1944
Sept. 5, 6 & 7
1947
Feb. 21

BETWEEN:

THE GOVERNOR AND COMPANY OF ADVENTURERS OF ENGLAND TRADING INTO HUDSON'S BAY .. } APPELLANT;

AND

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

Revenue—Income—Income War Tax Act R.S.C. 1927, c. 97, s. 6 (1) (a)—Deductible disbursements—Expenses of litigation incurred to enjoin competitor from using appellant's name are deductible—Disbursements or expenses "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income"—Appeal allowed.

Appellant is a corporation incorporated by Royal Charter of May 2, 1670, giving appellant the lands, territories, rights and powers therein set forth. Its head office is in London, England, and its chief office for Canada is in Winnipeg, Manitoba. It has carried on business continuously since its incorporation and has maintained and still maintains many stores and trading posts in Canada. It is the largest dealer in raw furs in the English-speaking world and deals in dressed furs and in fur garments. Its goods are known in Canada and also in the United States and it has acquired a valuable and long established reputation for honest and reliable dealing and has a valuable trade name and good will.

In making its income tax return for the years 1938 and 1939, appellant deducted from income for these years certain disbursements made by it in payment of legal expenses of its attorneys, solicitors and counsel for services in connection with an action brought by the appellant in the United States District Court for the Western District of Washington, ninth circuit, against Hudson Bay Fur Company Inc., a trade competitor, which the appellant alleged had designedly adopted the name used by it, to restrain that company from interfering with the appellant's trade. The action was terminated by the issue of the usual injunction.

In assessing the appellant for the years 1938 and 1939 the Commissioner for Income Tax refused to allow the deductions claimed by the appellant. These accounts were affirmed by the Minister of National Revenue and appellant appealed to this Court.

Held: That the costs and expenses laid out by the appellant to prevent the use of a firm name so closely resembling its own as to mislead customers are disbursements or expenses laid out and expended for the purpose of earning the income of appellant within the meaning of s. 6(1) (*a*) of the Income War Tax Act; they were not laid out with the object of acquiring or bringing into existence an asset but were made in the ordinary course of preserving and maintaining the trade of the appellant and safeguarding it from the diversion thereof by a party misusing the appellant's name.

APPEAL under the provisions of the Income War Tax Act.

The appeal was heard before the Honourable Mr. Justice Angers at Winnipeg.

F. M. Burbidge, K.C. for appellant.

C. R. Smith, K.C. and *A. A. McGrory* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

ANGERS J. now (February 21, 1947) delivered the following judgment:

This is an appeal, under the provisions of sections 58 and following of the Income War Tax Act, 1917, and the amendments thereto from the assessment of the appellant for the years 1938 and 1939 in respect of disbursements made or expenses laid out by it for the alleged purpose of earning its income, consisting of legal costs and expenses in prosecuting a suit brought by it in the United States District Court, Western District of Washington, against Hudson Bay Fur Company of Seattle, incorporated under a statute of the State of Washington.

On the application of the solicitor for respondent an order was made that formal pleadings be filed. A brief summary of these pleadings seems apposite.

(The learned Judge here refers to the pleadings and continues):

The appellant's income tax returns for the fiscal years ended January 31, 1938, and January 31, 1939, respectively are among the documents filed by the deputy minister (taxation) and form part of the record. The first shows an income subject to tax amounting to $1,507,334, and the tax of 15 per cent amounting to $226,100, and the second an income subject to tax of $1,005,568, and the tax of 15 per cent amounting to $150,835. The notice of assessment for the year ended January 31, 1938, annexed to the income tax return of the same year, appearing to have been mailed on December 3, 1941, shows a taxable income of $1,512,874.29 and the tax of 15 per cent amounting to $226,931.14. The notice of assessment for the year ended

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January 31, 1939, annexed to the income tax return of the same year, appearing to have been mailed on December 3, 1941, shows a taxable income of $1,030,208.80 and the tax of 15 per cent amounting to $154,531.32.

Notices of appeal dated December 31, 1941, were given to the Minister of National Revenue by appellant's solicitors from the aforesaid assessments, in compliance with section 58 of the Income War Tax Act. In addition to stating in each of these notices that in declaring its income for the taxation years 1938 and 1939 the appellant deducted as disbursements or expenses laid out for the purpose of earning its income the sum of $10,377 in 1938 and the sum of $22,952.80 in 1939, paid as legal costs and expenses in prosecuting a suit brought by it in the United States District Court, Western District of Washington, Northern Division in Equity against Hudson Bay Fur Company of Seattle, incorporated under a statute of the State of Washington, and further stating that in the notices of assessment for the said periods the said deductions have been disallowed and that the appellant appeals from such decisions and claims that the said sums should be allowed as necessary disbursements, and relating the fact that it was incorporated by Royal Charter on May 2, 1670, that it is the oldest corporation carrying on business in the English-speaking world, that it has acquired a high reputation in the business world for honourable and fair dealing and that its name and goodwill are very valuable in regard to business, the appellant goes on to say in brief as follows:

in the early part of the century, Mauritz Gutmann, a fur buyer in the City of Vancouver, British Columbia, who had dealings with appellant, left Canada, established a business in the City of Seattle and incorporated a company under the name Hudson Bay Fur Company;

the appellant, through its officials and public notice, objected to the use of the said name and through its attorneys had prolonged negotiations and correspondence about a change of name;

the Hudson Bay Fur Company, largely because of its name, became known as the largest fur dealer on the Pacific coast and for a time conducted two stores in the City of Seattle;

many of its customers believed that they were dealing with the appellant or a subsidiary thereof and the public was confused by the use of the said name and the appellant was thereby losing business;

although the Hudson Bay Fur Company led the appellant to believe that it would change its name and promised to do so, yet it failed in this; in 1934 the appellant brought a suit in the said Court for an injunction and damages; the sums deducted as disbursements were expended in the prosecution of the said suit or in negotiations leading to its settlement;

at the trial several witnesses testified that they had dealt with the Hudson Bay Fur Company believing that it was a branch or subsidiary of the appellant and that they would not have dealt with it had they known the facts;

there is a large tourist traffic on the Pacific Coast throughout the year; many tourists visit Canada and the appellant's stores at Vancouver and Victoria and buy goods there; more would have done so had they not believed that Hudson Bay Fur Company was a branch of the appellant;

the discontinuance of this name by Hudson Bay Fur Company should be of substantial benefit to the appellant's business at Victoria and Vancouver; in addition to those large department stores the appellant has smaller department or general stores at the cities of Nelson, Vernon and Kamloops, in British Columbia; letters have been received by the managers of these stores from residents of the United States, indicating that they believed that the Hudson Bay Fur Company's store at Seattle was a branch of appellant;

the appellant has for hundreds of years imported from England blankets known as "Hudson Bay Point Blankets", which are sold largely in the United States through distributors of the appellant there; Hudson Bay Fur Company in Seattle bought such blankets from the distributors in Seattle and showed them in the window of their store with cards indicating that they were Hudson's Bay Blankets, thereby intending to induce the public to believe

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that the entire business was conducted by the appellant or was a branch of it; Hudson Bay Fur Company dealt in such blankets;

Hudson Bay Fur Company not only imitated the appellant's name but adopted other practices, leading the public to believe that it was associated with the appellant; for example, it adopted a picture of the beaver as its coat of arms, when the beaver has for centuries been intimately associated with appellant;

this litigation was incurred to protect the name, reputation and goodwill of appellant and to turn customers from Hudson Bay Fur Company to appellant and to make a profit from the sale of its goods; the suit was not brought to defend its corporate rights, but to protect its trade name and trade;

the appellant also sells liquors, tobacco, tea and coffee through distributors in the United States and it was and is essential to protect its name, reputation and character by preventing others from using its name or imitation thereof;

the appellant for many years carried on business at many places in what was known as Oregon Territory and had an important post known as Fort Vancouver on the Columbia River in what is now the State of Washington and during that period it acquired a valuable reputation;

the said expenses are not a capital expenditure; there are still companies in the United States doing business under the name of "Hudson Bay Fur Company" and others may start at any time.

The decision of the Minister, represented by the Commissioner of Income Tax, who by the way signed the notices of assessment, dated February 5, 1942, included among the documents filed by the Minister and forming part of the record, after referring to the fact that the taxpayer incurred certain legal costs and expenses in the suit brought by it in the United States District Court, Western Division of Washington, against Hudson Bay Fur Company of Seattle and that, in determining its income and making its return, it added back to income for the year 1938 $10,000 of said costs and expenses and claimed as a

reduction from income the sum of $377, and for the year 1939 claimed as a deduction the sum of $22,952.80, contains the following considerations:

And whereas in assessing the taxpayer for the years 1938 and 1939, the aforesaid legal costs and expenses were disallowed as deductions from income and taxes were assessed by Notices of Assessment dated the 3rd December, 1941.

And whereas Notices of Appeal were received from the solicitors for the taxpayer dated the 31st December, 1941, in which objection is taken to the assessed tax for the reasons therein set forth and in particular for the reason that the litigation was incurred to protect the name, reputation and good will of the taxpayer and to turn customers from Hudson Bay Fur Company to it and to make profit from the sale of its goods; that the suit was not brought to defend its corporate rights but to protect its trade name and trade; that said expense was not a capital expenditure and should be allowed for Income Tax purposes.

The decision then concludes thus:

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 Assessments on the ground that the legal costs and expenses in question were expenses of the taxpayer not wholly, exclusively and necessarily laid out or expended for the purpose of earning its income but were in fact expenses incurred in the prosecution of its action to protect its trade name and trade and were the application of profits after they had been earned as profits for the purpose of earning future profits and accordingly were properly disallowed for Income Tax purposes under and by reason of the provisions of Section 6 and other provisions of the Income War Tax Act in that respect made and provided and the assessments are accordingly affirmed as being properly levied.

Notice of this decision was given to appellant and its solicitors in compliance with section 59 of the Income War Tax Act.

Following this decision the appellant supplemented its notice of appeal by a statement of facts, dated March 3, 1942, also attached to the documents filed by the Minister; it contains in short the following averments:

in paragraph 3 of the notice of appeal, M. Gutmann was described as a fur buyer in the "City of Vancouver" when it should read in the "City of Victoria";

the judgment of the Supreme Court of Canada in *The Minister of National Revenue* v. *The Dominion Natural Gas Company, Limited* (1), does not apply to the present case and it and the reasons therefor are distinguishable; further, a petition for leave to appeal to His Majesty in Council from the judgment of the Supreme Court has

(1) (1941) S.C.R. 19.

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been filed by the said Gas Company and the decision upon the said petition is pending; in any case the said judgment and reasons of the Supreme Court cannot be regarded as final under the circumstances.

On the same day the appellant sent to the Minister a notice of dissatisfaction, which merely expresses the desire that its appeal from the decision of the Minister be set down for trial; this notice, given in accordance with section 60 of the act, is included among the documents filed by the Minister.

Also forming part of the record produced by the Department of National Revenue is the reply of the Minister, in which he denies the allegations contained in the notice of appeal and the notice of dissatisfaction in so far as incompatible with the allegations of his decision and affirms the assessments as levied.

At the opening of the trial counsel for appellant said that, in view of the voluminous nature of the pleadings, he and his opponent had prepared a summary outlining the nature of the case; it was read into the record as follows:

> The disbursements in question were made by the appellant, which is commonly known as the Hudson's Bay Company and is a dealer in furs, both raw and dressed, and fur garments, in payment of legal expenses of its attorneys, solicitors and counsel for services in connection with an action brought by the appellant in the United States District Court for the Western District of Washington, ninth circuit, against Hudson's Bay Fur Company Inc., a trade competitor, which the appellant alleged had designedly adopted the name used by it to restrain that company from interfering with the appellant's trade. The said action was terminated by the issue of the usual injunction.

A brief recapitulation of the evidence seems convenient.

