74, 1948

In the Privy Council.

No. 51 of 1947.

ON APPEAL FROM THE SUPREME COURT OF CANADA

BETWEEN

D. R. FRASER AND COMPANY LIMITED ... APPELLANT

AND

THE MINISTER OF NATIONAL REVENUE ... RESPONDENT.

CASE FOR THE APPELLANT

RECORD

1.—This is an Appeal from a Judgment of the Supreme Court of Canada (Kerwin, Taschereau, Rand and Estey, JJ.) dated the 4th February, 1947, which dismissed the Appellant's Appeal from a Judgment of the Exchequer Court of Canada dated the 20th December, 1945. p. 151 a / p. 148

2.—The Appellant, who at all material times carried on a logging, sawing, planing and general lumber-milling business in the Province of Alberta, by its amended return under the Income War Tax Act (hereinafter called "the Act") claimed an allowance of $11,723.40 for exhaustion of its timber limits in the year 1941 under Section 5 of the Act, of which the material part is as follows :— pp. 265–268 / Foot of p. 267

> 5. "Income" as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions :—
>
> Depletion
>
> (a) The Minister in determining the income derived from mining and from oil and gas wells and timber limits may make such an allowance for the exhaustion of the mines, wells and timber limits as he may deem just and fair, and in the case of leases of mines, oil and gas wells and timber limits the lessor and lessee shall be entitled to deduct a part of the allowance for exhaustion as they agree, and in case the lessor and lessee do not agree the Minister shall have full power to apportion the deduction between them and his determination shall be conclusive.

RECORD

3.—In *Pioneer Laundry and Dry Cleaners Limited* v. *Minister of National Revenue* (1940 A.C. 127, it was decided that the taxpayer had a statutory right to an allowance for depreciation under the wording of the relevant section of the Act, which then read :—

> 5. " Income " as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions :—
>
> (a) Such reasonable amount as the Minister in his discretion may allow for depreciation, and the Minister in determining the income derived from mining and from oil and gas wells and timber limits shall make such allowance for the exhaustion of the mines, wells and timber limits as he may deem just and fair ; and in the case of leases of mines, oil and gas wells and timber limits the lessor and the lessee shall each be entitled to deduct a part of the allowance for exhaustion as they agree, and in case the lessor and the lessee do not agree the Minister shall have full power to apportion the deduction between them and his determination shall be conclusive.

4.—The Appellant submits that there is no substantial difference in meaning between the wording of Section 5 (a) of the Act which provides for an allowance for exhaustion, and the former wording which provided for an allowance for depreciation ; and that when the Parliament of Canada amended Section 5 (a) Parliament should be taken to have intended the words used to bear a meaning in accordance with the decision in the Pioneer Laundry Case. The Appellant therefore contends that it was the duty of the Minister to make an allowance for the exhaustion of the Appellant's timber limits and on proper principles to determine the amount of such allowance.

p. 62, ll. 14–21

5.—The timber limits in respect of which the Appellant claimed an allowance for exhaustion were all in Crown lands in Alberta, about 30 miles South and 70 miles West of Edmonton. The timber berths were numbered, respectively, 1161, 1727 and 6722. The Appellant's interest in berth 1161 had originated in 1904 in a licence from the Government of Canada to the Appellant and to others whose interests the Appellant subsequently acquired. The Appellant's interest in berth 1727 similarly originated in 1912. Berth 6722 was acquired in 1940 by licence from the Government of Alberta.

p. 54, ll. 5–10 ; p. 54, l. 22–p. 55, l. 34

p. 56, ll. 32–39

p. 58, ll. 26–29

p 63, ll. 22–32

6.—Each licence was granted for one year and was renewable from year to year. Each year the Government of Canada renewed the licences granted by it until, by agreement, Crown lands in Alberta ceased to be held in right of Canada and were held in right of the Province of Alberta.

