BETWEEN:

EMCO LIMITED ....APPELLANT;

Montreal 1968 June 17 — Oct. 16

AND

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

Income tax—Capital cost allowances—Buildings sold for value of land alone—Price treated as recaptured allowance—Subsequently adding amount back—Income Tax Act, secs. 11(1), 20(5)(e), 20(6)(g).

Two old buildings purchased by appellant company in 1954 in Montreal and Quebec were used by appellant in its business pending its location elsewhere and were sold in 1956 and 1957 to purchasers who demolished them. Appellant treated the purchase price received for the buildings in 1956 and 1957 as being recaptured capital cost allowances and reduced the undepreciated capital cost assigned to its property of that class accordingly. Following the decision of this court in *M.N.R. v. Steen Realty Ltd.* ([1964] Ex. C.R. 543) appellant added back the amounts so deducted in 1956 and 1957 on the ground that no part of the price received from the purchasers was for the buildings on the land but for the land only, and claimed capital cost allowances for 1960 on the increased amount.

Held, allowing an appeal from the Tax Appeal Board, appellant was entitled to the deduction claimed in 1960.

APPEAL from Tax Appeal Board.

Philip F. Vineberg, Q.C. for appellant.

M. A. Mogan for respondent.

NOËL J.:—This is an appeal from a decision of the Tax Appeal Board[1] which confirmed an assessment dated April 24, 1963, wherein a sum of $6,739.95 was added to the appellant's taxable income for its 1960 taxation year as capital cost allowance claimed in 1960 on amounts recaptured on disposal of a number of buildings situated in Montreal and Quebec City in the years 1956 and 1957 respectively.

The appellant, an Ontario company, located in London, Ontario, purchased in 1953, at which time its name was Empire Bros. Ltd., the outstanding shares of a Quebec company, called Thomas Robertson Ltd. which, at the time, was a client and to some extent in a small area in the eastern part of Ontario a competitor of the appellant. This company was in the plumbing and heating supply business and owned a number of buildings situated on

[1] 40 Tax A.B.C. 97.

Craig Street and Common Street in the city of Montreal and on Ste-Marguerite Street, in the city of Quebec, from which it carried on its operations.

In January 1954, Thomas Robertson Ltd. was wound up and its assets, including the above mentioned buildings, passed directly on to the books of the appellant which from the date of purchase of the shares of the above corporation, in 1953, carried on its business operations in Montreal and Quebec City in these buildings until the Montreal buildings were sold in 1956 to the Montreal Star, a local newspaper, and the Quebec buildings, in 1957, to La Compagnie Paquet, a departmental store.

In accordance with section 144 of the *Income Tax Act*, the undepreciated capital cost of the buildings for the purpose of section 20 of the Act (as they had all been acquired by Thomas Robertson prior to the year 1949) was in 1956 and there is agreement by the parties on these figures, $42,252.37 for the Montreal buildings (of which $25,170.53 was for the Common Street building sold to a transport company and which is not relevant to the present appeal) and $17,081.84 for the Craig Street buildings, which is relevant to the present appeal. The undepreciated capital cost of the Quebec buildings in 1957 was $63,544.62 and the deemed capital cost of these buildings was $92,544.62.

The evidence discloses that the original building in Montreal had been constructed around 1887 and the upper part of this building on Craig Street from the ground up was rented to Union Electric for an amount of $480 per month. According to Mr. Stevens, chairman of the board of Emco Limited (the appellant), the building and premises were not satisfactory for their operations. The cost to operate in the Montreal building was very high in comparison to a modern warehouse; the shipping facilities were very limited and at certain times of the day, particularly when newsprint and other supplies of that type were being delivered to the Montreal Star, its next door neighbour, its laneway was blocked. There was no parking allowed on Craig Street and the appellant's business depends considerably on what is called pick-up business. Mr. Stevens stated that there was no question in their minds the day the appellant company acquired the buildings that they intended to dispose of this property.

The Quebec City property located at 673 Ste-Marguerite was in the shape of an "L", fronted on both Ste-Marguerite Street and Bridge Street and covered some 21,000 square feet.

Although appellant's predecessors had expended from 1940 to 1951 some $70,000 on the Quebec City buildings in either constructing or renovating them, Mr. Stevens stated, and the evidence discloses, that these premises also were not satisfactory for the requirements of their business, in that they were inadequate to receive and deliver goods. Furthermore, the warehouse part was on four levels and the movement of material was very difficult. He states that here also it was firmly fixed in his mind that economies could be effected by getting into a warehouse where material handling was less difficult.

