CASES

DETERMINED BY THE

SUPREME COURT OF CANADA ON APPEAL

FROM

DOMINION AND PROVINCIAL COURTS

PIONEER LAUNDRY & DRY CLEANERS LTD. ..... APPELLANT;

AND

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

1938

*April 28, 29
* Dec. 12.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Income tax—Revenue—Amount deductible for depreciation—Discretion of the Minister of National Revenue—Income War Tax Act, R.S.C., 1927, c. 97, sections 2 (h), 3, 5, 6, 9, 60, 75, 80.

The appellant was incorporated under the *Companies Act* of British Columbia. On the form of income tax return for 1933, the appellant set out, for the purpose of an allowance for depreciation, the value of machinery and other equipment at $168,458.72, and the amount of depreciation claimed was $17,255.55. Such equipment had been purchased by the appellant from another company bearing the same name and having the same shareholders as the appellant company. The amount of depreciation was totally disallowed, except for a small amount of $255.08 in respect of three new motor cars, by the Commissioner of Income Tax, acting on behalf of the Minister of National Revenue, on the ground that, as the company who had sold the machinery and equipment had been allowed over a period of years approximately 100% depreciation in their work values, the appellant was not entitled to any deduction for depreciation upon the same machinery and equipment. Section 5 of the *Income War Tax Act* provides that "'Income' * * * shall * * * be subject to", as exemption and deduction, "such reasonable amount as the Minister, in his discretion, may allow for depreciation * * *." Upon appeal, the Exchequer Court of Canada affirmed the decision of the Minister of National Revenue.

Held, The Chief Justice and Davis J. dissenting, that the judgment appealed from should be affirmed.

Per Crocket and Hudson JJ.—The provisions of the relevant sections of the *Income War Tax Act* indicate that it was the intention of Parliament that there should be no depreciation allowance unless the Minister of National Revenue, in his sole discretion, decided that there should be. In this case, the Minister has exercised his discretion and the statute does not define or limit the field for operation of such discretion.

* PRESENT:—Duff C.J. and Crocket, Davis, Kerwin and Hudson JJ.

1938

PIONEER LAUNDRY & DRY CLEANERS LTD. v. THE MINISTER OF NATIONAL REVENUE.

Per Kerwin J.—The discretion conferred upon the Minister by section 5 of the Act has been exercised without disregarding any statutory provision; and there is no ground upon which his determination may be challenged.

Per The Chief Justice and Davis J. (dissenting): The ground upon which the Commissioner of Income Tax put his denial of any amount of depreciation was not a proper ground upon which to exercise the discretion that has been vested in the Minister. The Commissioner was not entitled, in the absence of any fraud or improper conduct, to disregard the separate legal existence of the appellant company, which was a new owner for all legal purposes; and its predecessor's depreciation allowance is immaterial when considering what is a reasonable amount to be allowed for its own depreciation. The decision of the Minister was not a legitimate exercise of the discretion which Parliament vested in him. The discretion granted by the statute to the Minister involves an administrative duty of a quasi-judicial character and is a discretion to be exercised on proper legal principles. The Commissioner, acting for the Minister, having exercised such discretion upon principles wrong in law, the case should be remitted to the reconsideration by the Minister of the subject-matter, stripped of the application of these wrong principles.

Judgment of the Exchequer Court of Canada ([1938] Ex. C.R. 18) affirmed, The Chief Justice and Davis J. dissenting.

APPEAL from the judgment of the Exchequer Court of Canada, Angers J., dismissing an appeal from the decision of the Minister of National Revenue confirming the appellant's assessment under the *Income War Tax Act* for the fiscal period of appellant ending March 31st, 1933.

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

Martin Griffin K.C. for the appellant.

