1951

May 28, 29 & 30

Dec. 14

BETWEEN:

THE JAMES MacLAREN CO. LTD. ....APPELLANT;

AND

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

Revenue—Excess Profits Tax—Excess Profits Tax Act, 1940—Income War Tax Act R.S.C. 1927, c. 97, s. 3, s. 5(1) (w)—P.C. 331, January 30, 1948 as amended March 6, 1948—Portion of corporation taxes paid Province of Quebec deductible from income—Method of computing amount deductible—Cost of "barking" logs excluded as being considered as part of manufacturing or processing—Appeal allowed.

Held: That in computing the net income of appellant for the year 1947 to ascertain its profits under the Excess Profits Tax Act, 1940, the appellant is entitled to deduct from its taxable income a proportion of taxes paid for that year to the Province of Quebec under the provisions of the Quebec Corporation Tax Act; *Spruce Falls Power & Paper Co. Ltd.* v. *The Minister of National Revenue*, Post p. 75.

2. That in computing the costs of the integrated operations carried on by appellant in order to arrive at the amount properly deductible from income computed on a cost-ratio basis the cost of "barking" the logs should be excluded entirely from the computation, "barking" being considered as part of the manufacturing or processing.

APPEAL under the Excess Profits Tax Act.

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

John Aylen, K.C. and *J. Ross Tolmie* for appellant.

D. W. Mundell, K.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 14, 1951) delivered the following judgment:

In its amended income and excess profits tax return for the year 1947, the appellant claimed a deduction from its taxable income of a proportion of taxes paid for that year on its net income to the Province of Quebec under the provisions of the Corporation Tax Act (Statutes of Quebec, 1947, c. 33, s. 6). By his amended notice of assessment dated May 19, 1949, the respondent totally disallowed that deduction. The appeal now before me is in respect of that disallowance insofar only as it relates to excess profits tax payable by the appellant.

Under the Excess Profits Tax Act, 1940, as amended, the "profits" of the corporation means the amount of its net taxable income as ascertained under the provisions of the Income War Tax Act, R.S.C. 1927, c. 97, as amended, subject to certain exemptions not here of importance. Under the latter Act, "income" is defined by section 3, and by section 5 certain deductions and exemptions are allowed.

For the taxation year 1947, the relevant permissible deduction was as follows:

5(1) (*w*). Such amount as the Governor in Council may, by regulation, allow in respect of taxes on income for the year from mining or logging operations.

The appellant bases its claim on para. (*w*) and on the regulations of the Governor in Council applicable thereto, namely, P.C. 331, dated January 30, 1948, as amended by P.C. 952, dated March 6, 1948. The respondent denies that the appellant is entitled to any deduction under para. (*w*) on the ground that the deductions permitted thereby are limited to taxes levied specifically on logging and mining operations; and that in any event the appellant has not brought itself within the provisions of P.C. 331 as amended. I understand that in the Province of Quebec there has never been a tax levied specifically on logging operations.

The appellant is a corporation having its head office at Buckingham in the Province of Quebec and carries on business exclusively in that province. It is engaged in the manufacture of newsprint paper from pulp wood, its business being wholly integrated. It cuts logs on timber limits held under lease from the Province of Quebec, transports the logs by various methods to its pulp mill at Buckingham and to its sulphite mill at Masson, at which points the logs are converted into wood pulp and sulphite pulp; at a later stage the wood pulp is conveyed to the mill at Masson where it is mixed with sulphite pulp and then manufactured into newsprint paper which is sold to the consumers. In addition thereto, it also sells to others timber of a type not needed by it in the manufacture of newsprint, either on the stump or after it has been cut. It also purchases for its own use a certain percentage of pulp wood which has been cut by settlers in the area.

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It will be seen, therefore, that the appellant carried on two separate operations. The first was a purely logging operation, namely, the cutting and selling of logs as such. Its records are kept in such a way that the net income arising from that operation is clearly ascertained. The appellant's fiscal year ends on November 30 and it is established that its net profit for that purely logging operation for the calendar year 1947 was $88,587.87. By the provisions of section 3(*a*) (i) of P.C. 331, a taxpayer is entitled to deduct the whole of the provincial tax paid in respect of that net profit. The provincial tax being at the rate of 7 per cent, the appellant claims the right to deduct eleven-twelfths of 7 per cent of that sum, namely, $5,674.48.