The appellant operated its business from the above premises from the date of the purchase of the shares of Thomas Robertson Ltd., in 1953, until the year 1956, when it sold its Montreal properties on Craig Street to the Montreal Star for $300,000 and until the year 1957, when it sold its Quebec City properties to the Paquet Company for the sum of $215,000.

The deal for the Montreal property was closed in early 1955 and the appellant was allowed to use it until completion of its new premises and remained in the buildings until after July 1, 1956, when it was turned over to the purchasers. The evidence discloses that the appellant carried fire insurance on its Montreal properties in the amount of $1,100,000 although this was on the combined buildings (of Craig Street and Common Street) as well as their contents, which, according to the evidence, could reach at times an amount close to the full insurance coverage. Exhibit R-4 shows that the municipal assessment for the relevant Montreal properties was $102,900 for the buildings (including the one situated on Common Street) and $102,500 for the land.

The deed of sale of the Quebec properties was executed on July 19, 1957, and the appellant was given six months' time (and later a further additional 3 months) to vacate the premises in order to allow it to construct a new building. The appellant vacated the buildings some eight or nine months after signing the deed. During the period of occupancy by the appellant of the Quebec buildings after

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the sale, Emco undertook to pay and did pay the insurance premiums covering the buildings sold which were in an amount of $150,000. The municipal assessment for the property in Quebec for the year 1955-56 was $32,530 for the buildings and $15,170 for the land.

The appellant, upon the sale of its properties in Montreal in 1956, reduced its class 3 assets by an amount of $17,081.84, the undepreciated capital cost of the building sold, as being the proceeds of disposition for these buildings. When the Quebec property was sold in 1957, the appellant, instead of reducing its class 3 assets by an amount of $63,500.78 which correspond to the undepreciated capital cost of the Quebec building in 1957, inconsistently reduced it by an amount of $92,544.62 which happened to be the historical cost of the buildings. By so reducing in both instances the amount of its class 3 depreciables, the appellant, of course, reduced also the amount of capital cost it could have taken following their sale.

N. A. Robert Martin, the controller of the appellant company explained that as a result of a decision of this court in *M.N.R. v. Steen Realty Ltd.*[2] it reversed, in 1960, the above entries by adding back the amount of $17,081.84 and $92,544.62 and then calculated in that year its capital cost allowance from the increased amounts thus obtained.

It was indeed held *in re Steen Realty,* where the facts were very similar to the present case, that as the purchasers had paid the full price for the land alone and that it was not reasonable to regard any part of the sale price as being the consideration for the disposition of the buildings, no amount should be deducted for the value of the buildings. The appellant also felt, and for the same reason, that it did not have to deduct and should not have deducted in 1956 and 1957 any amounts for the sale of its properties in Montreal and Quebec.

Before dealing with the matter of the apportionment of the selling price of the appellant's real property between land and buildings, respondent's submission that the appellant is now barred from adding in 1960 amounts which it had deducted in the years 1956 and 1957 must now be considered. Counsel for the respondent urged that, under the theory of estoppel which he says applies here, the

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[2] [1964] Ex. C.R. 543.

appellant is prevented from correcting, in 1960, the situation it created in 1956 and 1957. He submitted that where a person makes a representation of a fact and another person acts on it to his detriment, the person who makes the representation is estopped from denying the original representation. He suggested that in the present case, the allocation made by the taxpayer when the amounts were deducted in 1956 and 1957, was the representation and that the subsequent assessment on that representation was the acceptance of it or the action taken by the Minister thereon. Such a representation acted upon by the Minister cannot, he says, later be changed because such a change would be to the detriment of the Minister in that over the passage of time, it becomes more and more difficult for the Minister to ascertain what was in the minds of the vendor and purchaser at the time of the disposal to a point where it could become impossible to ascertain the true facts at the time of sale.

The framework of the Act, he says, is such that after assessment for a particular year and the expiration of the period of appeal, the matter is closed and there is no possibility of reopening it by means of a journal entry.

