STOCK EXCHANGE BUILDING CORPORATION LIMITED ..... APPELLANT

1954 *Nov. 1, 2, 3

AND

1955 *Jan. 25

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Revenue—Income Tax—Deductions—Borrowed capital used in the business to earn income—Borrower-lender relationship essential—Interest allowed only on amount actually so used—Depreciation allowance in Minister's discretion—The Income War Tax Act, R.S.C., 1927, c. 97, ss. 5 (1) (b), 6 (1) (n).

By s. 5 (1) (*b*) of the *Income War Tax Act,* R.S.C. 1927, c. 97, "Income" as hereinbefore defined shall for the purpose of this Act be subject to the following deductions: (*b*) Such reasonable rate of interest on borrowed capital used in the business to earn income as the Minister in his discretion may allow . . . .

The appellant in 1929 financed the erection of an office building by an issue of debentures secured by a deed of mortgage and trust bearing interest after as well as before maturity and after as well as before default. The debentures after discount and brokerage charges netted $90 per $100 bond. The appellant defaulted on the interest payments but, in its annual income tax returns, deducted the interest payable, including interest on interest, as a charge against operating revenue. In assessing the appellant in 1946, '47 and '48 the Minister disallowed the deductions of interest on unpaid interest and also interest on $10 of each $100 debenture issued and disallowed part of the depreciation claimed on the building.

Held: 1. that the interest in default upon which, by the terms of the mortgage, the borrower was obligated to pay interest was not "borrowed capital used in the business to earn income" within the meaning of s. 5 (1) (*b*) of the *Income War Tax Act.* The relation of borrower and lender necessary to justify the allowance was absent.

2. that the borrowed capital referred to in s. 5 (1) (*b*) is the amount of money borrowed, not the extent of the obligation incurred in order to borrow it. The appellant was able to borrow 90% of the face amount of the debentures and it was that amount alone which was used in the business and upon which interest was allowable as a proper deduction from income. *Montreal Light Heat & Power Consolidated* v. *Minister of National Revenue* [1942] S.C.R. 89, followed.

3. that the amount of depreciation to be allowed in computing the amount of profits to be assessed was such amount as the Minister in his discretion may allow and there was no evidence adduced to establish that the Minister failed to exercise the discretion vested in him in good faith and upon proper principles.

Decision of the Exchequer Court of Canada [1954] Ex. C.R. 230, affirmed.

*PRESENT: Rand, Estey, Locke, Cartwright and Abbott JJ.

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APPEAL from the judgment of the Exchequer Court of Canada, Thorson P. (1) dismissing the appellant's appeal and allowing the respondent's cross-appeal from the judgment of the Income Tax Appeal Board. (2)

J. A. Clark, Q.C. for the appellant.

A. H. J. Swencisky and *T. Z. Boles* for the respondent.

The judgment of Rand, Locke and Abbott JJ. was delivered by:

LOCKE J.:—This is an appeal from a judgment of the President of the Exchequer Court, by which the appeal of the present appellant from a judgment of the Income Tax Appeal Board was dismissed and the cross-appeal of the Minister from that decision allowed.

The appellant is the owner of the Stock Exchange Building, situate at the corner of Howe and Pender Streets in Vancouver. The building was constructed in the year 1929 at a cost of approximately $875,000., its construction being financed in part by moneys realized from the sale of debentures issued by the appellant and secured by a deed of mortgage and trust in favour of The Toronto General Trust Corporation. These bore interest at the rate 6% per annum, payable semi-annually, and interest on overdue interest was payable at the same rate.

The debentures were either underwritten or sold by a firm of investment bankers. The price to the public was $99. for each $100. debenture but the amount received by the appellant from the underwriters in respect of each was only $90. As an investment the venture proved to be unsuccessful and, for a long period of years, the appellant was unable to pay the interest charges in full. As of December 31, 1945. debentures in the principal amount of $534,400. were outstanding and interest was in arrear in an amount approximating $421,000.

The appeals concern assessments made in respect of the taxation years 1946, 1947 and 1948. In 1946 the appellant claimed in its return, as an expense of operation, debenture interest in the sum of $56,459.87, this including interest upon interest in default in the amount of $24,395.87. For

(1) [1954] Ex. C.R. 230; [1954] C.T.C. 62; 54 D.T.C. 1033.

