RIEDLE BREWERY LTD.....APPELLANT; 1939

* Jan. 25, 26.
* June 27.

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Income tax—Deduction in computing assessable income—Income War Tax Act, R.S.C., 1927, c. 97, s. 6—Expenses "wholly, exclusively and necessarily" laid out "for the purpose of earning the income"—Expenditures by brewery company for treating in hotels selling its product, to promote sales of product—Manner of payment—Provincial statutory prohibitions as affecting the question.

Appellant company brewed and sold beer in Manitoba. Nearly all its shares were owned by R., who also controlled other corporations, each of which owned a hotel in Manitoba licensed to sell beer. During the taxation period in question appellant spent $4,206.40 through its officers or employees treating to beer frequenters of said hotels and other licensed hotels and clubs, the beer so purchased being nearly always of appellant's manufacture, though other beer was bought when, occasionally, a person being treated expressed a

* PRESENT: Duff C.J. and Rinfret, Crocket, Davis and Kerwin JJ.

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preference for it. Such treating was practised generally by brewers in the province, as they found it maintained or increased their sales, whereas discontinuance of the practice decreased their sales.

Held (reversing judgment of Maclean J., President of the Exchequer Court of Canada) (Rinfret and Davis JJ. dissenting): The said sum should be allowed to appellant as a deduction in estimating its profits or gains assessable for tax under the *Income War Tax Act*, R.S.C., 1927, c. 97. It was "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within the meaning of s. 6 of that Act.

With regard to *The Government Liquor Control Act, 1928* (Man.) (as amended), and the Crown's contention that appellant's policy was an evasion of s. 141 (against canvassing, advertising, etc., except as authorized); and that its procedure was in contravention of s. 84 (1) (4) (against a beer licensee taking anything except current money in payment or directly or indirectly allowing credit, etc.) in view of the facts that, in purchases in hotels controlled by R., instead of cash a chit was handed in and it then became a matter of accounting between the particular hotel corporation and appellant, and that in other hotels sometimes cheques were subsequently given by R. for the purchases:

Held (*per* The Chief Justice, Crocket and Kerwin JJ.): This Court should not, in the present proceedings, undertake the responsibility of determining the guilt or innocence of appellant under the provincial enactment; legality of the payments must be assumed. (*Per* The Chief Justice: It was incumbent upon the Crown to establish an actual violation of the statute in respect of the payments it contends should be disallowed. Moreover, it would seem that the Minister could not enter into the investigation of such an issue: *Minister of Finance* v. *Smith*, [1927] A.C. 193).

Per Rinfret and Davis JJ. (dissenting): Appellant adopted a system of treating which was largely based upon inducing the proprietors of hotels and clubs to sell on credit in breach of s. 84 (as amended) of *The Government Liquor Control Act, 1928*, Man. (s. 181 also referred to); under which Act alone the beer could be lawfully sold to the public; and in view of this the payments for its purchases cannot properly be said to have been "necessarily" made for the purpose of earning the income, within the contemplation of s. 6 of the *Income War Tax Act*. (If provincial laws, such as the prohibition against the usual advertising and publicity of brewers, which gave rise to this unusual treating system, are not to be taken into account, then the expenditures were of such an abnormal nature in the brewery business that they cannot be said to come within the contemplation of the Dominion statute as expenses for the purpose of earning income.) Further, appellant's treating system was, in part at least, to prevent a diminution of the sales of the business from which income would be earned, and therefore its expenditures in question could not be said to be "exclusively" incurred for the purpose of earning the income (*Ward & Co. Ltd.* v. *Commissioner of Taxes*, 39 T.L.R. 90, referred to).

APPEAL from the judgment of Maclean J., President of the Exchequer Court of Canada, dismissing the appellant's appeal from the decision of the Minister of National Revenue affirming the disallowance of an item of $4,206.40 claimed by appellant as a deduction in computing its income subject to tax under the *Income War Tax Act* (R.S.C., 1927, c. 97, and amendments). Appellant company carried on the business of brewing and selling beer in the province of Manitoba, and expended the said sum in treating, in places where beer manufactured by it was sold, for the purpose of promoting sales of its product.

A. Sullivan K.C. and *B. B. Dubienski* for the appellant.

W. C. Hamilton K.C. and *J. R. Tolmie* for the respondent.

THE CHIEF JUSTICE.—The question presented by this appeal is by no means free from difficulty, which it is perhaps needless to observe in view of the differences of judicial opinion to which it has given rise. After fully considering the questions involved, I find myself in agreement with the judgment of my brother Kerwin.

