

BETWEEN:

THE D'AUTEUIL LUMBER COM- }
 PANY LIMITED }

APPELLANT;

1956
 Mar. 27, 28
 Sept. 28

AND

THE MINISTER OF NATIONAL }
 REVENUE }

RESPONDENT.

Revenue—Income Tax—Timber limits—Depletion allowance—Income War Tax Act, R.S.C. 1927, c. 97, s. 5(1)(a) as amended by S. of C. 1946, c. 55, s. 4(1).

The appellant company in 1943 purchased a timber limit from one of its shareholders who held a controlling interest but who took no part in any of the meetings of its directors or shareholders relating to the purchase. On a cordage basis the limit had a value at least equal to the price paid by the appellant and the Minister for the taxation years 1943 to 1946 used such price as the basis of the allowance for depletion provided by s. 5(1)(a) of the *Income War Tax Act*, R.S.C. 1927, c. 97. The section as amended by 1946, S. of C., c. 55, s. 4(1), provided that in determining income derived from timber limits there may be deducted such an allowance for the exhaustion of the limits as may be fixed by regulation of the Governor in Council. By Order in Council P.C. 2771 of June 17, 1948, Regulations for the Depletion of Timber Limits applicable to the income of 1947 and subsequent taxation years were made and para. 3 thereof provided that:

If the Minister is satisfied that the previous owner or holder of a timber limit . . . directly or indirectly had or has a controlling interest in the present owner . . . it shall be deemed that the capital cost was the capital cost to such previous owner . . . and the depletion already allowed such previous owner . . . will be regarded as having been allowed the present owner . . .

In its income tax returns for 1947 and 1948 the appellant claimed as a deduction from taxable income depletion of the timber limit based upon its cost to it. The Minister ruled that the deduction should be based on the cost to the former owner and used that figure as the basis for the 1947 and 1948 allowance for depletion in determining the appellant's assessments for those years. The assessment was affirmed on an appeal to the Income Tax Appeal Board. The appellant then appealed to this Court and submitted that Order in Council 2771 was *ultra vires* of the authority given the Governor in Council by s. 5(1)(a) of the Act.

Held: That Parliament had unlimited power to enact legislation relating to the depletion or exhaustion of timber limits and to delegate such power to the Governor in Council.

2. That s. 5(1)(a) of the *Income War Tax Act* as amended, was a valid enactment of Parliament, which gave authority to the Governor in Council to deal with the matter of depletion or exhaustion of timber limits by regulation without any restriction.

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3. That the regulations passed under Order in Council P.C. 2771 are legal, valid and binding and the Minister in determining the appellant's income was bound thereby and correctly applied the rule laid down in paragraph 3 thereof.
- Pioneer Laundry and Dry Cleaners Ltd. v. Minister of National Revenue* [1940] A.C. 130; *D. R. Fraser & Co. Ltd. v. Minister of National Revenue* [1949] A.C. 24. *Minister of National Revenue v. T. E. McCool Ltd.* [1950] S.C.R. 80, distinguished.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Fournier at Montreal.

P. F. Fineberg for appellant.

Maurice Paquin, Q.C. and *Alban Garon* for respondent.

FOURNIER J. now (September 28, 1956) delivered the following judgment:

This is an appeal from the decision of the Income Tax Appeal Board dated May 6, 1953, dismissing the appellant's appeal from its income tax assessments for the taxation years 1947 and 1948, whereby the Minister of National Revenue disallowed as deductible from taxable income certain amounts for depletion of its timber limit and in respect of the Quebec Education Tax.

At the hearing, the appellant filed a withdrawal of the appeal or objections against the disallowance of amounts claimed as expenses with respect to the Quebec educational tax paid for the years 1947 and 1948.

In its income tax returns for the above taxation years, the appellant claimed as a deduction from taxable income depletion of the timber limit based upon its cost to the appellant in the sum of \$1,500,000. The Minister of National Revenue based his assessments on a valuation of \$591,667, representing the cost of the limit to the former owner.