(2) 7 Tax A.B.C. 199; 52 D.T.C. 379.

the year 1947 it claimed a deduction for interest in the amount of $59,898.31, which included $27,834.31 compound interest. For the year 1948 the amount claimed as a deduction was $62,477.30 for debenture interest, which included $28,382.58 compound interest. The amounts claimed as deductions for compound interest were in each case disallowed.

During each of these years the appellant also claimed, as a deduction from income, interest on the face amount of the debentures and this deduction was allowed only on the principal amount of $90. for each $100. debenture, being the amount received by the company as the proceeds of their sale.

The Minister disallowed the claim for a deduction in respect of the compound interest which became payable in each of the years in question, on the ground that it was not interest on borrowed money used in the business to earn the income, within the meaning of paragraph (*b*) of subsection (1) of section 5 of the *Income War Tax Act*. The appeal against this portion of the assessment was dismissed by the Income Tax Appeal Board and by the judgment of the Exchequer Court. The Appeal Board, however, allowed the appeal as to the principal amount upon which the appellant was entitled to reckon interest as a deduction, finding that the company was entitled to compute simple interest on $99. for each $100. debenture issure, being the amount at which they were sold to the public. The learned President has allowed the cross-appeal of the Minister in respect to this portion of the assessment.

Dealing first with the claim for the allowance of the compound interest as a deduction, the right to this must be based upon section 5(1)(*b*), referred to by the Minister, which reads:

> 5. (1) "Income" as hereinbefore defined shall for the purpose of this Act be subject to the following exemptions and deductions:—
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> * * *
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> (*b*) Such reasonable rate of interest on borrowed capital used in the business to earn the income as the Minister in his discretion may allow notwithstanding the rate of interest payable by the taxpayer, but to the extent that the interest payable by the taxpayer is in excess of the amount allowed by the Minister hereunder, it shall not be allowed as a deduction and the rate of interest allowed shall not in any case exceed the rate stipulated

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for in the bond, debenture, mortgage, note, agreement or other similar document, whether with or without security, by virtue of which the interest is payable.

In my opinion, the appellant was entitled to claim as of right such rate of interest on borrowed capital used in the business as the Minister in his discretion might allow. That discretion was exercised by allowing the rate fixed in the mortgage to the extent that it was payable upon the principal amount which the company received as the proceeds of the sale of its debentures. The question to be determined is whether the interest in default upon which, by the terms of the mortgage, the borrower was obligated to pay interest is "borrowed capital used in the business to earn the income", within the meaning of the language of the subsection. In my opinion it was not. The section appears to me to contemplate the allowance of the interest on capital borrowed for the purpose of enabling the enterprise of the taxpayer to be carried on and, in respect of such moneys, to justify the allowance the relation of borrower and lender must be created at the outset between the taxpayer and the person to whom the interest is payable. In the present matter, there was no such borrowing of the interest in default: it was merely a debt which became payable by reason of the inability of the borrower to pay the interest as it fell due. It was not, in any sense, capital used in the business to earn the income, within the meaning of the subsection.

The second question to be determined is whether the appellant was entitled to deduct simple interest upon the face amount of the outstanding debentures or upon 90% of that amount, being the sum actually received by it and used in its business.

It is not clear from the evidence whether the debentures were bought outright by the underwriters at 90% of their face value, or whether the underwriters agreed to purchase and did purchase such of the debentures as were not purchased by the public at that rate. At the trial, the Crown were without information on the point and counsel for the appellant contented himself with saying that he agreed with a statement appearing in the reasons for judgment of the Income Tax Appeal Board, to the effect that the underwriters were paid $9. out of every $99. received from the

public to cover its charges of underwriting the issue. While this would not be underwriting in the generally accepted meaning of that term, I think, for the decision of the point in issue, that it makes no difference whether it was the one or the other.

It was shown by the evidence of the appellant's accountant that in the year 1929 the appellant, by its return, sought to write off $18,333.34 as part of what was called "bond discount" and further portions of the total discount of $55,000. in the years 1931 to 1934 and that all of these claims were disallowed by the Department.

The ruling of the Department at that time appears to me to be in accordance with what was later decided in this Court in the case of *Montreal Light, Heat and Power Consolidated* v. *Minister of National Revenue* (1). Expenses of the same general nature were there disallowed as proper deductions from income. Sir Lyman Duff, C.J. and Kerwin, J. (as he then was) considering them to have been payments on account of capital within the meaning of that expression in section 6(1) (*b*) of the Act, and this view was not dissented from in the judgment of the Judicial Committee (2). These are expenditures of a capital nature which, in a properly prepared balance sheet, may be amortized out of income only after taxation and cannot be deducted in computing income.