F. P. Varcoe K.C. and *J. R. Tolmie* for the respondent.

The judgment of the Chief Justice and of Davis J. (dissenting) was delivered by

DAVIS J.—The appellant is a company which was incorporated under the *Companies Act* of British Columbia on the 23rd day of March, 1932, with its head office and principal place of business in the city of Vancouver, where it carries on a laundry and dry cleaning business. The company is a taxpayer within the definition of that word in the (Dominion) *Income War Tax Act,* R.S.C., 1927, chap. 97 and amendments. As in duty bound it made its income tax return to the Government for its fiscal year that ended March 31st, 1933. On the form of return supplied

by the Income Tax Department and required to be filled in and returned, the appellant set out, for the purpose of an allowance for depreciation, the value of the company's machinery at $146,690.13, furniture and fixtures at $5,740.74, horses and wagons at $1,352.50, and automobiles at $14,675.35; and in its said return the appellant claimed deductions for depreciation according to the customary percentages which were being allowed by the Department: 10% on machinery, horses and wagons, furniture and fixtures; and 20% on automobiles. The total amount of depreciation claimed amounted to $17,255.55. The amount was totally disallowed, with the exception of $255.08 in respect of three new motor cars which had been purchased by the appellant.

The correctness of values of the machinery and other equipment as set out in the return was not questioned by the Department. By sec. 80 of the *Income War Tax Act*,

> Any person making a false statement in any return or in any information required by the Minister, shall be liable on summary conviction to a penalty not exceeding ten thousand dollars or to six months' imprisonment, or to both fine and imprisonment.

No fraud or improper conduct was alleged against the appellant. What was said against the appellant was that the machinery and other equipment (save and except the three new motor cars) had been purchased by the appellant from another company, Home Service Company Limited, and that the latter company in turn had purchased the same from the liquidator of still another company (hereinafter for convenience called "the first company"), which had had the same name as the appellant company, and that the shareholders of the appellant are the same persons as the shareholders of the first company (which had gone into voluntary liquidation) and that as the first company had been allowed over a period of years, approximately 100% depreciation on its book values of the said machinery and equipment, the present company, appellant, is not entitled to any deduction for depreciation upon the same machinery and equipment.

Further, it was said against the appellant that it set up its assets on its books at a greater sum than that at which the same assets had been carried on the books of the first company. The appellant does not deny that. It

1938

PIONEER LAUNDRY & DRY CLEANERS LTD. v. THE MINISTER OF NATIONAL REVENUE.

Davis J.

was proved in evidence that the figures which the appellant set up in its books as the value of the assets in question were the same as the prices which had been fixed by an independent appraisal as the purchase price of the machinery and equipment when purchased by the appellant from the said Home Service Company Limited. The appellant admitted that these amounts were greater than the amounts at which the same assets had been carried on the books of the first company—but, it said, that was no concern of its. What is suggested is that the first company had carried these assets on its books for years, in fact prior to the coming into existence of a Dominion income tax in 1917, at valuations much below their real value, in consequence of which the allowance for depreciation to that company, on the ordinary percentage basis that had been adopted by the Department, had become exhausted.

The appellant is a separate legal entity. The Government looks to it as such as a taxpayer and has assessed it for income tax. What then are its rights? It is taxable upon its "income," which by sec. 3 of the Act means its "annual net profit or gain." Now the annual net profit or gain of a commercial corporation cannot fairly be arrived at without taking into account depreciation in its machinery and equipment due to the ordinary wear and tear during the year. While sec. 6 (*b*) of the Act provides that in computing the amount of the profits or gains to be assessed a deduction is not to be allowed in respect of any depreciation, depletion or obsolescence, "except as otherwise provided in this Act," sec. 5 had provided that

> "Income" as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:—
>
> (*a*) Such reasonable amount as the Minister, in his discretion, may allow for depreciation, * * *

It was under this sec. 5 that the Minister of National Revenue disallowed entirely the deduction claimed from gross profits in respect of depreciation of the machinery and equipment.

The decision of the Minister was in fact the decision of the Commissioner of Income Tax whom the Minister, purporting to act under and by virtue of the provisions of the Act and particularly sec. 75 thereof, had authorized to exercise the powers conferred by the said Act upon the Minister as fully and effectively as he could do himself,

he being of the opinion that such powers may be more conveniently exercised by the said Commissioner of Income Tax. Counsel for the appellant took no objection to the fact that the decision was that of the Commissioner and not that of the Minister.