At the trial, no verbal evidence was heard, but the parties admitted several facts for the purpose of this cause only, reserving their right to argue the relevancy or materiality of the several admissions. A summary of the facts admitted follows.

On April 19, 1943, K. C. Irving personally purchased from the New Brunswick Railway Co. 175,935 acres of timber lands, known as the Restigouche limit, for which he

paid the price of \$710,000. Then on May 10, 1943, he sold part of this limit to the appellant, as appears in the copy of the contract of sale which is on file before the Court. Though the contract mentions that the sale was made for one dollar and other considerations, the parties admit that the true price paid by the appellant to K. C. Irving for the portion of the limit purchased was \$1,500,000. The cost to K. C. Irving of that portion of the limit sold to the appellant was \$591,667, which figure was used by the Minister of National Revenue as the basis for the 1947 and 1948 allowance for depletion in determining the appellant's assessments for the above taxation years.

At the time of the purchase of the Restigouche limit by K. C. Irving and his sale of a portion of the limit to the appellant, and thereafter up to and including the 1947 and 1948 taxation years of the appellant, he owned 856 out of the 1,550 common voting shares of the appellant, or a little more than fifty-five per cent of the appellant's voting stock. The offer to purchase the limit from K. C. Irving at the price of \$1,500,000 was made for the company by Aime Gaudreau, the president of the appellant, after an expert appraisal of the timber limit established that, on a cordage basis, it had a value at the time of at least \$1,500,000. The majority shareholder, K. C. Irving, owner of the limit, did not participate in any discussions or meetings of the directors and/or of the shareholders of the appellant, authorizing and/or ratifying the purchase of the limit by the appellant from the owner.

During the period the owner held the limit, that is, from April 19, 1943 to May 10, 1943, he took no depletion whatsoever on it for income tax purposes. The parties agreed that, at the time of the transaction, on a cordage basis, the portion of the limit purchased by the appellant had a value of at least \$1,500,000. For the taxation years 1943 to 1946 inclusive, the Minister of National Revenue used as the basis of the allowance for depletion the cost to the appellant and the value of the timber limit on a cordage basis; that is to say, the sum of \$1,500,000.

Then the respondent, in determining the allowance for depletion of the limit for the years 1947 and 1948 under paragraph (a) of s-s. (1) of s. 5 of the *Income War Tax Act*,

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c. 97, R.S.C. 1927 and amendments, and under the regulations of Order in Council 2771 of June 17, 1948, did not consider the cost to the appellant of the timber limit nor its value, but established the allowance on the basis of the cost of the timber limit to K. C. Irving, the former owner.

The question in the appeal relates to the authority given to the Governor in Council, when determining taxable income from timber limits, to fix by regulation deductible allowances for the depletion or exhaustion of the timber limits.

Before 1940 the above section read as follows:

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

- (a) *Depreciation and exhaustion. Depletion between lessor and lessee.*
 —Such reasonable amount as the Minister, in his discretion, may allow for depreciation, and the Minister in determining the income derived from mining and from oil and gas wells and timber limits shall make such an allowance for the exhaustion of the mines, wells and timber limits as he may deem just and fair.

At that time the provisions for exemptions and deductions for depreciation and exhaustion were made under this section.

While this section was the law a case relating to depreciation, based on the above section, was heard and decided by the Privy Council and is known as *Pioneer Laundry v. Minister of National Revenue* (1).

In that instance, the appellant company, having acquired certain second-hand machinery and equipment which had formerly belonged to a company, which had gone into voluntary liquidation, of the same name as, and carrying on business similar to that of the appellant company, claimed in its return for taxation purposes certain allowances for depreciation in respect of the acquired machinery and equipment. The appellant company was in fact controlled by the same shareholders who formerly controlled the company to which the machinery and equipment in question had been fully written off by depreciation. The Minister of National Revenue refused the claim of the appellant company on the ground that there had been no actual change in ownership of the assets acquired.

