CATHERINE SPOONER .....APPELLANT;

VS.

MINISTER OF NATIONAL REVENUE..RESPONDENT.

1930

Sept. 16.
Oct. 23

Revenue—Royalty—Income—Capital—Depletion or Depreciation—Section 5 of the Income War Tax Act, 1917

The appellant sold all her right, title and interest in a piece of land, including the mines and minerals thereon, to an oil company for a certain sum in cash, plus certain shares in the company, subject to her reserving a royalty consisting of 10 per cent of all oils, etc., taken

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out. The Crown assessed the appellant, for the year 1927, for income tax, on the amount received by her in that year representing this ten per cent royalty. Hence the present appeal.

Held that such a royalty is a reservation, operating as an exception out of the demise, in favour of the vendor, of the profits derived from the working and development of the land sold and is in its very nature income, and could not, in any sense, amount to capital. It is variable in quantities and is properly taxable as income under the Income War Tax Act.

2. *Held,* further, that the statutory allowance for depletion or depreciation (Section 5 of the Act), should be deducted from the amount of the tax.

APPEAL by the appellant from the decision of the Minister assessing certain royalty or reservation.

The appeal was heard by the Honourable Mr. Justice Audette at Calgary.

H. S. Patterson for appellant.

C. Fraser Elliott, K.C., for respondent.

The facts are stated in the Reasons for Judgment.

AUDETTE J., now (October 23, 1930), delivered judgment.

This is an appeal, under the provisions of The Income War Tax Act, 1917, and Amendments thereto, from the assessment of the appellant, for the year 1927, on her income received from the Vulcan Oils Limited, in the nature of ten per cent royalty of all petroleum, natural gas and oil, under the reservation mentioned in the deed of agreement hereinafter recited.

The question to be determined is whether such royalties are capital or income.

At the opening of the trial the parties filed the following admission of facts which reads as follows:

Agreed upon by Counsel for the parties hereto.

1. The Appellant in 1902 purchaser from the Canadian Pacific Railway the lands referred to in the hereinafter referred to Agreement along with other lands, the whole for the purpose of conducting ranching operations thereon. The Appellant was not and is not a dealer in or in the business of buying and selling oil lands or leases.

2. The Appellant was in 1927 and is now a resident in Canada.

3. The Respondent determined the income of the Appellant to be in the sum of $9,570.41, being monies received as "Royalties" under the Agreement hereinafter referred to.

4. Vulcan Oils Limited was and is a Company incorporated on the 13th day of April, 1925, under the laws of the Province of Alberta, organized and operated for the purpose of drilling for and procuring the production and vending of oil.

5. That Vulcan Oils Limited and the Appellant entered into an Agreement dated the 15th day of April, 1925, a true copy of which has been filed with and forms part of the records of this Court.

6. That of the property referred to in the said Agreement the Appellant was the owner in fee simple except as to the coal therein and thereunder.

7. That in accordance with the said Agreement Vulcan Oils Limited entered upon the property as in the Agreement described and commenced the operations of drilling for oil with equipment and in a manner satisfactory to the Appellant.

8. That during the fall of 1926 Vulcan Oils Limited struck oil (as referred to in the contract) "in commercial quantities on the said lands."

9. A transfer of the petroleum, natural gas or oil has not been effected and the Appellant is still the owner in fee simple of the said lands except as to coal.

10. That due to the mining operations the whole of the oil produced in the year 1927, the year in question, was sold by Vulcan Oils Limited and out of the monies received from the sale of the oil (before the Company deducted expenses or made any reduction therefrom) one-tenth of the gross proceeds were paid over to the Appellant.

11. That the oil produced by Vulcan Oil Limited is not in fact physically divided by the Company, nor is it sold in two distinct portions of 90 per cent and 10 per cent, but the whole is handled in bulk. Vulcan Oils Limited never in fact delivered any of the actual oil to the Appellant, but has in fact delivered (as per the Agreement), "to the order of the said Vendor the royalties hereby reserved to the Vendor" (the Appellant), the delivery in fact being effected by payment in cash.

12. That the Appellant, or her Agent, has in fact from time to time entered upon and viewed the operations and workings of Vulcan Oils Limited as to the operations of the mining of oil on the property.

13. The Appellant upon entering into the said Agreement received the sum of $5,000 in cash and 25,000 shares of Vulcan Oils Limited at a par value of one dollar each, as fully paid up and since the production of oil and the sale thereof has been receiving "royalties" under the contract.

