BETWEEN:

1954

Sept. 28 & 29

Dec. 29

PICKLE CROW GOLD MINES LTD. .....APPELLANT;

AND

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

Revenue—Income—Income tax—The Income Tax Act, 1948, S. of C. 1948, c. 52, s. 11(1)(b)—Regulation 1205—Exploration and development expenses incurred by a gold mining company prior to coming into production—Liability for such expenses—Purpose of Regulation 1205—Meaning of "expenses incurred by the taxpayer" in Regulation 1205—Appeal from Income Tax Appeal Board dismissed.

Prior to May, 1938 appellant was engaged in the business of prospecting, exploring and mining for gold. Near its claims were other claims owned then by Albany River Mines Ltd. The two companies were entirely independent of each other and Albany River had spent substantial amounts on exploration and development of its claims but had not come into operation. Pursuant to an agreement entered into by the two companies in May, 1938, a new company—the Albany River Gold Mines Ltd.—was incorporated in July, 1938, and all the assets of Albany River were transferred to it and the shares of Albany Gold allotted to Albany River, appellant and another mining company as mentioned in the agreement. Between July, 1938 and October 31, 1945 appellant expended very large amounts in exploring and developing the claims acquired by Albany Gold from Albany River and these amounts were claimed and allowed as deductions from appellant's taxable income for the years 1946, 1947 and 1948. On October 31, 1945 Albany Gold agreed to sell and appellant agreed to purchase all the assets, rights and properties of Albany Gold in consideration for the issue to Albany Gold of 136,850 fully paid shares of appellant to be distributed among its shareholders (other than the appellant). In its income tax return for the year 1949 appellant sought to deduct 25 per cent of the amount disbursed by Albany River Mines Ltd. prior to July, 1938 for pre-production expenses. The claim was disallowed by the Minister and from the assessment an appeal was taken to the Income Tax Appeal Board which dismissed the appeal and from that decision appellant appealed to this Court. On the evidence the Court found that the 1945 agreement between the appellant and Albany Gold was a bona fide sale and purchase by which the appellant acquired the actual assets of Albany Gold, including the mining claims on which both Albany Gold and Albany River had incurred and paid certain exploration and development expenses; that the transaction involved no contractual relationship whatever between the appellant and Albany River or the latter's shareholders; that the only liability of the appellant thereunder (so far as this case is concerned) was to issue to Albany Gold the number of shares agreed upon.

Held: That Regulation 1205 referable to section 11(1)(*b*) of the Income Tax Act, S. of C. 1948, c. 52 was to give special relief to the mines specified in paragraph (1) thereof because of the fact that in many

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cases they might incur substantial expenses prior to the year in which they come into production in reasonable commercial quantities. The Regulation enabled them to do what they could not otherwise have done, namely, to deduct these expenses from income in and following the year in which they came into production in reasonable commercial quantities, and therefore had income from which the deduction could be made.

2. That the words "expenses incurred by the taxpayer" in Regulation 1205 have a natural and ordinary meaning of expenses either paid out by the taxpayer or which he has become liable to pay. Here Albany River became liable for and did pay the costs or expenses of its prospecting, exploration for, and development of its mine and thereafter no other person or corporation became liable to pay them. The question of liability for or payment of these expenses was at an end before the appellant had anything whatever to do with the matter.

3. That the theory advanced by appellant that it reimbursed the shareholders of Albany River for *their* outlay in the exploration and development of Albany River mine and that in this manner the appellant ran into or brought upon itself a liability in regard to the amount of pre-production expenses and thereby "incurred" them, is unsupportable on the proven facts of the case.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Cameron at Toronto.

Stuart Thom and *A. W. Langmuir* for appellant.

Peter Wright, Q.C. and *T. Z. Boles* for respondent.

