THE MONTREAL LIGHT, HEAT & POWER CONSOLIDATED .... APPELLANT;

1941
* Nov. 3, 4.
1942
* Feb. 3.

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Revenue—Income—Deductions—Outstanding bond issue—Disbursements or expenses incurred in refunding same and replacing it by a new bond issue bearing lower rate of interest—Whether they are "disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income" within the meaning of section 6 (a) of the Income War Tax Act, R.S.C., 1927, c. 97.

The appellant company, in 1936, had $27,615,000 par value bonds maturing in 1951. In order to reduce the annual outgo for interest and exchange charges, it was decided to redeem a portion of that bond issue to an amount of $15,000,000 (the balance being redeemed out of proceeds of the sale of investments) and to replace the same by a new issue of bonds bearing a lower rate of interest. The result of the operation was to reduce the fixed interest charges by the sum of $275,000 per annum, a total saving of $303,119.18 being made, with a decrease in the exchange charges being added. In connection with the operation, the appellant company incurred certain disbursements and expenses amounting to $2,282,679.42 and proposed to amortize the same over the life of the new bonds, the amortized amount sought to be deducted in 1936 amounting to $104,596.04. In addition to that amount, there was a direct expenditure in that year of $79,166.64 representing the overlapping interest between the date of the calling of the old bonds and the date of their retirement, interest during that period of sixty days having been paid on both sets of bonds. The appellant company claimed the right

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

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to deduct these amounts from its taxable income for 1936, and further amounts for each year during the period of amortization. These deductions were disallowed by the Commissioner of Income Tax, whose decision was affirmed by the Minister of National Revenue. An appeal from this decision to the Exchequer Court of Canada was dismissed with costs.

Held, affirming the judgment appealed from ([1941] Ex. C.R. 21), Rinfret and Taschereau JJ. dissenting, that the above disbursements or expenses incurred by the appellant company were "not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income", within the meaning of section 6 (*a*) of the *Income War Tax Act*.

Per the Chief Justice—The sums borrowed by means of the original issue of debentures were capital, as distinguished from income, and the sums borrowed by the second issue of debentures for the purpose of retiring the earlier issue were also capital. The sums which the appellant company seeks to deduct are sums paid in respect of capital and they are not expenses incurred in the process of earning income in respect of which the appellant company is assessable.

Per Rinfret and Taschereau JJ. (dissenting)—The several elements of the operation performed by the appellant company are essentially linked together and inseparable. In order to pay a lower interest and to get rid of the exchanges, it was necessary to redeem the original bonds; and the expenses required to achieve that result were wholly, exclusively and necessarily laid out for the purpose of decreasing the fixed interest and exchange charges and, therefore, "for the purpose of earning the income". Accordingly, the disbursement or expense so incurred come strictly and literally within the class contemplated by section 6 (*a*) of the *Income War Tax Act* and should have been allowed as a legitimate deduction in computing the amount of the profits or gains of the appellant company within the meaning of that section.

APPEAL from the decision of the Exchequer Court of Canada, Maclean J. (1), dismissing an appeal by the appellant from a decision of the Minister of National Revenue which had affirmed an assessment levied against the appellant under the *Income War Tax Act*.

The material facts of the case and the questions at issue are stated in the above head-note and in the judgments now reported.

Geo. H. Montgomery K.C. and *Aimé Geoffrion K.C.* for the appellant.

F. P. Varcoe K.C. and *A. A. McGrory* for the respondent.

THE CHIEF JUSTICE—The material facts may be stated in the words of the factum of the appellant company, as follows:—

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In the beginning of the year 1936 the appellant had outstanding $27,615,000 par value of Series "A" 5% bonds maturing in 1951, and payable both as to principal and interest at either Montreal, Toronto, New York or in London at the holder's option. Not only was the coupon rate unduly high at the time, having in view the credit standing of the Company, but the taxable earnings of the Company had been seriously reduced each year through the heavy exchange rates which the Company had been obliged to pay upon its half-yearly interest instalments. After consultation with the Company's investment bankers it was decided that the most economical way of reducing the annual outgo for interest and exchange charges would be by the issue of new bonds as follows:—

2½% Series due Feb. 1, 1937........................	$ 1,000,000
2½% Series due Feb. 1, 1938........................	1,000,000
2½% Series due Feb. 1, 1939........................	1,000,000
2½% Series due Feb. 1, 1940........................	1,000,000
2½% Series due Feb. 1, 1941........................	1,000,000
3½% 20-Year Sinking Fund, due Feb. 1, 1956......	10,000,000
	$15,000,000

the balance of the funds for the purpose of retiring the issue of $27,615,000 principal amount of the outstanding 5% issue being provided by the sale of certain investments which the Company had in its treasury.

The result of the above operation, in so far as concerned the $15,000,000 refunded and replaced by a new issue, was to reduce the fixed interest charges by the sum of $275,000 per annum and the elimination of the three-way pay option and the substitution of Canadian pay only did away with the exchange charges and effected a total saving, based upon the experience of the previous nine years, of $303,119.18. The taxable income of the Company was increased by a corresponding sum.