This admission is a corrected one substituted for a former one to which was attached an exhibit, called transfer of land, and withdrawn from the record.

The deed of agreement (exhibit A) upon which these royalties are paid, reads as follows, viz:

AGREEMENT made in duplicate this Fifteenth day of April, 1925.

BETWEEN:

CATHERINE SPOONER of Vulcan, Alberta, hereinafter called the "Vendor"

OF THE FIRST PART,

AND

VULCAN OILS LIMITED of Vulcan, Alberta, hereinafter called the "Company"

OF THE SECOND PART.

WHEREAS the Vendor herein is the owner of the North West Quarter of Section Thirteen (13), Township Twenty (20), Range Three (3), West

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of the Fifth Meridian, including all mines and minerals thereon or under the said lands.

WHEREAS the said Catherine Spooner has agreed to sell to the Company herein the South twenty acres of the said Section thirteen (13), Township twenty (20), Range three (3), West of the 5th Meridian. Subject to the provisos, conditions, restrictions, stipulations and royalties hereinafter reserved.

NOW THEREFORE THIS INDENTURE WITNESSETH:

1. That the Vendor hereby sells, assigns, transfers, and sets over unto the Company, its successors and assigns, all her right, title and interest, in and to the following property; namely, the South twenty acres of the North West quarter of Section thirteen (13), Township twenty (20), Range three (3), West of the 5th Meridian, which includes all mines and minerals, on, in or under the said lands. Subject to the provisos, conditions and royalties hereinafter reserved.

2. The Company hereby agrees in consideration of the said sale to it, to pay to the said Vendor the sum of Five Thousand ($5,000) dollars in cash upon the execution of this Agreement by the Company, and to issue to the Vendor or her nominee certificates of stock of the Company to the aggregate amount of twenty-five thousand shares of the par value of One Dollar each and the said shares shall be deemed to be and are hereby declared to be fully paid shares and not liable to any call thereon, and the holders of such stock shall not be liable to any further payment thereon.

3. The Company hereby further agrees in consideration of the said sale to deliver to the Order of the said Vendor the royalty hereby reserved to the Vendor, namely; ten per cent of all the petroleum, natural gas, and oil, produced and saved from the said lands free of costs to the said Vendor on the said premises. And the said petroleum, natural gas and oil shall be delivered under the instructions and upon the method decided by the Vendor, and the Company further covenants and agrees that it will deliver to the said Vendor the before-mentioned percentage of petroleum, natural gas and oil saved on the said land at least once in every thirty days and will not sell or remove any petroleum, natural gas or oil from the said premises until the said percentage or share thereof belonging to the Vendor shall have been delivered as aforesaid.

4. The Company shall keep or cause to be kept proper books of account at its registered office showing correctly the quantity of petroleum, natural gas, and oil produced from the said lands, and of all oil and gas taken away or removed therefrom and will from time to time on demand produce the said books of account and permit the said Vendor or her attorney or agent to inspect them and take extracts therefrom or copies thereof, and the Company will permit and suffer the Vendor, her attorney or agent at all times to enter upon the said premises for the purposes of inspecting the operations of drilling or pumping and working in any well or wells finished or in the course of construction on the said premises.

5. The Company covenants and agrees with the Vendor that it will proceed forthwith to obtain standard drilling machinery fully equipped and will commence drilling operations upon the said lands as expeditiously as possible, and to continue such drilling operations without interruption, except as may be unavoidable until oil and/or gas in commercial quantities is struck or to a minimum depth of 4,500 feet.

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6. Upon oil or petroleum being discovered the said Company hereby covenants and agrees to install and properly maintain the necessary machinery for pumping or procuring said oil or petroleum from the well or wells and delivering it in pipes, reservoirs or tanks and the said Company hereby agrees to carry on the operations of pumping or otherwise procuring the said oil or petroleum or gas from the said lands.

7. In the event of oil or gas being discovered in commercial quantities on the said lands the Vendor as part of the consideration for this Agreement, covenants to transfer to the said Company by good and sufficient transfer in fee simple the said twenty acres of land freed and discharged from all encumbrances and also shall transfer to the said Company by good and sufficient transfer in fee simple, freed and discharged from all encumbrances the South twenty acres of the North West Quarter of Section twenty-four (24), Township twenty (20), Range three (3), West of the 5th Meridian, and such transfers shall be completed and delivered forthwith after oil or gas is discovered in commercial quantities by the said Company, reserving always however to the Vendor the said Royalty of ten per cent of all petroleum, natural gas and oil in respect to the said South twenty acres of the N.W. ¼ of Section 13, Township 20, Range 3, West of the 5th Meridian, and also free access on and over all said lands described in this paragraph to an extent not exceeding three trails and the location of the said trails shall be selected by the Vendor.