It is my opinion that the borrowed capital referred to in section 5(1) (*b*) is the amount of money borrowed and not the extent of the obligation incurred in order to borrow it. In this case, on the security of these debentures, the appellant was able to borrow 90% of their face amount and it was that amount alone which was used in the business and upon which interest may be allowed as a proper deduction from income.

The facts upon which the appellant bases its claim in respect of allowances for depreciation of the building and the equipment are set forth in detail in the judgment appealed from. I respectfully agree with the conclusion of the learned President that the question of the propriety of the allowances made by the Department for depreciation

(1) [1942] S.C.R. 89. (2) [1944] A.C. 127 at 134.

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between the years 1929 and 1945 cannot be considered in the present appeal, which is concerned only with the allowances for the years 1946, 1947 and 1948.

Claims for depreciation of buildings or equipment as a deduction from income must be based upon the provisions of section 6(1) (*n*) of the *Income War Tax Act* which, so far as relevant, reads:

> 6. (1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
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> * * *
>
> (*n*) depreciation, except such amount as the Minister in his discretion may allow.

I find no evidence in this record to support a contention that, in respect to the three years in question, the Minister failed to exercise the discretion vested in him in good faith and upon proper principles.

The appeal should be dismissed with costs.

ESTEY J.:—The appellant submits that in the computation of its income tax for the years 1946, 1947 and 1948 it is entitled to a deduction for payments made on account of (*a*) compound interest; (*b*) interest on the face value of the bonds in the sum of $100., though only $90. was received by it; (*c*) a larger amount by way of depreciation.

Incorporated under the laws of British Columbia in 1928 with a capital of $500,000., divided into 2,500 preference shares and 2,500 common shares of $100. each, the appellant acquired, in Vancouver, certain lots and erected thereon an office building. The construction of the latter was financed in part by the sale of $550,000. First Closed Mortgage 6% Fifteen Year Sinking Fund Gold Bonds issued under the terms of an Indenture of Mortgage and Trust dated the first day of February, 1929. This Indenture contained the following:

> The Bonds shall bear interest at the rate of 6% per annum (after as well as before maturity and after as well as before default and interest on overdue interest at the said rate) payable semi-annually on the 1st days of February and August in each year during the currency of the bonds upon surrender of the coupons attached thereto.

Appellant commenced to operate the building on July 1, 1929, and by December 1, 1932, the payment of interest was in arrears and has remained so at all times material hereto.

The consequent items of compound interest disallowed by the Minister were in 1946, $24,395.87, in 1947, $27,834.31 and in 1948, $31,482.10.

The bonds were in denominations of $100. each, but were sold at a discount of $1. and a brokerage fee of $9. per bond was charged. The appellant, therefore, realized only $90. in cash from the sale of each bond. The Minister, under the provisions of s. 5(1) (*b*) of the *Income War Tax Act* (R.S.C. 1927, c. 97) allowed a deduction of simple interest at 6% on the $90., but disallowed the above amounts of compound interest.

Section 5(1) (*b*) provides:

> 5 (1) "Income" as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:—
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> * * *
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> (*b*) Such reasonable rate of interest on borrowed capital used in the business to earn the income as the Minister in his discretion may allow notwithstanding the rate of interest payable by the taxpayer, but to the extent that the interest payable by the taxpayer is in excess of the amount allowed by the Minister hereunder, it shall not be allowed as a deduction and the rate of interest allowed shall not in any case exceed the rate stipulated for in the bond, debenture, mortgage, note, agreement or other similar document, whether with or without security, by virtue of which the interest is payable.