Counsel for appellant filed as exhibits the following documents:

Exhibit 1—Certified copy of bill of complaint, in the United States District Court, for the Western District of Washington, ninth circuit, in equity No. 1049, *in re* The Governor and Company of Adventurers of England trading into Hudson's Bay (commonly called *The Hudson's Bay Company*) v. *Hudson Bay Fur Company, Inc.*, filed April 6, 1934.

Exhibit 2—Certified copy of amended bill of complaint filed on the same day.

Exhibit 3—Certified copy of amended bill of complaint, filed October 6, 1936.

Exhibit 4—Certified copy of the defendant's answer to the bill of complaint, filed October 23, 1936.

Exhibit 5—Bill of particulars by defendant, filed August 2, 1937.

Exhibit 6—Certified copy of stipulation, filed January 7, 1941.

In the document called stipulation, a copy whereof was marked as exhibit 6, it is stipulated *inter alia* as follows:

the defendant admits that the allegations in the amended bill of complaint are true;

the plaintiff may cause to be entered herein findings of fact, conclusions of law and/or a final decree in accordance with paragraph 1 of the prayer of the amended bill of complaint;

the plaintiff waives all claims for damages and profits prayed for in paragraph 2 of the prayer of the amended bill of complaint; the parties request that no judgment for costs shall be entered against the plaintiff or the defendant, each paying their own costs;

the defendant requests that the first affirmative defence (sic) and paragraph IV of the fifth affirmative defence of its answer be stricken.

I do not believe that it would serve any useful purpose to quote or even merely sum up the statements contained in the first affirmative defence and in paragraph IV of the fifth affirmative defence. Having been struck from defendant's answer they are totally immaterial and irrelevant.

Exhibit 7—Copy of decree dated January 7, 1941, and filed on same day.

I deem it advisable to quote the essential portion of this decree:

it is therefore,

Ordered, adjudged and decreed that a perpetual injunction issue out of and under the seal of this Court directed to the Defendant, its officers, agents, attorneys, clerks, servants, workmen and employees, enjoining and restraining them and each of them from using or employing (*a*) the name "Hudson Bay Fur Company" and any name having the words "Hudson"

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and "Bay" either jointly or severally, (*b*) the initials "HB", (*c*) any colourable imitation of the name "Hudson's Bay" and (*d*) the representation of a beaver in its crest; or any similar name or symbol calculated to deceive the public and to create the impression that the Defendant is in any manner identified or affiliated with the Plaintiff; and from making any direct or indirect representation, either oral, written or printed, and either publicly or privately to the effect that the Defendant is affiliated or in any maner connected in a business way with the Plaintiff. The foregoing order for a perpetual injunction is subject to the following provisions:—

Provided, first, the Hudson Bay Fur Company shall have the right to use the name "Hudson Bay Fur Company" as at present for a maximum period of two years beginning January 1, 1941, during which period the said Hudson Bay Fur Company shall adopt a new name which does not have the words "Hudson" and/or "Bay", as set forth above.

Provided, second, that the adoption of the said new name the Hudson Bay Fur Company shall have the right for a maximum period ending December 31, 1946, to use and only to use in combination with said new name the clause "Formerly Hudson Bay Fur Company" and where the words "Hudson" and "Bay" of said clause are displayed in extent and prominence no greater than the said new name.

Provided, third, the representation of the beaver imbedded in the terrazzo entrance floor of the store of the Hudson Bay Fur Company may remain until the entrance is reconstructed, at which time it will be removed. In any event the same shall be removed by January 1, 1947.

A letter from the Inspector of Income Tax, at Winnipeg, to appellant, dated October 21, 1941, was filed as exhibit 8; it reads thus:

I wish to advise you that in view of the Dominion Natural Gas Company, Limited, case decision, legal expenses paid in connection with the infringement of the Company name are deemed to be capital and not allowable for Income Tax purposes.

Accordingly, revised assessments will be issued in due course in respect to the 1936 and 1938 fiscal periods of your company.

A notice of assessment dated October 2, 1940, for the year 1938 was filed as exhibit 9. The first page thereof, headed "Dominion of Canada and Province of Manitoba—Notice of Assessment—Dominion and Manitoba Income Tax for 1938," contains the following note: "Your income for the year above mentioned is hereby assessed and approved in the amount declared. All taxes have been paid in accordance with receipt(s) already issued to you. No further payment is required." The second page headed "Adjustment of income declared" includes the following items, leaving aside the figures relating to the Manitoba income tax with which we are not concerned.

Net income declared	$1,507,334 00
Add interest on income tax (Alta.)	497 69
Cost of new cash registers (F.T.C.O.) less Dep'n.	4,665 60
	$1,512,497 29

These figures disclose the acceptance of the appellant's return without raising the question of the legal costs or expenses, as pointed out by counsel for appellant.

Finally a copy of a notice of assessment, the mailing date whereof appears to be the 16th of January, 1941, was filed as exhibit 10. It shows a taxable income of $1,512,497.29 and the tax of 15 per cent amounting to $226,874.59. The summary dealing with the federal income tax discloses the following amounts:

Amount levied	$226,874 59
Amount paid on a/c	226,874 59

Norman Wilfred Douglas, assistant store manager of appellant's store in Winnipeg since January, 1939, who had been assistant merchandise manager of its store in Vancouver from September, 1926, to June, 1937, and subsequently store manager of its store in Calgary from June, 1937, to January, 1939, declared that the company's stores at Victoria and Vancouver are largely retail departmental stores.

He testified that as assistant merchandise manager in the Vancouver store he spent at least 75 per cent of his time in and around the store and not in an office and that he could see the customers who come in from time to time.

Asked if he could say if there were customers from the United States, Douglas replied:

> Well, having been in the store business for a number of years you sort of have a second sense when you see tourists, you can tell them by their appearance, and Vancouver being more or less a tourist city, and Victoria, there was quite a large amount of business done with our friends from the South.

Speaking of the means of communication between Seattle and Vancouver and Victoria, Douglas stated that one can come from Seattle to Vancouver or Victoria by automobile, bus, plane, train and steamboat. In reply

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to a question by counsel for appellant if he could say the number of tourists in 1938 and 1939 who came from the United States to Canada by motor car, he stated:

As far as the actual figures are concerned I couldn't say whether it was five hundred thousand or five hundred and fifty thousand, but I do know, going back to the time I was in Vancouver, figures could be had through the Vancouver Tourist Bureau, and this is more or less from memory, in the early thirties it would be somewhere between four hundred thousand and five hundred thousand people, and that was for motor car only.

Douglas declared that the tourist season in Vancouver and Victoria runs all through the year, but admitted that the summer months, namely, June, July, August and September, are the largest tourist months.

He asserted that he was aware of a business conducted in Seattle under the name of Hudson's Bay Fur Company and that associated with it was a *chap* by the name of Silver and another one known as "Bronfman, or Gutmann or some such name as that".

He said he saw the original store of Hudson Bay Fur Company in Seattle in the early part of his stay in Vancouver. According to him the company dealt in furs of all kinds. He understood that in the later years the company opened up a curiosity shop having moccasins, bead work, ivory pieces and the like such as the appellant has carried on in its various stores' museums. He added that all the appellant's stores, depending on their size, had historical museum pieces, Indian work, bead work and the like, but that in the later years these were all assembled in the Winnipeg store.

Asked if from his personal experience he had reason to believe that there was misapprehension amongst the American tourists as to the business carried on by the appellant and the one carried on by the Hudson Bay Fur Company at Seattle, Douglas replied:

Particularly in the summer period of June to September when we have the largest number of tourists being continually in the store and up and around the fur department, or in the linen department, and so on, you would have these American customers mention that they had been in our Seattle branch, and they were on their way up to Vancouver and they thought they would stop off and see our larger store. And this did not happen just occasionally, it happened quite frequently. At the same time occasionally also they would say, "When I take this garment home if I don't like it can I get a refund on it in Seattle." Or, in buying a fur coat it is a sort of unwritten law that the supplier takes care of the coat for about a year or a year and a half and often-

times you have to make repairs on the fur or lining, and so on, and they would ask if there is any cause to have this coat repaired, can I have it done in your Seattle store?

Douglas stated that the American tourists know that Canada is not only a producer of furs, but of fur garments, and that certain types of furs are cheaper in Canada than in the United States. He noted that in the thirties tourists were allowed to take from Canada ino the United States merchandise to the value of $100 per person.

According to him there is a good trade with the American tourists in raw and dressed furs and in fur coats. He declared that they were more interested in the better types of furs, such as seals, muskrats, silver foxes, and also in expensive neck pieces and capes.

He asserted that there was an interference with the appellant's trade by reason of the business carried on by the Hudson Bay Fur Company of Seattle and that it would run into thousands of dollars over a period of years.

Douglas specified that tourists come from the States of California and Oregon and stop over in Seattle for a day or two on their way to Vancouver, Seattle being the usual stopover for tourists en route.

Replying to a question as to whether the misapprehension previously referred to arose not only in connection with tourists from Seattle but also with tourists from all along the coast, Douglas said:

I think I can explain that all that is necessary is to be in the Vancouver store for a while and carry on conversations with tourists whom you meet in the store, and you naturally find out where they all come from, and folks living in Seattle would be a small portion of those coming up through Seattle. There would be as many or more from California as there would be from Seattle coming through there.

In cross-examination, Douglas admitted that the tourist business done by the appellant's stores in Vancouver and Victoria varies from year to year. He agreed that from 1926 to 1929, the period of boom days, there was an increase in the tourist trade and that in the years following, during the depression, there was considerably less business, until the tariff in the United States was changed so as to allow tourists to take more Canadian merchandise into the United States free of duty. According to him this happened sometime in the thirties.

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He stated that occasionally tourists purchasing furs in Vancouver or Victoria would ask if they could get service and alterations in the Seattle store and that they were disappointed when they learned that it was not a store of the appellant, as they had been given to understand, when in Seattle, that it was a store of the Hudson's Bay Company.

In re-examination, Douglas pointed out that American tourists coming into Canada would benefit by the exchange on the currency.

James G. Mundie, chartered accountant, of Winnipeg, since 1911, associated with the firm of Riddell, Stead, Graham & Hutchison, former president of the Manitoba Institute and of the Dominion Association, admitted that, in dealing with expenditures made by a company, they fall either into expenditures attributable to revenue or expenditures attributable to capital. He was then asked by counsel for appellant a question which I think I ought to quote verbatim:

> I am going to put to you a test which has been suggested in a decided case, and ask your opinion as to that test. Is it a part of the company's working expenses; is it expenditure laid out as part of the process of profit earning? Or, on the other hand, is it a capital outlay; is it expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which is a condition of carrying on its trade at all?

An objection was entered by counsel for respondent on the ground that this is a question of law, in the present case, and that it is the issue raised before the Court.

Counsel for appellant agreed that it is largely a question of law, but he said that he will be referring to cases in which the evidence of a chartered accountant was admitted and that he thought it prudent in the circumstances to submit the opinion of a chartered accountant. He summed up his question as follows:

> Would you say according to commercial principles of commercial accounting the principles laid down in that test would be true?

Mundie answered in the affirmative.

He supplemented his answer by stating that they were the principles which he would follow and that they would be applicable to legal expenses, to wit expenses in con-

nection with the organization of a company, or a bond issue, or the refunding of a bond issue or the acquisition of fixed assets.

Mr. Burbidge read to Mundie the statement agreed upon by counsel hereinabove reproduced and asked him if those litigation expenses were attributable to working expenses or to capital according to commercial accounting principles and got this reply:

I would say to working expenses in my opinion.

Asked in cross-examination what he would say about expenses to protect or improve capital assets, Mundie stated that it depends on the nature of the improvement, but he specified that an expense made to protect a capital asset would unquestionably be a revenue charge. He agreed that if it did actually improve the value it is definitely capital.

To a question by counsel for appellant as to whether expenses to protect a capital asset, like repairs to a building, would be ordinary revenue expenses, Mundie replied in the affirmative.