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

CAMERON J. now (December 29, 1954) delivered the following judgment:

By its decision dated January 10, 1953 (7 T.A.B.C. 348), the Income Tax Appeal Board dismissed an appeal by Pickle Crow Gold Mines, Ltd. from an assessment made upon it for the taxation year 1949, and a further appeal has been taken to this Court. In its return for that year, the appellant had claimed the right to deduct from its income certain exploration and development expenses, but in the assessment the respondent disallowed all that portion of such expenses which was referable to expenditures incurred and paid by another company—Albany River Mines, Ltd. —prior to July 4, 1938. The appellant based its claim, and

now relies, on the provisions of section 11(1)(*b*) of the Income Tax Act and the Regulation referable thereto, which in the year 1949 were as follows:

11. (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

(*b*) such amount as an allowance in respect of an oil or gas well, mine or timber limit, if any, as is allowed to the taxpayer by regulation;

Regulation 1205.

(1) A taxpayer may also deduct from the profits for a taxation year reasonably attributable to the operation in Canada of a coal, base metal or precious metal mine or an industrial mineral mine described in section 1203 of these Regulations, such amount as he may claim, not exceeding 25 per cent of an amount calculated as set forth in subsection (2).

(2) The amount referred to in subsection (1) is the aggregate of all expenses incurred by the taxpayer which are reasonably attributable to the prospecting and exploration for and the development of the mine, prior to coming into production in reasonable commercial quantities, but not including . . .

I have omitted that part of subsection (2) of the Regulation which follows the words "but not including", it being admitted that it has here no relevancy. The Regulation was first made applicable to a taxation year ending in 1949.

The amount originally claimed as deductible under that head was $128,021.00. At the trial, however, I granted leave to the appellant to amend its claim by reducing it to $77,076.00, that sum being 25 per cent of $308,307.50 which the parties have agreed was disbursed by Albany River Mines, Ltd. (hereinafter to be called Albany River) prior to July, 1938, on account of expenses which were reasonably attributable to the prospecting and exploration for and the development of a mine, prior to coming into production in reasonable commercial quantities. For the sake of brevity I shall hereafter refer to such expenses as pre-production expenses. The parties have further agreed that no part of the said sum of $308,307.50 has been applied as a deduction in computing the income of Albany River Mines, Ltd., of the appellant, or of another company—the Albany River Gold Mines, Ltd. (which acquired the mining claims of Albany River in 1938, and owned them until they were transferred to the appellant in 1945)—under the Income War Tax Act or the Income Tax Act.

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In order to appreciate the nature of the claim now advanced by the appellant, it is necessary to set out something of the history of the transactions which took place between the two corporations.

The appellant is a company incorporated under The Companies Act of the Province of Ontario and at all times material to this appeal had been engaged in the business of prospecting, exploring and mining for gold in the District of Patricia. Near its claims were certain other claims owned in 1938 by Albany River. Prior to May 27, 1938, the two companies were entirely independent of each other and Albany River had expended very substantial sums on exploration and development of its claims but had not come into production.

On that date the appellant and Albany River entered into an agreement (Exhibit 7) by the terms of which the appellant agreed to proceed immediately and at its own expense to examine the ore deposits of Albany River to such extent as it considered advisable; and if the said examination proved satisfactory to the appellant, it agreed to carry out, on or before June 7, 1938, the remaining terms of the agreement. Briefly, these terms were that the appellant would cause to be incorporated a new company to be called Albany River Gold Mines, Ltd. (hereinafter to be called "Albany Gold"), with a capitalization of three million shares, with a par value of one dollar each. Upon its incorporation, all the assets of Albany River were to be conveyed to Albany Gold (except a small amount of cash to be reserved for the costs of winding up Albany River). The shares of Albany Gold were to be allotted as follows:— to Albany River—1,087,483 shares (for distribution among its shareholders); and to the appellant—1,692,223 shares. The board of Albany Gold was to consist of five directors, three to be appointed by the appellant and two to represent Albany River. The appellant was forthwith to proceed with the active exploration and development of the claims held by the new company and to have complete control of such operations. Before the new company could declare any dividends, the appellant was to be repaid all its costs in relation thereto. It was further provided that if either Albany River or the appellant acquired any interest in

certain adjacent claims owned by Winoga Patricia Gold Mines, Ltd., such claims were to be transferred to Albany Gold at cost.