As to the point based upon provisions of the Manitoba *Government Liquor Control Act, 1928,* I think it was incumbent upon the Crown to establish an actual violation of the statute in respect of the payments it contends should be disallowed. I do not see, moreover, in view of the judgment of the Judicial Committee in *Minister of Finance* v. *Smith* (1), how the Minister could enter into the investigation of such an issue.

The judgment of Rinfret and Davis JJ., dissenting, was delivered by

DAVIS, J.—This appeal raises the question whether certain expenditures of the appellant brewery, alleged to have been made for the purpose of encouraging the sale of its beer, can be set up as deductions against gross profits for the purpose of arriving at net profits for Dominion income tax purposes. The Minister of National Revenue disallowed the deductions ($4,206.40) claimed in respect of the appellant's income tax assessment for the fiscal year which ended October 31st, 1933. Upon an

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appeal to the Exchequer Court of Canada from the decision of the Minister, that Court, by a judgment of the President, Mr. Justice Maclean, delivered April 12th, 1938, affirmed the Minister's decision, and the appellant appealed further to this Court.

The appellant is a company incorporated under the laws of the province of Manitoba, with its head office at the City of Winnipeg in the said province, and carried on in the said province the business of brewing and selling beer.

During the taxation period in question the appellant adopted the practice of having its officers or employees from time to time purchase its own manufactured beer in different beer parlours and licensed clubs throughout the province for the purpose of then and there treating those who were at the time on the premises, with the object of making the appellant's beer better known to the beer-drinking public and of creating and fostering a taste among beer-drinkers for its particular beer. The appellant's total sales for the said period amounted to $154,254.55 and the amount expended for "treating," $4,206.40, was, in the circumstances, a very moderate sum. The total advertising expenses of the appellant for the period in question amounted to only $331.29.

The said treating expenditures were made in 67 different licensed premises in the province by Mr. Riedle, now deceased, the then President of the company, or by the Assistant Manager or by one of the travellers of the company. The proprietors of these premises handled and sold the beer of several, if not all, of the brewers operating in the province and the customers who were treated by the appellant's officers or employees were supplied with either draught or bottled beer manufactured by the appellant which was being sold on the premises. In this way the appellant's beer was brought to the attention of and kept before the beer-consuming public and in the case of bottled beer the consumers, in addition, could see the appellant's labels on the bottles when these bottles were placed on the tables by the servers in the beer parlours.

However objectionable this treating system may be, the evidence is plain that it was general and widespread in

the province of Manitoba and that most, if not all, of the brewery companies whose beer was on sale at the different licensed beer parlours and clubs had adopted this same practice (because of the virtual prohibition against advertising—sec. 141 (3) of the Manitoba *Government Liquor Control Act, 1928*) to maintain or increase their sales.

Dominion income tax, under the *Income War Tax Act*, R.S.C., 1927, c. 97, is assessed upon the annual net profit or gain, and in computing the amount of the profits or gain to be assessed, sec. 6 provides that 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.

There cannot be any doubt upon the evidence that the expenditures by way of "treating" made by the appellant during the taxation period in question were made for the purposes of the business of the appellant; there was nothing charitable or benevolent about the expenditures.

The Privy Council in *Tata Hydro-Electric Agencies, Bombay*, v. *Income Tax Commissioner, Bombay Presidency and Aden* (1) adopted and applied the test laid down in *Robert Addie & Sons' Collieries, Ld.* v. *Commissioners of Inland Revenue* (2):

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 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?

Certain statutory prohibitions contained in the (Man.) *Government Liquor Control Act* present a difficulty to me in determining whether the expenditures in question here can properly be considered to be disbursements "wholly, exclusively and necessarily" incurred for the purpose of earning the income of the appellant company. "Necessarily" in sec. 6 means, I am satisfied, necessarily in a commercial sense, and if the practice of treating had become generally adopted in the province by most, if not all, of the brewers doing business in that province, it

(1) [1937] A.C. 685, at 696. (2) 1924 S.C., 231, at 235.

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would be reasonable to regard such treating expenditures as necessarily incurred within the meaning of the statutory provision. As Lord Sumner said in the *Usher* case (1):

> It is all very well for the tax-gatherer to reap where he has not strawed; it is too much (unless the legislature says so) that he should tax not only the harvest, but also the seed.