David Henry Laird, barrister, of Winnipeg, declared that the firm with which he has been associated have been solicitors for the appellant for some twenty odd years and that he personally has had charge of the appellant's general business to a large extent.

Required to let the Court know the nature of the appellant's business, Laird made the following detailed statement which I think I had better quote:

It is a matter of history the Company was incorporated in 1670, to trade into Hudson Bay, and I think the primary business was dealing in raw furs, chiefly beaver. As the business has developed over the last one hundred years or more, they have gone largely into the retail trade, and have large departmental stores in Victoria, Vancouver, Edmonton, Calgary, Saskatoon, and Winnipeg, and smaller stores in half a dozen other smaller towns.

The raw furs were largely accumulated at Trading Posts, as they were called, or forts, in the north from the native Indians or Esquimeaux, in exchange for goods chiefly, or sometimes for money. Of recent years the raw fur business has grown extensively by the purchase for cash of raw furs from various centres, for example, Vancouver, Winnipeg, Regina, Prince Albert, and they have what they call raw purchasing, by buying furs from largely white trappers rather than from the native Indians or Esquimeaux. Actually I don't know, but I expect the retail business

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has become the largest end of the business rather than the fur trade, which was the original business, but the fur trade is still a substantial part of the business, that is, the raw fur business.

Laird declared that the litigation in the State of Washington regarding Hudson Bay Fur Company was conducted under his direction as solicitor for the Winnipeg office of appellant. He said he visited Seattle in the fall of 1937 with a view to preparing for the trial. He was present at the hearing in May or June, 1938, at Tacoma. He stated that he was present throughout the hearing of the evidence.

He asserted that there have been six or seven similar actions in the United States about which he was consulted and he thought that there were others about which he learned but in which he did not do any active work. He added that apart from actual suits there were a number of instances where the appellant sought to have the name of the firm carrying on business under a name akin to that of Hudson's Bay Company dropped. Asked if the appellant had the experience, common to other companies enjoying a good trade, of having people copy their names, Laird answered that it is accentuated in the present case because of the long history of the company and of its good reputation. He stated that the Hudson Bay Fur Company of Seattle, basing his opinion on the company's advertisements in the Seattle papers, on the city directories, which he personally checked, and on the evidence given in Court in the present case, was founded by the late Mauritz Gutmann, about 1902 or 1903. He said that Gutmann had been in business dealing in raw furs in Victoria, that he checked the city directory and found that Gutmann was in business there in 1902. According to him, Gutmann, after his wife died in 1902, went down to Seattle. Laird asserted that he advertised for a while as Hudson's Bay Company, successor to M. Windmiller, who, he believed, had been a fur trade dealer.

Laird declared that Gutmann then incorporated the Hudson Bay Fur Company in the State of Washington in July, 1904, and that after Gutmann's death his son, Addis, became president. He stated that he met him

several times, as he was present practically every day at the trial. He said he then met Max Silver, the manager, who was a son-in-law of the late Mr. Gutmann.

He stated that there was a museum of curios in the new store of Hudson Bay Fur Company in Seattle in 1937, situated on Fifth Avenue, the chief shopping district in Seattle. He gave a description of the store and of its curios department, of which it may be convenient to quote a passage:

> It was a fine looking store from the outside. I have photographs there in Court if my friends are interested. Some were taken under my direction, and others taken at other times. The store on the ground floor had a frontage of fifty to sixty feet, an entrance in the centre, and the entrance recessed back. And upstairs on the first floor was this curio establishment which extended over buildings on both sides, north and south. The curio part of the business upstairs had probably a frontage of well over one hundred feet, and ran back, I suppose, fifty feet. I went through that, was shown by Mr. Silver through the premises. They had the usual Totem pole and curios, a lot of stuffed animals and skins; all sorts of Indian and Esquimo work. They advertised it very extensively as the largest curio establishment on the Pacific Coast.

Laird declared that the appellant did not deal only in fur garments but that it also dealt largely in raw furs. He said that he himself searched the Exchange records and that he talked in Vancouver to the representative who bought furs for them. He specified that some of these furs were dyed and dressed and that many were made into fur garments; others, he believed, were sold in their raw state.

He asserted that the appellant had considerable mail order business, that he was shown the shipping room and that he saw a large number of parcels ready to be shipped on the Pacific Coast.

Asked if prior to the present suit there had been negotiations with the Seattle firm, Laird replied that there were prolonged negotiations, that as far back as 1904 the appellant protested, that he saw a notice put by the company in the Seattle paper and that, when his firm became solicitors for the appellant, the question of this Seattle concern was one of the problems.

Laird believed that there were understandings given by the Hudson Bay Fur Company with respect to carrying on business under that name. I think I had better quote an extract from the deposition:

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Mr. Gutmann came to Winnipeg about the subject, and I did not interview him personally, but he interviewed officials of the Company. I saw correspondence and telegrams from their attorneys that they fully expected the name to be changed. Shareholders meetings were called, and matters of that sort, and I believe Mr. Mauritz Gutmann definitely said he would change the name, but he died and his son and son-in-law were not so willing to carry out his promises.

Laird said that the action was brought in April or May, 1934. He added that he was consulted as to whether or not interviews should be had and that he recommended to the appellant's general manager to see Mr. Silver. He believed that interviews took place at Vancouver towards the end of 1933 or the beginning of 1934.

He stated that the suit started in the spring of 1934 and was not brought on to trial until the spring of 1938 and that there was evidence taken under Commission in Washington, New York and Chicago during the first part of 1938. He pointed out that this added to the costs of litigation, but that it was deemed necessary.

According to him part of the evidence was that the United States Navy Department dealt with Hudson Bay Fur Company of Seattle and bought supplies from them, believing that they were the Hudson's Bay Company or a subsidiary thereof.

He asserted that he was present at the trial and heard the evidence which was given. He stated that Mr. Justice Cushman became ill and could not continue with the case and that subsequently he retired and died, which explains the long delay between the hearing in May, 1938, and the decree in January, 1941.

Laird felt that evidence had been adduced at the trial which established the appellant's case. He declared that witness after witness were called to prove that they had bought goods in the store of Hudson Bay Fur Company in Seattle, believing that they were dealing with Hudson's Bay Company or a subsidiary or affiliated company. Referring to the document Exhibit 6 termed a stipulation, counsel for appellant asked the witness if from this stipulation it appears that the defendant was willing to submit to an injunction and decree; Laird answered affirmatively and added:

A. Yes, and they withdrew the original defence. They made some very grave charges against the Hudson's Bay Company, and in the stipula-

tion they withdrew those charges entirely. I insisted upon that, for we could not accept any decree by consent unless those charges were withdrawn, and they were withdrawn and struck out.

Q. And from the point of view of the Hudson's Bay Company, the appellant here, it was wise to accept what the defendants were willing to do rather than incur very heavy expenses of continued litigation?

A. I recommended that.

Laird declared that before the war raw furs were shipped to London and sold on the market there and that the Hudson's Bay fur auction sales were held originally twice but latterly three times a year and advertised all over the world. He said that since the war that market has been closed and that to collect and buy raw furs in Canada the Company has posts in the Northern country where the furs are to be found, in all the Provinces except the Maritime Provinces, and many of them in the Northwest Territories. He said that the appellant has these posts where it can acquire furs from the natives or white trappers and ship them to London.

He stated that Hudson Bay Fur Company of Seattle was also engaged in the raw fur business, that it advertised as having a branch in Alaska where the appellant had been buying furs and that it bought on the Vancouver Exchange as well.

He noted that not only was there a sale of dressed furs interfering with the appellant's trade but that the raw fur business was also an interference with it by the use of the name.

In cross-examination, Laird acknowledged that in the pleadings in the Seattle case there is a reference to a subsidiary of the appellant Company incorporated in the State of New York. Asked if he was familiar with the income tax returns of Hudson Bay Company, he replied that he has been consulted about various items but was not prepared to say that he was familiar with it. These subjects do not appear to me to have any relevance to the matter at issue.

Counsel for appellant stated that there are profits earned in Great Britain, which are segregated and do not appear in the Canadian balance sheet. He further stated that the Canadian balance sheet contains the Canadian business and the Newfoundland business, but that the profits of the latter are segregated from the earnings of the Cana-

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dian business. He also declared that the proportion of the income earned by the appellant which came from the Canadian business amounted to 95 per cent in 1937, 97 per cent in 1938 and 92 per cent in 1939. He said that the income earned in Great Britain and in Newfoundland is not included in the appellant's income tax returns involved herein and is accordingly not charged any taxes in Canada.

This closed the appellant's case. Counsel for respondent did not call any witnesses.

It is perhaps convenient to quote the definition of income contained in section 3 of the Income War Tax Act, although the case rests principally, nay exclusively, on the determination of what incomes are not liable to taxation. The definition reads thus:

> * * * "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be whether derived from sources within Canada or elsewhere; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source * * *

Section 6, under the heading "deductions from income not allowed", enacts *inter alia:*

> (1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> (*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income,
>
> (*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.

Can the expenses or costs paid out by the appellant in the circumstances hereinabove related be considered as disbursements or expenses "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income"? This is the question which I have to solve.

Counsel for the appellant in his argument pointed out that the Minister, assisted by a very able staff, did not think at first that there was any objection to the legal costs and expenses in issue being deducted from the income

and the return was accepted. He submitted that it was only when the decision of the Supreme Court in the case of *The Minister of National Revenue* v. *Dominion Natural Gas Company Limited* (1), was rendered that the Minister changed his mind, reopened the assessment and disallowed the deduction of the said costs and expenses.

Counsel intimated that the reassessment was made on an erroneous view of what was decided in the *Minister of National Revenue* v. *Dominion Natural Gas Company Limited* case and that, if the case of *Income Tax Commissioner* v. *Singh* (2) had been decided before the *Minister of National Revenue* v. *Dominion Natural Gas Company Limited* case, the decision of the Supreme Court in the latter case might have been different. Counsel suggested that the Supreme Court thought that they were compelled to give judgment against their own opinions possibly, because they considered themselves bound by some remarks of the Privy Council. He drew the conclusion that it is clear, according to the judgment in the case of *Income Tax Commissioner* v. *Singh,* that the Privy Council did not intend to lay down any such rule as that suggested in the Supreme Court judgment.

Council for respondent on the other hand relied on the case of *Minister of National Revenue* v. *Dominion Natural Gas Company Limited,* among several others, and it seems convenient to analyze it first.

The respondent company since 1904 had supplied natural gas to the inhabitants of the Township of Barton under a by-law granting rights for that purpose and before and after that date has been developing gas fields and supplying gas to the inhabitants of other municipalities. Since 1904 parts of the township were at different times annexed to the City of Hamilton. The respondent continued to supply the annexed territory with natural gas as before annexation. The United Gas and Fuel Company of Hamilton Limited, hereinafter called The United Company, had since 1904 been supplying the City of Hamilton, as it was before the annexations, and its inhabitants with manufactured gas under authority granted by by-laws of the City. About 1930 the United Company made a claim under these by-laws that it had the exclusive right to sell

(1) (1941) S.C.R. 19. (2) (1942) 1 A.E.R. 262.

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gas in the City of Hamilton, including the annexed districts, and that the respondent had no competing rights.

Under authority conferred by an agreement between the City of Hamilton and the United Company dated March 24, 1931, confirmed by statute of the Province of Ontario (21 Geo. V, chap. 100), the United Company in 1931 took action in its own name and in the name of the City of Hamilton, in the Supreme Court of Ontario, against respondent claiming:

a declaration that the respondent was wrongfully maintaining its mains in the streets, public squares and lanes in the City of Hamilton and supplying gas to the inhabitants thereof;

an injunction restraining the respondent from continuing so to do;

a mandatory order requiring respondent to remove its mains and other property from the streets, public squares, lanes and other places of the City of Hamilton;

damages.

The respondent company defended the action, which in due course came on for trial and was dismissed. Appeals by the United Company to the Court of Appeal of Ontario and to the Privy Council were dismissed. The costs of this litigation paid by the respondent amounted to $48,560.94 after crediting all sums recovered from the United Company as taxable costs.