That the "interest on overdue interest" provided for under the Indenture and here referred to as compound interest is a payment for a "retention . . . of a sum of money" and, therefore, as the appellant submits, interest as defined in *Halsbury's Laws of England,* 2nd Ed., Vol. 23, p. 174, para. 253, and as such it is often provided for in agreements for the lending of money, may be readily accepted. It can also be conceded that interest may be deducted in the computation of income as, indeed, under s. 5(1) (*b*) the Minister has here allowed a deduction of simple interest. It is the contention of the appellant that the amounts of compound interest should have been allowed as a deduction upon the same basis. This submission is made upon two basis: (*a*) that the Minister, in the exercise of his discretion, having allowed interest at 6% upon the amount realized from the sale of the bonds, should have allowed it upon the overdue interest, as the statute makes no difference between simple and compound interest; (*b*) that in reality there is here, by virtue of the above provision

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in the Indenture of Mortgage and Trust, a loan by the bondholders of this unpaid interest upon which the company, under the terms of that Indenture, must pay 6% per annum. It was particularly emphasized that the interest had, in fact, here been capitalised.

The appellant cited *In re Morris* (1). There the mortgage provided for the payment "of 40,000 pounds with compound interest for the same at the rate of 4 pounds 10s. Od. per cent. per annum . . . " The issue turned upon whether the overdue interest was capitalised and became part of the capital or remained as interest. It was held that the interest was not capitalised. After pointing out that as a matter of practice or of bookkeeping it would be treated as capital and in fact was "commonly and conveniently spoken of as capitalising the interest," Lord Sterndale stated at p. 192:

> I do not think that these words "compound interest with yearly rests" at all necessarily show, or indeed do show, that the mortgagors intended that any unpaid interest should become capital for all purposes, . . . I think that the word "capitalisation" used in many of the books quoted is a convenient word, but for the purposes for which it has been used in the argument before us it is a fallacious word, because it is taken as referring to capitalisation for all purposes, income tax and otherwise. I do not think that is the meaning of the word. I think, not to beg the question, that when these sums come to be paid, at the end of the time when payment off of the mortgages is made, although interest has been charged upon them, and although as a matter of bookkeeping, they have been from time to time added to the capital, they do not cease to be interest on money; that is to say, they are overdue interest upon which interest has been paid.

It is not suggested that this so-called capitalisation effected a payment of the interest and, in fact, it would seem that the parties intended no more by this provision than to add to the obligation of the appellant a liability to pay interest upon overdue interest. The position upon this point is similar to that described by Lord Thankerton:

> In my opinion there was no discharge of the debtor's liability for the overdue interest and the result of the arrangement was the improvement of the security, and an increased liability for interest by the overdue interest being made to carry interest. *Inland Revenue Commissioners* v. *Oswald* (2).

The Indenture of Mortgage and Trust, with respect to the interest as it becomes due and unpaid, does not, either by

(1) (1922) 91 L.J. Ch. 188. (2) [1945] A.C. 360 at 369.

express terms or necessary implication, provide that while it remains unpaid the bondholders should be lenders and the appellant a borrower thereof.

It is because of the absence of this relationship of lender and borrower, essential to the application of s. 5(1) (*b*), that the appellant's submission must fail. It is true there is a covenant to pay interest upon overdue interest in the Indenture, but that covenant becomes operative only on a default of a payment of interest on the principal sum.

There is, with respect to the principal sum of $550,000., the relationship of lender and borrower, but, as to the interest, it is difficult to find any other relationship than that of debtor and creditor, particularly as the language in the Indenture goes no further than to say "and interest on overdue interest at the said rate." In the circumstances, there is not here present that relationship of lender and borrower contemplated in s. 5(1) (*b*). *Minister of National Revenue* v. *T. E. McCool Ltd.* (1).

The appellant further submits that this item of compound interest ought to be allowed as a deduction under s. 6(1) (*a*), the relevant portions of which read:

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, . . .

In *Minister of National Revenue* v. *The Dominion Natural Gas Co. Ltd.* (2), this Court disallowed a deduction for legal expenses incurred in defending its right to supply natural gas to the inhabitants of a portion of the City of Hamilton. Sir Lyman Duff C.J., with whom Davis J. concurred, was of the opinion it was a capital expenditure, while Crocket J., Hudson J. and Kerwin J. (now C.J.) held that this expenditure could not be allowed as a deduction because it did not come within the scope of the test applied in *Robert Addie & Sons' Collieries Ltd.* v. *Commissioners of Inland Revenue* (3):

What is "money wholly and exclusively laid out for the purposes of the trade" is a question which must be determined upon the principles of ordinary commercial trading. It is necessary, accordingly, to attend to

(1) [1950] S.C.R. 80. (2) [1941] S.C.R. 19.
(3) (1924) S.C. 231 at 235.