The preliminary examination of the claims of Albany River proved satisfactory to the appellant and in the result the above agreement was implemented as provided therein about July 1, 1938. The new company Albany Gold was incorporated, the assets of Albany River were transferred to it; the Winoga claims were acquired for the consideration of 220,000 shares of Albany Gold; and the shares of Albany Gold were allotted to Albany River, Winoga and the appellant in the manner prescribed. Between July 1938, and October 31, 1945, the appellant expended very substantial amounts in respect of exploration and development work on the 17 claims owned by Albany Gold and which the latter company had acquired from Albany River and Winoga.

In October 31, 1945, an agreement (Exhibit 11) was entered into between Albany Gold and the appellant. The important terms of that agreement were that Albany Gold agreed to sell and the appellant agreed to purchase all the assets, rights and properties of Albany Gold in consideration of the issue to Albany Gold of 136,850 fully paid shares of the appellant company of a par value of one dollar each, and the payment by the appellant of all debts of Albany Gold. Further, the latter company was released from its obligation to pay to the appellant the amount which the appellant had expended on the Albany Gold claims in exploration and development, an amount agreed upon at $241,154.33. The appellant was also to deliver up for cancellation all its remaining shares (1,631,225) in Albany Gold. The latter company was to distribute rateably among its shareholders (other than the appellant) the shares in the appellant company which Albany Gold received as a result of the sale, each shareholder to receive one share of stock in the appellant company for each 10 shares of Albany Gold held by him.

As stated in the "Agreement on Facts", filed, the 17 claims owned by Albany Gold were transferred to the appellant on or about October 31, 1945. Exhibits 12 and 13, dated December 1945, are the formal documents completing the transfer of all the assets of Albany Gold to the

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appellant. It is also agreed that the 136,850 shares of the appellant company were duly issued to Albany Gold pursuant to the terms of the agreement. The appellant, therefore, in late 1945 became the owner of the 8 mining claims originally owned by Albany River and the 9 mining claims originally owned by Winoga.

In its returns for the years 1946, 1947 and 1948, the appellant claimed deductions from its taxable income in respect of development work done by it on the properties in the years prior to the time when it acquired formal title to the claims of Albany Gold and these claims were allowed in the total amount of $241,154.33—the precise sums which the appellant had spent on behalf of Albany Gold in the years 1938 to 1945.

The question which I have to decide is to be determined by the interpretation to be put upon the provisions of Regulation 1205 (*supra*). I am invited by the appellant to so construe it as to permit the appellant to deduct from its income for the year 1949 a proportion of the amount of pre-production expenses incurred and paid prior to July 4, 1938, by a company which until that date was entirely separate from and had no connection whatever with the appellant.

It seems to me that Regulation 1205 was designed to give special relief to the mines specified in paragraph (1) thereof because of the fact that in many cases they might incur substantial expenses prior to the year in which they come into production in reasonable commercial quantities. The Regulation enabled them to do what they could not otherwise have done, namely, to deduct these expenses from income in and following the year in which they came into production in reasonable commercial quantities, and therefore had income from which the deduction could be made.

In this case, if the appellant is entitled to succeed I must first be satisfied that the expenses now claimed as deductible were "expenses incurred by the taxpayer", that being one of the conditions laid down in the Regulation. It seems to me that these words are precise and unambiguous and that, therefore, no more is necessary than to expound them in their natural and ordinary sense. In my opinion, the words "expenses incurred by the taxpayer" have a natural

and ordinary meaning of expenses either paid out by the taxpayer or which he has become liable to pay. In this case Albany River became liable for and did pay the costs or expenses of its prospecting, exploration for, and development of its mine and thereafter no other person or corporation became liable to pay them. The question of liability for or payment of these expenses was at an end before the appellant had anything whatever to do with the matter.

That finding is sufficient by itself to enable me to reach the conclusion that the deductions claimed were not expenses incurred by the taxpayer and that the appeal should be dismissed.

In view, however, of the able argument advanced by Mr. Thom, counsel for the appellant, it is necessary to consider as briefly as I can the submission made by him that the expenses were in fact "incurred" by the appellant.