In its Income Tax return for 1934 the respondent company deducted from its taxable income this sum of $48,560.94. This deduction was disallowed and the respondent company's assessment increased accordingly. The company appealed to the Minister of National Revenue, who dismissed the appeal. The company thereupon appealed to the Exchequer Court of Canada and this appeal was allowed. The Minister appealed to the Supreme Court and the latter reversed the judgment of the Exchequer Court, holding unanimously that the legal expenses in question were not deductible.

The judgment of the Chief Justice, Sir Lyman Duff, and of Davis J. was delivered by the former. At page 22 of the report we find the following observations:

> There are two broad grounds upon which I think the Minister is entitled to succeed. First, in order to fall within the category "disbursements or expenses wholly, exclusively and necessarily laid out or expended

for the purpose of earning the income," expenses must, I think, be working expenses; that is to say, expenses incurred in the process of earning "the income". The judgment of Lord Clyde in *Lothian Chemical Co. Ltd.* v. *Rogers* ((1926) 11 Tax Cases 508, at 521) seems to point to the material distinction. The passage is pertinent, because the words Lord Clyde is applying are more comprehensive than those of sec. 6(*a*).

The Chief Justice then quotes an extract from the notes of Lord Clyde, which have some pertinence, although not exactly in point. Reference thereto may be useful but they are too extensive to reproduce herein.

Duff C.J. then continues as follows (p. 23):

Similar language is used by Lord Clyde in *Addie's* case (*Robert Addie & Sons' Collieries Ltd.* v. *Inland Revenue Commissioners*, (1924) S.C. 231, at 235) and was approved and applied by Lord Macmillan in delivering the judgment of the Judicial Committee in *Tata* v. *Income Tax Commissioner* ((1937) A C. 685). Under s. 10, sub-s. 2, of the Indian Income Tax Act, the profits or gains of any business carried on by the assessee are to be computed after making allowance for "(ix) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains."

There follows a passage from the reasons of Lord Macmillan which are interesting and of which it may be expedient to reproduce an extract (p. 23):

Their Lordships recognize, and the decided cases show, how difficult it is to discriminate between expenditure which is, and expenditure which is not, incurred solely for the purpose of earning profits or gains. * * * In the case of *Robert Addie & Sons' Collieries, Ltd.* v. *Commissioners of Inland Revenue* ((1924) S C. 231, at 235), the Lord President (Clyde), dealing with corresponding words in the British Income Tax Act, says. "What is 'money wholly and exclusively laid out for the purposes of the trade' is a question which must be determined upon the principles of ordinary commercial trading. It is necessary, accordingly, to attend to the true nature of the expenditure, and to ask oneself the question, Is it a part of the Company's working expenses; is it expenditure laid out as part of the process of profit earning?" Adopting this test, their Lordships are of opinion that the deduction claimed by the appellants is inadmissible as not being expenditure incurred solely for the purpose of earning the profits or gains of the business carried on by the appellants.

Duff C. J. notes that the distinction is also explained in the judgment of the Court of Appeal for New Zealand in a passage approved by the Judicial Committee of the Privy Council in *Ward & Co. Ltd.* v. *Commissioner of Taxes* (1).

Further on the learned Judge adds (p. 24):

Again, in my view, the expenditure is a capital expenditure. It satisfies, I think, the criterion laid down by Lord Cave in *British Insulated* v. *Atherton* ((1926) A.C. 205 at 213). The expenditure was incurred "once

(1) (1923) A.C. 145, at 149.

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and for all" and it was incurred for the purpose and with the effect of procuring for the company "the advantage of an enduring benefit." The settlement of the issue raised by the proceedings attacking the rights of the respondents with the object of excluding them from carrying on their undertaking within the limits of the City of Hamilton was, I think, an enduring benefit within the sense of Lord Cave's language.

The Chief Justice then refers to the observations of Lord Macmillan in *Van den Berghs Ld.* v. *Clark* (1) reading as follows (p. 24):

Lord Atkinson indicated that the word "asset" ought not to be confined to "something material" and, in further elucidation of the principle, Romer L J. has added that the advantage paid for need not be "of a positive character" and may consist in the getting rid of an item of fixed capital that is of an onerous character: *Anglo-Persian Oil Co.* v. *Dale* ((1932) 1 K.B. 146).

The Chief Justice then points out what the character of the expenditure is in the following words (p. 24):

The character of the expenditure is for our present purposes, I think, analogous to that of the expenditure in question in *Moore* v. *Hare* (1914-1915 S.C. 91), where promotion expenses incurred by coalmasters in connection with two parliamentary bills giving authority to construct a line to serve the coalfield were held to be capital expenditures.

The Chief Justice concludes thus (p. 25):

I do not perceive any distinction between expenditures incurred in procuring the company's by-laws authorizing the undertaking and the expenses incurred in their litigation with the City of Hamilton.

In the ordinary course, it is true, legal expenses are simply current expenditure and deductible as such; but that is not necessarily so. The legal expenses incurred, for example, in procuring authority for reduction of capital were held by the Court of Sessions not to be deductible in *Thomson* v. *Batty* ((1919) S.C. 289).

Mr. Justice Crocket expressed the following opinion (p. 26):

If we were free to decide this appeal on considerations of practical business sense and equity, or to deduce from decided cases the governing rule, which should be applied in determining whether the respondent was or was not entitled, under the formula prescribed by s. 6 of the Canadian *Income War Tax Act,* to the deduction claimed in computing its assessable profits or gains for the year 1934, I should have no hesitation in adopting the conclusion at which the learned President of the Exchequer Court arrived and the reasons he has given therefor. We are confronted, however, with a recent judgment of the Judicial Committee of the Privy Council in the case of the appeal of *TaTa Hydro-Electric Agencies, Ltd., Bombay,* v. *Commissioner of Income Tax, Bombay Presidency and Aden* ((1937) A.C. 685) in which a test, formulated in 1924 by Lord President Clyde of the Scottish Court of Session in the case of *Robert Addie & Sons Collieries, Ltd.* v. *Commissioners of Inland Revenue* ((1924) S.C. 231), for determining whether a deduction is allowable under practically

(1) (1935) A.C. 431, at 440.

identical provisions of the English *Income Tax Act*, 1918, is expressly adopted and applied. The English Act of 1918, ch. 40, 8 & 9 Geo. V, by rule 3 of Schedule "D", prohibits deductions in respect of "any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation," or in respect of "any capital withdrawn from, or any sum employed or intended to be employed as capital in such trade," etc, as well as other specified capital expenditures for improvements and the like, the effect of which, as regards this case, it seems to be impossible to distinguish from the prohibitions (*a*) and (*b*) of s. 6 of the Canadian Act. I apprehend, therefore, that the test so distinctly adopted by the Judicial Committee in the *Tata* case ((1937) A.C. 685) is binding upon us

After making some comments on the judgment of the House of Lords in *Strong & Co. Ltd.* v. *Woodifield* (1), and especially to the notes of Lord Davey, Crocket, J. made the following observations (p. 29):

Singularly enough, it was apparently upon this dictum of Lord Davey, and not that of the Lord Chancellor, concurred in by Lords Macnaghten and Atkinson, that Lord President Clyde of the Court of Session in the *Addie* case ((1924) S.C. 231), formulated the test, which the Judicial Committee adopted 13 years later in the *Tata* case ((1937) A C. 685). See Lord Clyde's judgment in the Court of Session, Session Cases (1924), at the bottom of p. 235.

In any event, we must now recognize the rule as expressly affirmed by the Judicial Committee of the Privy Council, and determine whether the expenditure in question in this appeal was wholly and exclusively made by the respondent as part of the process of profit earning Being unable to convince myself that the expenditure falls within this strict formula, I have reluctantly concluded that the appeal must be allowed.

The late President of the Exchequer Court, Maclean J., after summarizing the facts and commenting on certain decisions, among which we find *Anglo-Persian Oil Company Limited* v. *Dale* (2); *Ward & Company Limited* v. *Commissioner of Taxes* (3), made in his judgment (4), the following observations which seem to me pertinent (p. 19):

It seems to me that if legal expenses are incurred in successfully defending an action in which one's title to existing assets, rights or facilities are put in serious question, such expenses should normally be admissible as deductions, and particularly would this be so in the case where the earning of profits are directly dependent upon and require the utilization of such assets, rights or facilities, as was the case here. If the action is unsuccessfully defended the revenue authorities might contend that there was no asset, right or facility to defend, and that therefore such expenses should not be allowed as a deduction in computing net taxable income, but that is not this case. If such expenses arose out of the promotion or acquisition of additional assets, rights or facilities, it is

(1) (1906) A.C. 448; 5 Rep. of Tax Cases, 215.
(2) (1932) 1 K B. 124.
(3) (1923) A.C. 145.
(4) (1940) Ex. C.R. 9.

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probable no deduction would be permissible. It was imperative here that the Dominion Company defend the action and the failure of its directors to do so would probably have rendered themselves liable in damages to the shareholders of that company. The action threatened the earnings of the Dominion Company, wholly or partially, and had the action succeeded it would have been unable to sell gas, at least in some sections of the City of Hamilton; the company's capacity to earn revenue was put in jeopardy and, I think, it is immaterial that its capital assets, or some of them, were incidentally threatened with extinction or depreciation. It was because the Dominion Company was producing and selling gas that it had to defend the action and thus protect and preserve its credit and its revenue. The United Company sought an injunction restraining the Dominion Company from continuing to supply gas to the inhabitants of the City of Hamilton, which, had the United Company been successful, would have prevented the Dominion Company from earning its usual revenue.

Like Mr. Justice Crocket in his reasons (p. 27) I may note that the attention of the late President apparently was not called to the decision in *Tata Hydro-Electric Agencies Limited* v. *Commissioner of Income Tax* as he made no reference to it. The judgment of Mr. Justice Crocket adds that no mention of it was made either in appellant's or in respondent's factum, although Mr. Varcoe cited it in his argument. It is comprehensible in the circumstances that the late President may not have been aware of it. Whether the perusal of this decision would have modified his opinion is a matter of mere supposition which I do not feel disposed to adopt.

It was urged by counsel for appellant that the Supreme Court reversed the decision of the late President of the Exchequer Court because they felt bound by the decisions in the cases of *Robert Addie and Sons' Collieries Ltd.* v. *Inland Revenue Commissioners* (1); *The Lothian Chemical Co. Ltd.* v. *Rogers* (2); *Tata Hydro-Electric Agencies Ltd.* v. *Commissioner of Income Tax* (3); *British Insulated and Helsby Cables Ltd.* v. *Atherton* (4). A few brief observations about these decisions may be apposite.

In the *Robert Addie and Sons' Collieries Ltd.* v. *Inland Revenue Commissioners* case it will suffice to quote the head-note which is fully comprehensive (p. 671):

Under the terms of a mineral lease, a colliery company was obliged to restore to an arable state all ground occupied by it or damaged by its workings, or, at its option, to pay the lessor for all such ground not

(1) (1924) 8 Rep Tax Cases, 671.
(2) (1926) 11 Rep Tax Cases, 509.
(3) (1937) A C. 685.
(4) (1926) A C 205

so restored, at the rate of thirty years' purchase of the agricultural value thereof. In the exercise of its option, the company paid the lessor a sum of £6,104, as representing the value of the damaged lands.

Held, that such payment was in the nature of capital expenditure, and was not therefore a proper deduction in computing the company's liability to Income Tax.

I do not think that this case offers any similarity with the present one, and that it has any pertinence.