The other operation of the appellant is a wholly integrated one, namely, the acquisition or purchase of timber, or the right to cut timber, the transportation of the logs to the mills and the manufacturing and processing thereof into newsprint paper. The profit on these operations is derived solely upon the sale of the finished products to the consumers. The appellant alleges that in that integrated operation it also carried on "logging operations" up to the point where the logs are taken into the mills; and that therefore a proper proportion of the tax paid to the Province of Quebec on its net income is attributable to its logging operations, and may therefore be deducted from its net income in computing the taxable income under the Excess Profits Tax Act. Later herein, I will refer to the manner in which the appellant computes the amount so claimed.

By consent, this case and that of Spruce Falls Power & Paper Co. Ltd. (No. 33517) were heard together, the general issues being precisely the same. In the *Spruce Falls* case, the appellant was an Ontario corporation and had paid taxes in the same year to the Province of Ontario under the Ontario Corporations Tax Act, 1939. Its business was wholly integrated, consisting in the manufacture and sale of sulphite pulp and newsprint from pulp wood, which pulp wood it acquired from its own properties or from timber limits leased from the province or by purchase from settlers. It did not, however, sell any logs as such. In that case, I held that the appellant came within the

provisions of para. (*w*) of section 5(1) of the Income War Tax Act, and was entitled under the provisions of P.C. 331 to deduct that proportion of the tax paid to the Province of Ontario on its net income, which on sound accounting principles could be deemed as arising from its logging operations—that is, up to the point where the logs were taken into the mill for processing; and that in the absence of any established market value for such logs "at the time of delivery to the mill," such proportion was properly ascertained on sound accounting principles to be the ratio existing between the cost of the logging operations and the total cost of the integrated operations.

For the reasons stated in the *Spruce Falls* case (which need not be repeated here but may be considered as part of my reasons for judgment in this case), I hold that the appellant is entitled to the benefit of the provisions of para. (*w*) of section 5(1) of the Income War Tax Act, and to the provisions of the regulations applicable thereto, namely, P.C. 331 as amended by P.C. 952, although the tax paid by it to the Province of Quebec was not levied under an Act specifically directed to income derived from logging and mining operations. In essence, the provincial tax so levied was the same as that levied under the Ontario Corporations Tax Act, 1939, in the *Spruce Falls* case.

It follows, therefore, that under the provisions of section 3(*a*) (i) of P.C. 331, the appellant in computing its net taxable income is entitled to deduct that portion of the provincial tax which is referable to its net profit from the purely logging operations (i.e., where it sold the logs as such), and that amount has been established at $5,674.48 (see Ex. 6—p. 2). As in the *Spruce Falls* case, I also find that the portion of the second (or integrated) operation of the appellant which preceded the taking of the logs into the mills constituted a "logging" operation within the meaning and intent of para. (*w*) and of P.C. 331, and that in respect of that portion of the operation, the appellant is entitled to the deduction provided in Part (ii) of section 3(*a*) of P.C. 331.

I turn now to the method adopted by the appellant in computing the deduction which it claims in respect of the logging portion of the integrated operation. The evidence is that in the absence of any available market

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value for logs at the time of delivery to the mills, it is in accordance with sound accounting principles to consider that the income reasonably deemed to have been acquired from such logging operations is that same proportion of the total income from the entire operation which the costs of the logging operation bears to the total cost of the entire operation. That principle is established by the evidence of Mr. R. F. Burns, a chartered accountant and a partner in the accounting firm of McDonald, Currie & Co. (who were accountants for the appellant) and also by the evidence of Mr. F. A. Coffey, a chartered accountant and partner in the firm of P. S. Ross and Sons. For the reasons given by them and for the reasons given by me in the *Spruce Falls* case, I find that principle of apportionment to be within the provisions of P.C. 331 and one which the appellant is entitled to use. In the computation made in this case, all selling and administrative expenses are excluded.

The computation so made is as shown on Ex. 6 and is as follows: The total cost of the logging operations are established at $2,273,392.57, and the total cost of the integrated operations (referred to as the cost of sales) is established at $4,995,310.56, the former therefore being 45·51 per cent of the total. The total taxable profits, excluding income from other departments, such as interest received, profit on electric light department and on telephone lines, and on the purely logging operations, etc., is shown to be $3,108,011.87, of which sum 45·51 per cent is $1,414,456.20. The provincial tax which was levied on the income of the appellant for the integrated operations was levied on an income of $3,108,011.87, and of that amount 45·51 per cent, or $1,414,456.20 may be said to be the income derived from the "logging" portion of the integrated operation.