RECORD

The Government of Alberta then granted licences in renewal of the licences granted by the Government of Canada. For each of the Appellant's three berths the licences have thus been renewed by the proper authority for each year since the respective original grants. The six licences relevant to the Appellant's fiscal year 1941 (which ended on the 31st October, 1941), were in evidence before the Exchequer Court. pp. 196–251 p. 54, ll. 11–16

7.—Each of the licences (references being given to that for berth 1161 for the period from the 1st April, 1940, to the 31st March, 1941), contained terms the more important of which may be summarised as follows :—

(a) The licence gave the Appellant the full right, power and licence on stated conditions and subject to relevant regulations to cut timber on the berth, other than certain small timber and trees needed for seed. p. 214, l. 37–p. 215, l. 15 Separate document p. 216, ll. 18–24

(b) Subject to the conditions, the licence also gave the Appellant the full right, power and licence to take and to keep exclusive possession of the berth except for immaterial exceptions. p. 215, ll. 18–20

(c) The licence vested in the Appellant, subject to conditions, all rights of property in timber lawfully cut by the Appellant on the berth during the period of the licence, and all rights of property, enforceable by appropriate legal proceedings against anyone but the Crown in right of the Province, in all timber cut on the berth during the licence period by any other person without the Appellant's consent. p. 215, ll. 22–41

(d) The licence entitled the Appellant (subject to certain payments and to compliance with the contract made when the licence was first granted) to a renewal from year to year so long as there should be commercial timber on the berth. p. 216, l. 42–p. 217 l. 11

(e) The Appellant was to pay municipal, school, improvement, irrigation and drainage rates charged upon the berth, as occupant, or upon the licensee or occupier in respect of the berth. p. 2

8.—On the 8th June, 1944, the Minister of Lands and Mines for the Province of Alberta, pursuant to Section 5 (a) of the Act agreed as lessor that the Appellant as lessee should be entitled to 99 per cent. and the Province of Alberta should be entitled to 1 per cent. of the allowance for exhaustion for the year 1941 in respect of the Appellant's three timber berths. p. 270

9.—By notice dated the 5th February, 1944, the Appellant was assessed to income tax on the basis of its amended return but no allowance was made to the Appellant for the exhaustion of the Appellant's timber limits. The Appellant, under the provisions of the Act, therefore appealed to the Minister of National Revenue. p. 269

p. 3

10.—The decision of the Minister, given by the Deputy Minister of National Revenue for Taxation, affirmed the assessment " on the ground " that the taxpayer is not entitled to an allowance under the provisions " of sub-section (a) of Section 5 of the Income War Tax Act for the " exhaustion of timber limits owned by the Crown in the right of the " Province of Alberta on which the taxpayer has been licensed to cut " timber."

p. 4, l. 24–p. 9, l. 14

p. 9, ll. 16–34

11.—Pursuant to the Act, the Appellant then gave notice of dissatisfaction, setting out the facts and reasons submitted in support of the Appeal. By his Reply the Minister, acting by the Deputy Minister, denied the Appellant's allegations in so far as they were incompatible with his decision, and affirmed the assessment.

p. 10

pp. 11–18, p. 19, l. 1–p. 22, l. 32

p. 22, ll. 13–32

12.—Under Section 63 of the Act the proceedings were thereafter deemed an action in the Exchequer Court of Canada. An order was made for pleadings which were delivered. Amendments were made at trial. The substantial issue raised by the pleadings was whether or not the Appellant's title to the timber was such as to disentitle the Appellant to the exhaustion allowance. At the hearing, however, the Court permitted paragraph 17 to be added to the Defence alleging that the Appellant had recovered by way of allowance for exhaustion all costs of its timber licences and permits, and that therefore the Minister had exercised his discretion.

pp. 133–148

13.—In the Exchequer Court, Judge Cameron, in dismissing the action, held :—

p. 134, l. 32–p. 143, l. 27

(a) that the Appellant derives its income from timber limits, and while not an owner it is a lessee and if otherwise so entitled would be entitled to an exhaustion allowance by reason of its agreement with the Province of Alberta as the owner of the timber ; but

p. 143, l. 28–p. 146, l. 5

(b) that notwithstanding the reasoning of the *Pioneer Laundry* Case, the Minister's discretion under Section 5 (a) of the Act extended not only to the determination of what was a fair and just allowance but also as to whether or not in all the circumstances any allowance should be made ;

p. 146, ll. 6–8

(c) that the Minister in exercising his discretion did not act in an arbitrary way ;

p. 147, ll. 1–5

(d) that the Minister in exercising his discretion did not act on any wrong principals.

p. 146, ll. 8–46

In particular, the learned Judge found that the Appellant was not the owner of the timber being exhausted and had no depletable interest therein ; that it had already benefited by deductions from its income of all costs which could be called capital costs, and that the fact that the licensor, the Province of Alberta (which, pursuant to Section 5 (a) of the Act had

indicated its consent to 99 per cent. of the allowance being made to the Appellant), was not liable to the Dominion for income tax, was a matter which the Minister was entitled to consider in reaching a conclusion as to whether any allowance should be made.

