
1945
June 14
Aug. 3

BETWEEN:

WRIGHTS' CANADIAN ROPES LIMITED,

APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE,

RESPONDENT.

Revenue—Income tax—Income War Tax Act R.S.C. 1927, c. 97, sects. 6 (1) (i) and 6 (2)—Taxpayer not entitled to consideration of claim for deduction under s. 6 (1) (i) of the Income War Tax Act where

claim covers obligations not referred to in the subsection—Onus is on taxpayer to prove that Minister of National Revenue has not exercised his discretion on proper legal principles—Minister not required to disclose reports received from local Inspector of Income Tax—Minister may disallow any item in an expense account without disallowing the account in its entirety.

The appellant is a manufacturing company incorporated under the Dominion Companies Act. Its principal shareholders are two corporations in England who own all except three shares of its issued capital stock. By an agreement entered into with one of its English shareholders the appellant in return for the performance of certain services and an undertaking that the English Company would not sell rope in certain designated territory, undertook to pay that Company five per cent on all sales made by appellant anywhere. The appeal herein is from the refusal by the Minister of National Revenue to allow all of such payments as a deductible item from appellant's income for the years 1940, 1941 and 1942

Held: That appellant is not entitled to consideration by the Minister under s. 6 (1) (i) of the Income War Tax Act of its claim for deduction since the deduction claimed covers obligations not referred to in the subsection.

2. That it is not incumbent on the Minister of National Revenue to disclose to an appellant any report or reports received by him from a local inspector of Income Tax.

3. That the onus of proof that the Minister of National Revenue has not exercised his discretion on proper legal principles is upon the appellant and the appellant has not discharged such onus.

4. That every item in an expense account is in itself an expense and the Minister under s. 6 (2) of the Income War Tax Act is not required to disallow in its entirety any expense account which he found in any small particular to be in excess of what was reasonable or normal.

APPEAL under the provisions of the Income War Tax Act.

The appeal was heard before His Honour Judge J. C. A. Cameron, Deputy Judge of the Court, at Ottawa.

H. R. Bray, K.C. for appellant.

Robert Forsyth, K.C. and *H. H. Stikeman* for respondent.

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

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CAMERON, Deputy Judge, now (August 3, 1945) delivered the following judgment:

This is an appeal from three assessments made by the Commissioner of Income Tax upon the Appellant in respect of income tax and excess profits tax, for the years 1940, 1941 and 1942, and affirmed by the Minister of National Revenue (hereinafter called "The Minister"). The appellant is incorporated under the Dominion Companies Act.

On August 13, 1943, the Inspector of Income Tax at Vancouver notified the appellant by letter that under the powers vested in the Minister under section 6 (2) and section 75 (2) of the Income War Tax Act discretion was about to be exercised in respect of the matters now in dispute (*inter alia*) which appeared to be in excess of what was reasonable for the said business; and invited the appellant to submit written representations for consideration of the matter. In reply thereto the appellant, on September 8, 1943, forwarded copies of the agreements later herein referred to as exhibits 1 and 2.

On October 9, 1943, the said Inspector at Vancouver further notified the appellant that it was proposed to recommend to the Minister that commissions paid to Wrights' Ropes Limited, in 1940, 1941, 1942, be disallowed as deductions except as to the sum of $7,500 in each year.

The appellant, on October 21, 1943, acknowledged receipt of that letter and stated "We have nothing further to add to ours of the 8th ultimo and await the outcome of your recommendations to the Minister and the exercise of his discretion". No further representation were made by the appellant except that on October 29, 1943, it advised the Inspector that Wrights' Ropes Limited, had not the controlling interest in the Company as had been indicated in the letter of the Inspector, of October 9, 1943. The Minister—by the Commissioner of Taxation—under section 75 (2) of the Act, exercised his discretion and on May 10, 1944, notices of assessment for the said years were mailed to the appellant, all payments to Wrights' Ropes Limited of Birmingham, England, by way of commission on sales being disallowed as deductions except as to the sum of $7,500 in each of the said years.

On May 29, 1944, the appellant gave notice of appeal from the said assessments together with the required statement of facts and reasons for appeal.