Counsel further submitted that even without the theory of estoppel, the appellant could not do what it did because under section 20(5)(*e*) of the Act, which deals with the calculation of undepreciated capital cost such a calculation must be consistent with prior years and that the only adjustments permissible are those which deal with transactions in the year. He indeed draws such a conclusion from the definition of undepreciated capital cost in section 20(5)(*e*) of the Act which indicates that the time at which a particular disposal takes place is essential to the proper application of the formula set down to calculate a capital cost at a particular time as it refers to the cost of depreciable property before that time minus the aggregate of the total depreciation allowed before that time.

According to the respondent, the appellant took a position in 1956 and 1957 upon two transactions in those years that some of the proceeds of disposition of its properties were referable to the buildings. This was accepted by the Minister by way of an assessment and the only possibility for the taxpayer to challenge that decision of the Minister was by way of an appeal or by having the Minister chal-

lenge it by disallowing it. As this did not happen here, it is now too late to change it. He cannot, says he, reverse an allocation made on a series of transactions made a few years ago by means of a simple journal entry.

There is an answer to the position taken by the Minister herein in that one must not overlook the optional character of depreciation or of cost allowances. Indeed, the rates established for each class are applied to the undepreciated capital cost of the assets in that class as a whole and not to individual assets in that class and they are maxima rates as the taxpayer need not take the full amount allowed for depreciation in any given taxation year and may even take no amount at all and then take it in later years. Section 11(1) which sets down that such part of the capital cost of property "*may* be deducted in computing the income of a taxpayer..." indicates clearly the choice one has in this matter.

It may, of course, happen that a taxpayer does not obtain as much benefit or money out of taking capital cost allowances later rather than earlier as deceleration of capital cost is a depressant to the taxpayer. He may, however, have an interest in taking it later because he is not making enough or any profit at all, or is even suffering a loss and the cost allowance regulations under the Act are set up precisely to provide for such a situation.

In my view, it cannot be said that when the appellant deducted the amounts it did in 1956 and 1957, it made an allocation. It merely did not take the full amount of depreciation or cost allowance it was entitled to take under the Act and its regulations and this, it appears clearly, was done out of ignorance or a failure to appreciate the nature of the law. There was, however, no allocation made in its tax returns. The appellant in those years merely took less capital cost allowance, as it was under the Act entitled to take, and it was perfectly free to take, in 1960, a capital cost allowance to the extent allowed by the regulations at the undepreciated capital cost it was entitled to in that year. The only matter it had to determine in 1960 was what was the undepreciated capital in that year on which it was entitled to calculate the capital cost allowance it had a right to deduct. The appellant realized in 1960 that it had a greater amount of undepreciated capital cost on which it was entitled to calculate its capital cost than it

had after erroneously deducting the amounts it did deduct in 1956 and 1957 and, therefore, added them back to the pool of its assets.

The respondent claims that to allow such a correction to be made is detrimental to the Minister in that it becomes most difficult for him in later years to find out what is in the minds of the vendor and purchaser at the time of disposal. There is, in my view, no substance to this submission in that it is always (except beyond the four year period from the assessment, and this is not the situation here) the taxpayer who must rebut the facts assumed by the Minister in assessing him. The onus here is, indeed, on the taxpayer to establish that the deductions it made were in fact errors and if it does not establish the circumstances of the disposal of its property and rebut the Minister's assumptions, the assessments will be maintained.

I cannot see why the appellant cannot, in 1960, take whatever capital cost allowances it is entitled to take from a proper calculation of the undepreciated capital cost of its assets at that date even if it has prior thereto mistakenly calculated the undepreciated cost of its assets.

I also cannot see how such a course of action can or does upset what respondent claims is essential (the time at which a particular disposal takes place) to the proper application of the formula set down in section 20(5)(*e*) of the Act in order to calculate the capital cost which a taxpayer is entitled to deduct from his taxable income; nor does it give the appellant here any more than what it is entitled to receive under the Act and the pertinent regulations. As a matter of fact, in a sense the Department here gains from the procedure adopted by the appellant because the latter thereby pays too much too early and it cannot, in 1960, go back and recover whatever capital cost allowances it could have deducted in 1956 or 1957. It therefore follows that the appellant was not barred in 1960 from correcting the amount of its pool for its class 3 assets and the only question now remaining is whether or not it was right in assigning no part of the sale price to its buildings and then adding back as it did, the amounts it had deducted in 1956 and 1957.

