BETWEEN:

McTAGGART, HANNAFORD, BIRKS & GORDON LIMITED .. } APPELLANT;

AND

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

1951
Apr. 17
1952
Dec. 12

Revenue—Income and excess profits tax—Income War Tax Act, R.S.C. 1927, c. 97, ss. 3, 4(n), 5(p)—Meaning of word "losses" in s. 5(p).

The appellant sustained a business operation loss of $145,246 in 1946 in its dealings with securities but received $168,402.24 in dividends from other Canadian corporations. These were exempted from taxation by section 4(*n*) of the Income War Tax Act and the appellant contended that they must not be taken into account in determining the amount of the losses sustained by it in 1946 that were deductible under section 5(*p*) of the Act from what would otherwise be its 1945 income. The assessment for 1945 denied this contention.

Held: That the fact that the dividends received by the appellant in 1946 were exempt from tax by section 4(*n*) has no bearing on the question whether it sustained a loss in 1946. The dividends were clearly items of income within the meaning of section 3 and their receipt resulted in the appellant having a net profit in 1946. The exemption of the dividends from taxation did not change their character as items of income or leave the appellant with a loss instead of a profit.

2. That the word "losses" in section 5(*p*), after its amendment in 1944 with the words "in the process of earning income" omitted, must be given its ordinary meaning according to accounting practice and is not limited in its meaning to "business operation losses".

APPEAL from assessment for income and excess profits tax.

The appeal was heard before the President of the Court at Montreal.

J. G. Porteous Q.C. and *K. S. Howard* for appellant.

J. Tellier Q.C. and *R. G. Decary* for respondent.

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

THE PRESIDENT now (December 12, 1952) delivered the following judgment:

This is an appeal from the appellant's income and excess profits tax assessment for 1945. The issue in the appeal is whether the appellant sustained a loss in 1946 within the meaning of section 5(*p*) of the Income War Tax Act, R.S.C. 1927, chapter 97, as it stood in 1945.

1952

McTAGGART, HANNAFORD, BIRKS & GORDON LIMITED v. MINISTER OF NATIONAL REVENUE

Thorson P.

The facts are not in dispute. The appellant is a Canadian corporation and deals in securities. In 1945 it had, according to the Minister, a taxable income of $18,340.35 and was assessed accordingly. In 1946 it sustained a loss of $145,246 in its dealings with securities but received $168,402.24 in dividends from other Canadian corporations leaving it with a profit, according to its own profit and loss statement for 1946, of $23,156.24. The appellant contends, and the respondent denies, that in determining whether it sustained a loss in 1946 that was deductible under section 5(*p*) only its business operation loss should be considered and the amount of the dividends received by it must not be taken into account. If the appellant is right it was entitled to deduct from its 1945 income a sufficient amount of its 1946 loss to make it non-assessable for 1945.

To determine the meaning of the word "losses" as used in section 5(*p*), as it stood in 1945, it is necessary to consider its history. When it was first enacted in 1942 by section 5(7) of chapter 28 of the Statutes of 1942-43 it read as follows:

> 5. "Income" as hereinafter defined shall for the purposes of this Act be subject to the following exemptions and deductions:—
>
> (*p*) losses sustained in the process of earning income during the year last preceding the taxation year by a person carrying on the same business in both of such years, if in the calculation of such losses, no account is taken of any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence, or of any disbursements not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income, except such amount for the depreciation as the Minister may allow.

In 1943 paragraph (*p*) was repealed and re-enacted by section 5 of chapter 14 of the Statutes of 1943-44, the only change being the addition of the words "and depletion" in the last line. In 1944 paragraph (*p*) was again repealed and re-enacted by section 4(5) of chapter 43 of the Statutes of 1944-45 and read as follows:

> (*p*) amounts in respect of losses sustained in the three years immediately preceding and the year immediately following the taxation year, but
>
> (i) no more is deductible in respect of a loss than the amount by which the loss exceeds the aggregate of the amounts deductible in respect thereof in previous years under this Act,

(ii) an amount is only deductible in respect of the loss of any year after deduction of amounts in respect of the losses of previous years, and

(iii) nothing is deductible in respect of a loss unless the taxpayer carried on the same business in the taxation year as he carried on in the year the loss was sustained,

if, in ascertaining the losses, no account is taken of an outlay, loss or replacement of capital, a payment on account of capital, any depreciation, depletion or obsolescence or disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income, except such amount for depreciation and depletion as the Minister may allow for the purposes of this paragraph.

There were thus two changes in the 1944 amendment as compared with the former enactment. One was that whereas the 1942 enactment allowed the deduction of losses sustained in a previous year the 1944 amendment allowed the deduction of losses sustained in a subsequent year as well as in three previous ones. The second change was that the words "in the process of earning income" which appeared in the 1942 and 1943 enactments were omitted.

