BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

1962
Dec. 3-5
1964
June 19

AND

PREMIUM IRON ORES LIMITED ....RESPONDENT.

Revenue—Income Tax—Income Tax Act, S. of C. 1948, c. 52, s. 12(1)(a) —Sales Agency—Sales commissions—Written contracts to be given their plain ordinary meaning—Whether money paid to third party under contract a current business expense or a capital outlay—Whether legal costs incurred in resisting claim of foreign Government to tax a deductible expense—Dispute as to taxability as opposed to quantum of tax claimed.

In 1943 the respondent entered into a contract with Steep Rock Iron Mines Limited, by the terms of which it became the exclusive sales agent to sell all the ore mined by Steep Rock, for which it was to receive a commission of two per cent of the value thereof. The agreement also provided for the respondent to purchase shares of Steep Rock and to lend it money under certain conditions In 1944 the respondent entered into an agreement with Transcontinental Resources Limited, in which reference was made to the 1943 agreement with Steep Rock, and by the terms of which Transcontinental agreed that upon the respondent purchasing a certain number of Steep Rock shares at a specified price, Transcontinental would buy a certain number of them from the respondent at a specified price. By the

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terms of this agreement the respondent agreed to pay Transcontinental a sum equal to twenty per cent of all monies paid to the respondent by Steep Rock during each year of the agency under the agency contract.

The appellant assessed the payments made by the respondent to Transcontinental under the second agreement, which amounted to twenty per cent of the commissions received by the respondent from Steep Rock, as income of the respondent, whereas the respondent alleged that the execution of the two contracts and the circumstances leading thereto established the relationship of partnership or joint venture between the respondent and Transcontinental, or that the monies received by the respondent from Steep Rock were impressed with a trust to the extent of twenty per cent thereof in favour of Transcontinental or, finally, that the payments to Transcontinental by the respondent were an outlay or expense made by it for the purpose of gaining or producing income from its business.

By way of cross-appeal the respondent claimed expenses incurred in successfully resisting payment of United States income and capital gains tax as an allowable deduction in computing its taxable income.

Held: That the two contracts under review must be given their plain, ordinary meaning and there is nothing in the language thereof from which a partnership relationship, a joint venture or a trust can be inferred.

2. That the purchase by the respondent of Steep Rock shares was an investment of capital and the money paid to Transcontinental by the respondent in consideration of Transcontinental buying some of these shares from the respondent was equally a capital outlay and cannot be regarded as a current expense of the respondent's business.

3. That legal costs incurred in disputing a claim for income tax are not an allowable deduction in computing business profits and this is so whether the dispute relates to the amount of the taxable profit or to the taxability of the profit at all, and whether the dispute arises out of a domestic or foreign tax imposition.

4. That the appeal is allowed and cross appeal dismissed.

APPEAL from the Tax Appeal Board.

The appeal was heard by the Honourable Mr. Justice Cattanach at Toronto.

S. J. M. Grange and *S. Silver* for appellant.

Charles Gavsie, Q.C., Guy Favreau, Q.C. and *D. O. Mungovan, Q.C.* for respondent.

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

CATTANACH J. now (June 19, 1964) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Tax Appeal Board[1] allowing appeals by the respondent from its income tax assessments for 1951

[1] (1959) 21 Tax A.B.C. 178.

and 1952 under the *Income Tax Act*, 1948 S. of C., c. 52 and a cross appeal by the respondent.

The appeal relates to an item of $46,532.16 in respect of 1951 and $45,192.03 in respect of 1952, being portions of commissions payable to the respondent for acting as a sales agent which portions the respondent had bound itself by contract with a third person to pay to that person.

The cross appeal relates to legal expenses incurred by the respondent in successfully resisting payment of United States income and capital gains tax.

The commissions that are the subject matter of the main appeal were payable to the respondent under an agreement made on January 15, 1943 between the respondent and Steep Rock Iron Mines Limited (hereinafter referred to as "Steep Rock"). By this agreement Steep Rock appointed the respondent "sole and exclusive sales agent" to sell all iron ores produced and mined from its lands and the respondent accepted the appointment and agreed that it would not act as sales agent for any other person engaged in the production and sale of iron ores. In addition to detailed provisions regulating the sales agency, including a provision for a commission of two percent of the value of all ores sold by the respondent and Steep Rock during the life of the agreement "for services rendered", the agreement contained a provision for the purchase, by the respondent from Steep Rock, of 1,437,500 shares of the capital stock of Steep Rock for the sum of $14,375, and for a loan by the respondent to Steep Rock not exceeding $1,000,000, if required by Steep Rock for certain purposes.

The other relevant agreement is an agreement between the respondent and Transcontinental Resources Limited (hereinafter referred to as "Transcontinental") made on December 29, 1944. This agreement, by its recitals, referred to the agreement of January 15, 1943, by which Steep Rock appointed the respondent its exclusive sales agent, and recited that the respondent had agreed, pursuant to certain paragraphs of that agreement relating to the $1,000,000 loan, to purchase from Steep Rock 267,000 shares of the capital stock of Steep Rock for $600,750. This agreement contained two relevant provisions, (a) Transcontinental agreed that, upon the respondent purchasing 267,000 shares of Steep Rock, it would buy 100,000 of the said shares from

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the respondent for $225,000 plus tax, and (b) the respondent agreed that in each year of the agency contract it would pay Transcontinental "a sum equal to twenty percentum" of all monies paid to the respondent by Steep Rock during such year by way of commission under the agency contract. Subsequently, Transcontinental assigned its right to be paid an amount equal to twenty percent of the respondent's commissions to Donald M. Hogarth and he assigned that right to John Alexander McFadyn.

