1969
*Apr. 24
June 6

THE MINISTER OF MINES FOR THE PROVINCE OF ONTARIO APPELLANT;

AND

RIO ALGOM MINES LIMITED RESPONDENT.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Taxation—Computation of tax—Appraisal of value of ore at the pit's mouth—Deductions—Processing allowance computed on all milling capital—Whether interest on borrowed capital deductible—The Mining Tax Act, R.S.O. 1950, c. 237 [am. 1955, c. 46, s. 2(1)].

The respondent company owned and operated two uranium mines in Ontario. The ore from these mines was not sold as such, but was processed by the company. As there was no "actual market value of the output at the pit's mouth" and "no means of ascertaining the market value", the mine assessor was required by s. 4(3) of *The Mining Act, R.S.O.* 1950, c. 237, to appraise the value of the output at the pit's mouth. The assessor, in working out his assessment, began with the value of the concentrate produced from the ore mined during the year in question and from this figure he deducted four items, referred to as "processing and marketing deductions". On appeal from the assessment, the Ontario Municipal Board increased the deduction for "processing allowance", and, in the end result, reduced the amount of tax. The company appealed to the Court of Appeal and the Minister cross-appealed. The effect of changes made by the Court of Appeal was to further reduce the tax payable. The Minister then appealed to this Court and sought to have the original assessment, made by the assessor, restored. By way of cross-appeal, the company sought to vary the judgment of the Court of Appeal, which had allowed, as an item of processing expense, two-thirds of the interest paid by the company in the year of assessment on borrowed processing capital, by increasing such item to the full amount of such interest paid.

Held: The appeal should be allowed in part and the cross-appeal dismissed.

Except with respect to the item of deduction for interest charges, the Court was in agreement with the judgment of the Court of Appeal. The company was not entitled to this deduction.

In view of the allowance, which was already granted on all milling capital, including capital which was borrowed as well as equity capital, it was not proper also to allow an outright deduction of interest on borrowed capital. To permit this, in computing the value of the output at the pit's mouth, for computation of tax, was to say that such value was lesser or greater depending upon the extent to which the milling capital was derived from borrowing or through equity capital. Furthermore, it would permit a taxpayer not only to deduct the interest charges, but also to obtain the benefit of the allowance on the borrowed capital upon which such interest was paid.

*PRESENT: Cartwright C.J. and Martland, Judson, Ritchie, Hall, Spence and Pigeon JJ.

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APPEAL and CROSS-APPEAL from a judgment of the Court of Appeal for Ontario, allowing in part an appeal and dismissing a cross-appeal from a decision of the Ontario Municipal Board on an appeal from an assessment made under *The Mining Act,* R.S.O. 1950, c. 237. Appeal allowed in part and cross-appeal dismissed.

J. D. Arnup, Q.C., and *S. Sadinsky,* for the appellant.

John J. Robinette, Q.C., for the respondent.

The judgment of the Court was delivered by

MARTLAND J.:—This is an appeal by the Minister of Mines for the Province of Ontario from a judgment of the Court of Appeal for Ontario, together with a cross-appeal by Rio Algom Mines Limited, hereinafter referred to as "the Company", from that judgment. The issues involve an assessment for taxes for the year 1957 under *The Mining Tax Act,* R.S.O. 1950, c. 237.

The Company in the year 1957 owned and operated two uranium mines at Elliot Lake, Ontario, together with a concentrating plant near each mine. The ore came out of the mine in chunks of 6″ to 8″ in diameter, and proceeded to the mill and concentrating unit, in which it was first crushed to pieces about $\frac{3}{4}$″ in diameter, and then was subjected to a chemical process which resulted in the chemical extraction of uranium concentrate.

The Mining Tax Act imposed a tax on mines whose "profits" exceed $10,000 per annum. Section 4(3) of the Act provided as follows:

> (3) The annual profits shall be ascertained and fixed in the following manner, that is to say: the gross receipts from the output during the calendar year of the mine, or in case the ore, mineral or mineral-bearing substance or any part thereof is not sold, but is treated by or for the owner, holder, lessee, tenant, occupier or operator of the mine upon the premises or elsewhere, then the actual market value of the output at the pit's mouth, or if there is no means of ascertaining the market value, or if there is no established market price or value, the value of the same as appraised by the mine assessor shall be ascertained, and from the amount so ascertained, the following, and no other, expenses, payments, allowances or deductions shall be deducted and made, that is to say:

Then followed a series of deductions to be made from the ascertained value of the output at the pit's mouth. These permitted deductions are not relevant to the issues in this case, which are concerned with the proper method of ascertaining that initial value.