(1) [1940] A.C. 127.

The Privy Council held that under s. 5(a) of the *Income War Tax Act*, R.S.C. 1927, c. 97, the appellant company was entitled to a deduction in respect of depreciation in "such reasonable amount as the Minister, in his discretion, may allow," and that the exercise of that discretion involved an administrative duty of a quasi-judicial character, to be exercised on proper legal principles. The decision of the Minister was not a proper exercise of his discretion inasmuch as he was not entitled, in the absence of fraud or improper conduct, to disregard the separate legal existence of the appellant company, and to inquire who its shareholders were and its relation to its predecessors. The taxpayer was the company, and not its shareholders.

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In that decision, no doubt was left that the taxpayer had a statutory right to depreciation and that the Minister's authority was limited to the fixing of the quantum of the depreciation.

Following that decision, the above section was amended in 1940 to read:

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

(a) *Depletion*.—The Minister in determining the income derived from . . . timber limits may make such an allowance for the exhaustion of the . . . timber limits as he may deem just and fair, . . .

It will be noticed that paragraph (a) of the section omitted to deal with depreciation, which was dealt with under another section of the statute to which I will refer later.

It would seem that, after the section was amended in 1940, the statutory right of deduction of allowances for the exhaustion of timber limits had disappeared and that the Minister was empowered, at his discretion, to allow or refuse such allowances.

A decision was rendered by the Privy Council based on the above amended section, relating to depletion of timber limits in the case of *Fraser v. Minister of National Revenue* (1). The above principle was held by the House of Lords in the following words:

The provision in s. 5, sub-s. 1(a), of the Dominion Income War Tax Act, R.S.C. 1927, c. 97, as amended by s. 10 of c. 34 of S.C. 1940, that the Minister may make under the head of "depletion" "such an allowance for

(1) [1949] A.C. 24.

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the exhaustion of the . . . timber limits as he may deem just and fair", confers on him a discretion to determine whether the case before him is one for making any allowance at all and does not limit his discretion to determining the extent of the allowance to be made. The language is permissive not obligatory, and he has a double discretion, first, to determine whether the case is one for an allowance, and second, if so, to determine how much shall be allowed. The Minister was accordingly under no legal obligation to make a depletion allowance to the appellant company, in respect of their assessment to income tax for the fiscal year 1940-41, for the exhaustion of timber limits owned by the Crown on which the appellant company had been licensed to cut timber.

Though the above case related to timber limits under lease, the same principle applies to the owner of timber limits. In 1949 the Supreme Court heard a somewhat similar case, *T. E. McCool Ltd. v. Minister of National Revenue* (1). The decision in that case stated that the taxpayer had no statutory right to a depletion allowance on a timber limit and that the Minister had full discretion to allow or deny such an allowance.

Before 1940 the statute provided that the Minister "shall make such an allowance as he may deem just and fair". From 1940 to 1946, the word "shall" was replaced by the word "may", and instead of being imperative the wording was permissive. During that period, the Minister exercised the discretion of making allowances for depletion and fixing the amount of same, but in 1946 s. 5(1)(a) was further amended, and the amendment is applicable to this case. S. 5(1)(a) now reads:

Sec. 5. *Exemptions and deductions.*—1. "Income" as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:—

(a) *Depletion.*—In determining the income derived from mining and from oil and gas wells and timber limits there may be deducted such an allowance for the exhaustion of the mines, wells and timber limits as may be fixed by regulation of the Governor in Council . . .

The amendment provided that the taxpayer would be entitled to deductions for allowances for the exhaustion of timber limits only as may be fixed by regulation of the Governor in Council.