But the real difficulty in this appeal which presents itself to me is the question whether or not the expenditures can be said to have been necessary even in a business sense where the system adopted was in contravention, if not of the exact letter of the law, certainly of the spirit of the law of the province. The *Government Liquor Control Act* provides by sec. 84, as amended in 1933, that

> (1) No beer licensee shall take, receive or accept anything except current money in payment for or on account of any beer supplied by such licensee, and no beer licensee shall directly or indirectly give or allow credit in whole or in part for or on account of any beer sold, supplied or to be supplied by such licensee nor advance any money for the purchase of such beer.

"Current money" means cash. Now what happened in this case? The late Mr. Riedle, during the taxation period with which we are concerned, owned practically all the shares of the appellant company; he also owned or controlled the shares of eleven other corporations, each of which owned or operated a licensed hotel in the province of Manitoba. The expenditures for treating with which we are concerned were made in some 67 different licensed premises in the province, as before stated, of which these eleven hotel corporations formed a part. Riedle apparently dealt with the brewery company (the appellant) and the eleven other corporations as if they were his own personal business, because the common method of payment for the beer that was bought in these eleven hotels was, at least in large part, to have the accounts between each of these hotel corporations and the brewery company set off one against the other at the end of each month. As to other hotels in which the beer was purchased for the purpose of treating the customers, it was paid for, very frequently at least, by securing credit and ultimately giving a cheque to clean up the indebtedness. The evidence as to this practice was given in the cross-examina-

(1) *Usher's Wiltshire Brewery Ltd.* v. *Bruce,* [1915] A.C. 433, at 471.

tion of John Popp, the manager of the appellant company, as follows:

Q. Now going back again to the method by which this was done. In your own hotels no payment was made at all?

A. No, sir, but that money was accounted for.

Q. The manager's account would show that he had given away that much beer at some one else's direction?

A. Yes, but it was paid for.

Q. How?

A. We have a stores account at the brewery covering groceries which we send to the various hotels. Now those groceries are charged against them and they are rendered an account at the end of the month and they present a contra account for the free beer served.

Q. But no payment was made when the beer was bought?

A. No, sir.

Q. In reality it amounts to this: The Hotel Manager carries that item as a charge against Riedle Brewery until the end of the month when it is adjusted?

A. Yes.

Q. You mentioned that in some instances, say the case of independent hotels, cheques would subsequently be given in payment?

A. Yes.

Q. Did that happen pretty frequently?

A. Yes, this bundle of cheques represent such payments.

Q. It runs into quite a large amount?

A. Yes, quite a sum.

Q. And these cheques would not be given until a few days after the purchases were made?

A. In a week or two, probably after two or three visits had been made. Some of these cheques are to our own hotels.

Q. But, in respect to the independent hotels, the Manager would make a charge against you and this charge would stand until a cheque came in to square off the account?

A. Yes.

Mr. Sullivan suggested during the argument that if we thought this practice of buying beer on credit had the effect of depriving the appellant of the right to have the expenditures treated as proper deductions, there should be a reference to ascertain what portion of the amount claimed as a deduction was paid in cash and what portion was incurred on credit transactions; it being quite plain that some of the purchases of beer were undoubtedly paid for in cash at the time of their purchase. But in a matter of this sort, where it is a question whether or not certain expenditures are legitimate deductions, I do not think the Court should direct a reference in an attempt to separate the numerous items that have gone to make the total amount claimed for the deduction. It is plain that a substantial portion of the expenditure was incurred in credit transactions.

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The real difficulty is whether or not we are entitled to take into account the system adopted for the repurchase by the appellants of their own beer for treating purposes. The prohibition of the provincial statute is against the licensee and not against the purchaser or consumer. Strictly, it is only the licensee who is prohibited; he must not sell the beer for anything "except current money." But sec. 181 provides that every one is a party to and guilty of an offence against the Act who does or omits any act for the purpose of aiding any person to commit the offence or who abets any person in commission of the offence. Subsection (4) of sec. 84 further provides that any money paid or given in contravention of the section may be recovered from the licensee by the person making the payment. The appellant adopted a system of treating which was largely based upon inducing the proprietors of hotels and clubs (i.e., the licensees) to sell on credit in breach of the provincial statute under which alone the beer could be lawfully sold to the public, and I cannot bring myself to the conclusion that the payments for such purchases can properly be said to have been "necessarily" made within the contemplation of the Dominion *Income War Tax Act* provision (sec. 6) which expressly provides that in computing the profits or gain of the taxpayer, disbursements or expenses shall not be allowed as a deduction unless they were "necessarily" laid out or expended for the purpose of earning the income. The Dominion *Income War Tax Act* has added "necessarily" to the adverbs "wholly" and "exclusively" used in the English *Income Tax Act* and has changed the words in the English Act "for the purposes of the trade" to the words "for the purpose of earning the income." The narrowing effect of the additional adverb must always be kept in mind. As Lord Hanworth said in *Thomas Merthyr Colliery Co. Ltd.* v. *Davis* (1):

> It is necessary to tread a narrow path in these income tax cases. It is that stern rule which must be followed.