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the true nature of the expenditure, and to ask oneself the question, Is it a part of the Company's working expenses; is it expenditure laid out as part of the process of profit earning? Or, on the other hand, is it a capital outlay; is it expenditure necessary for the acquisition of property or of rights of a permanent character, the possession of which is a condition of carrying on its trade at all?

In the Addie case the taxpayer had, under a lease for mining the coal, the right of access and passage over the land and to dump thereon debris. It was also contemplated that the removal of the coal might cause damage to the surface. For all of these compensation was to be paid under the terms of the lease. The amount thereof in the sum of 6,104 pounds was not allowed as a deduction within the foregoing test. In referring to the first item of access and passage the Lord President stated at p. 236:

> In any case, the expenditure was made for the acquisition of an asset in the form of the means of access and passage, which was part of the capital establishment of the Company, and, accordingly, it cannot be treated as other than a capital expense.

Lord Davey in another case spoke as follows:

> It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits. *Strong & Co., Ltd.* v. *Woodifield* (1).

Not only was there no borrowing of this interest, as already pointed out, but, on the contrary, the compound interest was payable because of the provision of the Indenture of Mortgage and Trust already quoted. The provision for its payment is part of the consideration promised by the appellant in order to secure its capital. As such, it is an expense incurred in the acquisition of capital, rather than an expenditure to earn income—a "payment on account of capital" within s. 6(1) (*b*), rather than a disbursement "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" under s. 6(1) (*a*).

The cases cited by the appellant are distinguishable on their facts. In *Reid's Brewery Co.* v. *Male* (2), the taxpayer had loaned not as a permanent investment but, as stated in para. 6 of the Statement of Facts, "only in connection with the current dealings and transactions of the customer with the" taxpayer. The taxpayer was allowed to deduct such portion thereof as he eventually wrote off as

(1) [1906] A.C. 448 at 453. (2) [1891] 2 Q.B. 1.

bad debts as "money wholly or exclusively laid out or expended for the purposes of such trade, manufacture, adventure or concern."

In *Vallambrosa Rubber Co.*, v. *Farmer* (1), the taxpayer had an estate for the production of rubber and asked a deduction of 2,022 pounds paid out for "superintendence, allowances, weeding, and so on." That a portion of such should be allowed as an expenditure of "money wholly or exclusively laid out or expended for the purposes of such trade . . ." was not disputed. The real issue turned upon the contention of the taxing authority that but one-seventh thereof should be allowed because the revenue in the taxation year was derived from one-seventh of the land. This contention was rejected.

In *British Insulated and Helsby Cables, Ltd* v. *Atherton* (2), the taxpayer decided to set up a superannuation fund for its employees and as part of its contribution thereto paid 31,784 pounds as a basis or a nucleus for the fund. This payment was not allowed as "money wholly and exclusively laid out or expended for the purpose of such trade, manufacture, adventure or concern," but was, in fact, described as a payment in the nature of a capital expenditure.

In *Morgan (Inspector of Taxes)* v. *Tate & Lyle, Ltd.* (3), the taxpayer expended the sum of 15,339 pounds in financing a campaign in opposition to nationalisation. Lord Morton of Henryton, at p. 417, stated:

> . . . the only purpose for which this money was expended was to prevent the seizure of the business and assets of the company, . . .

and at p. 431 Lord Reid stated:

> The respondent company's expenditure was wholly and exclusively laid out to prevent their business and assets being taken from them, . . .

Counsel for the appellant stressed the fact, as set forth in his factum, that "without the moneys which were loaned by the Bondholders there would have been no office building and therefore no profits or gains," from which fact he concludes: "It follows that the disbursements required to pay interest on the borrowed moneys were wholly, exclusively and necessarily laid out or expended for the purpose of earning the income." His statement of facts or premises

(1) (1910) 5 T.C. 529.
(2) [1926] A.C. 205.
(3) [1954] 2 All E.R. 413.