After this amendment became law, the Governor in Council passed Order in Council P.C. 4560 on November 7, 1947, replacing former regulations for the depletion of tim-

(1) [1950] S.C.R. 80.

ber limits. On June 17, 1948, this Order in Council was revoked and replaced by Order in Council P.C. 2771, which reads as follows:

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WHEREAS by Order in Council P.C. 4560 of 7th November, 1947, regulations were established pursuant to the provisions of paragraph (a) of subsection (1) of section 5 of The Income War Tax Act for the depletion of timber limits for 1947 and subsequent years;

AND WHEREAS the Minister of National Revenue reports that it is advisable, for the purpose of clarification, to provide in the said regulations that not more than one hundred per cent of the capital cost to the original owner of such timber limits may be depleted and that the residual value, if any, of such timber limits be taken into consideration when determining the capital cost thereof;

THEREFORE, His Excellency the Governor General in Council, on the recommendation of the Minister of National Revenue and pursuant to the provisions to paragraph (a) of subsection (1) of section 5 of The Income War Tax Act, Revised Statutes of Canada, 1927, chapter 97 is pleased to order as follows:

1. The regulations for the depletion of timber limits established by Order in Council P.C. 4560 of 7th November, 1947, are hereby revoked; and
2. The following regulations are hereby made and established in substitution for the regulations hereby revoked;

REGULATIONS FOR THE DEPLETION OF TIMBER LIMITS TO BE APPLICABLE
 TO THE INCOME OF 1947 AND SUBSEQUENT TAXATION YEARS
 AND OF FISCAL PERIODS ENDING THEREIN

* * *

3. If the Minister is satisfied that the present owner or holder of the timber limits or rights directly or indirectly had or has a controlling interest in a company previously the owner or holder of the said timber limits or rights, or that the previous owner or holder (which term shall include a series of owners or holders) directly or indirectly had or has a controlling interest in the present owner or holder or that the present owner or holder and the previous owner or holder were or are directly or indirectly subject to the same controlling interest, it shall be deemed that the capital cost was the capital cost to such previous owner or holder or the first of such previous owners or holders where more than one, and the depletion already allowed such previous owner(s) or holder(s) will be regarded as having been allowed to the present owner or holder.

The respondent's assessment is based on paragraph 3 of the above Order in Council.

The above regulation seems to have been inspired by the first proviso of s. 6(1)(n) though this proviso applies to depreciation of assets while the ownership was in the hands of a former owner who has a controlling interest in the actual taxpayer company. The proviso reads as follows:

Provided, however, that the Minister shall not allow a deduction in respect of depreciation of assets owned by an incorporated taxpayer if he is satisfied that the said taxpayer directly or indirectly had or has a controlling interest in a company or companies previously the owner or

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owners of the said assets or that the said previous owner (which term shall include a series of owners) directly or indirectly had or has a controlling interest in the said taxpayer or that the said taxpayer and the previous owner were or are directly or indirectly subject to the same controlling interest and that the aggregate amount of deductions which have been allowed to the said taxpayer and/or the said previous owner in respect of the depreciation of such assets is equal to or greater than the cost of the said assets to the said previous owner or to the first of the previous owners where more than one:

It is contended that Order in Council 2771 is *ultra vires* of the authority given the Governor in Council in s. 5(1)(a) of the *Income War Tax Act* to deal with the fundamental difference between, and separation of, the legal personalities of an individual and an incorporated company. In support of this contention, it is argued that the existence of the proviso sections of s. 6(1)(n) of the *Income War Tax Act* on depreciation, where the ambit of discretionary authority is broader than in s. 5, indicates the legal requirement of express statutory authorization for the type of regulation applied in the present case and, in the absence thereof, any such regulations are *ultra vires*.

