1950
Nov. 6
Nov. 21

BETWEEN:

GORDON KENNETH DALEY.....APPELLANT;

AND

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

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, ss. 3, 6(a), 6(b)—Section 6 to be read with section 3—Deductibility of proper disbursements and expenses inherent in concept of annual net profit or gain—Fee for call to the Bar and admission as solicitor in Ontario not deductible.

The appellant, a lawyer practising in Toronto, sought to deduct from his 1946 income one-third of the $1,500 fee which he had paid in 1946 to the Law Society of Upper Canada for his call to the Bar and admission as a solicitor in Ontario. He had previously been called to the Bar and admitted as a solicitor in Nova Scotia but had not practised therein. The Minister disallowed the deduction and the appellant appealed to the Income Tax Appeal Board which unanimously dismissed his appeal.

Held: That the amount of the taxpayer's profits or gains to be assessed must be ascertained or estimated according to the ordinary principles of commercial trading or accepted business and accounting practice.

2. That the deductibility of the disbursements and expenses that may properly be deducted in computing the amount of the profits or gains to be assessed is inherent in the concept of "annual net profit or gain" in the definition of taxable income contained in section 3 and stems from it and not, even inferentially, from paragraph (*a*) of section 6.

3. That a disbursement or expense such as the $1,500 which the appellant paid for his call to the Bar and admission as a solicitor in Ontario, which is laid out or expended not in the course of the operations, transactions or services from which the taxpayer earned his income but at a time anterior to their commencement and by way of qualification or preparation for them, is not the kind of disbursement or expense that could properly be deducted in the ascertainment or estimation of his "annual net profit or gain".

4. That there is no portion of the $1,500 fee that could have any relationship to the appellant's law practice in any one year.

5. That the expenditure which the appellant sought to deduct was not properly deductible from his 1946 receipts in the ascertainment or estimation of his taxable income for that year according to the ordinary principles of commercial trading or accepted business and accounting practice.

APPEAL from the decision of the Income Tax Appeal Board dismissing the appellant's appeal against his 1946 assessment.

The appeal was heard before the Honourable Mr. Justice Thorson, President of the Court, at Ottawa.

The appellant appeared in person.

R. S. W. Fordham K.C. and *P. H. McCann* for respondent.

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

THE PRESIDENT now (November 21, 1950) delivered the following judgment:

This is an appeal from the decision of the Income Tax Appeal Board dismissing the appellant's appeal against his income tax assessment for the year 1946. The facts from which it rises are simple. The appellant is a barrister and solicitor practising in Toronto, Ontario. He took his law course at Dalhousie University in Halifax, Nova Scotia, graduated therefrom in May, 1939, commenced a year of post-graduate study at Columbia University in New York City, returned to Halifax in December, 1939, to be called to the Bar and admitted as a solicitor in Nova Scotia and then completed his year at Columbia University in May, 1940. He paid the Nova Scotia Bar Society the sum of $50 as the fee on filing his articles of clerkship and the sum of $125 as the fee on his call to the Bar and admission as a solicitor, but did not practise in Nova Scotia. After the completion of his year at Columbia University he enlisted in the Canadian Navy and remained in that service until after the end of the war. On his return to civilian life he decided, for personal reasons, to practise law in Ontario rather than in Nova Scotia and, on application therefor, was called to the Bar and admitted as a solicitor in Ontario on September 19, 1946, having previously, on September 4, 1946, paid the Law Society of Upper Canada the sum of $1,500 as the fee for such call and admission, that being the fee charged to members of the legal profession outside of Ontario who apply for call and admission in Ontario. Thereupon the appellant commenced the practice of law in Toronto. In his income tax return for the year 1946 he claimed as a deduction the

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sum of $500, being one-third of the $1,500 that he had paid as the fee for his call and admission in Ontario. On his assessment for that year this deduction was disallowed, as appears from the notice of assessment, dated September 28, 1948. On November 27, 1948, the appellant gave notice of his objection to the assessment and on May 11, 1949, the Minister notified the appellant that he agreed to amend the assessment in respect of one of the objections taken by the appellant, with which we are not here concerned, but that he confirmed it in other respects on the ground that "the expense of a call to the Bar of Ontario claimed as a deduction from income is not a disbursement or expense wholly, exclusively and necessarily laid out or expended for the purpose of earning the income within the meaning of paragraph (*a*) of subsection (1) of section 6 of the Act but is a capital outlay within the meaning of paragraph (b) of subsection (1) of section 6 of the Act." On August 3, 1949, the appellant gave notice of appeal to the Income Tax Appeal Board. His appeal was heard by the Board on December 8, 1949, and unanimously dismissed on January 26, 1950. It is from this decision that the present appeal is taken.

The appellant's right to deduct the annual licence or practising fee charged by the Law Society of Upper Canada to its members is not disputed. The issue in the case of *Bond* v. *Minister of National Revenue* (1) does not, therefore, arise in this case. Here the only issue is whether the appellant was entitled, in computing the amount of his taxable income for the year 1946, to deduct from his receipts in 1946 one-third of the amount that he had paid the Law Society of Upper Canada for his call and admission.