The grounds for denying any depreciation on the said machinery and equipment to the appellant were very frankly and fairly stated in the decision, as follows:

> The Honourable the Minister of National Revenue, having duly considered the facts as set forth in the Notice of Appeal and matters thereto relating hereby affirms the said assessment on the ground that while the company was incorporated and commenced operations during the year 1932 there was no actual change in ownership of the assets purchased or taken over from Pioneer Investment Company Limited by Home Service Company Limited (of which the taxpayer is a subsidiary) and set up in the books of the taxpayer at appreciated values; that in the exercise of the statutory discretion, a reasonable amount has been allowed for depreciation and that the assessment is properly levied under the provisions of the *Income War Tax Act*.
>
> Notice of such decision is hereby given in accordance with section 59 of the said Act.
>
> Dated at Ottawa this 30th day of May, A.D. 1935.
>
> R. C. MATTHEWS,
> Minister of National Revenue.
> per C. F. ELLIOTT,
> Commissioner of Income Tax.

The appellant was entitled to an exemption or deduction in "such reasonable amount as the Minister, in his discretion, may allow for depreciation." That involved, in my opinion, an administrative duty of a quasi-judicial character—a discretion to be exercised on proper legal principles. Section 60 of the Act entitles a taxpayer, after receipt of the decision of the Minister upon appeal from an assessment, if dissatisfied therewith, to appeal to the Court. The decision is appealable; but the exercise of the discretion will not be interfered with unless it was manifestly against sound and fundamental principles.

The Commissioner of Income Tax put his denial of any amount for depreciation on the said machinery and equipment upon the ground that "there was no actual change of ownership of the assets" and they were "set up in the books of the taxpayer at appreciated values." In my view that was not a proper ground upon which to exercise the discretion that had been vested in the Minister. The Commissioner was not entitled, in the absence of any fraud or

1938

PIONEER LAUNDRY & DRY CLEANERS LTD. v. THE MINISTER OF NATIONAL REVENUE.

Davis J.

improper conduct, to disregard the separate legal existence of the company and to inquire as to who its shareholders were and at what figures these assets had been carried on the books of some other individual, partnership or corporation. In the words of Lindley J. (as he then was) in *Ryhope Coal Company, Ltd.* v. *Foyer* (1):

> This company was incorporated and formed on the 21st of December, 1875, under the *Companies Act* of 1862, by persons who had for many years previously carried on and worked the colliery which the company was formed to continue to work and carry on. The Income Tax Commissioners have assessed the company upon the principle that the company is in substance, and for legal purposes, the same as the old partners. In my opinion, at starting, that cannot be right in point of law. A company incorporated under the Act of 1862 is for no legal purpose the same as the persons who have become a corporation with distinct rights and distinct liabilities, and whether the shares are bought by those who form it seems to me for that purpose utterly immaterial; and I think, therefore, the principle on which the Commissioners have proceeded from first to last in assessing this corporation of five, six, or seven old partners, is to be regarded as erroneous and fundamentally wrong.

The appellant was a new owner for all legal purposes and its predecessor's depreciation allowance is immaterial when considering what is a reasonable amount to be allowed for its own depreciation. What is virtually said here against the appellant is—You are entitled to nothing because the beneficial ownership of your company is the same as the beneficial ownership of another company from which, indirectly, you purchased your machinery and equipment and we are entitled to look right through your legal existence and say that you are entitled to nothing at all for depreciation on your machinery and equipment.

