BETWEEN:

1959
Sept. 10, 11
Dec. 22

THE MINISTER OF NATIONAL REVENUE .... APPELLANT;

AND

LUMOR INTERESTS LIMITED ....RESPONDENT.

Revenue—Income—Income tax—Deduction—Cost of new elevator and rebuilding of elevator shaft to accommodate same—Whether "an outlay . . . made . . . for purpose of . . . producing income from property" or "an outlay . . . on account of capital"—The Income Tax Act, R.S.C. 1952 c. 148, s. 12(1)(a) and (b).

The Income Tax Act provides:

"S.12(1) In computing income, no deduction shall be made in respect of

(*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.

(*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part."

The respondent company owns and operates an office building equipped with an elevator and derives its income from leasing office space to tenants. The elevator had been in use for some forty years when the respondent was notified certain repairs would have to be made to it to meet the requirements of the law regulating elevators. In view of the cost of such repairs the respondent decided it was preferable to install a new elevator, and did so. In its 1955 income tax return it claimed as a deduction the installed cost of the new elevator as well as the cost of the rebuilding of the elevator shaft to accommodate it. Both deductions were disallowed by the Minister. The respondent appealed to the Income Tax Appeal Board which allowed the appeal in part and referred the assessment back to the Minister to allow as a deduction the amount expended for the new elevator and to treat the expenditure for the rebuilding of the elevator shaft as a capital expenditure. On an appeal and cross-appeal from the Board's decision:

Held: 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*.

2. That 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. *British Insulated & Helsby Cables Ltd. v. Atherton* [1926] A.C. 205 at 213, followed. *Samuel Jones Co. (Devondale) Ltd. v. C. I. R.* (1951) 32 T.C. 513, distinguished.

1959
MINISTER OF NATIONAL REVENUE v. LUMOR INTERESTS LTD.

3. That the expenses were outlays or replacements of capital within the meaning of s. 12(1)(b) of the Act.

APPEAL from a decision of the Income Tax Appeal Board[1].

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

G. W. Ainslie and *A. J. Irving* for appellant.

Frank Brodie for respondent.

FOURNIER J. now (December 22, 1959) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board[1], dated August 14, 1958, allowing in part the respondent's appeal from an assessment for its taxation year 1955 made and confirmed by the Minister of National Revenue and a cross-appeal by the respondent from that part of the decision dismissing the respondent's appeal.

In its income tax return for 1955 the respondent claimed as a deduction from income an amount of $17,705 which had been expended for the purchase and the installation of a new elevator in its building known as "Bank Street Chambers" and also an amount of $10,925 representing expenditure for the rebuilding of the elevator shaft in the said building in the 1955 taxation year.

In this re-assessment the Minister disallowed the two amounts as deductions and re-assessed accordingly. The respondent objected, but the re-assessment was confirmed by the appellant. The respondent appealed to the Income Tax Appeal Board, which allowed the appeal in part and referred the assessment to the Minister for him to allow as a deduction the amount expended for the new elevator and to disallow the expenditures incurred for the rebuilding of the elevator shaft, and other works connected therewith, because they were capital outlays.

It is from that decision that the appellant has given notice of appeal and the respondent notice of a cross-appeal. The appellant contends that the expenses for the purchase and the installation of the new elevator, as well as the expenditures for the rebuilding of the elevator shaft and

[1] 20 Tax A.B.C. 161; 58 D.T.C. 540.

other works connected therewith, were payments on account of capital within the meaning of s. 12(1)(*b*) of the *Income Tax Act*, and were not expenses made or incurred by the respondent for the purpose of gaining or producing income from a business or property within the meaning of s. 12(1)(*a*) of the Act. On the other hand, the respondent submits that both the expenditures for the new elevator and the rebuilding of the elevator shaft and other works were made to earn income from a property or business and were deductible in computing taxable income.