The expenses incidental to this operation the Company sought to amortize over the life of the new bonds; the amortized amount sought to be deducted in the year 1936 amounting to $104,596.04. In addition to the amount so amortized in 1936 there was a direct expenditure in that year of $79,166.64, representing the overlapping interest between the date of the calling of the old bonds and the date of their retirement, interest during that period of sixty days having been paid on both sets of bonds. The appellant claimed the right to deduct this amount from its taxable income for the year 1936.

The operation in connection with which these disbursements were made was simply this: Capital was borrowed at an agreed rate of interest for the purpose of repaying to the creditors the existing debt in respect of borrowed capital for which the company was paying a more onerous rate of interest. From a business point of view the main object of the transaction was to secure a reduction in the rate of interest and thereby, of course, to increase profits. Every one of these expenditures was part of the cost of borrowing capital from the lenders who took up the new issue of bonds, or of repaying the borrowed capital to the

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holders of the existing bonds; in other words, part of the cost of acquiring borrowed capital, or of repaying borrowed capital. Such expenses do not appear to me to come within section 6 (*a*) as expenses incurred in the process of earning "the income"; which is the test to be employed in the application of that subsection. *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (1).

The principle is illustrated in several cases, of which I mention two. In the *Arizona Copper Company* v. *Smiles* (2), a bonus which the taxpayer was obliged to pay on the repayment of borrowed capital before the maturity of the debt was described by the Lord President as

> a lump payment as one of the considerations stipulated for a loan of capital;

and was held to be

> entirely heterogenous to those outlays, the deduction of which is permitted to be necessarily incidental to the earning of profit,

and the bonus was held not to be deductible.

In *Texas Land and Mortgage Co.* v. *Holtham* (3), brokers' charges and other expenses of raising debentures were held not to be deductible.

Of course, there is a sense in which, as a rule, all expenditure properly made by a joint stock company, such as the appellant company, may be said to be an expenditure incurred for the purpose of earning profits, but the distinction between expenditures made in the actual process of earning profits and other expenditures made on account of capital, or otherwise, is one which it is absolutely essential to maintain, if the statute is to be workable.

I think, moreover, that these disbursements were made for a purpose which falls within the principle enunciated by Lord Cave in the *British Insulated and Helsby Cables Ltd.* v. *Atherton* (4); that is to say, the expenditures were made with a view to securing an enduring benefit, the reduction of the cost of borrowed capital over a period of at least fifteen years.

A reference is due to the argument of Mr. Geoffrion concerning the decision in *Texas Land and Mortgage Co.* v. *Holtham* (3) just mentioned. That case, he argues, is of no value because it rests on the decision in the *Anglo-*

(1) [1941] S.C.R. 19.
(2) (1891) 3 Tax Cases 149.
(3) (1894) 3 Tax Cases 255.
(4) [1926] A.C. 205, at 212.

Continental Guano Works v. *Bell* (1), and this last mentioned case is unfavourably criticized in *Farmer* v. *Scottish North American Trust, Ltd.* (2). Mathew J. in his judgment in the *Texas Land* case (3) says:—

> To increase its capital it (the taxpayer) raised money on debentures. The argument is that the cost of raising the money ought to be deducted from the profits in a particular year. We are clearly of opinion that that cannot be done.

Farmer's case (2) was the subject of much discussion in *The European Investment Trust Co. Ltd.* v. *Jackson* (4). In that case there was an advance of £10,000 to the taxpayer as a fixed loan with fixed interest running for a considerable period. Mr. Justice Finlay observed, at page 7, as regards this interest,

> it is obvious that that was treated as money paid—correctly treated, obviously—in respect of capital.

There were other advances made under an agreement from time to time to suit the convenience of the taxpayer and at varying rates of interest. Lord Justice Romer says at page 16:—

> In one sense, it is perfectly obvious that the moneys borrowed by the appellants from the Finance Corporation of America constituted capital; that is to say, they were capital sums as distinct from sums representing income.

He then goes on to point out that in *Farmer's* case (2) the House of Lords had to deal with the case of a trading company whose business it was to buy and re-sell investments at a profit, borrowed from a bank for the purpose of enabling it from time to time to purchase the investments which it was going to re-sell; and the House held that the moneys so borrowed were not sums employed as capital in the trade within the meaning of Rule 3, Sub-rule (*f*). He proceeds to say:—

> In point of fact, the money which was held not to be capital—although it was capital, as I say, in the sense that it was not income—was, really, what is frequently referred to as circulating capital.

He adds:—

> It is impossible, I think, to treat the decision of the House of Lords as laying down that capital, which is used as circulating capital, is not capital within the meaning of sub-rule (*f*).