In my view that is not a legitimate exercise of the discretion which Parliament vested in the Minister. I have not the slightest doubt that the Commissioner was as anxious to do justice as I am, but the public have been given the right to appeal to the court from the decision of the Minister and if the court is of the opinion that in a given case the Minister or his Commissioner has, however unintentionally, failed to apply what the court regards as fundamental principles, the court ought not to hesitate to interfere. I confess that I am influenced in this case by the insistence of many great judges upon the full recognition of the separate legal entity of a joint stock company and the impropriety in dealing with its affairs of ignoring

(1) (1881) 7 Q.B.D. 485, at 498.

its legal status as if it had never been incorporated and organized. And as to the familiar argument that we ought always to look "at the substance" of the thing, I shall only refer to the words of Lord Tomlin in *Inland Revenue Commissioners* v. *The Duke of Westminster* (1):

> Apart, however, from the question of contract with which I have dealt, it is said that in revenue cases there is a doctrine that the court may ignore the legal position and regard what is called "the substance of the matter," and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting "the incertain and crooked cord of discretion" for "the golden and streight metwand of the law" (4 Inst. 41). Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of "the substance" seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.

Lord Loreburn in the House of Lords in *Leeds Corporation* v. *Ryder* (2), said that the justices there were acting "administratively, for they are exercising a discretion which may depend upon considerations of policy and practical good sense—and they must, of course, act honestly. That is the total of their duty." But that was a certiorari proceeding and the Licensing Act under consideration "expressly leaves" as Lord Loreburn observed,

> to the discretion of the justices whether they will grant licences or not to persons whom they deem fit and proper persons.

That was, of course, quite a different case from the appeal now before us. Here the Minister was to say what was "a reasonable amount" to be allowed for depreciation and he says, in effect—nothing. The statute expressly gives the taxpayer a right of appeal from the Minister's decision. In *The Queen* v. *Vestry of St. Pancras* (3), a metropolitan vestry had a discretion by a statute not

(1) [1936] A.C. 1, at 19. (2) [1907] A.C. 420, at 423, 424.
(3) (1890) 24 Q.B.D. 371.

1938

PIONEER LAUNDRY & DRY CLEANERS LTD. v. THE MINISTER OF NATIONAL REVENUE.

Davis J.

merely as to granting or refusing a superannuation allowance to a retiring officer, but also, if an allowance were granted, as to the amount, subject to the scale of maximum allowance prescribed by the statute. Lord Esher, at p. 375, said:

> If people who have to exercise a public duty by exercising their discretion take into account matters which the Courts consider not to be proper for the guidance of their discretion, then in the eye of the law they have not exercised their discretion.

The *Income War Tax Act* gives a right of appeal from the Minister's decisions and while there is no statutory limitation upon the appellate jurisdiction, normally the Court would not interfere with the exercise of a discretion by the Minister except on grounds of law. But here the Commissioner, acting for the Minister, did exercise a discretion upon what I consider to be wrong principles of law and it is the duty of the Court in such circumstances to remit the case, as provided by sec. 65 (2) of the Act, for a reconsideration of the subject-matter, stripped of the application of these wrong principles.

I would therefore allow this appeal, set aside the assessment and the judgment appealed from and refer the matter back to the Minister. The appellant should have its costs throughout.

The judgment of Crocket and Hudson JJ. was delivered by

HUDSON J.—The appellant company in its income tax return for the fiscal period ending March 31st, 1933, claimed a depreciation allowance of $17,775.55. The Minister, on an appeal to him, disallowed this claim with the exception of $255.08, and an appeal from his decision to the Exchequer Court of Canada was dismissed.

The appellant contends (1) that under section 5 (*b*) of the *Income War Tax Act* the Minister is obliged to make some allowance for depreciation; and (2) that, in consequence of certain directions issued by him from time to time to inspectors of income tax, such allowance should be on a percentage basis as therein specified.

The Minister, on the other hand, contends that under section 5 he has an unfettered discretion to allow or disallow any claim in respect of depreciation, and moreover that in the present case the appellant company, although technically a different legal entity from a former company

of the same name is in reality the *alter ego* of the old company, having the same name, the same shareholders, the same assets for few exceptions and no new capital, and that the old company had already been allowed a total of 100% depreciation in respect of the assets in question, and under these circumstances that he, the Minister, had not acted unreasonably.