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is quite accurate and the amount received by the appellant from the sale of its bonds has been accepted by the Minister as "borrowed capital used in the business to earn the income" and interest at 6% has been allowed thereon under s. 5(1) (*b*). The position is quite different with respect to the compound interest, with which we are here concerned. It is not upon borrowed capital to earn income, but rather as a payment provided for under the Indenture of Mortgage and Trust only after the appellant, as borrower, has been in default in the payment of interest. It is, therefore, a payment consequent upon the appellant's default in the payment of a debt. Moreover, the provision for the payment of this interest does not nor does it purport to prevent the bondholders taking proceedings consequent upon the nonpayment of the interest. It was not, therefore, an expenditure directed to save the property in any sense analogous to the money expended in the *Morgan* case *supra.*

Counsel for the appellant submitted that the compound interest could be allowed under s. 3, notwithstanding the provisions of ss. 5 and 6. He pointed out that s. 5 does not enumerate all of the deductions that are accepted in commercial accounting and by the Minister under the *Income War Tax Act.* He also emphasized the absence in our legislation of a provision similar to that in s. 159 of the *English Income Tax Act,* 1842 (5 & 6 Vict., c. 35) (s. 209 of the *English Income Tax Act,* 1918, 8 & 9 Geo. V, c. 40):

> In arriving at the amount of profits or gains for the purpose of income tax (*a*) no other deductions shall be made than such as are expressly enumerated in this Act.

Income, as defined under s. 3, is arrived at upon the accepted principles of commercial accounting, subject to the provisions of the statute. While, therefore, all deductions are not specified in the statute, it follows that in so far as it contains specific provisions relative thereto they must be given effect. Even if it be accepted that the compound interest is a payment of interest on capital, it could not be allowed, as it comes within the specific prohibition of s. 6(1) (*b*), already quoted, which prohibits a deduction of "any payment on account of capital." This general prohibition is subject to an exception contained in s. 5(1) (*b*), but, as already pointed out, in respect to this compound

interest there is not here present that relationship of lender and borrower essential to bring it within this section (5(1) (*b*)). The omission of any such provision as found in the English Act above quoted does not affect the foregoing or assist the appellant.

The appellant also contends that the discount of $1.00 and the brokerage charge of $9.00 were expenses chargeable to capital and, therefore, that it should be allowed interest thereon as the Minister did allow interest on the 90% of the face value of the bonds under s. 5(1) (*b*).

In principle there does not appear to be, so far as this case is concerned, any difference between the discount and the commission. They were both expenses incurred in the acquisition of capital rather than in the earning of income and, as such, they were not different in character from the expenses incurred in the refunding or refinancing of the capital indebtedness in *Montreal Coke and Manufacturing Co.* v. *Minister of National Revenue* (1), where, at p. 134, Lord Macmillan stated:

> It was conceded in the courts in Canada, and, in any event, it is clear, that the expenses incurred by the appellants in originally borrowing the money represented by the bonds subsequently redeemed were properly chargeable to capital and so were not incurred in earning income. If the bonds had subsisted to maturity the premiums and expenses then payable on redemption would plainly also have been on capital account. Why, then, should the outlays in connexion with the present transactions, compendiously described as "refunding operations," not also fall within the same category? Their Lordships are unable to discern any tenable distinction.

These items of discount and commission being capital expenditures made for the purpose of obtaining capital, interest thereon cannot be allowed by the Minister under s. 5(1) (*b*), where he is restricted by the provisions thereof to allowing interest upon "borrowed capital used in the business to earn income." This distinction is emphasized by Lord Macmillan in the *Montreal Coke* case, *supra,* where, at p. 134, he states:

> The statute, in s. 5(*b*), significantly employs the expression "capital used in the business to earn the income," differentiating between the provision of capital and the process of earning profits.

Moreover, these items having been capital expenditures for the acquisition of capital, interest thereon could not be

(1) [1944] A.C. 126.

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classified as a disbursement "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within the meaning of s. 6(1) (*a*).

The foregoing is not affected by the fact that the appellant filed income tax returns throughout the period 1929 to 1948 inclusive. It may be, as the appellant contends, that under a statutory provision which permits of two or more constructions that should be preferred which is in accord with long established practice. However that may be, the present provision is sufficiently clear that once these expenditures were made for the acquisition of capital, in order that the building might be constructed, interest thereon could not be allowed.

The appellant further contends that the Minister has failed to deduct a sufficient amount for depreciation. An allowance for depreciation is provided for in s. 6(1) (*n*). In making the assessment, of which the appellant received notice under date of March 6, 1950, the Department reviewed the depreciation as computed by the company in making its income tax returns from 1929 to date, but applied the provisions of Ruling Number 15 dated January 4, 1929, only from the year 1943. It is not disputed that had the provisions of Ruling Number 15 been applied throughout the entire period larger deductions for depreciation would have been made in the relevant years. It is, therefore, the appellant's contention that "the Respondent has, by his review of depreciation since 1929, opened the entire matter and that the Appellant has a legal right to have its depreciation reviewed in the light of Ruling No. 15."