In *The Lothian Chemical Co. Ltd.* v. *Rogers* the facts were as follows. During the war the appellant company manufactured explosives for the Minister of Munitions, but owing to the dangerous situation of the works this was discontinued and in October, 1917, an arrangement was entered into with the Minister, ultimately embodied in an agreement dated April 22, 1918, under which the company agreed to convert its plant and works into a plant suitable for the manufacture of calcium nitrate to be sold to the Minister on stated terms. The Minister undertook to recoup to the company the cost of conversion up to a maximum of £15,000, which was the company's estimate of the cost. The converted works, except any existing plant and buildings and the land, were to be the property of the Minister, with an option to the company within three months from the determination of the agreement to purchase the works at a valuation and, if such option was not exercised, an option to the Minister within twelve months to remove the buildings, plant and machinery, so far as his property, or to purchase the company's interest in the land and buildings, etc., not his property. None of the options in the agreement was exercised at its termination and eventually the works and plant belonging to the Minister, of little value to the company, were taken over by the latter for £400. Owing to rises in wages and cost of materials during the progress of the work the cost of conversion exceeded the £15,000 paid by the Minister by £4,044, of which a sum of £1,879 was recovered from the Minister in settlement of an action which had been commenced against him, and the net deficiency of £2,165 was claimed by the company as a deduction in arriving at its profits for the purposes of Income Tax and Excess Profits Duty.

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It was held that the loss in question was a loss of capital and was not admissible as a deduction from the company's profits.

This decision does not seem to me to be more pertinent than the previous one. It unquestionably deals with a loss of capital.

The following case, *Tata Hydro-Electric Agencies Ltd.* v. *Commissioner of Income Tax,* differs in nature from the two previously referred to where the Court of Session (Scotland) held, in the first, that the payment of a sum representing the value of damaged lands and, in the second, that the loss in the cost of conversion of a plant and works were a loss of capital. In this case the appellant was a private limited company carrying on the business of managing agents of Tata Power Co. Ltd. and other hydro-electric companies. The company acquired this agency business from Tata Sons Ltd. under an assignment whereby the latter transferred to the appellant their rights and interest as agents of the hydro-electric companies under their subsisting agreement with them, but subject, as to their rights and interest under their agreement with Tata Power Co. Ltd., to their obligations under two agreements with F. E. Dinshaw Ltd. and Richard T. Smith. The assignment declared that the appellant should thenceforth be and act as the agents of the hydro-electric companies and be entitled to all benefits conferred by the agreement between Tata Sons Ltd. and these companies and should perform all the obligations thereby imposed and that the appellant should receive all the commissions to which Tata Sons Ltd. were entitled thereunder. The appellant agreed to carry out the conditions of the agreements with F. E. Dinshaw Ltd. and Richard T. Smith and to indemnify Tata Sons Ltd. against any consequences of the non-observance thereof. Under the agency agreement between Tata Sons Ltd. and Tata Power Co. Ltd., the benefit whereof the appellant acquired, the remuneration of Tata Sons Ltd. for their services consisted of a commission of 10 per cent on the anual net profits of Tata Power Co. Ltd., with a minimum of Rs.50,000 whether the company should make any profits or not, and they were entitled to have their expenses reimbursed. In return,

Tata Sons Ltd. undertook to endeavour to promote the interests of Tata Power Co. Ltd. The agreement was declared assignable and Tata Power Co. Ltd. undertook to recognize any assignees as its agents and, if required, to enter into an identical agreement with such assignees. In 1926, Tata Power Co. Ltd., being in need of financial assistance, Tata Sons Ltd., its then managing agents, approached F. E. Dinshaw Ltd. and Richard T. Smith, who agreed to provide the necessary funds. One of the conditions on which they agreed to do so was that in addition to the interest payable by Tata Power Co. Ltd. for the loan, they should each receive from Tata Sons Ltd. two annas in the rupee or 12½ per cent of the commission earned by Tata Sons Ltd. under their agreement with Tata Power Co. Ltd. Agreements were entered into between Tata Sons Ltd. and F. E. Dinshaw Ltd. and between Tata Sons Ltd. and Richard T. Smith dated October 15 and 19, 1926, respectively. After the acquisition of the agency business by the appellant the Tata Power Co. Ltd., in fulfilment of its obligation under the agreement with Tata Sons Ltd., entered into a new agency agreement with the appellant in terms identical with those of its previous agreement with Tata Sons Ltd. and the appellant also entered into agreements with F. E. Dinshaw Ltd. and the administrator of the estate of Richard T. Smith, who had died in the meantime, in terms identical with those of the previous agreements between Tata Sons Ltd. and these parties. By these transactions the appellant came in the place and stead of Tata Sons Ltd., both as regards the right to receive from Tata Power Co. Ltd. the agency remuneration and as regards the obligation to pay out of its remuneration 12½ per cent to F. E. Dinshaw Ltd. and 12½ per cent to the administrator of Richard T. Smith's estate. The assessment of appellant's income for the fiscal year to March 31, 1934, is based on its income, profits and gains for the year 1932 and the question is whether in the computation for tax purposes of its income, profits and gains for that year it is entitled to deduct a sum representing the 25 per cent of the commission earned and received from Tata Power Co. Ltd. which it paid to F. E. Dinshaw Ltd. and Richard T. Smith's administrator.

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It was held that in computing its income, profits and gains, the appellant was not entitled to deduct the 25 per cent in question; that this percentage of the commission paid to F. E. Dinshaw Ltd. and the administrator of Richard T. Smith's estate was not expenditure incurred by appellant "solely for the purpose of earning * * * profits or gains" of its business; that the obligation to make the payments was undertaken by appellant in consideration of its acquisition of the right and opportunity to earn profits, i.e. of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business.

This decision, to my mind, has very little, if any, weight in the present instance.

In the case of *British Insulated and Helsby Cables Ltd.* v. *Atherton,* the appellant, a company carrying on the business of manufacturers of insulated cables, established a pension fund for its clerical and technical salaried staff. The fund was constituted by a trust deed which provided that members should contribute a percentage of their salaries to the fund and that the company should contribute an amount equal to half the contributions of the members; and further that the company should contribute a sum of 31,784*l* to form the nucleus of the fund and provide the amount necessary in order that past years of service of the then existing staff should rank for pension.

This sum was arrived at by an actuarial calculation on the basis that the sum would ultimately be exhausted when the object for which it was paid was attained. On the winding up of the fund the whole amount was to be distributed among the members. The company, having paid the sum of 31,784*l* out of current profits, claimed that it was an admissible deduction in computing its profits. It was held by Viscount Cave, L.C., Lord Atkinson and Lord Buckmaster, Lord Carson and Lord Blanesburgh dissenting, that this payment was in the nature of capital expenditure and accordingly not an admissible deduction.

I may note that the House of Lords in this case affirmed by a majority of three against two the order of the Court of Appeal (Pollock M.R., Warrington L.J. and Scrutton L.J.), which had reversed an order of Rowlatt J. of the

Court of King's Bench. Opinions diverged widely, as is often the case; I may say with all due deference, that the reasons of Lord Blanesburgh, who dissented, elaborate and careful, steadily support the view contrary to that adopted by the majority of the Court. At all events I am satisfied, after a careful perusal of it, that this case has no bearing on the one now pending, as the facts differ materially.

In the case of *Ward and Company Limited* v. *Commissioner of Taxes* (1) it appears from the report that a poll of the voters in New Zealand being about to be held on the question whether or not prohibition of intoxicants should be introduced, a brewery company expended money in printing and distributing anti-prohibition literature. The poll resulted in a small majority against prohibition and the company sought to deduct the expenditure from the income derived from its business for the purposes of the Land and Income Tax Act, 1916, of New Zealand. Under section 86, subsection 1(*a*), of the Act no deduction is allowed in respect of expenditure "not exclusively incurred in the production of the assessable income". It was held by the Privy Council that the company was not entitled to make the said deduction having regard to the provision of said section 86, subsection 1(*a*).

Viscount Cave, L.C., who delivered the judgment of the Court, expressed the following opinion (p. 149):

> The expenditure in question was not necessary for the production of profit, nor was it in fact incurred for that purpose. It was a voluntary expense incurred with a view to influencing public opinion against taking a step which would have depreciated and partly destroyed the profit-bearing thing. The expense may have been wisely undertaken, and may properly find a place, either in the balance sheet or in the profit-and-loss account of the appellants; but this is not enough to take it out of the prohibition in s. 86, sub-s. 1 (*a*), of the Act. For that purpose it must have been incurred for the direct purpose of producing profits.

Dealing with this case Kerwin J. in *re Minister of National Revenue* v. *Dominion Natural Gas Company Limited* made the following comments (p. 30):

> The cases referred to on the argument deal with expressions used in other statutes and certainly, so far as clause (*a*) is concerned, I have been unable to derive any assistance from them. *Ward and Company, Limited* v. *Commissioner of Taxes,* (1923) A.C. 145, was determined on the wording of the New Zealand Act there in question "in the production of the assessable income." In view of the fact that that wording is less liberal

(1) (1923) A.C. 145.

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and comprehensive than the wording in our statute "laid out or expended for the purpose of earning the income," the decision is, I think, inapplicable.

In his judgment in *Dominion Natural Gas Company Limited* v. *Minister of National Revenue* (1), Maclean J., after stating that considerable reliance has been placed by counsel for the Minister of National Revenue on the case of *Ward and Company Limited* v. *Commissioner of Taxes (ubi supra)* and after relating the facts as hereinabove set forth, added (p. 17):

> It was held by the New Zealand Court of Appeal that no deduction was allowable in respect of such an expenditure because it was "not exclusively incurred in the production of the assessable income * * *", which decision was, on appeal to the Judicial Committee of the Privy Council, sustained, their Lordships holding that the expenditure was a voluntary expense incurred with a view to influencing public opinion, and not one necessary for the production of profit, and that it was not in fact incurred for that purpose. I should not have thought myself that any other conclusion was possible, but at any rate it is not, in my opinion, an authority applicable to the state of facts here.

The learned judge then made the following remarks of a broader character which seem to me apposite (ibid):

> No distinction is to be drawn between legal expenses and other business expenses. The question always is whether the expense was a necessary one for the purpose of earning the annual net profit or gain of the taxpayer. In the well known case of *Usher's Wiltshire Brewery Ltd.* v. *Bruce* ((1915) A.C. 433 at 437) legal expenses were allowed as a deduction. In that case these expenses consisted of "solicitors costs and disbursements in respect of the renewal of publicans' licences or tenancy agreements, the assessments of tied houses, obtaining a full licence, complaints against tenants, and advising as to thefts of beer." There is little discussion in the speeches of their Lordships concerning the particular deduction claimed for legal expenses, and, in fact, it would appear that no objection was taken by the Attorney-General against their allowance. The legal expenses were held to be a proper debit in ascertaining the balance of profit and loss in the taxpayer's trade.

The last five cases, on which counsel for respondent placed so much reliance, being set aside, we remain with the decision of the Supreme Court, which is certainly more in point.

Another case which also has some pertinence is that of *Anglo-Persian Oil Company Limited* v. *Dale* (2) in which the King's Bench Division of the High Court of Justice (Lord Hanworth M.R., Lawrence and Romer L.J.) confirmed the judgment of Rowlatt J. who had reversed

(1) (1940) Ex.C.R. 9. (2) (1932) 1 K.B. 124.

the decision of the Commissioners of Income Tax. I may note that Mr. Justice Crocket and the late President of the Exchequer Court, in the case of the *Minister of National Revenue* v. *Dominion Natural Gas Company Limited,* made some appropriate and interesting remarks relating thereto.