If we are not to take into account local or provincial laws, such as the prohibition in Manitoba against the usual advertising and publicity of brewers which gave rise to this unusual treating system, then the expenditures were of such an abnormal nature in the brewery business that they cannot be said to come within the contemplation of

(1) [1933] 1 K.B. 349, at 370.

the Dominion statute as expenses for the purpose of earning income.

A further question arises, Was the expenditure under consideration "exclusively" incurred in earning income? In *Ward and Company Limited* v. *Commissioner of Taxes* (1), the Privy Council had to consider a New Zealand case where the appellants, who were brewers and maltsters, had spent money in canvassing, advertising, printing, etc., with a view to defeating a prohibition proposal and then sought to deduct the same in computing their assessable income. The New Zealand statute, sec. 86 (1) (*a*), provided that no deduction should be made in respect of "expenditure or loss of any kind not exclusively incurred in the production of the assessable income." Their Lordships, putting aside the circumstance that the expenditure was not of such a nature as to produce income in the actual tax year in which it was incurred, agreed with the reasoning of the Court of Appeal of New Zealand that it was quite impossible to hold that the expenditure was incurred exclusively, or at all, in the production of the assessable income. Their Lordships said:

> The expenditure in question was not necessary for the production of profit, nor was it in fact incurred for that purpose. It was a voluntary expense incurred with a view to influencing public opinion against taking a step which would have depreciated and partly destroyed the profit-bearing thing. The expense may have been wisely undertaken, and may properly find a place, either in the balance-sheet or in the profit and loss account of the appellants; but this is not enough to take it out of the prohibition in section 86 (1) (*a*) of the Act. For that purpose it must have been incurred for the direct purpose of producing profits. The conclusion may appear to bear hardly upon the appellants; but, if so, a remedy must be found in an amendment of the law, the terms of which are reasonably clear.

Under our statute, the expenditure must have been incurred "exclusively"—to use the words of the Privy Council in the above case, "for the direct purpose" of earning the income. The evidence makes it abundantly plain that the treating system adopted by the appellant was, in part at least, to prevent a diminution of the sales of the business from which income would be earned. Its sales, it was said, would fall away and its business greatly decrease if it failed to indulge in this voluntary treating system.

For the above reasons I would dismiss the appeal, with costs.

(1) (1922) 39 Times L.R. 90.

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The judgment of Crocket and Kerwin JJ. was delivered by

KERWIN, J.—The appellant company, carrying on the business of brewing and selling beer in Manitoba, filed a return of its income for the 1933 taxation period under the provisions of the *Income War Tax Act*. In assessing the company to income tax, the Minister disallowed a sum of $4,206.40, which appellant had inserted in its statement of operating expenses, and upon appeal to the Exchequer Court the Minister's decision was affirmed.

The great majority of the shares of the company were owned by A. W. Riedle who also controlled a number of other corporations each of which owned a hotel in Manitoba and each of which was licensed under provincial authority to sell beer by retail. Officers or employees of the appellant expended the sum in question at these and other licensed hotels and clubs for the purpose of treating frequenters of these premises to beer. As pointed out by the President of the Exchequer Court:

> Occasionally, it was said, if a person being treated expressed a preference for a beer other than that produced by the appellant, he would be supplied with the beer designated by him, but this would rarely occur;

that is, in practically all cases the beer purchased for the purpose of treating was beer of the appellant's manufacture. It appears that this is a practice adopted by the brewers in the province and continued because the brewers found that, if followed consistently, their sales would either be maintained or increased, whereas when the practice was discontinued, their sales would materially decrease. The evidence upon this point is uncontradicted. It was pointed out that the hotels controlled by Riedle used the appellant's draught beer exclusively, although carrying some beer bottled by other brewers, and that in these hotels nearly sixteen hundred dollars of the total sum in question was expended; the respondent's argument being that this amount particularly could not have been laid out or expended for the purpose of earning the income.