The scope of section 5(*p*), as it stood in 1943, was considered by this Court in *Luscar Coals Ltd.* v. *Minister of National Revenue* (1). There the appellant, which was in the business of coal mining, claimed that it was entitled to deduct from its income for 1943 the sum of $20,299.57, being its business operation losses in 1942, but the Minister allowed a deduction of only $9,945.97 on the ground that the appellant had received the sum of $10,352.60 in dividends from other Canadian companies and that this amount must be deducted from the amount claimed by the appellant in order to arrive at the amount of the 1942 losses that were deductible under section 5(*p*). It was contended for the appellant that the words "losses sustained in the process of earning income" meant the appellant's losses in the operation of the business from which it earned its income without any deduction of the amount of dividends received by it. Cameron J. agreed with this view and allowed the appeal accordingly. In his opinion, the losses that were deductible under section 5(*p*) were the losses sustained "in the process of earning income". This meant that the appellant was entitled to deduct the losses sustained by it in 1942 in its coal mining operations and that

(1) (1949) Ex. C.R. 83.

1952

McTAGGART, HANNAFORD, BIRKS & GORDON LIMITED v. MINISTER OF NATIONAL REVENUE

Thorson P.

in the computation of such losses the amount of the dividends received by it must not be taken into account. It is plain that Cameron J. considered that the words "in the process of earning income" qualified the losses that were deductible under section 5(*p*) as business operation losses and that if these words had not been in the section he would have given the word "losses" its ordinary meaning and held that in computing the appellant's losses in 1942 the amount of the dividends received by it in that year must be taken into account. At page 87, Cameron J. said:

> I think it is clear that if the words "in the process of earning the income" did not appear in the subsection the appellant would have no case.

And, at page 90, he elaborated his view of the effect of the words as follows:

> I think it is clear that if the words "in the process of earning the income" were not used in the subsection, then "losses", lacking any direction as to what losses are meant, would have to be given the meaning attributed to it in ordinary commercial practice, in which case I have no doubt that the losses would be reduced by the amount of investment income received. But I regard the use of these words in the subsection as a provision requiring a departure from the ordinary commercial principles, and conferring on the appellant a right to deduct, not the net losses incurred in the prior year, but its losses incurred in the operating of its business of coal mining, that being the only activity in which there was a process of earning income.

In the present case we have to determine the meaning of the word "losses" in section 5(*p*), as it stood in 1945, with the words "in the process of earning income" omitted from it. Counsel for the appellant submitted that the remarks of Cameron J. in the *Luscar Coals* case (*supra*) on the effect of these words were *obiter dicta* in that they were not necessary to the decision. He contended that the omission of the words made no change in the law and that the "losses" that were deductible under section 5(*p*), as it stood after the deletion of the words, were business operation losses just as they had been previously. In support of this submission he relied on section 4(*n*) of the Act which, after its amendment in 1943 by section 3(1) of chapter 14 of the Statutes of 1943-44, read as follows:

> 4. The following incomes shall not be liable to taxation hereunder:
>
> (*n*) Dividends paid to an incorporated company incorporated in Canada, the profits of which have been taxed under this Act, except as hereinafter provided by sections 19, 22A and 32A.

The exceptions referred to have no application in the present case. It was then argued that since the dividends received by the appellant in 1942 were not liable to taxation by reason of the exemption granted by section 4(*n*) they must not be taken into account in determining whether there were losses that were deductible under section 5(*p*) and that to hold otherwise would have the effect of bringing the exempted dividends back into taxability notwithstanding their exemption.

There are several reasons for not accepting this submission. I reject the contention that the remarks of Cameron J. in the *Luscar Coals* case (*supra*) on the effect of the words "in the process of earning income" in section 5(*p*) were *obiter dicta* as not being necessary for his decision and that their omission made no difference. It is as plain as language can make it that his decision was based on the presence of these words as defining the losses that were deductible under the section and that if they had not been there he would have decided that the word "losses" must bear its ordinary meaning, in which case the amount of the business operation losses would have been reduced by the amount of the dividends.

The matter has been dealt with by the Income Tax Appeal Board and its decisions have all been against the appellant's argument. In *McTaggart, Hannaford, Birks & Gordon Limited* v. *Minister of National Revenue* (1), the present appellant filed its income tax return for 1946 showing its statement of profit before income and excess profits taxes of $23,156.24 and also the receipts of $168,-402.24 in dividends from Canadian corporations which it claimed as a deduction. The dividends being exempt from taxation, the appellant received a notice of assessment showing no income tax payable by it. From this it appealed to the Income Tax Appeal Board asking for a declaration that it had sustained a loss in 1946. The Board held that it had no jurisdiction to make any such declaration and dismissed its appeal. Mr. Fisher, however, went further and expressed the opinion that in 1946 the appellant had not suffered any loss within the meaning of section 5(*p*) of the Act. While this expression of opinion is *obiter* in view of the decision by the Board that it had no jurisdiction, I agree with it.

