Montreal 1967 May 9 Ottawa May 19

BETWEEN:

GLENCO INVESTMENT CORPORATION APPELLANT;

AND

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

Income tax—Current expense or capital outlay—Installation of special wiring and plumbing for long-term tenant—Whether enduring benefit.

In December 1961 appellant bought for $525,000 a warehouse building in Montreal and in February 1962 negotiated a 10-year lease at a total rental of $500,000 to a company in the business of servicing, cleaning and flushing aircraft radiators. In order to meet the particular needs of the lessee appellant as a condition of obtaining the lease installed special electric wiring at a cost of $3,146, and a water inlet, drainage pipe, washroom and toilet facilities at a cost of $11,882.60.

Held, the installations were an enduring benefit and their cost therefore not a current expense but a capital outlay.

APPEAL from Tax Appeal Board.

David I. Fleming for appellant.

P. F. Cumyn and *J. R. London* for respondent.

DUMOULIN J.:—This is an appeal on behalf of Glenco Investment Corporation from a decision of the Tax Appeal Board, dated June 9, 1965, affirming the levy by the Minister of National Revenue of an additional $1,721.84 tax in connection with the above firm's income returns for the year 1962.

It may be said that the principal facts are not in dispute, the litigants having agreed to the correctness of the amounts expended for the installation of various fixtures in the appellant's warehouse (as it was at the start of 1962), bearing civic number 780, St. Remi Street, in the City of Montreal.

The Court, consequently, is confronted anew with the perennial discussion as to what constitutes "an outlay or expense . . . for the purpose of . . . producing income from property or a business of the taxpayer", therefore outside

the prohibition of section 12(1)(*a*) of the *Income Tax Act*; or, on the contrary, "an outlay... of capital, a payment on account of capital . . ." provided for in section 12(1)(*b*), within its prohibition and liable, accordingly, to taxation.

On or about December 13, 1961, the appellant purchased from Imperial Tobacco Limited this immoveable at a price of $525,000, the vendor agreeing to remain the tenant of the two upper floors. At the time, the building was mainly utilized for warehousing purposes.

Subsequent negotiations led to the conclusion, on February 7, 1962, with Heatex Limited, of a ten-year lease, May 1, 1962-April 30, 1972, at a total rental price of $500,000 (cf. Exhibit A-4). This company pursued the tasks of servicing, cleaning and flushing aircraft radiators, a business requiring considerable water supply and high-powered electricity.

The lessor covenanted in the deed of lease, Exhibit A-4 (clause 2, page 8) "to make available to the Lessee at Lessor's cost 220 and 550 volt wiring, providing 600 Amps at 550 Volt, and 600 Amps at 220 Volt, to a point at the rear of the building inside the premises"; the cost of such installation being $3,146. Clauses 6, 7 and 12 of the indenture next oblige the Lessor to install, "at its own cost", in the building, "an additional three inch water inlet . . .", "a six inches drainage pipe below the basement floor level . . ." plus the requisite surface connection points; and, also, to erect "washroom and toilet facilities in the basement and ground floor level for a total personnel of seventy-five (75) persons together with further facilities on the second floor for a personnel of forty (40) persons, in accordance with the City of Montreal Health Department authorities and the plan hereto annexed". Lastly a concrete sewer pit was installed; this and the plumbing work amounted to $11,882.60.

At trial, Ray Fleming, President of Glenco Corporation, testified that these fixtures and installations had to be agreed upon by the Lessor as an essential condition of the

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ten-year lease and were made, in addition to pre-existing facilities, for the particular needs of Heatex Limited.

I might now summarily dispose of an incident which may uselessly take up too many pages of the eventual transcript. One Alfred Louis Lépine, who describes himself as a realtor or real estate agent, exhibited, in Court, a document purporting to be a proposal from a firm by the style of St-Arnaud et Bergevin Limitée, offering Heatex Limited to sub-lease its premises, on condition that all alterations performed so far be undone and some partitioning walls torn down. This supposed offer, unaccepted as yet by Heatex Limited, unauthenticated by the would-be sub-lessees, and unsubmitted to the appellant's consent, as required by clause 8 of the original lease, bore the somewhat coincidental date of May 8, 1967, less than 24 hours before the appeal was heard. Due to these irregularities, the Court ruled that both the proffered document and the deponent's attempted evidence were inadmissible.