On September 26, 1944, the Minister—by his Deputy Minister of National Revenue for Taxation—gave his decision which in part is as follows:

The Honourable the Minister of National Revenue having duly considered the facts as set forth in the Notice of Appeal and matters thereto related and having exercised his discretion under the provisions of Subsection 2 of Section 6 of the Income War Tax Act, hereby affirms the said assessment wherein $9,881.94 of the Commission of $17,381.94 in the year 1940, $21,825.85 of the commission of $29,325 85 in 1941 and $31,980.91 of the commission of $39,480.91 in 1942 paid to Wrights' Ropes Limited of Birmingham were disallowed as expenses or deductions for the purposes of the said Act. Therefore on these and related grounds and by reason of other provisions of the Income War Tax Act and Excess Profits Tax Act the said Assessments are affirmed.

On October 11, 1944, the appellant filed a Notice of Dissatisfaction together with statement of facts and stating its reasons for appeal as follows:

Reasons for Appeal

1. That the commissions paid by the appellant to Wrights' Ropes Limited were an obligation imposed on the appellant by a valid contract.

2. That the opinion of the Minister herein was not based on a consideration of the facts.

3. That the opinion of the Minister herein was unreasonable and was not formulated in accordance with the law.

4. That the Minister in forming his decision appealed from, gave no consideration to the provisions of section 6 (i) of the Income War Tax Act containing in lines 8 to 13 thereof as follows:

but only if the company or organization to which sums are payable, or the company in Canada, is controlled directly or indirectly by any company or group of companies or persons within or without Canada, which are affiliated one with the other by the holding of shares or by agreements or otherwise;

5. That no opportunity has been given the appellant to refute any material that may have been laid before the Minister of National Revenue or the Commissioner of Income Tax relative to the said assessment and which may be prejudicial to the interests of the appellant.

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6. That the Minister did not exercice his discretion as required by Subsection 2 of said Section 6 of the said Act.

The Sections of the Income War Tax Act having to do with the issues raised are as follows:

6—1. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of . . . . .

(i) Any sums charged by any company or organization outside of Canada to a Canadian company, branch or organization, in respect of management fees or services or for the right to use patents, processes or formulae presently known or yet to be discovered, or in connection with the letting or leasing of anything used in Canada, irrespective of whether a price or charge is agreed upon or otherwise; but only if the company or organization to which such sums are payable, or the company in Canada, is controlled directly or indirectly by any company or group of companies or persons within or without Canada, which are affiliated one with the other by the holding of shares or by agreements or otherwise; provided that a portion of any such charges may be allowed as a deduction if the Minister is satisfied that such charges are reasonable for services actually rendered or for the use of anything actually used in Canada.

2. The Minister may dissalow any expense which he in his discretion may determine to be in excess of what is reasonable or normal for the business carried on by the taxpayer, or which was incurred in respect of any transaction or operation which in his opinion has unduly or artificially reduced the income.

The Excess Profits Tax Act provides as follows:

Section 8. In computing the amount of profits to be assessed, subsections one and two of section six of the Income War Tax Act shall, *mutatis mutandis,* apply as if enacted in this Act. . . . .

The payments made by the appellant to Wrights' Ropes Limited were made pursuant to an agreement dated September 12, 1935 filed as Exhibit 2 herein. This agreement was supplemental to an agreement dated May 19, 1931, between the same parties—the appellant therein being referred to as Cooke's (Exhibit 1).

The agreement of September 12, 1935, is between Wrights' Ropes Limited, Birmingham, (called Wrights'); Charles Hirst & Sons Limited, (called Hirst's) and the appellant (called the Canadian Company). It recites that Wrights' have assigned and transferred to the Canadian Company its business and sales agencies in Western Canada (in accordance with the agreement of May 19, 1931) and *inter alia* provides as follows:

2. (*a*) Except as provided by paragraph (*c*) of this clause Wrights' will not directly or to their knowledge supply for sale or sell any wire ropes in Western Canada.

(*b*) Wrights' to refer to the Canadian Company Enquiries and orders for Western Canada.

(*c*) Payment by Wrights' to the Canadian Company of certain commissions.

(*e*) The Canadian Company to be at liberty to consult Wrights' in all matters pertaining to the business of the Canadian Company and Wrights' to act as technical advisers, etc.

