74, 1948

No. 51 of 1947.

In the Privy Council.

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 Respondent.

RECORD.

1. This is an appeal by special leave from a unanimous Judgment of the Supreme Court of Canada, dated the 4th day of February, 1947, dismissing the Appellant's appeal from a Judgment of the Exchequer Court of Canada, dated the 20th day of December, 1945, which had dismissed an appeal from a decision of the Respondent affirming the assessment for income tax made upon the Appellant under the Dominion Income War Tax Act (Chapter 97 of the Revised Statutes of Canada 1927 as amended by section 10 of Chapter 34 of 1940) for the taxation year ended the 31st day of October, 1941. p. 151n. p. 151a. p. 148. p. 3. p. 269.

2. During the taxation year 1941, the Appellant operated a logging, sawing, planing and general lumber milling business in the Province of Alberta. The Appellant was the holder of three timber licences granted by the Province of Alberta, and under these licences during the year in question cut some 8,374,000 feet of timber. In making its income tax return the Appellant claimed to be entitled to deduct the sum of $11,732.40, or $1.40 for every 1,000 feet of timber cut, as an exhaustion allowance under section 5 (1) (*a*) of the Dominion Income War Tax Act (Chapter 97 of the Revised Statutes of Canada, 1927, as amended by section 10 of Chapter 34 of 1940). The assessment upon the Appellant made no allowance in respect of exhaustion. The Appellant appealed to the Respondent against the assessment. The Respondent dismissed the appeal on the ground that the Appellant was not entitled to receive an allowance. The question for determination in this appeal is whether the Appellant is entitled to receive the allowance claimed. p. 2. p. 269. pp. 2–4.

3. Sections 5 and 6 of the Income War Tax Act, as amended, provide as follows :—

> "5. (1) 'Income' as hereinbefore defined shall for the purpose of this Act be subject to the following exemptions and deductions :—
>
> (*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 each 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;

* * * * *

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

(*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income;

(*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescense, except as otherwise provided in this Act;

* * * * *

(*n*) depreciation, except such amount as the Minister in his discretion may allow, including such extra depreciation as the Minister in his discretion may allow in the case of plant and equipment built or acquired to fulfil orders for war purposes."

pp. 15–16. 4. In its Statement of Claim the Appellant contended that the Respondent's decision affirming the assessment and ruling that the Appellant was not entitled to an allowance under section 5 (1) (*a*) was against sound and fundamental principles, that the Respondent had failed to exercise his discretion under section 5 (1) (*a*), that the reasons given by him for his decision were not proper grounds, and that the amount of the allowance claimed for exhaustion, namely, $1.40 per thousand feet, was fair, just and reasonable.

pp. 17–22. 5. In his Statement of Defence, the Respondent contended that in the years prior to the taxation year, 1941, the Respondent had allowed to the Appellant amounts for exhaustion which had enabled the Appellant to recover free of income tax its entire cost of any timber licences or permits held by it, and that the Respondent had properly exercised the discretionary power vested in him by section 5 (1) (*a*). He also pleaded that the Appellant had no proprietary or other depletable interest in the timber limits, that Appellant was not a lessee of timber limits but merely a purchaser of timber, and that the cost of the timber had been allowed to the Appellant as a deduction in determining the profits subject to tax.

6. At the trial of the action in the Exchequer Court of Canada the following facts were proved or admitted:—

pp. 167–174. (A) The three timber licences held by the Appellant were granted in respect of Berths Numbers 1161, 1727, and 6722.

pp. 214–232. (B) The licence in respect of Berth Number 1161 had originally been granted by the Dominion Government to the Appellant jointly with other persons whose interests had later been acquired