The facts were briefly as follows:

The Anglo-Persian Oil Company Limited, incorporated in 1909 with the object of raising, refining, selling and otherwise dealing with crude oil and its products in Persia and elsewhere, entered into an agreement in May, 1914, with Strick, Scott and Company Limited under which the latter were appointed agents of the company to manage its business in Persia and the East and carry out the sale of petroleum and other products thereof for a term of ten years. The remuneration under the agreement having proved to be more onerous than anticipated, the company decided to bring the agency to an end and thenceforth to do its own agency work. Accordingly in 1922 the company entered into an agreement with Strick, Scott and Company Limited by which it was agreed that the agency should be terminated, that the latter should go into liquidation and should not act in or about any business conected with petroleum at Mohammerah in Persia, while in return the company should pay Strick, Scott and Company Limited 300,000*l.* The 300,000*l.* was paid and the agency terminated. This sum was treated in the company's accounts as a revenue payment and charged to revenue in instalments of 60,000*l.* for five years. The company claimed that this course was correct and justified, the deduction of the 300,000*l.* from its annual expenses in seeking the profits and gains. The inspector of taxes disputed this course and claimed that the 300,000*l.* ought to be treated as an expenditure on capital account, an expenditure which brought to an end an onerous contract and secured to the company a freedom from charges which would have continued for some years. The Commissioners accepted the inspector's argument and held that the sum of 300,000*l.* was not an admissible deduction in computing the profits and gains of the company for the year ending

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March 31, 1923, and adjusted the figures of assessments for the years ending April 5, 1923, 1924, 1925 and 1926, accordingly.

Rowlatt J. held that the sum was an admissible deduction. His judgment was affirmed. The headnote of the King's Bench Division, precise and comprehensive, sums up the decision thus (p. 124):

On appeal:—

Held, applying the test laid down by Lord Cave L C in *British Insulated and Helsby Cables* v *Atherton* (1926) A.C 205, 213, that the payment in question did not bring any asset into existence and could not properly be said to have brought into existence an advantage for the benefit of the Company's trade within the meaning of that expression as used by Lord Cave.

Held, therefore, that the payment was a revenue payment and was deductible by the company in ascertaining its net profits.

Test of whether the money was provided from fixed or circulating capital adopted in *Hancock* v. *General Reversionary and Investment Co.* (1919) 1 K B 25; *Mitchell* v. *B. W. Noble, Ltd.* (1927) 1 K B. 719; and *Mallett* v *Staveley Coal & Iron Co.* (1928) 2 K B 405 applied.

Decision of Rowlatt J. affirmed.

Lord Hanworth, after stating that it was argued that the finding of the Commissioners ought to be accepted as one of fact within their own sphere and so not the subject of appeal as a question of law, that this argument is not, to his mind, well founded, that the cases upon the point of what is attributable to revenue and what to capital account run upon fine lines of distinction, that the Commissioners have to direct themselves correctly upon the questions of law involved, that the deductions that are permissible must be examined from the point of view of law, that they cannot be said to be simply questions of fact irrespective of the principles of law and that it is accordingly necessary to consider the principles upon which items have been held to belong to capital or revenue and the characteristics which have been held to turn a particular item into one category or the other and that certain illustrations can be given of items that have been held to fall on one side of the line or the other, made a brief but fairly exhaustive review of a number of cases in which the question had been determined and concluded thus (p. 139):

Upon this survey of the cases I have come to the conclusion that the Commissioners have not asked themselves the right question, and

have not directed themselves aright on this difficult point of law. The consequent result is that I think it is open for the Court to express its opinion in law.

Then, as Rowlatt J. points out, there is no evidence of the purchase of the goodwill of some business, nor is there any trace of a payment to start a business. The payment is to put an end to an expensive method of carrying on the business which remains the same whether the distributive side is in the hands of the respondents themselves, or of their agents.

Romer L.J., who concurred with his colleagues in the affirmation of the judgment of Rowlatt J., dealing with the deductions permissible under the law, made the following observations (p. 144):

> Towards the solution of this problem little, if any, assistance is afforded by the Income Tax Act. It is, indeed, provided by s. 209 that in arriving at the amount of profits or gains for the purpose of income tax, no other deductions are to be made than such as are expressly enumerated in the Act. But, as has often been pointed out, the Act nowhere enumerates the deductions that may be made It merely prohibits the making of certain specified deductions. Nor is it to be taken that any deduction may legitimately be made that is not expressly prohibited by r. 3 to Cases I and II under Sch. D, or that deductions are to be limited to those expressly excepted from the prohibitions in that rule.

Further on the learned judge added (p. 145):

> So far as the Act itself is concerned, one is, therefore, left without guidance as to the deductions that are permissible, but with the mind somewhat unsettled by reason of the list of prohibited deductions as to what, in the view of the Legislature, is to be considered for the purposes of income tax the balance of the profits or gains.

After stating that in the circumstances it is not surprising that the cases in which the Court has been called upon to say whether some particular deduction is or is not permissible should have been numerous and not always easy to reconcile with others wherein the facts were similar and then passing to the year 1925 when all these authorities were considered by the House of Lords in *re British Insulated and Helsby Cables* v. *Atherton* and the law applicable to such cases placed beyond the realms of controversy, Romer L.J. observed that the boundary line between deductions that were permissible and those that were not had previously been uncertain and difficult to follow, that as regards the large majority of deductions there could be no conceivable doubt, they being clearly on one side of the line or the other but, as regards a comparatively small number, it was difficult to say on which

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side of the line they fell. He pointed out that this is particularly the case where an expenditure is not a recurring one but is made once and for all. I believe I had better quote a passage from the reasons of Romer L.J. (p. 145):

> It was pointed out by Lord Cave in *Atherton's* case, (1926) A.C. 205, 213, that an expenditure, though made once and for all, may nevertheless be treated as a revenue expenditure, and he then added this: "But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital." It should be remembered, in connection with this passage, that the expenditure is to be attributed to capital if it be made "with a view" to bringing an asset or advantage into existence. It is not necessary that it should have that result. It is also to be observed that the asset or advantage is to be for the "enduring" benefit of the trade. I agree with Rowlatt J. that by "enduring" is meant "enduring in the way that fixed capital endures." An expenditure on acquiring floating capital is not made with a view to acquiring an enduring asset. It is made with a view to acquiring an asset that may be turned over in the course of trade at a comparatively early date. Nor, of course, need the advantage be of a positive character. The advantage may consist in the getting rid of an item of fixed capital that is of an onerous character, as was pointed out by this Court in *Mallett v. Staveley Coal & Iron Co.*, (1928) 2 K. B. 405.

In the case of *Mitchell* v. *B. W. Noble Limited* (1) it was held by the Court of Appeal, affirming the judgment of Rowlatt J., that the payment of a sum of money to get rid of a director in order to save the company from scandal must be regarded as money "wholly and exclusively laid out and expended for the purposes of the trade" of the company. It was also held that as the payment was not made to secure an actual asset so as to increase the capital of the company but was made in order to enable the directors to carry on the business of the company as they had done in the past, unfettered by the presence of the retiring director, which might have a bad effect on the credit of the company, it must be treated as an income and not as a capital expenditure and was accordingly deductible for income tax purposes.

We find at page 737 of the report the following comments by Lord Hanworth M.R.:

> I do not in the least wish to go back upon anything I said myself in the British Insulated and Helsby Cables case, (1926) A.C. 205, but it

(1) (1927) 1 K.B. 719.

appears to me, upon the facts of this case, that this payment should be treated as a revenue item and not as a capital item. It seems to attain more closely to the payments in Hancock's case, (1919) 1 K.B. 25, and Smith's case, (1914) 3 K.B. 674, than to those in the other cases such as *Ounsworth* v. *Vickers, Ltd.*, (1915) 3 K.B. 267, and the British Insulated and Helsby Cables case, (1926) A.C. 205, itself. It was a payment made in the course of business, with reference to a particular difficulty which arose in the course of the year, and was made not in order to secure an actual asset to the company but to enable the company to continue to carry on, as it had done in the past, the same type and high quality of business, unfettered and unimperilled by the presence of one who, if the public had known about his position, might have caused difficulty in its business and whom it was necessary to deal and settle with at once.

In the case of *Rhodesia Railways, Limited* v. *Collector of Income Tax* (1) the report discloses that the company had in one year expended a large sum of money in replacing rails and sleepers or ties. In making its income return the appellant debited a sum of 252,174*l* under the heading "renewals of permanent way" and showed a loss for the year over all of 97,445*l*. In the notice of assessment the Income Tax Collector wrote back the item of 252,174*l* deducted by the appellant, thereby converting the loss of 97,445*l* into a profit of 154,729*l*. The appellant objected to the assessment in respect of the disallowance of the deduction of 252,174*l* for renewals of permanent way. The respondent having overruled the objection the company appealed. It was held by the Judicial Committee of the Privy Council, reversing the judgment of the Special Court of the Bechuanaland Protectorate, that the appellant company was entitled to the deductions claimed because the sum expended was an outgoing "not of a capital nature" and was "expended for repairs of property occupied for the purpose of trade or in respect of which income is receivable".

Lord Macmillan, who delivered the judgment of the Privy Council, stated (p. 374):

The periodical renewal by sections of the rails and sleepers of a railway line as they wear out by use is in no sense a reconstruction of the whole railway and is an ordinary incident of railway administration. The fact that the wear, although continuous, is not and cannot be made good annually does not render the work of renewal when it comes to be effected necessarily a capital charge. The expenditure here in question was incurred in consequence of the rails having been worn out in earning the income of previous years on which tax had been paid without deduc-

(1) (1933) A.C. 368.

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tion in respect of such wear, and represented the cost of restoring them to a state in which they could continue to earn income. It did not result in the creation of any new asset; it was incurred to maintain the appellants' existing line in a state to earn revenue.

The decision of the House of Lords in the case of *Usher's Wiltshire Brewery, Limited* v. *Bruce* (1), although perhaps not so apposite as the preceding ones, may be consulted with advantage. It will suffice to quote an extract of the headnote which is fairly accurate and complete:

> A brewery company, as a necessary incident of the profitable working of their brewery business, acquired and owned licensed houses which they let to tied tenants, who, in consideration of the tie, paid a rent less than the full annual value. The tenants were under an agreement to repair and to pay rates and taxes, but the company in fact did the repairs and paid the rates and taxes in order to avoid loss of tenants. The company also in respect of these houses paid premiums on insurances against fire and loss of licences and incurred legal expenses in connection with the renewal of the licences and otherwise. All these sums were solely and exclusively expended or allowed by the brewery company for the purposes of their business:
>
> Held that, in estimating the balance of the profits of their business for the purposes of assessment to income tax, the brewery company were entitled to deduct all these sums as expenses necessarily incurred for the purpose of earning the profits. *Brickwood & Co.* v. *Reynolds* (1898) 1 Q.B. 95 overruled.
>
> Decision of the Court of Appeal (1914) 2 K.B. 891 reversed.

There are two cases in which the judgments were delivered subsequently to the hearing by the Supreme Court of the case of the Minister of National Revenue and Dominion Natural Gas Company. These cases, in my opinion, offer as much relevancy to the problem at issue herein as those previously referred to and they certainly deserve being noted.

The first of these cases is that of *Southern* v. *Borax Consolidated, Ltd.* (2).

The respondent purchased certain property for the purposes of its business. Subsequently an action was taken against the company claiming that its title was invalid. The company defended the action and incurred legal expenses amounting to 6,249*l*, which it claimed to be entitled to deduct as business expenses in computing its profits for the purposes of assessment to income tax.

(1) (1915) A.C. 433. (2) (1940) 4 A.E.R. 412.

The Crown contended that the action concerned the capital assets of the company and was contested in order to preserve the existence of those assets and that the sum of 6,249*l* was a capital expense.

The King's Bench Division (Lawrence, J.) held that the expense had been incurred, not in creating any new asset, but in maintaining the title to the company's property and was, therefore, an expense wholly and exclusively incurred for the purposes of the company's trade and, as such, properly deductible.

Lawrence J., after reviewing the precedents cited by counsel, concluded as follows (p. 419):

> It appears to me that the legal expenses which were incurred by the respondent company did not create any new asset at all, but were expenses which were incurred in the ordinary course of maintaining the assets of the company, and the fact that it was maintaining the title, and not the value, of the company's business does not make it any different.

The second case is *Income Tax Commissioner* v. *Singh* (exactly Maharajadhiraj Sir Rameshwar Singh of Darbhanga) (1).

In this case the Judicial Committee of the Privy Council affirmed the judgment of the High Court of Judicature at Patna, India, which had decided a reference made to it, at the request of the respondent, in favour of the latter.