(*f*) Wrights' to furnish the Canadian Company with information regarding developments in wire rope industry, etc.

(*g*) Wrights to direct and supervise the supply of wire by Hirst's to the Canadian Company.

5. In consideration of the due performance by Wrights' of their obligations under this Agreement the Canadian Company will pay to Wrights' a commission at the rate of five per centum upon all cash received in respect of the net selling price of all wire ropes both manufactured and sold by the Canadian Company after the date of this agreement. . . . .

The payments claimed by the appellant as deductible expenses were made pursuant to paragraph five of the above agreement and the evidence establishes that the payments were made in fact in accordance with the said agreement.

I propose to deal with the appellant's case by considering separately the reasons for appeal and in the order mentioned therein.

(1) There is no dispute that the commissions paid by the appellant to Wrights' Ropes Limited were an obligation imposed by a valid contract. The original contract (exhibit 1) was executed in 1931 and extended with some alterations in 1935 by a further agreement (exhibit 2). A copy of the contract was in the possession of the Commissioner when the assessments were made and was no doubt given consideration. By section 6 (2) very wide powers are given to the Minister to disallow *any* expense which he, in his discretion, may determine to be in excess of what is reasonable or normal for the business. There is nothing in this section which requires him to allow as proper deductions any sums paid by a taxpayer under a valid contract.

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(2) There is no evidence to support the contention that the decision (opinion) of the Minister was not based on a consideration of the facts. The evidence of the Deputy Minister of National Revenue for Taxation taken on his examination for discovery and read into the record at the hearing shows that consideration was given to the facts.

(3) No evidence was given to indicate that the decision (opinion) of the Minister was unreasonable unless it could be referred to as unreasonable because the whole claim was not allowed; and I recall no suggestion in the evidence or in the argument that it was not formulated in accordance with the law except for the matters mentioned in reason 5 below.

(4) There is no evidence that the Minister did or did not give consideration to the provisions of section 6 (1) (i) of the Act particularly lines 8 to 13 thereof. It is clear however that he—acting through the Commissioner of Taxation—exercised the discretion conferred on him by section 6 (2) and the assessments later made on the appellant were made, in so far as the matters in dispute are concerned, under section 6 (2) and not under section 6 (1) (i). This is clearly established by the letter of August 13, 1943, above referred to and by the decision of the Minister, dated September 26, 1944.

The contention of the appellant is that the Minister should have considered the matter under section 6 (1) (i) of the Act and should have found:

(1) That the commissions paid by the appellant to the English Company were in respect of the matters mentioned in the first part of the subsection and

(2) That the appellant was not controlled by Wrights' Ropes Limited (referring to lines 8 to 13 of said section) and

(3) That, therefore, as the items claimed as deductions were not paid to a controlling company, they could not be disallowed but, in fact, should be allowed in full.

I find it somewhat difficult to ascertain the exact meaning of lines 8 to 13 of subsection (i). The intent seems to

be that the charges mentioned in the first part of the paragraph should be disallowed *only if* the payer or payee of the sums charged is controlled in the manner indicated (subject to the later proviso as to the power of the Minister to allow a portion of such charges).

The appellant endeavoured to establish that it was not controlled by Wrights' Ropes Limited but the evidence is not at all clear. The share capital of the Company is 1,500 common shares all of which are issued—749 shares being held in the name of Hirsts' Limited, 748 in the name of Wrights' Ropes Limited and 3 qualifying shares held in the name of the three Canadian directors. In the appellant's letter to the inspector, dated October 29, 1943, it stated that Wrights' Ropes Limited and Hirsts' Limited each held 50 per cent of the shares. In the consent, dated June 1, 1945, and filed at the trial, it was agreed that at all pertinent times Wrights' Ropes Limited *held* 49·86 per cent of the shares and not 50 per cent as mentioned in the letter of October 29, 1943.