Under s. 6(1) (*n*) only such an amount may be allowed by way of depreciation as the Minister, in his discretion, may allow. As, therefore, the Minister has exercised his discretion, in order for the appellant to succeed it must show either that the Minister has acted "manifestly against sound and fundamental principles," (*Pioneer Laundry and Dry Cleaners, Ltd.* v. *Minister of National Revenue* (1), or, as otherwise stated, he has failed to exercise his discretion "bona fide, uninfluenced by irrelevant considerations and not arbitrarily or illegally" (*D. R. Fraser and Company, Limited* v. *Minister of National Revenue* (2).

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

(2) [1949] A.C. 24 at 36.

The Minister in this case reviewed the depreciation allowances asked by the appellant throughout the entire period of its existence and has, in computing the depreciation allowance for the relevant years, accepted the appellant's computation thereof for the earlier years and applied Ruling Number 15 in the later years. The suggestion is that this discloses he has acted in an arbitrary or discriminatory manner. It is not suggested that the Minister has not taken all relevant circumstances into account and, apart from evidence in support thereof, it would appear that the mere fact that he has so determined depreciation does not establish that he has exercised his discretion in any arbitrary, discriminatory or illegal manner. In this connection it is important to observe that Ruling Number 15 is not a statutory provision, but rather a circular to provide direction and assistance to the officials of the Department. In the *Pioneer Laundry* case, *supra,* the taxpayer had computed depreciation in accord with the provisions of certain circulars and contended that the Minister had, in the preparation of these circulars, exercised his discretion. Their Lordships of the Privy Council disposed of this contention at p. 134 as follows:

> The amount of depreciation claimed by the appellant company in its statutory return was in conformity with the rates stated in certain circulars issued by the respondent to local officers of the department (Exhibits 3, 4, 5 and 6), and the appellants sought, because of their being made available to the public, to have them treated as an exercise by the respondent of his statutory discretion as to depreciation. Their Lordships agree with the view of Crockett and Hudson JJ. that these departmental circulars are for the general guidance of the officers, and cannot be regarded as the exercise of his statutory discretion by the respondent in any particular case.

It would seem that rigid adherence to such a circular would defeat the intention of Parliament in enacting s. 5(1) (*a*), which contemplates that each taxpayer is entitled to have the Minister allow such an amount for depreciation as, after an examination of all relevant factors, he may, in the particular case, in the exercise of his discretion determine.

In the foregoing case the Minister disallowed certain items of depreciation, in referring to which their Lordships of the Privy Council, at p. 137, stated:

> . . . the reason given for the decision was not a proper ground for the exercise of the Minister's discretion, and that he was not entitled, in

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the absence of fraud or improper conduct, to disregard the separate legal existence of the appellant company, and to inquire as to who its shareholders were and its relation to its predecessors.

The other cases referred to by counsel for the appellant are all distinguishable from that here under consideration on the basis either that the Minister had failed to make any allowance and, therefore, to exercise any discretion, or that he had erred in relation to the facts. In the present case the Minister has admittedly reviewed the depreciation and, in the exercise of his discretion, decided that Ruling Number 15 should not be applied to the entire period. As already intimated, this does not justify a conclusion that he has acted in either an arbitrary or a discriminatory manner.

The judgment of the Exchequer Court should be affirmed and the appeal dismissed with costs.

CARTWRIGHT J.:—The judgment of the learned President of the Exchequer Court from which this appeal is taken dealt with the income tax assessments of the appellant for the taxation years 1945, 1946, 1947 and 1948, but no argument was addressed to us in regard to the first of such years.

I agree with the conclusions of the learned President on all the points raised as to the taxation years 1946, 1947 and 1948. I also agree with his reasons except as follows. The learned President gives as a second ground for holding that the respondent was right in disallowing the deductions of compound interest claimed by the appellant that such interest had not in fact been paid. This ground was not dealt with in argument before us. In view of my agreement with the learned President in regard to the first ground on which he based his judgment on this branch of the case it becomes unnecessary for me to consider this second ground and I express no opinion in regard to it.

I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitor for the appellant: *D. M. Clark.*

Solicitor for the respondent: *T. Z. Boles.*