This argument clearly implies that the provisos of s. 6(1)(n) were *intra vires* of the powers of Parliament. This seems to have been the view of this Court in the case of *The Minister of National Revenue v. Simpson's Limited* (1) where the Honourable President of the Court held that . . . the first proviso to section 6(n) of the Act set a top limit to the total amount of deductions in respect of depreciation that could be allowed in the case of assets acquired under the circumstances of controlling interest specified in it and while it does not direct the Minister to base his allowance of deductions in respect of the depreciation of such assets on their cost to their former owner there is nothing in the proviso or elsewhere that precludes him from using such a base.

In the case of *Minister of National Revenue v. Stovel Press Limited* (2), the same view was expressed when the Court found that there was no valid reason why the Minister, in determining whether he should base his allowance of deductions in respect of depreciation of the assets in question on their cost to the former owner or on the amount for which they were acquired by the respondent, should not consider the proviso to s. 6(1)(n) and its possible effect in future.

(1) [1953] Ex. C.R. 93.

(2) [1953] Ex. C.R. 169.

In these decisions it was held that, in determining whether the allowance of deductions in respect of depreciation of the assets could be based on their cost to the former owner, the Minister was not barred from applying the above rule, in assessing the taxpayer's taxable income. There is no doubt in my mind as to the validity of the provisos in s. 6(1)(n), and I agree with the view expressed in the *Stovel Press Limited* case.

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These provisos were enacted in 1946 at the same session of Parliament at which the actual s. 5(1)(a), applicable to this case, was passed. As to matters related to depreciation, the legislator thought best to enact the above provisos. In s. 5(1)(a), the legislator decreed that, in determining the income, an allowance, which may be fixed by regulation of the Governor in Council, may be deducted for the exhaustion of timber limits. This was a sweeping power which, in my opinion, gave a discretionary authority broader than in the first proviso of s. 6(1)(n).

Vested with this authority, the Governor in Council passed Order in Council 2771, embodying para. 3, which is in dispute in the present instance. Though Parliament cannot delegate to the Governor in Council any more authority than it itself possesses, it certainly can delegate to the Governor in Council powers which are *intra vires* of its authority.

The power given to the Governor in Council, embodied in s-s. (a), is in clear and easily understandable terms. The authority is to the effect that, in determining the income derived from timber limits, there may be deducted allowances as they may be fixed by regulation. In the exact words of the section, I find no restriction on the authority delegated to the Governor in Council. If Parliament had the unlimited power, which I believe it had, to enact legislation relating to depletion or exhaustion of timber limits, I find no valid reason why this power could not be delegated to the Governor in Council. The Governor in Council's authority, in my mind, was discretionary. This being the case, when the regulation was passed it was enacted that, in determining the income derived from timber limits, when the former owner or holder of a timber limit directly or

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indirectly had or has a controlling interest in the present owner or holder, it shall be deemed that the capital cost was the capital cost to the previous owner or holder.

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Being of the opinion that s. 5(1)(a) was a valid enactment of Parliament, which gave authority to the Governor in Council to deal with the matter of depletion or exhaustion of timber limits by regulation without any restriction, I have to conclude that the regulations passed under Order in Council 2771 are legal, valid and binding. The Minister, therefore, in determining the appellant's income, was bound by the regulation. Having been convinced that the previous owner or holder of the timber limit in question had a controlling interest in the present owner or holder of the timber limit, the Minister applied the rule laid down in para. 3 of the Order in Council. In my judgment there is no reason for finding that his action in this case was otherwise than in accord with the terms of para. 3 of Order in Council 2771, enacted under the provisions of s. 5(1)(a).

The appellant having filed a withdrawal of his objection against the disallowance of the amounts claimed as expenses with respect to the Quebec Educational Tax paid for the years 1947 and 1948, the Minister's disallowance of this item in his assessments is hereby confirmed.

For these reasons, I have arrived at the conclusion that the Minister's assessments in the taxation years 1947 and 1948 were made according to the established facts of the case and to the provisions of the *Income War Tax Act* and the regulation passed thereunder by Order in Council 2771 on June 17, 1948.

The appeals are dismissed with costs.

Judgment accordingly.