The sums in question in the main appeal were received by the respondent under the agreement of January 15, 1943 as commissions for services rendered as sales agent for Steep Rock. They were then paid by the respondent to Mr. McFadyn under the agreement of December 29, 1944.

Evidence was given as to the circumstances in which these agreements were entered into and it is clear that the undertaking by the respondent to purchase Steep Rock shares and to loan money to Steep Rock was part of the same bargain that resulted in the sales agency contract.

It was contended by counsel for the respondent that, as a consequence of the two above described contracts and the circumstances surrounding the entry into such contracts, the relationship of partnership or "joint venture" existed between the respondent and Transcontinental and that, accordingly, the monies to which Transcontinental was entitled were not income of the respondent. Alternatively, it was submitted that the monies received by the respondent from Steep Rock were impressed with a trust to the extent of twenty percent thereof in favour of Transcontinental and therefore did not represent revenue of the respondent. Finally it was submitted that the payments to Transcontinental by the respondent were an outlay or expense by the respondent for the purpose of gaining or producing income from its business within the meaning of section 12(1)(*a*) of the Act.

In my view no such result follows from the clear and unequivocal language employed in the contracts.

After having given these arguments of counsel the most careful consideration, I am unable to find anything in the language of the written contracts from which I can infer a partnership relationship, a joint venture or a trust. Further, after a very careful review of the oral evidence and other documents I am unable to find anything therein that has

the effect of changing the import of the two contracts referred to above, or of giving them anything other than their plain ordinary meaning.

The contract of January 15, 1943 clearly provides for the respondent acting as sales agent for Steep Rock and receiving a commission for its services. That commission must be included in computing the respondent's profits.

The contract of December 29, 1944 was an agreement by the respondent to pay to Transcontinental an amount equal to twenty percent of the commissions received by it under its contract of January 15, 1943 with Steep Rock. The apparent consideration for this contract was Transcontinental's agreement to buy Steep Rock shares from the respondent. Payments made for such a consideration cannot be regarded as a current expense of the respondent's business.

In so concluding, I do not overlook the submission that the respondent's business was assisting in the financing and development of Steep Rock. I have not, however, been able to convince myself that the matter can be so regarded. On the one hand, as I view it, the respondent provides services as a sales agent to Steep Rock. On the other hand, the respondent has made an investment in Steep Rock shares. The purchase of such shares is an investment of capital and monies paid to a third party for purchasing some of those shares is equally a capital outlay and cannot be regarded as a current expense of the respondent's business.

In my opinion the Minister was, therefore, right in assessing the respondent as he did and accordingly the appeal herein must be allowed with costs.

Turning to the subject of the cross appeal herein, the respondent was informed in 1950 by an officer of the Internal Revenue Service of the United States, some six years after it had begun to sell iron ore in substantial quantities, that the Internal Revenue Service was making the claim that the respondent was doing business in the United States, that it had a permanent establishment in that country and accordingly that the commissions received by the respondent from sales of Steep Rock ore to consumers in the United States, which comprised all of the sales made by the respondent, were taxable in the United States from the year 1943 forward.

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The amount of the tax claimed to be exigible in the United States was estimated as being slightly in excess of two million dollars.

The amounts in issue in the cross appeal are legal expenses incurred by the respondent, being $12,317.36 paid in 1951, and $8,514.16 in 1952, in connection with this claim by the United States Internal Revenue Service, which claim ultimately was successfully resisted.

It is well settled that the legal costs incurred in disputing a claim for income tax may not be allowed as a deduction in computing business profits. In *Smith's Potato Estates, Ltd. v. Bolland*[1] Lord Simonds said at page 374:

> . . . neither the cost of ascertaining taxable profit nor the cost of disputing it with the revenue authorities is money spent to enable the trader to earn profit in his trade. What profit he has earned, he has earned before ever the voice of the taxgatherer is heard. He would have earned no more and no less if there was no such thing as income tax. . . .

It was submitted by counsel for the respondent that the *Smith* case is not applicable because it dealt with the cost of ascertaining the amount of taxable profit and the cost of disputing it, whereas in the present case the dispute involved the jurisdiction of the United States Revenue authorities to impose taxation.

I cannot accept that argument because in my view the principle of the above case applies equally to a dispute as to taxability.

The decision in the *Smith* case relates to the deduction of the cost of disputing domestic tax impositions in the computation of profits. However, the present problem relates to a claim for income tax made by another country.

Foreign income tax was considered in *I.R.C. v. Dowdell O'Mahoney & Co.*[2], where a company resident in Eire carried on business at two branches in England. The whole of its profits, including those arising from its businesses in England, were subject to income tax in Eire and its profits from the businesses in England were subject to United Kingdom excess profits tax. The company sought to deduct a proportion of the Eire taxes in computing the profits of the businesses in England for assessment to excess profits tax in the United Kingdom. It was held by the House of Lords that the Irish taxes were not paid for the purpose of

[1] [1948] 2 All E R 367. [2] [1952] 1 All E.R. 531.

earning profits, but were an application of profit when made.

Lord Oaksey said at page 533:

> . . , I am of opinion that taxes such as those now in question, viz, income tax, corporation profits tax and excess profits tax, are not, according to the authorities, wholly and exclusively laid out for the purposes of the company's trade in the United Kingdom. Taxes such as these are not paid for the purpose of earning the profits of the trade; they are the application of those profits when made and not the less so that they are exacted by a Dominion or foreign government. No clear distinction in point of principle was suggested to your Lordships between such taxes imposed by the United Kingdom government and those imposed by Dominion or foreign governments. . .

If income taxes payable to a foreign jurisdiction are not deductible as an outlay or expense for the purpose of gaining income, the legal expenses incurred in disputing or attempting to reduce those foreign taxes are not deductible.

The cross appeal is therefore dismissed with costs.

Judgment accordingly.