The important and relevant facts established before the Court are hereinafter summarized. The respondent, a body corporate, is resident in Canada with its head office in the city of Ottawa. It is the owner of a number of buildings in Ottawa amongst which is the Bank Street Chambers, a store and office building. The respondent derives revenue from the renting of store and office space to tenants in this building. It purchased this property in 1943 for the sum of $150,000. The construction of the building dates back to 1890. About forty years ago a manual operated elevator was installed to accommodate the tenants of the upper floors. Since its installation and up to 1955 it was maintained in a good state of repair. Though no written lease was filed for the period, at the trial a sample copy was produced. The appellant admitted that the service of an elevator was one of the conditions of the leases between the respondent and its tenants. It appears that no complaints were made by the tenants as to the service given and that they were satisfied with the old elevator. The respondent was fulfilling his obligation towards its tenants and the old elevator could have continued to be operated for some time.

But in 1955 the respondent was notified in writing by the Ontario Department of Labour that the elevator did not comply with the law and regulations of the Province and would have to be repaired so as to meet the requirements of the Statute providing for the licensing and regulating of elevators. If the indicated repairs were not made, the elevator would be condemned and the tenants barred from using it. After obtaining estimates as to the cost of the

1959

MINISTER OF NATIONAL REVENUE v. LUMOR INTERESTS LTD.

Fournier J.

repairs, the respondent inquired about the cost of a new elevator which would conform to all the requirements of the law.

Believing the cost of repairs to the old elevator to be too great an expenditure to be made on an old elevator, it was decided to purchase and install a new elevator. After giving a contract to implement this decision, the respondent was informed that certain regulations of the city of Ottawa dealing with the installation of new elevators would have to be complied with. A rebuilding of the elevator shaft and other works would have to be effected to receive the new elevator. Even the motor would have to be moved from the basement to a penthouse on the roof. Though the cost of these works would be high, the respondent, instead of proceeding with the repairs to the old elevator as requested by the authorities, decided to have a new elevator installed. The cost of the rebuilding of the shaft was $10,925 and that of the new elevator $17,705, or a total of $28,630.

So the question to be answered is whether the amounts of $10,925 and $17,705 which were claimed by the respondent as a deduction in computing its income and which were disallowed by the appellant come within the ambit of s. 12(1)(*a*) or s. 12(1)(*b*). These sections read as follows:

> 12(1) In computing income, no deduction shall be made in respect of
>
> (*a*) An outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer,
>
> (*b*) An outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this part, . . .

To answer the question, it is necessary to read alternately one provision after the other to determine if the facts of the case meet the tests required to allow the amounts involved to be deducted in computing income.

Section 12(1) expresses the general rule that in computing income no deduction shall be made in respect of a revenue outlay or expense, nor of a capital expenditure. But exceptions are provided for in the two subsections. In s. 12(1)(*a*) there is an exception for expenses made or incurred for the gaining or producing income; in s. 12(1)(*b*) there are exemptions when they are expressly permitted

1959 — MINISTER OF NATIONAL REVENUE v. LUMOR INTERESTS LTD. — Fournier J.

by the Act. In most cases, one meets the difficulty that outlays or expenses under the two subsections may have the result of gaining or producing income. Certain rules have been devised to indicate that an expense is of a revenue nature or of a capital nature. Though a taxation provision in principle should be in expressed words, under our fiscal law taxes are imposed through general principles and not by enumerating everything that should be considered as income. So various tests have been devised to be applied to certain sets of facts to determine if they come within the ambit of the general principle.

A short review of the tests applicable to the facts of this case is necessary to determine the present dispute, because I believe no one test is sufficient to arrive at a proper decision.

The first test which came to my mind, after considering the facts adduced in evidence, was whether the expenditure for a practically new elevator shaft with necessary adjuncts and the purchase and installation of a new elevator were recurrent outlays chargeable against the respondent's current expenses for the operation of his business or not. I believe the answer should be in the negative in this case for the following reasons.