The summary of the judgment, fairly comprehensive and exact, may advantageously be quoted:

> The respondent's father made a loan of 10 lakhs of rupees to a company in which he was a shareholder, and recovered this loan in an action, the costs of which were allowed as an expense incurred in his moneylending business in the assessment of his income tax. Certain shareholders in the company brought an action against the respondent's father and others for conspiracy, collusion, misrepresentation, and breach of contract. The basis of this action was an alleged transaction, of which the loan was part, whereby the respondent's father agreed to finance and manage the company. The action was dismissed, the version of what took place relied upon by the plaintiffs being found to be completely false. The respondent's father died before the conclusion of the suit, and the respondent who continued his business claimed to deduct the costs in arriving at the assessment of profits. The appellant contended that there was no connection between the loan and the alleged transaction which was the basis of the action against the respondent's father, the action being of a personal character and unrelated to his business as a moneylender:

(1) (1942) 1 A.E.R. 362.

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Held: the respondent was entitled to make the deduction claimed. The allegations against the respondent's father were built up upon the transaction in which the loan was made, and the defence of the action was necessary for the protection of his rights as the creditor in the loan.

Lord Thankerton, who delivered the judgment of the Court, stated (p. 365, *in fine*):

> Their Lordships are, therefore, of opinion that the facts stated by the commissioner cannot justify the opinion expressed by him, but that the expenditure in question was incurred solely for the purpose of earning the profits or gains of the moneylending business, and that the High Court are right in holding the respondent entitled to the deduction claimed and in answering the question of law asked by the commissioner in favour of the respondent.

The jurisprudence in the United States holds the same views: *Citron-Byer Co.* v. *Commissioner of Internal Revenue* (1); *Kornhauser* v. *United States* (2); *National Outdoor Advertising Bureau, Inc.* v. *Helvering* (3).

In the cases of *Montreal Coke and Manufacturing Company* and *Montreal Light Heat and Power Cons.* v. *Minister of National Revenue* (4) in which the Privy Council affirmed the judgment of the Supreme Court, which by a majority had affirmed the judgment of Maclean J., disallowing deductions for expenditure made by appellants in connection with the redemption of existing bonds before maturity and the reborrowing of the sums paid out at lower rates on less onerous conditions as to repayment, with a view to reducing their interest charges, alluded to by counsel but without insistence, differ materially with the present case and have practically no bearing on it. Nevertheless a passage from the notes of Lord Macmillan, who delivered the judgment of the Privy Council, may be useful (p. 100):

> It is obvious that there can be many forms of expenditure designed to increase income which would not be appropriate deductions in ascertaining annual net profit or gain. The statutory criterion is a much narrower one. Expenditure to be deductible must be directly related to the earning of income. The earnings of a trader are the product of the trading operations which he conducts * * * It is not the business of either of the appellants to engage in financial operations. The nature of their businesses is sufficiently indicated by their titles. It is to these businesses that they look for their earnings. Of course, like other business

(1) (1930) 21 B T.A. 308
(2) (1928) 276 U.S.R. 145.
(3) (1937) 89 Fed. Rep. (2d) 878.
(4) (1944) Canada Tax Cases 94.

people, they must have capital to enable them to conduct their enterprises, but their financial arrangements are quite distinct from the activities by which they earn their income.

Further on Lord Macmillan added:

It was conceded in the Courts in Canada, and in any event it is clear, that the expenses incurred by the appellants in originally borrowing the money represented by the bonds subsequently redeemed were properly chargeable to capital and so were not incurred in earning income. If the bonds had subsisted to maturity the premiums and expenses then payable on redemption would plainly also have been on capital account. Why then should the outlays in connection with the present transactions, compendiously described as "refunding operations" not also fall within the same category? Their Lordships are unable to discern any tenable distinction.

The various Income Tax Acts considered in the aforesaid cases, apart from that of *Minister of National Revenue* v. *Dominion Natural Gas Company Ltd.*, based on the Canadian Income War Tax Act, contain provisions fundamentally similar, regarding deductions not allowable, to the Canadian Act. A difference, however, between the foreign acts referred to in the decisions pre-cited and our own is that in paragraph (*a*) of section 6 of the Canadian Income War Tax Act the adverb "necessarily" has been added to the adverbs "wholly" and "exclusively" which are also found in the other acts. This adverb "necessarily" was inserted in the statute by 13-14 Geo. V, chap. 52, section 3. I do not believe that it adds any strength to the paragraph.

I do not know if the intimation by counsel for appellant that the Supreme Court in the case of the *Minister of National Revenue* v. *Dominion Natural Gas Company Ltd.* reversed the judgment of the Exchequer Court, feeling that it was bound to do so by the decisions in the cases of *The Lothian Chemical Co. Ltd.* v. *Rogers, Robert Addie & Sons' Collieries Ltd.* v. *Inland Revenue Commissioners, Tata Hydro-Electric Agencies Ltd.* v *Commissioner of Income Tax, British Insulated and Heisby Cables Ltd.* v. *Atherton* and *Ward and Company Ltd.* v. *Commissioner of Taxes* is justified. It appears from the report that these cases were fully considered, commented on and accepted by the Court as authorities. I may note that the doctrine has evolved appreciably since these judgments were rendered. Having previously reviewed them, I shall only make now a few brief remarks.

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Now in the two first ones it was held, on facts widely different from those forming the basis of the case in appeal, that the expenses and costs incurred were in the nature of capital expenditure or loss of capital. These cases do not seem to me to have any relevance to the matter in issue.

In the third case, *Tata Hydro-Electric Agencies Ltd.* v. *Commissioner of Income Tax,* the Privy Council held that in computing its income for tax purposes the appellant was not entitled to deduct the 25 per cent of the commission received from Tata Power Co. Ltd. and paid over to F. E. Dinshaw Ltd. and Richard T. Smith under certain agreements, as this percentage of the commission so paid was not expenditure incurred by appellant "solely for the purpose of earning * * * profits or gains" of its business, and that the obligation to make the payments was undertaken by appellant in consideration of its acquisition of the right and opportunity to make profits, that was, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business. This case differs substantially from the present one and I do not think that it has any application.

The fourth case relied upon by the Supreme Court is *British Insulated and Helsby Cables Ltd.* v. *Atherton,* in which there was, as already stated, a considerable difference of opinion. The House of Lords maintained, by a majority of three to two, the judgment of the Court of Appeal which had unanimously reversed the judgment of Rowlatt J. in the King's Bench Division. I have previously reviewed the decision of the Privy Council and I do not deem it useful to deal with it anew, except perhaps to point out briefly that the Court held that, when an expenditure is incurred "once and for all" with a view to bringing into existence an asset or advantage for the enduring benefit of a trade, there is very good reason for treating such an expenditure as properly attributable not to revenue but to capital. We are not faced with this problem in the present case. What we are concerned with is not an expenditure laid out for the creation or acquisition of an asset but one made to protect and safeguard an asset already in existence.

The last case referred to by the Supreme Court is *Ward and Company Ltd.* v. *Commissioner of Taxes* in which the Judicial Committee of the Privy Council affirmed the judgment of the Court of Appeal of New Zealand holding that a sum expended by appellant, a brewery company, in printing and distributing anti-prohibition literature in connection with a poll of voters being about to be held on the question as to whether or not prohibition of intoxicants should be introduced is not an expenditure which may be deducted from the company's income derived from its business, as not being an expenditure exclusively incurred in the production of the assessable income, as enacted by section 86, subsection 1(*a*) of the Land and Income Tax Act, 1916, of New Zealand. This decision is, in my judgment, irrelevant and inapplicable.

At the outset of his argument counsel for respondent reiterated his admission that Hudson's Bay Company did a substantial business with American tourists and said he was also prepared to admit that the company took proceedings, incurred the costs in question herein and paid them.

It was submitted on behalf of respondent that the fact of the Commissioner having twice accepted and verified the appellant's return, including the deduction of said costs, did not prevent him from reassessing if he thought fit. This power is given him by section 55 of the Act, which reads thus:

> Notwithstanding any prior assessment, * * * the taxpayer shall continue to be liable for any tax and to be assessed therefor and the Minister may *at any time* assess, re-assess or make additional assessments upon any person for tax, interest and penalties.

I may note incidentally that this section was repealed and another one substituted therefor by 8-9 George VI, chapter 43, section 15, which limited, rightly so in my opinion, the time for reassessment, save in the case of misrepresentation or fraud when it is left indefinite, to six years. This seems sufficiently long for the Minister to become aware of the taxpayer's financial status. On the other hand, in all fairness and equity the uncertainty of the taxpayer regarding his indebtedness to the Treasury should not be unduly prolonged.

I agree with counsel for respondent's statement that the Minister, notwithstanding any previous assessments,

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may reassess as often as he wishes, subject, however, I may add, to the right of the Court to affirm, vary or disallow the final assessment.

Replying to counsel for appellant's submission that the defence as set forth in the statement of defence is too wide, counsel for respondent, referring to the portion of the Minister's decision in which he affirms the assessments "on the ground that the legal costs and the expenses in question were expenses of the taxpayer not wholly, exclusively and necessarily laid out or expended for the purpose of earning its income", pointed out that this is the exact language of Section 6(*a*) which is pleaded in the statement of defence. Counsel then dealing with the following declaration of the decision: "but were in fact expenses incurred in the prosecution of its action to protect its trade name and trade and were the application of profits after they had been earned as profits for the purpose of earning future profits and accordingly were properly disallowed for income tax purposes under and by reason of the provisions of section 6 and other provisions of the Income War Tax Act in that respect" stated that, while the exact language of subsection (*b*) of section 6 is not used, the effect of the language that is used is to bring it into operation. He concluded that the statement of defence is not too wide when one has in mind the decision of the Minister. I must say that this seems to me a mere technicality without any importance.

Counsel for respondent stressed the point that appellant is an English company incorporated by Royal Charter in England, having its head office in that country, but operating in Great Britain, Canada, Newfoundland and other countries. He submitted that, if it were a Canadian company, all its earnings, wheresoever they might be obtained, would be income for taxation purposes in Canada and that there might be some deduction for tax purposes in other countries but that they would be taken into account in determining the tax payable in Canada and that all of its disbursements properly attributable to income would be deducted no matter where they might have been incurred. Reasserting that the appellant is an English company doing business in Great Britain, in Canada,

Newfoundland and various other countries, Mr. Smith declared that it is not taxed in Canada in respect to its profits on the English business or the Newfoundland business and that those profits are kept separate and distinct. He added that they are not brought into charge for the determination of the Canadian income tax and that likewise its expenses in earning the income in Britain, Newfoundland or other countries are not deductible from its Canadian earnings. This seems manifest. Counsel nevertheless insisted by stating that the costs of an action brought by appellant in England similar to the one instituted by it in the United States could not be deducted from the Canadian earnings of the company for income tax purposes in Canada. He observed that it is clear from appellant's statement, as filed in the Income Tax office, that the Canadian earnings and expenses are separated, for Canadian income tax purposes, from its earnings and expenses in Great Britain, Newfoundland and other places where a separate business is carried on.

Counsel pointed out that the proceedings in the State of Washington against Hudson Bay Fur Company Inc. were brought and the expenses in connection therewith incurred in a foreign country. He further pointed out that a subsidiary company of appellant has been incorporated in the state of New York under the name of Hudson's Bay Company Inc. He intimated that, if the appellant has earnings in the United States and if it incurs expenses in connection therewith, these earnings and expenses should be attributable to the appellant's American subsidiary rather than to the Canadian aspects of the appellant's business. He specified particularly that, if the appellant, which is an English company, deems it necessary to take proceedings in the United States against an American company in respect of its trade name, reputation and goodwill, the costs of such proceedings should be charged to the American subsidiary of appellant or at least against the United States business of the appellant. He wondered why these costs, incurred in a foreign country, should be charged against the Canadian earnings of appellant rather than against its earnings in England where its head office is situate. He asked himself where the line

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is to be drawn between Canadian and other business if the costs of proceedings instituted in the United States are to be charged against the appellant's Canadian income. He observed that the appellant claims a universal reputation as the greatest fur producing and trading establishment in the world and, supposing that the appellant should bring an action, similar in scope and object to the one whose costs are now in question, in Australia, China or Brazil, asked himself if it would be proper to deduct the costs of such action from the appellant's Canadian income. His contention was that the question put in that form answers itself. He said that the head office of the appellant being in Great Britain it would not be proper to deduct the said costs from the Canadian income of the company. He saw no reason why the costs of an action taken in the United States should differ from costs of actions taken in other parts of the world, bearing in mind that the appellant is an English company, that it segregates its British and Newfoundland business from its Canadian business.