Under these conditions, Glenco Investment contends in paragraph 5 of its Notice of Appeal:

> 5. That the said expenditures were effected for the purpose of gaining income and do not in any manner enhance the value of the immoveable,

to which the Minister of National Revenue counters as follows, in paragraph 7 of the Reply:

> 7. The Respondent states that the said amounts of $3,146.00 and $11,882.60 were expended for the enduring benefit of the building as a vehicle for investment and in fact enhanced the value of the building, and the said amounts are therefore outlays on account of capital and not deductible in computing the Appellant's income for its 1962 taxation year.

Throughout the years, the interpretation of paragraphs 12(1)(*a*) and 12(1)(*b*) prompted a recourse to several tests in the hope of differentiating an income producing outlay from a strictly capital expenditure. Among these criteria, in keeping with the peculiarities of the cases, some are cumulative, others single in applicability. By itself a mere allegation of money spent "for the purpose of gaining or producing income from property or a business of the taxpayer" does not excuse from the prohibition decreed in s. 12(1)(*a*). As stated by Mr. Justice Cameron, late of

this Court, in *Thompson Construction (Chemong) Limited and the Minister of National Revenue*[1], an appeal dealing with the purchase price of a new diesel engine in a power shovel to avoid major repairs to the old one: "In a broad sense it may be said that the outlay for the new engine was an expense incurred for the purpose of earning the appellant's income. The same might be said of all outlays of capital for all types of buildings, machinery and the like, to be used in the business"; and the learned Judge, on page 104, formulates one of many qualifying norms: "But I think it is clear that if the outlay brings into existence a capital asset . . . such outlay will not be allowed as a deduction".

In *The Minister of National Revenue and Lumor Interests Limited*[2], wherein the installed cost of a new elevator in an office building was sought as a deduction in lieu of repairs to the existing one, the late Mr. Justice Fournier (of the Exchequer Court) reached a similar conclusion through a slightly different test, holding that:

> ... the outlays for the replacement of the old elevator by the new one and the rebuilding of the elevator shaft and other works connected therewith were not current expenses made in the ordinary course of the respondent's business operations to earn income within the meaning of s. 12(1)(*a*) of the *Income Tax Act*.
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> 2. ... the outlays were not recurrent but were made or incurred to create a new asset and bring into existence an advantage of enduring benefit and were properly attributable to capital and not revenue.

We may at once note a common trait between the latter precedent and the suit at bar, namely, that the installation of high voltage and hygienic facilities, the cost of plumbing fixtures and water mains "were not current expenses made in the ordinary course of the appellant's business operations to earn income . . .", neither were they recurrent, having never before been incurred and never since.

The matter of *Minister of National Revenue and Vancouver Tugboat Company Limited*[3], dealt at some length with the factor of recurrence of certain operating expendi-

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[1] [1957] Ex. C.R. 96 at 102-104. [2] [1960] Ex. C.R. 161.
[3] [1957] Ex. C.R. 160 at 171.

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tures. In the latter case, Vancouver Tugboat Company operated along the Pacific coast of Canada. It placed, in 1951, a new engine in one of its tugboats at a total cost of $42,086.71 and claimed this amount as a deduction from income for that year. Reversing the decision of the Income Tax Appeal Board, Mr. Justice Thurlow, of this Court, allowed the Minister's appeal for several reasons, one of which is of particular interest, bearing as it does with the topic of recurring expenses. The learned Judge wrote:

> . . . While the expense of replacing engines is a recurring one in the sense that it recurs in respect to each tug once in five, eight, or ten years, I do not think the expenditure can be classed as one made to meet a continuous demand. There may be more or less continuous demand for repairs to the tug and to the engine in it, but there is no continuous demand for replacement of the engine any more than there is continuous demand for replacement of the hull as a whole. Moreover, in my opinion, the respondent's trade has gained an advantage by the expenditure, in that the expenditure has provided an engine which makes the tug more reliable, keeps it more constantly in service, and enables it to earn greater revenue and at the same time avoids the abnormal repairs formerly required. And such advantage is of an enduring nature in that the anticipated life of the new engine is ten years. No doubt there will be wear and tear each year beyond what is restored by repairs in the year and the advantage will ultimately be exhausted, but in my opinion that does not affect the nature of such advantage as capital. If any deduction from income is to be allowed in respect of such exhaustion, in my view, it must be by way of an allowance of the kind permitted under the exception to s. 12(1)(*b*).