p. 51, l. 39. by the Appellant. Under the Regulations in force when the

licence was granted a licensee was required to pay a lump sum or bonus in respect of the grant of the licence in addition to the rent and other dues payable under the licence. The licence had been renewed by the Dominion Government from year to year until an agreement was made transferring certain natural resources from the Dominion Government to the Government of Alberta. Thereafter the licence was renewed by the Government of Alberta. It was expressed to be for a period of one year, renewable at the option of the licensee if there remained on the berth timber of the kind and dimensions described in the licence in sufficient quantity to make it commercially valuable and if the conditions of the licence and the provisions of The Provincial Lands Act, 1939, and of the Regulations had been fulfilled. The licence authorised the licensee to take and keep exclusive possession of the lands comprised in the licence except as otherwise provided by the licence. It permitted the licensee to cut timber of a certain dimension and vested in the licensee the property in any timber which he was entitled to cut and which had been cut within the limits of the berth. A sum of $50 was payable under the licence in respect of ground rent, licence fee, fire-guarding charges and Timber Areas Tax. Dues were payable according to the amount of timber cut. p. 61, ll. 10–20.

(C) The facts relating to the licence in respect of Berth Number 1727 were substantially the same as those described in (B) above. The licence in respect of Berth Number 6722 was granted to the Appellant in 1940. The grant was made by the Government of Alberta under The Provincial Lands Act, 1939. It was not renewable after 1950. No bonus had been payable upon the original grant. Instead a deposit had been paid as security for the payment of dues. This deposit was repayable to the licensee except in so far as it had been used for the payment of dues. In other respects the facts relating to this licence were substantially the same as those described in (B) above. pp. 159–166. pp. 232–251.

(D) In each year up to 1939 the Appellant in computing its income for tax purposes had charged as an expense part of the capital cost of acquiring Berths Numbers 1161 and 1727, until by 1939 the whole of this cost had been written off. This fact was taken into account by the Respondent in refusing to grant the Appellant an exhaustion allowance. pp. 77–78. p. 129, l. 20.

(E) On the 8th June, 1944, the Minister of Lands and Mines, Alberta, agreed with the Appellant that the Appellant should receive 99 per cent. of any allowance for exhaustion in respect of Berths Numbers 1161, 1727, and 6722. It should be observed that the Province of Alberta is not liable to pay Dominion Income Tax in respect of any income which it derives from these berths. p. 270.

(F) In respect of Saw-Logs scaled during the Calendar Year, 1943, in the area generally described as West of the Cascades Range of Mountains or in the Coastal Logging Area, the Respondent had granted special allowances to other taxpayers. In earlier years he had also approved the making of such allowances in the case of companies mining coal and precious and base metals and in the case of companies producing oil. He had also granted allowances for depletion to the Pulp and Paper Industry commencing with the fiscal periods ended in 1941. pp. 252–3.

7. On the 20th December, 1945, His Honour Judge Cameron gave judgment rejecting the Appellant's claim. He considered the purpose of section 5 (1) (*a*) of the Income War Tax Act :—

pp. 136–7.

" I think I can assume that this section is made part of the Income Tax Act in order to ensure that the tax is levied on income and not on capital and that, therefore, special consideration is given to the industries where the capital asset is extracted and disposed of and where in the ordinary course of things the proceeds of such disposal would be income. The apparent intention is to provide for a deduction from gross income of an amount which in part at least will take the place of the capital asset so extracted and disposed of. The first part of the section, in my opinion, is intended to give such relief to the owner of the capital asset being exhausted. But with the knowledge that some extractive industries are frequently worked under a lease special provision is made later in the section for the division of such allowance as the Minister may make, between the lessor and the lessee as they agree ; and failing agreement, to be apportioned between them as the Minister may determine.

" It would seem that except for the special provision relating to the case of lessor and lessee, the allowance should be made to the owner of the industry, for it is his capital asset that is being exhausted.

" But the section does include a provision for the case where timber limits are operated under a lease and that in such cases each is entitled to that portion of the allowance agreed upon. I think that what is here contemplated is that when the Minister has determined, after consideration of all the facts, that an allowance for exhaustion should be made, that the lessor and the lessee may then deduct such allowance in the proportions they have agreed upon.

" The Appellant here is clearly not the owner of the capital asset being exhausted, i.e., the standing timber ; the owner is the Province of Alberta and the terms of the annual licences clearly provide for the vesting of the right of property in the Appellant only when the trees have been cut. The ownership of all uncut trees is clearly still in the Province and remains so until such trees have been cut in any subsequent year under the terms of new licence."

p. 143, ll. 22–27.