There are several Canadian cases in which the Court has discussed the principles to be applied in determining whether in the computation of taxable income a particular expenditure is deductible and considered the construction to be placed on sections 6(*a*) and 6(*b*) of the Income War Tax Act, R.S.C. 1927, chap. 97, which read as follows:

6. 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;

(1) (1946) Ex. C.R. 577.

(*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;

and on section 3, in which the definition of taxable income appears, in part, as follows:

3. For the purposes of this Act, "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; . . .

It was stated in *Imperial Oil Limited* v. *Minister of National Revenue* (1) that the words "profits or gains to be assessed" in the introductory portion of section 6 have the same meaning as the words "annual net profit or gain" in section 3, with which section 6 must be read, and that the principles to be applied in the computation of such profits or gains are not defined in the Act but stated in judicial decisions such as *Gresham Life Assurance Society* v. *Styles* (2) where Lord Halsbury L.C. said:

Profits and gains must be ascertained on ordinary principles of commercial trading,

and *Usher's Wiltshire Brewery, Limited* v. *Bruce* (3) where Earl Loreburn approved the statement:

profits and gains must be estimated on ordinary principles of commercial trading by setting against the income earned the cost of earning it,

There are many other decisions in which similar statements are made. The law on the subject is well settled. In the *Imperial Oil Limited* case (*supra*) stress was placed on the fact that section 6(*a*) was not concerned with the deductibility of disbursements or expenses but dealt only with the exclusion from deductibility of those disbursements or expenses that fell within its negative terms, and the opinion was expressed that if a particular disbursement or expense was not within the express terms of the exclusions of the section its deduction ought to be allowed if it would otherwise be in accordance with the ordinary principles of commercial trading or well accepted principles of

(1) (1947) Ex. C.R. 527.
(2) (1892) A.C. 309 at 316.
(3) (1915) A.C. 433 at 444.

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business and accounting practice. At page 530, I put my view of the purpose of section 6(*a*) and the construction that ought to be placed on it in these words:

> The section is couched in negative terms. It is not primarily concerned with what disbursements or expenses may be deducted and does not define them, so that their deductibility is determinable only by inference. But it is concerned with and does define the disbursements or expenses whose deduction is not allowed. It is a specific instruction to the Minister that in his assessment operation he is not to allow the deduction of disbursements or expenses that are "not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income". The section directs that such disbursements or expenses are not to be deducted, even although they might be deductible according to ordinary principles of commercial trading or, as it has been suggested "well accepted principles of business and accounting practice". The range of deductibility according to such principles may be wider than that which is inferentially permitted under the section. To that extent they must give way to the express terms of the section, which must, of course, prevail. The result is that the deductibility of disbursements or expenses is to be determined according to the ordinary principles of commercial trading or well accepted principles of business and accounting practice unless their deduction is prohibited by reason of their coming within the express terms of the excluding provisions of the section. These provisions were, no doubt, inserted in the interests of the revenue as a protecting safeguard against deductions which might otherwise be made but, while it is necessary to enforce the prohibitions of the section, it is not proper to go beyond its express requirements. The section ought not, in my opinion, to be read with a view to trying to bring a particular disbursement or expense within the scope of its excluding provisions. If it is not within the express terms of the exclusions its deduction ought to be allowed if such deduction would otherwise be in accordance with the ordinary principles of commercial trading or well accepted principles of business and accounting practice.

And later, at page 545, after expressing the opinion that it was obvious that the words "for the purpose of earning the income" in section 6(*a*), as applied to disbursements or expenses, could not be applied literally, for the laying out or expending of a disbursement or expense could not by itself ever accomplish the purpose of earning the income, and adopting the statement of Watermeyer A.J.P. in *Port Elizabeth Electric Tramway Company* v. *Commissioner for Inland Revenue* (1) that income is earned not by the making of expenditures but by various operations and transactions in which the taxpayer has been engaged or the services he has rendered in the course of which expenditures may have been made, I described the disbursements and expenses that were inferentially deductible as being outside the exclusions of section 6(*a*) as "those that

(1) (1935) 8 S A. Tax Cases 13 at 14.

are laid out or expended as part of the operations, transactions or services by which the taxpayer earned the income", and then went on to say:

> They are properly, therefore, described as disbursements or expenses laid out or expended as part of the process of earning the income. This means that the deductibility of a particular item of expenditure is not to be determined by isolating it. It must be looked at in the light of its connection with the operation, transaction or service in respect of which it was made so that it may be decided whether it was made not only in the course of earning the income but as part of the process of doing so.