14.—The Appellant appealed to the Supreme Court of Canada which dismissed the Appeal. Reasons for Judgment were given by Kerwin J. on behalf of himself and Taschereau J., by Rand J. and by Estey J. p. 151a pp 151b–151m

15.—Kerwin J., in giving judgment on his own behalf and on behalf of Taschereau J., dismissed the Appeal on the simple ground of the change by Parliament of the word " shall " in Section 5 (a) of the Act, to the word " may." He does not discuss (nor do either of the other Judges who gave reasons) the essential similarity of the amended wording to the wording of the section which was interpreted by the Judicial Committee in the *Pioneer Laundry* Case. In Kerwin J.'s opinion the Minister is not required to make an allowance for all classes of industry described in the section. Kerwin J. does not find it necessary to decide the nature of the Appellant's title to its timber. p. 151b–151c p. 151c, ll. 16–28 p. 151c, ll. 29–31

16.—The reasons of Rand J. for dismissing the Appeal may be summarised as follows :— p. 151c–p. 151g

(a) that the Appellant's income is clearly derived from " timber limits " ; p. 151 c, l. 37–p. 151d, l. 19

(b) that in applying the section the Minister is free to choose not only whether a group described in the section is entitled to an allowance for exhaustion, but also to choose within such a group what members thereof are so entitled, in this way ensuring a " flexible applicability " ; p. 151d, ll. 20–40

(c) that in dealing with depreciation, depletion and obsolescence, the attention is directed to physical assets which Rand J. thinks must be regarded in terms of their capital value which in his view is normally their costs, and that for depletion (i.e., exhaustion)—" we must look to the property " in the aspect of that value (i.e., cost), unless by the terms " of the statute or by the direction of the Minister some " other basis is prescribed or allowed " ; p. 151e, ll. 1–30

(d) that the Appellant has recovered by way of deductions from its income all of its costs, whether of a capital or operating nature, and that it is not clear whether these have been recovered as expenses of operation or as exhaustion allowance ; p. 151e, l. 31–p. 151f, l. 8

(e) that in this case a depletion allowance is designed only " to " enable the Minister broadly in time, factors and basis to " afford assurance of the recovery of investment committed " to the risk undertaken " ; p. 151f, l. 9–p. 151g, l. 19

p. 151g, ll. 19-36

(f) that even if an absolute right to an allowance for exhaustion be conceded, it is necessarily bound by the limitation of value (cost) spread evenly over the asset as a whole.

pp 151h-151m

17.—The reasons given by Estey J. for dismissing the Appeal are in effect :—

p. 151j, l. 10-p. 151k, l. 23

(a) that notwithstanding the *Pioneer Laundry* Case, the use of the word " may " rather than the word " shall " results in the Appellant having no statutory right to an allowance, and the effect of the amendment is that the Minister may, not that he must, make such an allowance ;

p. 151k, l. 24-p. 151l, l. 34

(b) that in exercising his discretion with respect to an allowance for exhaustion the Minister may take into consideration all allowances already made in relation thereto, i.e., he may consider the fact, if it is a fact, that all costs have been recovered, even if recovered as expense of operation under Section 6 of the Act ;

p. 151l, l. 35-p. 151m l. 20

(c) that the allowance of exhaustion is a matter entirely in the discretion of the Minister, and that he having arrived at his conclusions, Estey J. was not prepared to say that he violated any sound or fundamental principles or that his decisions were arbitrary or discriminatory.

18.—The Appellant respectfully submits—

(a) with respect to the Judgment of Kerwin J. and Taschereau J.—

(i) that the wording of Section 5 (a), the section requiring interpretation in this Appeal, is in substance identical with the wording of the section which was interpreted by the Judicial Committee in the *Pioneer Laundry* Case, and that on the authority of the decision in that case the taxpayer has a statutory right to an allowance for exhaustion ;

(ii) that the holding that the Minister is not bound to make an allowance for all classes is erroneous.