His contention is that "incurred" has a much broader meaning than I have attributed to it. Various dictionary definitions were referred to but I think that they are all summed up in that given in *Corpus Juris* as follows:

> To assume, contract for or become liable or subject to through one's own action; to become liable for or subject to; to bring on; to occasion or cause to render liable or subject to; to run into; sometimes it is used in the sense of meeting with, of being exposed to or being liable to.

He says that in substance the transactions between the appellant, Albany River and Albany Gold, which I have referred to, when considered in the light of the evidence given at the hearing, amount to a payment by the appellant to the shareholders of Albany River of an amount computed with reference to and approximately equivalent to the amount expended for such expenses by the shareholders of Albany River; and that, therefore, the appellant assumed, or contracted for, or became liable or subject to the payment of, and did in fact pay, such pre-production expenses. Part of his argument was stated in these words:

> . . . it is exactly as though Pickle Crow had gone into the share market—had sold a new issue—sufficient of its shares to an underwriter and taken that cash and had gone on to the first Albany representatives and said, "Now how much cash do we have to give you to buy out your interests in these claims which we have been working and exploring for the last seven years?"
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> . . . we feel that it (the argument) has substance and that one must get away from the notion that "incurred" means "paid" and that "incurred" has a much broader and more comprehensive meaning and that the Pickle

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Crow Company did literally "incur" expenses by taking upon themselves these assets in 1945 and paying the owners of them or giving them back their money in the form of shares of the Pickle Crow stock.

It is shown that Albany River, in its balance sheet which formed part of the agreement of May 27, 1938, with the appellant, treated "exploration and development" expenditures as an asset; that Albany Gold, which acquired all the assets of Albany River, in its annual statements and in the agreement of 1945 with the appellant, stated its "exploration and development" expenses as an asset in the balance sheet, including therein from time to time the amount of such expenditures which were previously made by Albany River. It is said, therefore, that the asset which it called "exploration and development" was in fact an asset—one which was kept alive from 1938 onwards, and was included in the assets acquired by the appellant from Albany Gold in 1945.

Then it is suggested that I should find that there was a direct link between the appellant company and the shareholders of Albany River by reason of the agreement of 1945 between the appellant and Albany Gold and the manner in which the parties thereto agreed on the number of shares in the appellant company which were allotted to Albany Gold in return for the transfer of all its assets to the appellant. The documentary evidence shows only that the appellant was to issue a specified number of its shares (having a par value of one dollar each) to Albany Gold and that the latter company was to divide them rateably among its shareholders. The oral evidence is that in negotiating the agreement it was decided that the stock to be issued by the appellant should be valued at $4.00 per share—which was approximately its market value; that the number of shares to be issued should be such that at that valuation the shares which Albany Gold would then have available for its shareholders who derived their title thereto from the implementation of the agreement of Albany River to sell its assets to Albany Gold would have a total value approximately equivalent to the total outlays by the shareholders of Albany River. That amount was taken to be something in excess of $400,000.00, the main item of which was that of $308,307.50 for "exploration and development". Accordingly, it was agreed to issue 136,850 shares of the appellant

company, some of which would be distributed to the Winoga interests and to the estate of a deceased shareholder. In the result, each shareholder of Albany Gold would receive one share in the appellant company for every 10 shares held by him in Albany Gold.

From these facts I am asked to find that the substance of the series of the transactions was the purchase by the appellant from the shareholders of Albany River of an asset called "exploration and development expenses"; and that as the value and number of the shares issued by the appellant was computed on a basis which included as its main item the costs of the development work done by Albany River, that the appellant did, in fact, "incur" such costs or expenses. I am invited to overlook the existence of Albany Gold and to consider it as having been merely a vehicle or an interim corporation for the carrying out of a transaction between Albany River and the appellant.

In considering this submission I was greatly assisted by Mr. Wright, counsel for the respondent who analyzed it in great detail. I have given it careful consideration and must reject it as insupportable on the proven facts. The whole submission rests on the theory that the appellant reimbursed the shareholders of Albany River for *their* outlay in the exploration and development of Albany River mine and that in this manner the appellant ran into or brought upon itself a liability in regard to the amount of pre-production expenses and thereby "incurred" them.