It is perhaps convenient at this stage to point out that by section 9 of the *Income War Tax Act* a tax is to be assessed, levied and paid upon "income," which by section 3 means, for our present purpose: "The annual net

profit or gain * * * being profits from a trade or commercial or financial or other business." By section 6:

> 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.

Nowhere in the Act is there a statement of what deductions are allowable in computing the annual net profit or gain but, if in any particular case they are shown to have been in fact and in law "wholly, exclusively and necessarily laid out or expended for the purpose of earning the income," then they should be allowed.

In coming to a conclusion upon that question in this case, I find the many decisions referred to by counsel of little assistance, as the enactments under consideration in them are expressed in terms varying, if not entirely different, from the *Income War Tax Act*.

Now upon the evidence, it appears to me that the appellant company disbursed the sum in question for the purpose of earning income and not as a capital expenditure. As to the words "wholly" and "exclusively," it is not suggested that the appellant desired to give away its funds, or any part of them, nor is it contended that there was any fraud or bad faith, or that any part of the expenditures was fictitious. The learned President of the Exchequer Court held that the expenditure was not necessary but, with respect, I find it impossible to agree. As already mentioned, the practice followed by appellant is one adopted by the other brewers in Manitoba, and followed by all as something considered by them, not merely as advisable, but as obligatory, to increase, or at least sustain, the volume of their sales. Being considered thus in a commercial sense, I think it should be similarly held for the purposes of the Act.

There remains the question as to whether the money was thus laid out for the purpose of earning *the* income, that is, the income for the 1933 taxation period. In any consideration of this question, a certain degree of latitude must, I think, be allowed. For instance, in the case of a manufacturing company employing travellers to solicit business, meticulous examination of the latter's expense accounts might easily disclose that sums expended towards the end of one taxation period were not productive of

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orders or of the filling of the orders or of the payment for the goods supplied,—in the same period. That result should not prevent the company deducting such expenses in its returns under the Act. The statutory provisions may be given a reasonable and workable interpretation by holding that, as long as the disbursements fulfil the requirements already discussed, the taxpayer expended them "for the purpose," i.e., with the object and intent that they should earn the particular gross income reported for the period. In my opinion, the $4,206.40 was expended for that purpose in the circumstances of this case.

Finally, it was argued that the policy pursued by the appellant was an evasion, and in the manner of its procedure was a contravention, of the provisions of the *Government Liquor Control Act, 1928,* of Manitoba. Section 141 (1) (*a*) thereof provides as follows:

> Except as permitted by this Act or the regulations made thereunder, no person within the Province shall:
>
> (*a*) canvass for, receive, take or solicit orders for the purchase or sale of any liquor or act as agent or intermediary for the sale or purchase of any liquor, or hold himself out as such agent or intermediary.

and the contention is that the evidence discloses that the appellant's officers or employees visited the beer parlours in an endeavour to promote sales. Section 84, subsections 1 and 4, provides:

> (1) No beer licensee shall take, receive or accept anything except current money in payment for or on account of any beer supplied by such licensee, and no beer licensee shall directly or indirectly give or allow credit in whole or in part for or on account of any beer sold, supplied or to be supplied by such licensee nor advance any money for the purchase of such beer.
>
> (4) Any money, security or any deposit paid, given or pledged in contravention of this section, or the full value thereof, may be recovered in any court of competent jurisdiction by the person making the deposit, payment, gift or pledge, as aforesaid, from the licensee, free of all claims of the licensee in respect thereof, and in addition the beer licensee shall be liable to any penalty provided for the breach of this section.

With reference to these provisions, it is stated that a large part of the beer was bought on credit and the submission is that such a method is a direct contravention of the section. This refers to the evidence that, for each purchase made in hotels controlled by Riedle, instead of cash a chit was handed in and it then became a matter of accounting between the particular hotel corporation and the appellant, at whose office the main book-keeping of

the hotel corporation was done. As to other hotels, the evidence is that on some occasions cheques were given by Riedle for the purchases.

In my view, it is unnecessary to decide these questions. This Court should not, in these proceedings, undertake the responsibility of determining the guilt or innocence of appellant under the provincial enactment. I assume the legality thereunder of the payments made and for the reasons given above would allow the appeal with costs.

Appeal allowed with costs.

Solicitors for the appellant: *Dubienski & Popp.*
Solicitor for the respondent: *W. S. Fisher.*