Counsel submitted that the costs of legal proceedings instituted in defence of reputation, trade name or goodwill should be chargeable against the appellant's business in the country where the costs are incurred and, if it is not possible to do so, that they should be charged against the business in the country where the appellant has its head office, to wit, in the present instance, in England. He urged that the trade name, reputation and goodwill are assets of the corporation as a whole and not of its Canadian business alone and that it is difficult to see how expenses made in a foreign country in connection with these assets can properly be charged against the appellant's Canadian business alone.

It was argued on behalf of appellant that, as there is no suggestion in the pleadings nor in the Minister's decision that the costs and expenses in question ought not to be charged to the Canadian business of appellant, but ought to be charged to its business in the United States or, if that cannot be done, to its business in England, where the company has its head office, this omission disposes of this aspect of the defence and that the respondent cannot now

raise that point. I am inclined to adopt that view. However that may be, the evidence discloses that it was the appellant's Canadian business which was being interfered with by Hudson Bay Fur Company Inc. of Seattle and that the action taken in the United States to check that interference was legitimate. I believe that the costs incurred in connection with this action were properly chargeable against the Canadian income.

Counsel for respondent submitted that, in dealing with English cases, it is necessary to remember that the English rule corresponding to section 6(*a*) of the Income War Tax Act is broader. Rule 3 of rules applicable to cases I and II, schedule D, under the English act, reads thus:

> In computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of (*a*) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation.

Counsel for respondent drew the attention of the Court to the difference between the text of paragraph (*a*) of section 6 of the Canadian act and of paragraph (*a*) of rule 3 of the English act, the first one mentioning "for the purpose of earning the income" and the second one using the words "for the purposes of the trade," etc. He concluded that the language of the Canadian sections is narrower and therefore less favourable to the taxpayer. There is evidently a difference in the phraseology of the two provisions, but I do not think that it has the importance which counsel attempted to attach to it. The question has been considered from a broad point of view of commercial accountancy, as to what are proper charges against revenue and what are proper charges against capital. In the case of *Strong and Company of Romsey, Ltd.* v. *Woodifield* (1), Lord Davey stated (p. 220):

> It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade or is made out of the profits of the trade. It must be made for the purpose of earning the profits.

In the case of *Robert Addie and Sons' Collieries Ltd.* v. *Commissioner of Inland Revenue* (2), Lord Clyde adopted the same opinion: see page 676.

(1) 5 Rep. of Tax Cases, 215; (1906) A.C. 448.
(2) (1924) 8 Rep. of Tax Cases, 671.

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The legal expenses and costs laid out by the appellant to protect its trade name, business and reputation were not incurred with the object of creating or acquiring any new asset but were incurred in the ordinary course of protecting and maintaining its already existing assets. On the other hand, I do not believe that these expenses and costs can be considered as being a capital outlay or loss.

Counsel for respondent submitted that the appellant, by means of the proceedings instituted in the United States, had obtained an enduring asset. I cannot agree with this proposition. There was no new asset brought into existence by these proceedings. The expenses were incurred in the ordinary course of maintaining the already existing assets of the company.

Reverting to the distinction between revenue and capital, I may note that in the case of *Southern* v. *Borax Consolidated Limited* (*ubi supra*) Lawrence J., in addition to making the statement hereinabove quoted, expressed the following opinion, which, as I think, is applicable to the present case (p. 417):

* * * The only way in which it can be said that there was here any alteration in the capital assets of the respondent company was that the city of Los Angeles had been removed from the category of possible litigants who might challenge the company's title. I cannot think that that makes the payment a capital payment.

The respondent, in *re Southern* v. *Borax Consolidated Limited*, obtained a decision maintaining the title to its property. In the case of *Hudson's Bay Company* v. *The Hudson Bay Fur Company, Inc.*, the plaintiff merely got a decision in a passing off action enjoining the defendant (*inter alia*) from using or employing, after a certain period, the name "Hudson Bay Fur Company" and any name having the words "Hudson" and "Bay" either jointly or severally, the initials "HB" or any colourable imitation of the name "Hudson's Bay".

As suggested by counsel for appellant, the latter might face at any time the obligation of instituting other proceedings against Hudson Bay Fur Company, Inc., or start an action against someone else using the name "Hudson Bay" or a colourable imitation thereof.

In the case of *Kellogg Company of Canada Limited and the Minister of National Revenue* (1), referred to by Mr. Burbidge, the appellant, a manufacturer of cereal products, and one of its customers were made defendants in an action brought by Canadian Shredded Wheat Company which claimed infringement by both defendants of certain trade mark rights and asked for an injunction restraining them from using the words "Shredded Wheat" or "Shredded Whole Wheat" or "Shredded Whole Wheat Biscuit" or any words only colourably differing therefrom and damages. The appellant successfully defended the action on behalf of both defendants. In computing its income for 1936 and 1937 the appellant deducted the sums of money paid out for legal expenses on account of said action. These deductions were disallowed by the Commissioner of Income Tax. The latter's disallowance was naturally affirmed by the Minister of National Revenue, from whose decision an appeal was taken to the Court. It was held that the payments were made involuntarily in the course of business to enable the appellant to continue the sales of its products as before action was taken against it and not to secure or preserve an actual asset or enduring advantage to appellant.

A brief extract from the judgment of Maclean J. may be convenient (p. 43):

> The broad principle laid down by Lord Cave in *British Insulated v Atherton,* (1926) A.C. 205 at 213, is not, in my opinion, of any assistance in the present case. Applying that test to the present case, the payment here made was not, I think, an expenditure incurred or made "once and for all", with a view of bringing a new asset into existence, nor can it, in my opinion, properly be said that it brought into existence an advantage for the enduring benefit of Kellogg's trade within the meaning of the well known language used by Lord Cave in a certain passage of his speech in that case. What the House of Lords was considering in that case was a sum irrevocably set aside as a nucleus of a pension fund established by a trust deed for the benefit of the company's clerical staff, and, as was said by Lawrence L.J. in the *Anglo Persian Oil* case, *supra,* I have no doubt that Lord Cave had that fact in mind when he spoke of an advantage for the enduring benefit of the company's trade. Such an expenditure differs fundamentally from the expenditure with which we are concerned in the present case. Here, the expenditure brought no such permanent advantage into existence for the taxpayer's trade. I do not think it can be said that the expenditure in question here brought into existence any asset that could possibly appear as such

(1) (1942) Ex. C R. 33.

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in any balance sheet, or that it procured an enduring advantage for the taxpayer's trade which must pre-suppose that something was acquired which had no prior existence.

After stating that the case of *Kellogg and the Minister of National Revenue* closely resembles that of *Noble* v. *Mitchell* (*ubi supra*), in which a large sum of money was expended by a company to get rid of a managing director, and quoting passages from the reasons of the Master of the Rolls and of Lord Justice Sargent, which I do not deem necessary to transcribe here and which may be easily referred to, Maclean J. declared that these remarks would appear to be applicable and added (p. 45):

> Here, Kellogg had encountered a business difficulty, one associated directly with the sales branch of its business, which it had to get rid of, if possible, in order to continue the sales of its products as it had in the past.

An appeal was taken by the Minister of National Revenue and the same was dismissed (1). Sir Lyman Duff, who delivered the judgment of the Court, after referring to the case of the *Minister of National Revenue* v. *The Dominion Natural Gas Company, Limited,* made, among others, the following statements (p. 60):

> The present appeal concerns expenditures made by the respondent company in payment of the costs of litigation between that company and the Canadian Shredded Wheat Company.
>
> * * *
>
> As regards this payment, the question in issue was whether or not the registered trade marks of the plaintiffs in the action were valid trade marks, or, in other words, whether or not the present respondents, the Kellogg Company, and all other members of the public were excluded from the use of the words in respect of which the complaint was made. The right upon which the respondents relied was not a right of property, or an exclusive right of any description, but the right (in common with all other members of the public) to describe their goods in the manner in which they were describing them.

The comments contained in paragraph 316 of Halsbury's Laws of England, 2nd edition, volume 17, are pertinent and illustrative:

> 316. Though it is clear that the expenses allowable are such as are necessary to earn the receipts of the trade, this proposition must be applied in a reasonable way, and must not be construed so as to preclude the deduction of those expenses as a result of which receipts or profits may accrue in the future. For example, the cost of a reasonable amount of advertising is usually admitted as a business expense, although the result of a particular advertisement might not be reflected in an increase

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

in trade receipts in the year in which the cost was incurred. The principle is that expenses to earn future profits are allowable deductions, and this principle has been extended to include expenditure to avoid future expense which does not bring into being a tangible asset.

The cases mentioned in notes (*i*) and (*k*) at the bottom of page 155 deserve attention and may be usefully consulted.

The costs and expenses laid out by the appellant to prevent the Hudson Bay Fur Company, of Seattle, from using a firm name so closely resembling its own that it misled many American tourists and induced them to believe that Hudson Bay Fur Company was a branch or subsidiary of the appellant and to thereby turn to the appellant company the profits or gains derived by Hudson Bay Fur Company from sales made to purchasers believing that they were dealing with the appellant must, in my judgment, be considered as disbursements or expenses laid out and expended for the purpose of earning the income as prescribed in paragraph (*a*) of subsection 1 of section 6 of the Income War Tax Act. These costs and expenses were not laid out with the object of acquiring or bringing into existence an asset; they were made in the ordinary course of preserving and maintaining the trade of the appellant and safeguarding it from the diversion thereof by a party misusing the appellant's name. I do not believe that these costs and expenses can be considered as a capital outlay.

I do not think that the assertion set forth by counsel for respondent that the costs and expenses in question constitute an expenditure made once and for all for the enduring benefit of the trade is founded.

The argument made on behalf of respondent that the appellant in taking proceedings against Hudson Bay Fur Company Inc. had acquired part of the latter's goodwill, since it had been in business for approximately thirty years, apart from the fact that it is not mentioned in the pleadings, is not, to my mind, serious. The action was taken after long and protracted negotiations had been carried on, when it was seen that no solution could be obtained otherwise.

I have already stated that the respondent's contention that the costs and expenses in question, if deductible from

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the profits and gains of the appellant, must be deducted from the profits and gains of the American subsidiary, viz. Hudson's Bay Company Inc., of New York, or, if it cannot be done, from those of the appellant's business in Great Britain, is, to my mind, ill-founded, seeing that the business of appellant which was affected by the illegal trade of Hudson Bay Fur Company was the Canadian section thereof.

After a careful perusal of the evidence and of the able and comprehensive argument of counsel and an elaborate study of the precedents, I have reached the conclusion that the legal costs and expenses in question amounting to $10,377 and $22,952.80 paid by the appellant in its fiscal years ending January 31, 1938, and January 31, 1939, respectively, must be considered as disbursements or expenses wholly, exclusively and necessarily laid out for the purpose of earning its income and that they are not an outlay, loss or replacement of capital.

There will accordingly be judgment in favour of the appellant maintaining the appeal, setting aside the decision of the Minister and the notices of assessment for the years 1938 and 1939 and declaring that the sums of $10,377 and $22,952.80 must be deducted from the income of the appellant for its fiscal years ending January 31, 1938, and January 31, 1939, respectively.

The appellant will be entitled to its costs against respondent.

Judgment accordingly.