For duty's sake there now remains the rather irksome task of "airing" a triology of *loci classici*; an inescapable obligation of this branch of the law, trapping the judicial writer in the dilemma of being plagued for exceptional oversight should he omit to quote them, or cursed for boredom if he does. I choose what appears to be the lesser risk.

In *Vallambrosa Rubber Co. Ltd. v. Farmer*[4], the Lord President, at page 536, stated the following test, relating to recurrent expenses:

> Now, I don't say that this consideration is absolutely final or determinative, but in a rough way I think it is not a bad criterion of what

[4] (1910) 5 T.C. 529.

is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing that is going to recur every year.

A second touchstone is that of *British Insulated and Helsby Cables v. Atherton*[5] propounded by Lord Cave, L.C., and referring to the creating of a trade asset or advantage; I quote:

> But when an expenditure is made not only once and for all but with a view to bringing into existence an asset or advantage for the enduring benefit of the trade, I think that there is a very good reason in the absence of special circumstances leading to an opposite conclusion for treating such an expenditure as attributable not to revenue but to capital.

A third criterion purporting to distinguish between capital outlays and purely operating costs is formulated by Lord Sands in *re: Commissioners of Inland Revenue v. The Granite City Steamship Co. Ltd.*[6], wherein the British jurist says:

> Under the Income Tax legislation no allowance is permissible, in estimating annual profits, by way of deduction from annual income of capital outlay during the year of charge. As I had occasion to point out in the *Law Shipping Co., Ltd. v. Inland Revenue* (12 T.C. 621), 1924 S.C. 74, this is an arbitrary and artificial rule when the subject is a wasting one that exhausts the capital, so that, if the business is to continue, there will have to be a renewal of capital outlay in a few years. In such a case a portion of the capital outlay is consumed in each year in earning the annual income. But the Income Tax Acts take no account of this consideration. Broadly speaking, outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment.

The appellant's learned counsel argued that these oft described installations did not constitute an enduring benefit, "they were made", contended Mr. Fleming, "for the convenience of one particular tenant and may have to be removed for the convenience of some other".

In view of the uncontradicted facts: a ten-year lease, yielding a total rent of $500,000, it does seem hard to reconcile such an opinion with the contrary evidence of

[5] [1926] A.C. 205 at 213.

[6] (1927) 13 T.C. 1 at 14.

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reality, as to the enduring and beneficial nature of those non-recurrent expenditures. Such facilities, assuredly, would cause no inconvenience to any class of commercial or industrial occupants, and would prove useful to most.

Appellant's president, Ray Fleming, replying to my question, readily agreed that maintenance costs of these installations "would not appreciably increase the building's operating budget".

I, therefore, must conclude conformably to the several precedents cited, that the improvements made at Heatex' request involved an outlay of capital.

The Court, moreover, is in complete agreement with the closing statement expressed by the learned member of the Tax Appeal Board, Mr. W. O. Davis; I quote:

> In the circumstances of the present appeal, there is no question of renewal or maintenance or repair to an existing capital asset. The expenses in question were laid out for the creation of a new capital asset in that they had the effect of changing the original warehouse, which was suitable for storage purposes only, into a modernized and well-equipped commercial building suitable for rental to tenants with a large number of personnel, and provided a benefit to the appellant which would endure at least for the life of the leases and any renewals thereof. Furthermore, many of the facilities provided, such as washrooms and separate electrical metering arrangements, would be of advantage in attracting new tenants if and when the present leases are finally terminated.

For the reasons above, the appeal will be dismissed and the respondent is entitled to recover all taxable costs.