At the hearing, on cross-examination, the managing director was asked how many shares were held by Wrights' Ropes Limited and he answered "750 odd" which, of course, would appear to give control at a general meeting. His counsel then interrupted the cross-examination saying "you can take a look at that" (showing a document, presumably the share register) and the witness then said "748 shares". No evidence was given as to whether the three directors' shares were held beneficially or as nominees of one or other of the two major shareholders. The first answer of the witness is possibly significant and it would not be at all surprising to find that the control was actually in Wrights' Ropes Limited. However, in the view I take of the matter, it is not necessary to make any finding in regard thereto.

I have reached the conclusion that section 6 (1) (i) does not apply to the present case. It is to be noted that the agreement under which the payments were made (exhibit 2), provided in clause 5 thereof, that the commission of 5 per cent payable by the appellant to Wrights' Ropes Limited is "in consideration of the due performance by the latter of their obligations under this agreement".

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These obligations have been heretofore summarized and while they include the rendering of certain services and possibly certain managerial duties—as mentioned in section 6 (1) (i)—they also include a covenant not to sell or supply for sale any wire rope in Western Canada and to pay certain commissions to the appellant. These latter are not matters which are included in any way in the subsection. It is important to observe that neither at the hearing, nor when asked by the inspector at Vancouver to supply him with any further representations, did the appellant make any effort to break down the total charges of 5 per cent into portions, due in respect of management fees or services which, in my opinion, are the only two obligations undertaken by Wrights' Ropes Limited which could possibly be within the provisions of the subsection. In fact, I think, I could assume that it would be almost impossible to do so. No evidence was given at the trial as to what services were supplied, how frequently they were supplied or how important they were. It is true that the managing director expressed the opinion that the advice and services were worth the amounts paid but, without proof as to what they were, I would hesitate to accept that statement. In any event in considering section 6 (1) (i) I must deal with the sums charged by Wrights' Ropes Limited, which so far as the evidence shows, could only be under clause 5 of the agreement of 1935. These charges covering obligations not referred to in the subsection, I must find that section 6 (1) (i) has no application to the case.

(5) The appellant laid great stress on the fact that it had not been shown any report made by the local Inspector at Vancouver to the Minister and Commissioner or given any opportunity to meet any statements therein contained. It is clear that, following the usual practice, the local inspector did make one or more reports, statements or recommendations, to the Commissioner or Minister; that such were not shown to the appellant and that they were part of the material considered by the Minister—acting through the Commissioner—when the discretion was exercised. There is absolutely no evidence before me as to what was contained therein. It may or may not have been material. It may have contained nothing more than the

recommendations of the Inspector as stated to the appellant in the letter of October 9, 1943.

Counsel for the appellant referred me to the case of *Rex* v. *Local Government Board—ex-parte Aldridge* (1) as authority for holding that the Minister had acted improperly in not disclosing such report of the inspector and that the appellant was, therefore, prejudiced to such an extent that the assessments should be set aside. The decision referred to however was reversed in the House of Lords (2) where it was held that an appellant to the Local Government Board is not entitled as of right to see the report made by the Board's inspector upon the public local inquiry. This decision was referred to with approval in the case of *Danby and Sons Limited* v. *Minister of Health* (3). Reference may be made more particularly to page 350, where Swift J. quoting from the *Aldridge* case said:

...but there is one point which needs notice, namely, the claim that the respondent was entitled as of right to see the report of the inspector who held the public inquiry. No such right is given by statute or by an established custom of the department. Like every administrative body, the Local Government Board must derive its knowledge from its agents, and I am unable to see any reason why the reports which they make to the department should be made public. It would, in my opinion, cripple the usefulness of these inquiries. It is not for me to express my opinion of the desirability of an administrative department taking any particular course in such matters, but I entirely dissociate myself from the remarks which have been made in this case in favour of a department making reports of this kind public. Such a practice would, in my opinion, be decidedly mischievous.

Taking therefore, the view, as I do, that the Minister of Health and the person whom he causes to hold the inquiry are persons who, in arriving at their decision, must act judicially in the sense I have mentioned above, I see no reason for holding that such a report is liable to disclosure on the contrary, I am of opinion that it is not.