The relevant provisions of the Act are as follows: the charging section is no. 9:

9. There shall be assessed, levied and paid upon the income during the preceding year, of every person (*a*) residing or ordinarily resident in Canada during such year;

* * *

2. Save as herein otherwise provided, corporations and joint stock companies, no matter how created or organized, shall pay a tax upon income at the rate applicable thereto set forth in the first schedule of this Act.

Section 3 defines income as the annual net profit or gain. Section 6 provides:

6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

* * *

(*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence, except as otherwise provided in this Act.

Section 5:

5. "Income" as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:

(*a*) Such reasonable amount as the Minister, in his discretion, may allow for depreciation.

Reading these sections by themselves and without reference to any outside authorities, it would seem fairly plain that it was the intention of Parliament that there should be no depreciation allowance unless the Minister, in his sole discretion, decided that there should be. There is nothing anywhere to indicate the principle or basis on which the depreciation allowance is to be ascertained. It might vary according to different accounting methods, different economic theories, different general business conditions in the country. Nor is there anything in the statute which denies a right in the Minister to look beyond the legal facade for the purpose of ascertaining the realities of ownership or the possibilities of schemes to avoid taxation, and it would seem to be that it was the intention of Parliament that the Minister, and he alone, could properly estimate these different factors.

The authorities cited on behalf of the appellant are mostly of statutes, somewhat differently worded from ours,

1938

PIONEER LAUNDRY & DRY CLEANERS LTD. v. THE MINISTER OF NATIONAL REVENUE.

Hudson J.

and in effect hold no more than that where the statute gives a discretion to administrative officers and provides an area in time or space for the exercise of such discretion, the Commissioners must take that into account. In the present case, the Minister has exercised his discretion and, as already stated, the statute does not define or limit the field for operation of such discretion.

The second point raised by the appellant need not be discussed. The regulations referred to turned out to be merely directions given to local officers of the department for their general guidance and could not be considered as any general rule binding in any way on the Minister. I would dismiss the appeal with costs.

KERWIN J.—By subsection 1 of section 9 of the *Income War Tax Act* a tax is to be assessed, levied and paid upon the income during the preceding year of every person therein described. By section 2 (*h*) "person" includes any body corporate and politic, and by subsection 2 of section 9 corporations and joint stock companies are to pay the tax at the rate applicable, as set forth in the First Schedule. As applicable to this appeal, section 3 defines "income" as the annual net profit or gain from any trade, manufacture or business. The relevant parts of section 6 provide:

> In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> * * *
>
> (*b*) any outlay, loss or replacement of capital or any payment on account of capital or any *depreciation*, depletion or obsolescence, except as otherwise provided in this Act;

The only provision for an allowance for depreciation is contained in section 5 whereby income, for the purposes of the Act, shall be subject to the following exemptions and deductions:—

> (*a*) Such reasonable amount as the Minister, in his discretion, may allow for depreciation * * *

In the present case the Minister has made an allowance of $255.08 (as to which no question arises) and has given his reasons for not allowing the balance of the appellant's claim for depreciation as appears from the following extract from his decision:—

> The Honourable the Minister of National Revenue, having duly considered the facts as set forth in the Notice of Appeal and matters thereto relating hereby affirms the said assessment on the ground that while the company was incorporated and commenced operations during

the year 1932 there was no actual change in ownership of the assets purchased or taken over from Pioneer Investment Company Limited by Home Service Company Limited (of which the taxpayer is a subsidiary) and set up in the books of the taxpayer at appreciated values; that in the exercise of the statutory discretion, a reasonable amount has been allowed for Depreciation and that the assessment is properly levied under the provisions of the *Income War Tax Act*.

It appears that the discretion conferred upon him by section 5 has been exercised without disregarding any statutory provision and I can find no ground upon which his determination may be challenged.

The English cases referred to by counsel for the appellant do not appear to me to assist in the determination of the matter. I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: *Griffin, Montgomery & Smith.*

Solicitor for the respondent: *W. S. Fisher.*