8. The Vendor further covenants and agrees with the Company upon the request and at the cost of the Company to execute and do all such further assurances and things as shall reasonably be required by the Company, for vesting in it the property and rights agreed to be hereby sold and giving to it the full benefit of this Agreement.

9. It is further declared and agreed that these presents and everything herein contained shall enure to the benefit of and be binding upon the parties hereto, and each of their heirs, executors and administrators and successors and assigns, respectively.

IN WITNESS WHEREOF the Party of the First Part has hereunto set her hand and seal, and the Vulcan Oils, Limited, has hereunto affixed its corporate seal, attested by the signatures of its proper officers. * * *

This grant of express liberty to work such property, upon the payment of a fixed sum of money, with the reservation that if oil or petroleum are discovered in commercial quantities, to pay a certain share of the profits derived therefrom, seems to present no ambiguity or difficulty. It is the usual reservation provided in such circumstances.

Reservations of royalties are found in almost all Crown grants; they are also found in most of the C.P.R. land sales. The rights or superiorities of the King thereunder are called royalties. The word royalty reserved to the landlord of mines is also thus called apparently in analogy to such superiorities of the Crown. Brown's Law Dictionary, 470.

And this secondary sense or meaning of the word "royalty" signifies in mining leases, that part of the Red-

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dendum clause, whereby certain profit is reserved and which is variable and depends upon the quantity of mineral gotten. Stroud, Judicial Dictionary, 2nd Edition, pp. 1772, 1688.

The word "royalty", as used in a gas lease, generally refers to "a share of the product or profit reserved by the owner for permitting another to use the property." *Indiana Natural Gas & Oil Co.* v. *Stewart* (1). The word "royalty" as employed in coal mining lease means the share of the profit reserved by the owner for permitting the removal of the coal and is in the nature of a rent. *Kissick* v. *Bolton* (2).

The royalty payable under the agreement in question in this case is in the nature of a reservation operating as an exception out of the demise. *The King* v. *The Inhabitants of St. Austell* (3).

This royalty, mentioned in the agreement, is a reservation, operating as an exception out of the demise, in favour of the appellant, of the profits derived from the working and development of this land and is in its very nature income and could not amount, in any sense, to capital. It is quite variable in quantities and is taxable as income under the Act. See 11 Hals. 219. See also 20 Hals. 559, 560, *Edmonds* v. *Eastwood* (4); *Commissioners of Inland Revenue* v. *Marine Turbine Co.* (5); *Commissioners of Inland Revenue* v. *Sangster* (6). That reservation of ten per cent in the agreement was never sold and never passed out of the hands of the appellant.

The oil and gas having been discovered in commercial quantities, the $5,000 and the $25,000 of paid up shares having been duly satisfied and moreover the royalties having already been paid the appellant is now bound by clause 8 of the agreement, exhibit A, which says:

8. The Vendor further covenants and agrees with the Company upon the request and at the cost of the Company to execute and do all such further assurances and things as shall reasonably be required by the Com-

(1) (1910) 90 N.E. Rep. 384, 386; 45 Ind. App. 554.
(2) (1907) 112 N.W.R. 95, 96; 134, Iowa, 652.
(3) (1822) 5 Barn. & Ald. 693 (1821-22).
(4) (1858) 2 Hurlstone & Norman 811.
(5) (1920) 1 K.B. 193.
(6) (1920) 1 K.B. 587.

pany, for vesting in it the property and rights agreed to be hereby sold and giving to it the full benefit of this Agreement.

The facts and circumstances of the case having brought us to the time when oil and gas have been found in commercial quantities and when the royalties became payable, we have gone beyond the speculative questions and conjectures discussed at trial as to what would be the effect of the agreement before that time.

I, therefore, find the appellant is liable for income tax on the royalty; but before rendering account for the amount of the tax collectible, the statutory allowance for depletion or depreciation (section 5) must be ascertained and deducted. By doing so the amount of the claim by the Crown in the case will be reduced by crediting that amount to the appellant and under such circumstances there will be no costs to either party.

There will be judgment dismissing the appeal, each party paying his own costs.

Judgment accordingly.