In 1955, the respondent's property, the "Bank Street Chambers", was an old building with an old elevator. Both the building and the elevator had been repaired and maintained for amounts commensurate to the value of the property and the income derived therefrom. The maintenance and repair costs were charged in the respondent's current expenses and allowed in computing its income. This had been going on for years. The tenants entitled to elevator service did not complain and I assume that they were satisfied. This could have continued for how long, nobody knows. One thing is certain, the building and property continued to produce a stable amount of income. But in 1955 the respondent was advised by the authorities that extensive repairs to the old elevator were needed to comply with the laws and regulations of the Province of Ontario relating to elevators. After due consideration, the respondent decided to install a new elevator rather than repair the old one. After having taken this decision, the respondent was

1959
MINISTER OF NATIONAL REVENUE v. LUMOR INTERESTS LTD.
Fournier J.

informed that, in order to comply with the city of Ottawa regulations dealing with the installation of new elevators, the elevator shaft would have to be practically renewed. Even at that, it was decided that the elevator shaft would be rebuilt and the new elevator installed. The repairing of the old elevator would have been sufficient to comply with the provincial law and regulations. I do not believe this was a recurrent expenditure chargeable to operation expense account or made or incurred to produce income, but rather to comply with provincial regulations dealing with elevators. Without the above interventions, the old elevator would have continued to fulfil its function perhaps for the lifetime of the old building.

This brings me to the next test, which is whether the expense was made to yield an enduring benefit or made once and for a very long period. There is no doubt that the rebuilding of the shaft and the installation of a new elevator were made to replace equipment which could still be used. The life of the new work was estimated to be at least forty years. So the outlay for the new equipment would not be repeated annually or gradually or for a short period. The object of the expenditure was to continue in existence and usefulness over a period of four or five decades, as stated in evidence and admitted in the respondent's defence. Not only did the respondent incur the expense claimed as a deduction on account of certain regulations, but it seems to me that it undertook the replacement of the old elevator instead of having it repaired, because it was expected, and rightly so, that expense would be made once and for all. The expenditure was not made to cover the wear and tear of the old elevator. This could have been done for much less. The facts lead me to think that the outlays were made to create a new asset and to produce an enduring benefit to the respondent's business. It was a new means of transportation in the respondent's building and provided something which could have been given by the use of the old elevator if repaired, but perhaps not as efficiently or for all time. There is no evidence that the replacement of the old elevator by a new one was necessary to the earning of

income in the operation of the respondent's business or to fulfil its obligation towards its tenants. In my view it was replacement of capital.

In the case of *British Insulated & Helsby Cables Ltd. v. Atherton*[1], Lord Cave, dealing with the question of what would constitute a capital expenditure, says (p. 213, *in fine*):

> 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. . . .

In my view, this test applies to the facts here and justifies the conclusion that the outlays were attributable to capital and not revenue. The expense was made not only once and for all and to comply with certain regulations, but also to bring into existence an asset or an advantage for the enduring benefit of the business.

Counsel for respondent urged that the facts in this case could meet the test laid down by the Lord President in *Samuel Jones Co. (Devondale) Ltd. v. Commissioners of Inland Revenue*[2], wherein a chimney of a factory was replaced because it was in a dangerous condition. The cost to do so was claimed as a deduction, which was disallowed. On appeal, the Court held "that the whole cost of replacing the chimney was an admissible deduction." The Lord President (Cooper) at p. 518 said:

> . . . It is doubtless an indispensable part of the factory, doubtless an integral part; but none the less a subsidiary part, and one of many subsidiary parts, of a single industrial profit-earning undertaking.
>
> So viewing the matter I am unable to see why the expense incurred in relation to this transaction should not be treated as an admissible revenue expenditure on repairs, . . .