He was of opinion that the licences were both contracts for the sale of goods and leases.

pp. 143–4.

He rejected the Appellant's contention that it had a statutory right to an allowance for exhaustion. In this connection he drew attention to the alterations made in section 5 (1) (*a*) by the amending Act of 1940. Before its amendment the section provided as follows :—

" 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 an allowance for the exhaustion of the mines, wells and timber limits as he may deem just and fair . . ."

After its amendment the section provided as follows :—

"5. 'Income' as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions :—

"(*a*) The Minister in determining 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 . . ."

He held that the amended section permitted, but did not oblige, the Minister to grant the allowance. p. 145, ll. 37–40.

He held further that the Minister's discretion in the present case had not been exercised in an arbitrary manner :—

"As I have found, the Appellant is not the owner of the timber being exhausted, and has no depletable interest therein. In addition, it has already benefited by deductions from its income over a period of years of all costs which could possibly be called capital costs (as well as all costs of operation) and, therefore, by such deductions, has been allowed to keep its capital investment intact. And while, apparently, the Appellant had never previously claimed these deductions as depletion under section 5 (1) (*a*) but rather by way of depreciation or as disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning the income, they were in fact allowed. The result was that the Appellant was eventually able to write off its full capital investment." p. 146, l. 6.

He drew attention to the agreement between the Province of Alberta and the Appellant for the division of any allowance which might be made, 99 per cent. to the Appellant and 1 per cent. to the Province. He concluded this part of his judgment in these words :—

"Inasmuch therefore as the Minister appears to have reached a conclusion which in my interpretation of his powers he was quite entitled to reach and the decision on which is left to him, it is not a matter where the Court should interfere. Nor can I find that in exercising his discretion the Minister has proceeded on any wrong principles. All the facts necessary to determine the matter were in his possession and it has not been shown that in reaching his conclusion he did not follow the principles laid down for the exercise of discretion in the Pioneer Laundry and other cases."

8. The Appellant appealed to the Supreme Court of Canada. On the 1st May, 1947, the Judges of the Supreme Court gave judgment, rejecting the appeal.

(A) The judgment of Kerwin and Taschereau JJ. was delivered by Kerwin J. They were of opinion that section 5 (1) (*a*) as amended gave the Minister a discretion not merely as to the amount but as to whether any allowance for exhaustion should be made. The Minister had determined that no allowance should be made and the Court was not free, even if it so desired, to make one. p. 151b.

(B) Rand J. held that the purpose of section 5 (1) (*a*) was to enable the Minister to afford assurance of the recovery of investment committed to the risk undertaken, and that where there had been a return of p. 151c.

investment, the warrant for an allowance was removed. Even if the section gave an absolute right to an allowance the Minister was free to choose the basis of the allowance, and actual capital investment was clearly a permissible basis.

p. 151h. (C) Estey J. was of opinion that the Respondent had a discretion whether to grant or refuse an allowance, and that in exercising this discretion the Respondent was entitled to take into account the fact that the taxpayer had received so much by way either of depreciation or exhaustion allowances that no further exhaustion allowance should be made. He was not prepared to say that the Respondent in exercising his discretion had violated any fundamental principles.

9. It should be added that His Honour Judge Cameron and all the justices of the Supreme Court rejected the Appellant's argument based on the allowances made by the Respondent to other taxpayers as described in paragraph 6 (F) of this Case. The circumstances of these other taxpayers were different from those of the Appellant and afforded no basis for an argument that the Respondent had exercised his discretion in an arbitrary or discriminatory manner.

10. The Respondent respectfully submits that the judgment of the Supreme Court of Canada was right and should be affirmed for the following among other

REASONS.

(1) BECAUSE under section 5 (1) (*a*) of the Income War Tax Act the Respondent had a discretion whether to grant or to refuse the Appellant an allowance for exhaustion.

(2) BECAUSE the Appellant has not established that the Respondent failed properly to exercise his discretion.

(3) FOR the reasons given in the judgment of the Exchequer Court.

(4) FOR the reasons given in the judgments of the Supreme Court of Canada.

R. P. MORISON.

B. MACKENNA.

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