicate that apart from the release of the two covenants the lease continued in full force and effect. The $62,500 was at all times rent and under the circumstances of this case income. As to the

(1) (1867) L.R. 2 Q.B. 326 at 332.
(2) (1877) 2 O.A.R. 247.
(3) (1879) L.R. 12 Ch. D. 411, at 426.
(4) (1887) 56 L.T.R. 647, at 657.
(5) (1873) 13 Cox's C.C. 293

$116,640, it has been accepted as capital by the Minister of National Revenue and therefore there is no contest with respect to this item.

The principal issue upon this appeal is the disallowance by the taxing authorities as a deductible expense that portion of the $55,000 received by the trustee as interest on the bonds in the sinking fund. As and when received in each year this amount was utilized to purchase additional bonds which were then placed in the sinking fund and stamped "Not negotiable, property of the sinking fund". There is no provision for their ultimate cancellation but under the terms of the agreement they remain in the sinking fund.

Once so purchased and placed, these bonds are in reality paid and under this plan the amounts that would otherwise have been paid out as interest on these bonds are used to buy further bonds of this issue and thereby reduce the outstanding capital obligation of the Dominion Telegraph Securities, Limited. The agreements specifically provide for this, and further, when in the course of time these bonds have all been purchased, then this income shall be used to redeem the certificates of interest. In all the years material to the issues here to be determined, the amount of 5½% upon the bonds in the sinking fund was applied to purchase additional bonds. It was a "payment on account of capital" and therefore not deductible under the provisions of section 6 (1) (*b*) of the *Income War Tax Act*.

The appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitor for the appellant: *G. E. Hill.*

Solicitor for the respondent: *A. A. McGrory.*