Section 20(6)(*g*) of the *Income Tax Act* provides that where an amount can reasonably be regarded as being in part consideration for disposition of depreciable property

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and in part consideration for something else, the part that can reasonably be considered as being the consideration for such disposition shall be deemed to be the proceeds of disposition and the purchaser shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount. Is it reasonable to consider in the circumstances of the present case that any part of the price was consideration for the disposition of the buildings.

The property in Montreal consisted of some old buildings. There were some old buildings in Quebec City as well, some were renovated and one structure was built in 1951. Some of the buildings had been producing an annual net rental in Quebec of $840 and in Montreal of $5,760. It is difficult to estimate the full rental value of the buildings or their value to a concern that would want to pursue its operations therein, but it certainly would have been uneconomical for the vendor to hold on to them or even lease them out or for a purchaser to invest in them or in view of their inadequateness, even use them in his business.

It appears immaterial to me that the buildings may have had some continuing value to the appellant in the sense that in both cases it continued for a few months to use them until it had relocated elsewhere. This was of a transitional nature only and gave the buildings used after the sale no greater value than what they had at the time of the sales.

It is true that in both cases, insurance on the buildings was continued and the premiums were paid by the appellant for a few months during its occupancy after the sale until it relocated elsewhere. The insurance coverage of the buildings in Montreal, which would be part of the $1,100,000 coverage is somewhat indefinite as this covered the building on Common Street as well and also the contents of the building and its inventory. It was, however, a normal precautionary measure to continue this coverage during this period and until such time as the appellant had made proper arrangements to settle elsewhere, particularly with regard to the inventory which, if destroyed by fire, would have been disastrous. The insurance coverage in Quebec was in the amount of $150,000. It was, according to Mr. Stevens, an officer of the appellant, upon the purchaser's request that this insurance was continued not

because of the value to it of the buildings but because the destruction of the buildings would have permitted the purchaser to pay off part of the purchase price from the proceeds of the insurance. It is my view that in neither case the amounts for which the buildings were insured reflect the value of the buildings in the sale of the properties.

It is clear that we are faced here with a situation where, in both cases, because of the location of the buildings in a busy business sector of both cities, the best and most profitable use of these properties became their conversion into parking lots and this, of course, indicates that the buildings had been reduced to a nil value. The same situation would apply to a piece of machinery which became obsolete, and was scrapped, and was replaced by a new one. Under present capital cost regulations, the undepreciated value of the machinery, when scrapped, would still continue to be depreciated as well as the new machine purchased to replace it because (in view of the class system) a taxpayer can keep on taking depreciation on assets it no longer has.

It is indeed a truism that where land values are rising, the best and most profitable use of the property is to get rid of the buildings in order to use it for parking or to erect thereon a larger and more profitable building. As a matter of fact, the evidence discloses in both cases here that at the exchange level, the appellant's buildings had only a nuisance value. Mr. Brown of the Montreal Star even stated that if the building had not been on the Montreal property, the Star would have paid a higher price than it did and the same would apply to the Quebec City properties. The evidence also shows clearly that the purchaser of the appellant's properties had informed the appellant that they were being acquired for site purposes only and the buildings were demolished by the purchasers at their expense a few months after sales had taken place and immediately after the appellant had vacated the premises.

Counsel for the respondent agreed that had the appellant in both cases prior to the sales demolished the buildings, there would have been no question that no amount could have been allocated to the buildings. I can see no

reason to treat the matter differently merely because the purchaser demolished the buildings after purchasing the properties.

I must, I believe, conclude, that the evidence indicates clearly that the bargaining between the parties, the meeting of minds on both sides in these transactions, were exclusively attributable to the value of the land and nothing was attributable to the buildings. I am, therefore, satisfied that no amount of the selling price of these properties can be reasonably regarded as proceeds of disposition of the buildings and the appellant was right in adding back as it did in 1960 the undepreciated cost of its buildings. The facts here, in my view, are no different than those found by this Court in *M.N.R. v. Steen Realty Limited (supra)* where no part of the sale price was attributed to the buildings and I see no reason to reach a different conclusion here.

Counsel for both parties agreed at the hearing that the amount to be added back is $92,544.62 for the Quebec buildings and $17,081.84 for the Montreal buildings.

The appeal is therefore allowed with costs and the matter is referred back to the Minister for reassessment accordingly.