In the *Aldridge* case (4) Lord Shaw said:

I incline to hold that the disadvantage in very many cases would exceed the advantage of such disclosure. And I feel certain that if it were laid down in Courts of law that such disclosure could be compelled, a serious impediment might be placed upon that frankness which ought to obtain among a staff accustomed to elaborately detailed and often most delicate and difficult tasks. The very same argument would lead to the disclosure of the whole file. It may contain, and frequently does contain, the views of inspectors, secretaries, assistants, and consultants of various degrees of experience, many of whose opinions may differ but all of which form the material for the ultimate decision. To

(1) (1914) 1 K.B. 160.
(2) (1915) A.C. 120.
(3) (1936) 1 K.B. 337 at 343.
(4) (1915) A.C. at 137.

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set up any rule that that decision must on demand, and as matter of right, be accompanied by a disclosure of what went before, so that it may be weakened or strengthened or judged thereby, would be inconsistent, as I say, with efficiency, with practice, and with the true theory of complete parliamentary responsibility for departmental action. This is, in my opinion, implied as the legitimate and proper consequence of any department being vested by statute with authority to make determinations.

This conclusion is in no way changed by the circumstance of the determinations being, in point of fact, upon appeal from the deliverances of another or inferior authority. The judgments of the majority of the Court below appear to me, if I may say so with respect, to be dominated by the idea that the analogy of judicial methods or procedure should apply to departmental action. Judicial methods may, in many points of administration, be entirely unsuitable, and produce delays, expense, and public and private injury. The Department must obey the statute. For instance, in the present case it must hold a public local inquiry, and upon a point of law it must have a decision of the Law Courts. *Quoad ultra* it is, and, if administration is to be beneficial and effective, it must be the master of its own procedure.

While it is true that the decisions above referred to arose out of consideration of special acts, I believe that the principles there laid down are applicable to the present case. I have, therefore, reached the conclusion that it was not incumbent on the Minister to disclose to the appellant any report, or reports, he received from the local Inspector at Vancouver.

This conclusion has not been reached without some doubt in view of part of a judgment of Lord Loreburn in the case of *Board of Education* v. *Reid* (1) where he says:

> They can obtain information in any way they think best, always giving a fair opportunity to those who are parties to the controversy for correcting or contradicting any relevant statements prejudicial to their view.

This decision was referred to with approval by Davis J. in the case of *The King* v. *Noxzema Chemical Company* (2).

In neither of these cases, however, was it necessary for the Court to determine the direct question as to whether a report submitted by an official or an inspector to the departmental head should be disclosed to the opposite party and for that reason I prefer to follow the decisions previously referred to.

It was urged by counsel for the appellant that the Minister did not exercise his discretion as required by section

(1) (1911) A.C. at 182. (2) (1942) S.C.R. at 180.

6 (2) of the Act. I find no evidence that such is the case. Unquestionably his decision was made under that subsection, as above pointed out, after exercising his discretion. As to the manner of exercising that discretion there seems to be no valid ground for complaint. It was fully demonstrated that the appellant had every opportunity of presenting any material relevant to the case; that it received notice that discretion was about to be exercised; that the Minister when exercising his discretion had before him all the material submitted by the appellant and all other necessary information on which to reach a conclusion and to exercise his discretion.

Following the tests laid down by the Privy Council in *Pioneer Laundry & Dry Cleaners Limited* v. *Minister of National Revenue* (1) it is clear that the exercise of the discretion involved an administrative duty of a quasi-judicial character to be exercised on proper legal principles. I can find no evidence that the discretion in this case was not exercised in such a manner. The onus of proof that the discretion of the Minister was not properly exercised is on the appellant and it has not satisfied that onus.

Counsel for the appellant also argued that the Minister could not have used section 6 (2) as it required him to disallow the expense in toto. With that argument I can not agree. Every part of an expense account is in itself an expense—something that has to be expended—and the very words of that section make it quite clear that the Minister may disallow any expense which, in his discretion, he may determine to be in *excess* of what is reasonable or normal. If the argument for appellant were correct it would mean that the Minister would be required to disallow in its entirety any expense account which he found in any small particular to be in excess of what was reasonable or normal.

For the reasons above stated I have come to the conclusion that the discretion of the Minister conferred on him by section 6 (2) of the Act was properly exercised and that the assessments in question were properly made and it follows, therefore, that the appeals fail and must be dismissed with costs.

Judgment accordingly.

(1) (1940) A.C. 127.