By the computation shown in Ex. 6, it is shown that the total tax paid to the Province of Quebec for the period January 1, 1947, to November 30, 1947, in respect of the income from the integrated operation, was $198,540.42, and applying to that figure the same ratio as exists between $1,414,456.20 and $3,108,011.87 (or 45·51 per cent), it is shown that the total tax paid to the Province of Quebec on the logging portion of the integrated operation was $90,355.75. That amount added to the sum of $5,674.48

(the Quebec tax relating solely to the purely logging operation above mentioned) makes up the total claim of the appellant, namely, $96,030.23.

On the evidence, I find that the principles followed in that computation are in accordance with the provisions of P.C. 331 and that the net profit or gain so determined may be reasonably deemed to have been derived by the appellant from the operations mentioned in paragraphs A and B of section 3(*a*) (ii) of P.C. 331, and to have been computed in accordance with sound accounting principles with reference to the value of the logs at the time of such delivery to the mills, and excluding any amount added thereto by reason of processing or manufacturing the logs.

Section 3(*a*) (ii) is as follows:

> 3. In these regulations,
>
> (*a*) "Income derived from logging operations" by a person means
>
> (ii) where he does not sell but processes, manufactures or exports from Canada logs owned by him, the net profit or gain reasonably deemed to have been derived by him from
>
> (A) the acquisition of the timber or the right to cut the timber from which the logs were obtained, and the cutting and the transportation of the logs to the sawmill, pulp or paper plant or other place for processing or manufacturing, or to the carrier for export from Canada, as the case may be, or
>
> (B) the acquisition of the logs and the transportation of them to such point of delivery
>
> computed in accordance with sound accounting principles with reference to the value of the logs at the time of such delivery, excluding any amount added thereto by reason of processing or manufacturing the logs;

The evidence shows that in its computation of costs of the integrated operations, the appellant has included in its costs of the "logging" portion, the cost of "barking" the logs. It seems to me, however, that the provisions of the Order in Council which I have cited clearly exclude that as an item of costs of logging operations. The computation provided for in para. (ii) is to ascertain the net profit reasonably deemed to have been derived by the appellant from certain specific operations only, namely, the acquisition of the timber (or logs) or the right to cut timber, the cutting thereof, and the transportation of the logs to the mills or other point of delivery. It may well be as suggested by counsel for the appellant that logs when "barked" are still logs; but in view of the limitations

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mentioned, I think that item of cost should be excluded entirely from the computation, "barking" being considered as part of the manufacturing or processing.

The evidence does not supply the barking costs and I am unable, therefore, to correct the computation or to determine the proper percentage to be applied. I assume, however, that the records of the appellant are of such a nature that the exact costs of barking can be readily ascertained and the proper adjustment made.

The general conclusions arrived at in the *Spruce Falls* case are of equal application here. As in that case, therefore, I reject the application of the respondent to introduce evidence of the agreements entered into between Canada and seven of the provinces (not including Ontario and Quebec) under the Dominion-Provincial Tax Rental Agreements, Statutes of Canada, 1947, c. 58. A further objection was raised by the respondent that the "logging" costs of the integrated operations of the appellant are those of the logs actually consumed in the mills in 1947, whereas some of such logs may have been acquired, purchased and transported just prior to 1947. I considered that submission in the *Spruce Falls* case and for the reasons given in that case I must reject it. In the *Spruce Falls* case the respondent originally contended that the deduction claimed was barred by the provisions of section 6(1) (*o*) of the Income War Tax Act and the regulations thereunder (P.C. 5948). I do not know whether that question was originally raised in this case. In any event, counsel for the respondent, in argument, abandoned that defence entirely and it need not be referred to further.

The appeal will therefore be allowed and there will be a declaration that, (*a*) the appellant in computing its net income for the year 1947 under the Excess Profits Tax Act is entitled to deduct therefrom the sum of $5,674.48, that amount being referable solely to its income on its purely logging operations; (*b*) that the appellant is also entitled to deduct therefrom the same proportion of $198,540.42 which the costs of the "logging" portion of the integrated operation (namely, $2,273,392.57 minus the costs of barking to be ascertained) bears to the total cost of the integrated operation (or adjusted costs of sales), namely, $4,995,310.56.

The assessment will therefore be set aside and the matter referred back to the respondent: (1) to ascertain the costs of the barking of the logs above referred to, and (2) to compute the deduction to be allowed on the basis above set forth, and (3) to re-assess the appellant accordingly.

The appellant will be entitled to its costs after taxation.

Judgment accordingly.