Since the decision in the *Imperial Oil Limited* case (*supra*) I have given further consideration to the statement or implication in that case, and in several others, that section 6(*a*) inferentially permits the deductibility of the disbursements and expenses that fall outside its exclusions, and am now of the opinion that such a statement or implication is, strictly speaking, not correct. If any inference of deductibility is to be drawn it can only be from the opening words of section 6 "In computing the amount of the profits or gains to be assessed" and not from paragraph (*a*), which is concerned only with the exclusion from deductibility of the disbursements or expenses therein specified and not at all with the deductibility of any disbursements or expenses. The correct view, in my opinion, is that the deductibility of the disbursements and expenses that may properly be deducted "in computing the amount of the profits or gains to be assessed" is inherent in the concept of "annual net profit or gain" in the definition of taxable income contained in section 3. The deductibility from the receipts of a taxation year of the appropriate disbursements or expenses stems, therefore, from section 3 of the Act, if it stems from any section, and not at all, even inferentially, from paragraph (*a*) of section 6.

That being so, it follows that in some cases the first enquiry whether a particular disbursement or expense is deductible should not be whether it is excluded from deduction by section 6(*a*) or section 6(*b*) but rather whether its deduction is permissible by the ordinary principles of commercial trading or accepted business and accounting practice. If the answer to such enquiry is in the negative then that is the end of the matter and it is not necessary to make any further enquiry, for it would

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then automatically fall within the exclusions of section 6(*a*) and it would not be necessary to consider whether it would fall within those of section 6(*b*).

There are, in my judgment, several reasons for thinking that this is one of such cases and concluding, quite apart from sections 6(*a*) and 6(*b*), and as if they were not in the Act, that the expenditure which the appellant sought to deduct was not properly deductible from his 1946 receipts in the ascertainment or estimation of his taxable income for that year according to the ordinary principles of commercial trading or accepted business and accounting practice.

In the first place, the fee of $1,500 which he paid for his call to the Bar and admission as a solicitor in Ontario was an expenditure that was anterior to his right to practice law in Ontario and earn an income therefrom. Except that it was nearer in point of time it was no more related to the operations, transactions or services from which he earned his income in 1946, or in any year, than the cost of his legal education would have been or, for that matter, the cost of his general education or any cost or expense involved in bringing him to the threshold of his right to practice. If the fee he paid for his call and admission in Ontario were deductible so also would be the fee he paid for his call and admission in Nova Scotia before he enlisted in the Canadian Navy for the fact that he was a member of the legal profession from outside Ontario saved him from the time and expense of being enrolled as a student-at-law and serving as an articled clerk. If the fee or any portion of it were deductible there would be no reason why a young man commencing a business career should not similarly be entitled to offset against his business receipts the costs of his university course in commerce or business administration or any other costs of qualifying himself for a business career. It seems clear that a disbursement or expense such as this which is laid out or expended not in the course of the operations, transactions or services from which the taxpayer earned his income but at a time anterior to their commencement and by way of qualification or preparation for them is not the kind of disbursement or expense that could be properly deducted in the ascertain-

ment or estimation of his "annual net profit or gain". In my view, no accountant or business man could reasonably so regard it.

There is another way of looking at the matter. The appellant's taxable income for 1946 consisted basically of the receipts from his law practice in that year less the costs and expenses of his practice in that year. It is inconceivable that any accountant or professional or business man could reasonably consider that the fee of $1,500 which the appellant paid for his call and admission could properly be offset against his receipts from his first year of practice. There is an implied admission of this in the fact that the appellant claims a deduction of only $500. But if $1,500 is not deductible, how can $500 be deductible? And why should the deduction be spread over only three years? And if three years is too short a period over how long a period should the deduction be spread? The fee was not paid for any year or number of years. It is, in my view, quite different from the annual licence fee that was held to be deductible in *Bond* v. *Minister of National Revenue* (*supra*). The call and admission for which the fee was paid is not like a depreciable asset. It does not lend itself to an annual write-off and no one could reasonably apportion it over any given period of time. There is no portion of it that could have any relationship to the appellant's practice in any one year. The fee is not the kind of disbursement or expense that could properly enter into the ascertainment or estimation of his "annual net profit or gain". There could be no place for any portion of it in any annual statement of profit or loss prepared with proper regard to the ordinary principles of commercial trading or accepted business and accounting practice.

It is not necessary in this case to discuss the kind of disbursement or expense that might be deductible according to the ordinary principles of commercial trading or accepted business and accounting practice and yet be excluded from deduction by section 6(*a*). We have not that problem here for, since the expenditure which the appellant sought to deduct is not the kind of disbursement or expense that could properly enter into the ascertain-

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ment or estimation of his annual net profit or gain in 1946, or in any year, according to the principles referred to, it is outside the range of deductibility altogether. It cannot, then, have been wholly, exclusively and necessarily laid out or expended for the purpose of earning his income of 1946 or any year and must automatically fall within the exclusions of section 6(*a*).

The appellant argued that his call and admission fee was not the kind of expenditure that was excluded from deduction by section 6(*b*). In view of the conclusion I have reached it is not necessary to consider whether the words of the section are apt enough for the purpose or whether the fact that the fee was paid once and for all and the contention that its payment gave the appellant a lasting advantage made it an outlay of capital within the meaning of the section.

In my judgment, the deduction claimed by the appellant was properly disallowed by the Minister and the appeal herein must be dismissed with costs.

Judgment accordingly.