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Since the ore was not sold as such, but was processed by the Company, the assessor first had to consider whether, within the meaning of s. 4, there was a "market value of the output at the pit's mouth"; he concluded that there was not. The Ontario Municipal Board found as a fact that there was no "actual market value of the output at the pit's mouth" and "no means of ascertaining the market value" and in the Court of Appeal it was common ground that this was correct and that accordingly the task of the assessor was to appraise the value of the ore at the pit's mouth. The assessor, in working out his assessment, began with the value of the concentrate produced from the ore mined in 1957; there is no dispute that this value is $45,432,565.10. He then proceeded to take into account the cost of milling the ore and producing the concentrate therefrom, allowing a reasonable profit to the milling operation. From the sale price of the concentrate he deducted four items which he called "processing and marketing deductions" as follows:

Processing and marketing expenses	$10,562,491.41
Proportion of office, administrative and mine general expenses referable to processing	1,637,559.48
Depreciation—processing plant at 25%	6,406,581.66
Processing allowance	2,071,640.36

As to "processing allowance", the assessor followed a method which he had adopted some time previously to determine processing allowance for uranium and other ores. This involved determining a value for the Company's assets devoted in the year to milling, making an allowance for what he considered a fair rate of return thereon (which he placed at 8 per cent), or alternatively 15 per cent of the profit calculated under *The Mining Tax Act* before processing allowances, deducting whichever figure was the greater. In this case, as he calculated it, the percentage of profit under *The Mining Tax Act* was greater and amounted to $2,071,640.36.

The Company appealed the assessment to the Ontario Municipal Board which held that while the assessor's method of calculating the "processing allowance" of 8 per cent of capital invested in processing assets was proper, he had not applied the 8 per cent to the proper figure. He had applied it to the capital invested at the end of the previous year, December 31, 1956; a further $4,957,571 capital was

invested in the year 1957, more than half of it in the first three months of that year, and the Board held that two-thirds of the 1957 investment should be added to the figure for "capital invested" to which the 8 per cent figure was applied. The Board further held that there should be an addition to the capital figure for "pre-production expenses chargeable to the milling operation." The Company's books showed this at $4,106,325, but this included $1,397,000 for interest on borrowed money and $439,224 for financing expenses. The Board decided these two items should be deducted from the book figure of pre-production expenses but that the balance of that item, amounting to $2,270,101, should be added to the capital invested.

This increased the deduction from $2,071,640.36 to $2,503,034.48, and, in the end result, reduced the tax from $1,308,115.45 to $1,256,348.17.

The Company appealed to the Court of Appeal and the Minister of Mines cross-appealed. The Company asserted that the Ontario Municipal Board had been wrong in not allowing the whole of the pre-production expense as an element of invested capital, *i.e.*, had been wrong in deducting the items for interest and financing costs. The Company succeeded on this ground of appeal.

The Company further asserted that in calculating the total deduction referable to milling, the amount expended in 1957 for interest on borrowed capital and financing charges in raising the capital should be deducted as a direct expense. The Court of Appeal accepted this contention in part, allowing as an expense two-thirds of the interest claimed.

The effect of the changes made by the Court of Appeal was to reduce the tax payable from $1,256,348.17 (as fixed by the Ontario Municipal Board) to $1,133,115.28.

From this judgment the Minister of Mines appeals and seeks to have the original assessment, made by the assessor, restored. The Company seeks to vary the judgment of the Court of Appeal, which had allowed, as an item of processing expense, two-thirds of the interest paid by the Company in 1957 on borrowed processing capital, by increasing such item to the full amount of such interest paid.

Counsel on both sides were in agreement, with respect to this item, that there was no valid basis for apportioning

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the interest expense. The position of counsel for the Minister was that it should not be allowed at all, while counsel for the Company contended that it should be allowed in full.