The expenses were, in fact, both incurred and paid by Albany River and not by its shareholders. The corporate existence of that company cannot be overlooked any more than that of Albany Gold. The latter company carried on its business for a period of seven years before the appellant company conceived the idea of acquiring full ownership of its mining claims and other assets. It was Albany Gold and not the appellant which acquired ownership of the assets of Albany River; and in turn the appellant acquired the mining claims which included those formerly owned by Albany River, from Albany Gold. The appellant at no time entered into any contractual relationship of any kind with the shareholders of Albany River. In pursuance of the 1945 contract its duty was to issue its shares to Albany Gold

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and the latter company obligated itself to divide them rateably amongst *its* shareholders, not among the shareholders of Albany River. Moreover, there is no certainty as to what proportion of the shareholders of Albany River (as they were in 1938) later received the shares of the appellant company. By 1945 only 67 per cent had converted their shares into shares of Albany Gold and it is shown that in the intervening seven years there had been registered a very substantial number of transfers to others. It is highly probable, therefore, that a very large number of the shares issued by the appellant eventually were distributed by Albany Gold to parties who were not in 1938 shareholders of Albany River.

There cannot be the slightest doubt that the transactions between Albany River and Albany Gold and later between Albany Gold and the appellant were in fact sales. That is shown by the agreements and the conveyances which followed. Nor is there any doubt in my mind that in each case what was sold was mining claims on which exploration work had been done and not an asset which could be called "exploration and development expenses". As I have said, they were so called in the balance sheet, but in the transfers there was no conveyance of any such item; it was the mining claims that were conveyed. I cannot understand how such expenses could be called an asset as that term is normally understood. I have no doubt that in accounting quarters it may be useful to keep a record under that heading so as to fix the amount of outlay on that account and perhaps assist in determining the value of the mining claims on which the work has been done in the event of a sale. In a commercial sense, "asset" means property of one sort or another and I am at a loss to understand how the mere recording of an amount expended in years gone by could be considered as an asset and by itself become the subject of sale and purchase.

I must find, therefore, that the 1945 agreement between the appellant and Albany Gold was a bona fide sale and purchase by which the appellant acquired the actual assets of Albany Gold, including the mining claims on which both Albany Gold and Albany River had incurred and paid certain exploration and development expenses; that the transaction involved no contractual relationship whatever

between the appellant and Albany River or the latter's shareholders; that the only liability of the appellant thereunder (so far as this case is concerned) was to issue to Albany Gold the number of shares agreed upon.

It is probably correct to say that the appellant issued more of its shares to Albany Gold as consideration for the transfer to it of mining claims on which development work had been done by Albany River (as well as by Albany Gold itself) than it would have done had such development work not been done. The value of the mining claims was enhanced because of such development work. But the true nature of the agreement of 1945—and also of the 1938 agreement when it was implemented—was that of a sale of mining claims for shares. That was admitted by Mr. Bland, an official of both Albany Gold and the appellant, who also stated that there were no collateral agreements which in any way altered that fact. All that the appellant was required to do in 1945 was to issue its shares to Albany Gold. In my view that could not be considered as running into or becoming liable for or subject to, or assuming or contracting for, pre-production expenses; such expenses were not thereby "incurred" by the taxpayer, the appellant. I think, therefore, that this submission of the appellant must fail.

In view of my finding on the main point, it becomes unnecessary to consider another submission put forward on behalf of the respondent, namely, that in any event the appellant was not entitled to the deductions claimed as the "mine" referred to in Regulation 1205 was the same as the original mine of the appellant which admittedly came into production in reasonable commercial quantities in 1936, the added claims formerly owned by Albany River being at all times considered only as a reserve for the original mine.

For the reasons stated, the appeal will be dismissed and the assessment made upon the appellant will be affirmed. The respondent is also entitled to be paid his costs after taxation.

Judgment accordingly.