(b) with respect to the Judgment of Rand J.—

(i) that he was right in holding that the Appellant's income is derived from timber limits ;

(ii) that he erred in holding that the Minister is free to choose for allowance or not among not only the named groups but also among the members thereof ;

(iii) that he erred in holding that the basis on which exhaustion is to be allowed is the cost of the asset subject to exhaustion, and in failing to hold that both the wording of the section and the practice of the Department over many

years in administering it, indicate that the allowance for exhaustion is entirely unrelated to cost.

(c) with respect to the Judgment of Estey J.—

(i) that he erred in failing to apply the reasoning of the *Pioneer Laundry* Case to this Appeal;

(ii) that he erred in holding that the Minister may consider as a ground for refusing to make an allowance the fact that costs have been recovered as expense;

(iii) that he erred in holding that there was no violation of principle by the Minister.

19.—The Appellant submits that the correct view is :—

(a) that by the amendment of Section 5 (a) of the Act, Parliament did not make the *Pioneer Laundry* Case inapplicable, but adopted the principle of that Case;

(b) that the allowances previously made to the Appellant were clearly on the evidence made as expenses " wholly, exclusively " and necessarily laid out or expended for the purpose of " earning the income " and that such allowances are not properly to be considered in dealing with an exhaustion allowance;

(c) that in holding that the Minister may refuse an exhaustion allowance because costs have been recovered as expense, the learned Judges misconceived the intent and purpose of the section, which is either—

(i) to ensure that the taxpayer be allowed to recover tax free a just and reasonable allowance unrelated to cost for the exhaustion of the timber limits or other wasting asset being worked; or

(ii) compensation to the operator of the industry for the extraordinary hazard undertaken therein. The evidence established the fact of exhaustion of the Appellant's timber limits and the very great hazard from fire and other perils.

(d) that since the interests of the owners of timber limits and of the owners of coal mines and of pulp limits are all profits a prendre giving the right to win timber or coal, as the case may be, and since exhaustion allowances unrelated to costs have over many years been granted to all such owners except those of timber, the Minister has by the administrative practice of his department placed an interpretation on the section which the Appellant is entitled to have applied in the assessment of the Appellant to tax;

(e) that the Minister has no discretion to apply the principal of recovery of costs only to operators of timber limits while applying the quite different principle of payment over and

above expenses of ten cents per ton of coal extracted to coal mines ; or of cost plus 30 cents a cord to pulp companies ; or of a percentage of net income to gold and other mining companies and to the operators of oil wells ;

(f) (i) that the sole specific reason given by the Minister for his decision was—" that the taxpayer is not entitled to " an allowance under the provisions of sub-section (a) of " section 5 of the Income War Tax Act for the exhaustion " of timber limits owned by the Crown in the right of the " Province of Alberta on which the taxpayer has been " licensed to cut timber " ;

(ii) that such reason will not, on the facts which were before the Minister and the Court, support the decision.

20.—The Appellant accordingly submits that the Appellant should be held entitled to the allowance claimed or the case should be referred back to the Minister to determine the amount of the allowance, and that the Judgments of the Exchequer Court and Supreme Court are wrong and should be reversed for the following amongst other

REASONS.

1. Because the Exchequer Court and the Supreme Court of Canada misconstrued Section 5 (a) of the Income War Tax Act.
2. Because the Appellant derived its income from timber limits and Section 5 (a) requires the Minister to make such allowance for the exhaustion of those timber limits as he may deem just and fair.
3. Because the allowance claimed by the Appellant in its return is a just and fair allowance.
4. Because the Appellant's right to an allowance for depletion is independent of the cost to the Appellant of its timber limits or of any allowances made to the Appellant in respect of such cost.
5. Because the only specific ground for refusing an allowance set out in the Decision of the Minister does not justify the refusal.
6. Because the Minister has discriminated between taxpayers deriving income from oil and gas wells and timber limits used for pulpwood and taxpayers deriving income from other timber limits ; and the Minister is not entitled so to discriminate.

S. BRUCE SMITH.

FRANK GAHAN.

In the Privy Council.

No. 51 of 1947.

ON APPEAL FROM THE SUPREME COURT OF CANADA.

BETWEEN

D. R. FRASER AND COMPANY LIMITED ... ... APPELLANT

AND

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

CASE FOR THE APPELLANT

BLAKE & REDDEN,
17 Victoria Street,
S.W.1.

(A45866) VACHER & SONS, LTD., Westminster House, S.W.1.