Except with respect to this last item of deduction, I am in agreement with the judgment of the Court of Appeal.

The assessor, when computing the 8 per cent processing allowance, appears to have excluded from the Company's milling capital pre-production expenses, on the basis that, by analogy, such expenses could not be taken into account, by virtue of s. 4(4) of the Act, when computing allowable deductions from the value of the output at the pit's mouth. In my view, however, there is no such analogy.

Section 4(3) of the Act required the assessor to appraise the value of the output at the pit's mouth. In making that appraisal the provisions of the statute governing deductions from that figure for mining expenses were not relevant. In adopting the method which he used, which was held to be a proper method, he rightly included, when working back from the value of the concentrate produced from the ore mined in 1957, an allowance of 8 per cent on the Company's milling capital. In determining that capital it was necessary that he take into account all capital used in the processing which occurred in the year 1957. All of the pre-production expenses in accordance with good accounting practice were properly capitalized by the Company.

Similarly, the allowance made by the Board, and approved by the Court of Appeal, of two-thirds of the capital expended for milling in 1957 was properly made, in view of the fact that more than half of the milling capital expended in 1957 was expended in the first three months of that year. Consequently, that proportion of 1957 capital expenditure could properly be considered as having been used for the milling of the ore which produced the concentrate, in 1957, from the value of which the assessor had to work back in making his appraisal of the value of the ore at the pit's mouth.

On the other hand, with respect, I am not in agreement with the decision of the Court of Appeal to allow, as a direct expense of milling, two-thirds of the amount expended by the Company in 1957 for interest paid upon borrowed processing capital.

The basis for the decision of the Court of Appeal on this point is stated as follows:

> The Board considered that an allowance to appellant of two-thirds of the milling capital actually invested in 1957 was a fair and just allowance. It is impossible upon the facts to say that the Board was in error in doing so. I would allow the appellant as an expense of 1957 milling operations the same proportion of 1957 interest paid, namely two-thirds thereof.

This reference to what the Board had done relates to the decision of the Board that, for the purpose of determining what should be included in the Company's milling capital assets on which the 8 per cent processing allowance was computed, it was proper to include two-thirds of capital additions made in 1957. The assessor had made his computation on the basis of milling capital at the end of the year 1956.

With respect, it is my view that there is no relationship between that matter and the matter now under consideration. The Company seeks to deduct, as a direct expense, interest charges on borrowed capital devoted to the processing operation. What the Board was dealing with was the amount of capital upon which the 8 per cent processing allowance should be computed.

What the assessor was required to do by s. 4(3) of the Act was to appraise the value of the output at the pit's mouth. His method of doing this was to work back from the value of the concentrate, by deducting the cost of milling the ore and producing the concentrate. Included in the deductions is the allowance of 8 per cent on milling capital assets. This 8 per cent allowance is computed upon all milling capital, including capital which is borrowed as well as equity capital. It is the means by which, in computation of the tax, recognition is given to the right of the taxpayer to take into account a reasonable rate of return on the capital used in the milling operations.

In view of this allowance I do not think it is proper also to allow an outright deduction of interest on borrowed capital. To permit this, in computing the value of the output at the pit's mouth, for computation of tax, is to say that such value is lesser or greater depending upon the extent to which the milling capital is derived from borrowing or through equity capital. Furthermore, it would permit

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a taxpayer not only to deduct the interest charges, but also to obtain the benefit of the 8 per cent allowance on the borrowed capital upon which such interest is paid.

In my opinion the Company was not entitled to this interest deduction. Accordingly, I would allow the appeal, in so far as it relates to this item. The judgment of the Court of Appeal should be varied by deleting from the deductions permitted in determining the value of the output at the pit's mouth, for computation of tax, the amount of $880,042.66, representing two-thirds of the 1957 interest on borrowed milling capital. The amount of the tax payable by the Company should be varied accordingly. The appellant should have the costs of the appeal. The respondent's cross-appeal should be dismissed with costs.

Appeal allowed in part, with costs; cross-appeal dismissed with costs.

Solicitors for the appellant: Arnup, Foulds, Weir, Boeckh, Morris & Robinson, Toronto.

Solicitors for the respondent: McCarthy & McCarthy, Toronto.