One of the reasons given by the Lord President for treating the expenditure as a revenue expense is expressed thus:

> . . . and I am in part influenced in reaching that conclusion by the fact that the factory as a whole is insured for something in the region of £165,000 whereas the expense incurred in taking down the old chimney and building the substitute is only a matter of £4,300 or about 2 per cent. . . .

[1] [1926] A.C. 205. [2] 32 T.C. 513, 518.

1959

MINISTER OF NATIONAL REVENUE *v.* LUMOR INTERESTS LTD.

Fournier J.

The facts in the present instance may be distinguished from those in the above case. Taking for granted that the new elevator is a subsidiary part of the building, capital cost allowances are made at an annual rate of 5 per cent on the two items of expenditure amounting to $28,630. In the *Jones* case, the expenditure for the chimney was one to restore property on which there was no allowance for depreciation.

The chimney had become so dangerous that it had to be replaced. The elevator, after having been repaired, would have met the requirements of the law and regulations. I understand the condition of the chimney was such that it could not be used for the purpose for which it was built. The old elevator, once repaired, could have fulfilled its function. The cost of the chimney was only 2 per cent of the amount for which the factory was insured. The shaft and the new elevator cost $28,630 or 18 per cent of the amount for which the building was insured, to wit $150,000. True, after the new elevator was installed, the insurance was raised to $180,000, but the secretary of the respondent said that according to the insurance people the former amount was not sufficient. So, in the *Jones* case the Court was influenced by the insignificance of the expenditure as compared to the amount of the insurance on the building. In this case, I am impressed by the magnitude of the expenditure as compared to the amount for which the whole building was insured, especially when the evidence is to the effect that the expense for the maintenance and repair of the old elevator was in the neighbourhood of $500 per year.

The size of the expenditure is of assistance in determining the nature of the outlay. The building in question was purchased in 1943 for a sum of $150,000. The respondent's auditors in preparing its financial statements for income tax returns apportioned the value of the property as being $96,525 for the land and $56,299.97 for the building. Since then, every year a depreciation allowance at the rate of 5 per cent has been allowed on the building. During those same years, except for 1955, the costs of the repairs to the building were never in excess of $3,000 and the maintenance

costs to the elevator in the order of $500 or less each year. But in 1955 the cost of the rebuilding the shaft and the installation of a new elevator amounted to $28,630.

A witness heard on behalf of the respondent as an expert in appraisal matters and property management stated that he knew the building but had not examined it thoroughly in 1955 from an appraisal point of view and was not prepared to express an opinion as to its value at that time. Only the secretary of the company gave evidence on that point and he believed that its value was between $225,000 and $250,000. Though he had some experience in the cost of buildings, he did not impress me as an expert in appraisals of properties. So the evidence as to the value of the building in 1955, to my mind, was not satisfactory or conclusive. As to the rental value, it is understood that it was $44,075.

The book value of the building as appears in the respondent's income return for the year 1955 is $38,696.00. I am sure the book value was not the market value of the building, but having no satisfactory evidence on that point it is most difficult to compare the cost of the new installation with the real value of the whole building. I do know that the normal repair expenses for a building of that type would be between 5 per cent to 7 per cent of the gross revenue. The gross rentals being $44,075, the amount that should be spent on the building would be from $2,000 to $3,000 per year. This was what was spent before 1955. During that year, the repair outlays were those claimed by the respondent as a deduction. The sum expended was out of line with the amounts spent in former years and cannot be justified as spent for an accumulation of repairs, because it is far larger than the amount required to repair the elevator so that it would conform to the law and the regulations. The only reasonable conclusion is that the expenditure was to bring into existence an advantage which would be of a continuous and permanent nature.

As to the magnitude of the expenditure in relation to the value of the building, the only comparison that can be made would of necessity be based on the amount for which the building was insured, namely $150,000, and

1959

MINISTER OF NATIONAL REVENUE v. LUMOR INTERESTS LTD.

Fournier J.