(1) (1950) 2 Tax A B C. 26.

1952

McTAGGART, HANNAFORD, BIRKS & GORDON LIMITED v. MINISTER OF NATIONAL REVENUE

Thorson P.

The matter came squarely before the Board in *Corneil Limited* v. *Minister of National Revenue* (1). There the appeal was from the appellant's 1946 assessment. The appellant claimed as a deduction from its 1946 taxable income a loss of $886.96 in 1944 and $1,709.43 in 1945. These were business operation losses in these years but in these years the appellant received dividends from other Canadian corporations amounting to $3,916.45 in 1944 and $6,660 in 1945. The Board, with Graham J. dissenting, held that although the dividends were exempt from tax under section 4(*n*) of the Act they constituted income under section 3(1) of the Act and there were no losses in 1944 and 1945 that could be deducted under section 5(*p*) from the appellant's 1946 income. The judgment of the majority of the Board was given by Mr. Monet with Mr. Fisher concurring. I cite the following extract from the English translation of Mr. Monet's judgment, as it appears at p. 127:

> The appellant maintains that it is not bound to include dividends from Canadian corporations in its income because, it says, "These dividends are not taxable". It is true, in accordance with the provisions of section 4(*n*) of the Act, that dividends paid the appellant by Canadian corporations are not taxable and that the appellant is not required to take them into account when determining its taxable income. On the other hand, there is nothing in the Act permitting the appellant not to consider the dividends in question as income when determining whether or not it sustained a loss. The appellant maintains that if, in the computation of its income, regard must be had to the dividends received from Canadian corporations, which are non-taxable under the provisions of section 4(*n*) of the Act, it is not benefiting from the provisions of section 4(*n*) and is paying tax on the dividends in question. In my opinion, this is not so. As a matter of fact, when determining its *taxable income* the appellant company took full advantage of the provisions of the Act regarding dividends from Canadian corporations and did not pay tax on the dividends in question. Only when determining whether or not there was a loss, was the appellant required to include the dividends in question in its income.
>
> Acceptance of the appellant's proposal would mean that not only are the dividends it received from Canadian corporations non-taxable, but they should not even be considered as income. In view of the wording of section 3(1) of the Act which provides, among other things, that "'income' . . . . includes . . . . dividends . . .", it is impossible for me to accept this proposal.

The Board dealt with the matter again in *Smith, Davidson and Wright Limited* v. *Minister of National Revenue* (2). There the appellant in 1948 incurred an operating

(1) (1950) 2 Tax A.B.C. 116. (2) (1950-51) 3 Tax A.B.C. 187.

loss of $34,385.33 but received from another Canadian corporation a dividend of $12,495. It claimed a deduction of the former amount from its 1947 income but was allowed to deduct only its over-all loss of $21,888.33. The appellant's claim was disallowed by the Board which followed its previous decision in the *Corneil* case (*supra*).

I am in agreement with the reasoning in these cases. In my view, the fact that the dividends received by the appellant in 1946 were exempt from tax by section 4(*n*) has no bearing on the question whether it sustained a loss in 1946. The dividends were clearly items of income within the meaning of section 3 and were properly taken into account in determining its income position. Their receipt resulted in the appellant having a net profit of $23,156.24, according to its own profit and loss statement, prepared by its own auditor. Nothing can alter this fact. There is an obvious *non sequitur* in the argument that because the dividends were exempt from tax they must be excluded from the appellant's income and thus leave it with a loss. This identification of non-taxability with loss results from the confusion of two different ideas. It is quite possible for a taxpayer to have a profit and yet have no taxable income. That was the position of the appellant in 1946. It had no taxable income because the dividends it received were exempt from tax but it nevertheless had a profit because its receipts exceeded its expenditures. The exemption of the dividends from tax did not change their character as items of income or leave the appellant with a loss instead of a profit. Section 4(*n*) went no farther than to exempt the dividends. It did not touch the question whether the appellant had a profit or sustained a loss. The fact is that according to the ordinary principles of accounting it had a profit in 1946.

To succeed in its appeal the appellant must show that the word "losses" in section 5(*p*), as it stood after the 1944 amendment, meant only business operation losses, but this it cannot do. As I read the section, the word "losses" must bear its ordinary meaning according to accepted accounting practice. That being so, the appellant has failed to show that it comes within the benefit of section 5(*p*). It would have done so if the word "losses" had continued to be defined as business operation losses, as was the case prior

1952

McTAGGART, HANNAFORD, BIRKS & GORDON LIMITED v. MINISTER OF NATIONAL REVENUE

Thorson P.

to the 1944 amendment, when the deductible losses were those sustained "in the process of earning income", but to construe the word "losses" in the amended section as meaning only business losses means reading into it a limitation that was not there. This is not permissible.

The appellant has thus failed to discharge the onus cast on it to show that the assessment appealed against is erroneous and its appeal must be dismissed with costs.

Judgment accordingly.