5 per cent of this sum, viz. $7,500. In this case the expenditure was incurred for a new elevator and shaft and amounted to more than $28,000 or approximately 18% of the amount of the insurance. It cannot be said in this case that the money value of the renewal and replacement of the old elevator by a new elevator and shaft was insignificant in relation to the value of the building or the income derived from its rental.

The tests I have applied in this matter were discussed by Cameron J. in the case of *Thomson Construction Company v. Minister of National Revenue*[1].

The appellant, a road building contractor, in 1949 purchased a used power shovel powered by a diesel engine for $27,075. Up to the end of the year 1952, the shovel was treated by both parties as a depreciable asset and under regulations authorized by 11(1)(*a*) of the *Income Tax Act* the annual capital cost allowance claimed and allowed had for depreciation purposes reduced the shovel's book value to $9,268. In 1953, the engine, in need of major repairs, was replaced by a new one at a cost of $8,894 less $3,200, the trade-in value of the old engine, or a net cost of $6,000. The appellant in its income tax return for that year deducted the latter amount as an outlay for the purpose of gaining income from its business. The Minister disallowed the amount. On appeal before the Income Tax Appeal Board, the appeal was dismissed. This decision was appealed from in the Exchequer Court. Cameron J. held:

2. That, although as a general rule repairs necessitated by wear and tear of equipment used in the business are allowed as deductions (although no specific reference is found in the Income Tax Act regarding "repairs") if the outlay brings into existence a capital asset, such as a new piece of machinery, such outlay will not be allowed as a deduction.

3. That the outlay here brought into existence a new capital asset, namely the new engine, *Minister of National Revenue v. Dominion Natural Gas Co.*[2], and consequently could not be considered an outlay on revenue account. (The Court was influenced in part by the magnitude of the outlay when related to the value of the power shovel as a whole.) *Samuel Jones & Co. (Devondale) Ltd. v. C.I.R.* [*supra*].

4. That to allow a deduction in full as an operating expense of an outlay such as this which brought into existence a new capital asset would be to frustrate the clear intent of the provisions of s. 11(1)(*a*) of the Act and the regulations passed thereunder in regard to capital cost allowances.

[1] [1957] Ex. C.R. 97 *et seq.*

[2] [1941] S.C.R. 19.

5. That the outlay for the purchase of a new engine would properly be considered in accounting practice as a capital expenditure because of the enduring nature of the new asset.

I believe the rules laid down *supra* should be applied to the facts established in the present dispute.

In the case of *The Minister of National Revenue* and *Vancouver Tugboat Company Limited*[1], wherein the respondent was stated to have operated a tugboat service on the Pacific coast of Canada in the performance of which its tugboats often covered distances exceeding 800 miles in a single voyage, and a trip may have lasted from five to fifteen days. In 1951, it placed a new engine in one of its tugboats at a total cost of $42,086.71, which amount it claimed as a deduction from income for that year. The claim was allowed by the Income Tax Appeal Board from whose decision the Minister of National Revenue appealed to this Court. Thurlow J., applying all the tests to the facts I have mentioned in these notes, found that the outlay in question was an outlay or replacement of capital within the meaning of section 12(1)(*b*) and was not deductible from income. He allowed the Minister's appeal.

For all the reasons hereinabove stated and also in view of the evidence as to the amount of the sums spent in relation to the amount for which the building as a whole was insured and the amount of the gross income derived from the rental of space in the building, I find that

1) The outlays for the replacement of the old elevator by a 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 the *Income Tax Act*, section 12(1)(*a*).

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.

3) The expenses were outlays or replacement of capital within the meaning of section 12(1)(*b*) of the Act.

[1] [1957] Ex. C.R. 160.

1959

Minister of National Revenue v. Lumor Interests Ltd.

Fournier J.

Therefore, the appeal is allowed and the cross-appeal dismissed. The assessment will be restored.

The appellant is entitled to his costs to be taxed in the usual way.

Judgment accordingly.