For this he gives two reasons: The House did not draw any distinction between circulating capital and fixed

(1) (1894) 3 Tax Cases 239.
(2) [1912] A.C. 118.
(3) (1894) 3 Tax Cases 255.
(4) (1932) 18 Tax Cases 1.

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capital and, what is important here, they did not overrule, although they commented upon the decision in the *Anglo-Continental Guano Works* v. *Bell* (1), where money which was borrowed and used as circulating capital was treated as capital within the meaning of sub-rule (*f*).

He then adds that the effect of the decisions mentioned is that the question in each case is a question of fact.

From all this it will be seen that the comments upon the *Anglo-Continental Guano Works Company's* case (1) in the House of Lords in *Farmer's* case (2) were directed to a point which has no bearing whatever on the decision in the *Texas Land Company's* case (3) and has no relevancy to any question which arises in this case. In the *European Investment Trust Company's* case (4) there was no dispute that the sum of £10,000 borrowed by the taxpayer as a fixed loan with fixed interest running for a considerable period was borrowed capital. The point with which the House of Lords in *Farmer's* case (2) and the Court of Appeal and Mr. Justice Finlay in the *European Investment Trust Company's* case (4) were concerned was whether, the business of the taxpayer being that of dealing in investments, temporary loans of fluctuating amount borrowed for the purpose of financing individual transactions from time to time, out of which the taxpayer made its profit, could be classed as capital used in the taxpayer's business, or as so connected with the process of earning profits that the interest paid could be treated as an expenditure in the process of earning profits.

I have no doubt that the sums borrowed by means of the original issue of debentures were capital, as distinguished from income, or that the sums borrowed by the second issue of debentures for the purpose of retiring the earlier issue were also capital. The sums which the appellant company seeks to deduct are sums paid in respect of capital, and on the principle of the decisions in the *Arizona Copper Company's* case (5) and the *Texas Land and Mortgage Company's* case (3) they are not expenses incurred in the process of earning income in respect of which the appellant company is assessable.

The appeal should be dismissed with costs.

(1) (1894) 3 Tax Cases 239.
(2) [1912] A.C. 118.
(3) (1894) 3 Tax Cases 255.
(4) (1932) 18 Tax Cases 1.
(5) (1891) 3 Tax Cases 149.

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The judgment of Rinfret and Taschereau JJ. (dissenting) was delivered by

RINFRET J.—These two cases were heard together; the questions raised are identical and they may be disposed of upon the same reasons for judgment.

In each instance, the Exchequer Court of Canada dismissed an appeal from the decision of the Minister of National Revenue affirming an assessment levied against the appellant under the *Income War Tax Act;* and the question involved in the appeals is whether certain disbursements laid out and expended by the appellant in refunding an outstanding bond issue and replacing the same by a new issue of bonds at a lower rate of interest, for the purpose of effecting a saving in fixed charges, should be allowed as deductions on the assessment of the appellant for income tax for the years there in question.

In the case of the Montreal Light, Heat and Power Consolidated, the facts are as follows: In the beginning of the year 1936, the Company had outstanding $27,615,000 par value of Series "A" 5% bonds maturing in 1951 and payable both as to principal and interest at either Montreal, Toronto, New York or in London, at the holders' option.

The coupon rate was thought unduly high at the time, having in view the credit standing of the Company; and the taxable earnings of the Company had been seriously reduced each year through heavy exchange rates which the Company had been obliged to pay upon its half-yearly interest instalments. After consultation with the Company's investment bankers, it was decided that the most economical way of reducing the annual outlay for interest and exchange charges would be by the issue of new bonds (at $2\frac{1}{2}$% and $3\frac{1}{2}$%) for the total amount of $15,000,000, with due dates spread respectively on February 1st, 1937, 1938, 1939, 1940, 1941 and 1956 (N.B., the latter being the 20-year sinking fund bonds representing $10,000,000 of the total $15,000,000, and being the only bonds on which interest was to be paid at $3\frac{1}{2}$%). The balance of the funds for the purpose of retiring the issue of $27,615,000, principal amount of the outstanding 5% issue, was provided by the sale of certain investments which the Company had in its treasury.

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The result of the operation, in so far as concerned the $15,000,000 refunded and replaced by the new issue, was the reduction of the fixed interest charges by the sum of $275,000 per annum and the elimination of the three-way pay option and the substitution for it of the payment of interest in Canadian money only. This elimination did away with the exchange charges and effected a total saving, based upon the experience of the previous nine years, of $303,119.18.

The taxable income of the Company was increased by a corresponding sum.

The expenses incidental to this operation are detailed in the record as follows:

(i) Premium paid upon retirement of the issue of old bonds		$1,104,600 00
(ii) Exchange premium paid upon retirement of the issue of old bonds		676,726 00
(iii) Expenses in connection with retirement of the issue of old bonds		25,753 42
(iv) Discount on issue of new bonds:		
$5,000,000 par value at 1½%	$ 75,000 00	
$10,000,000 par value at 4%	400,000 00	
		475,000 00
		$2,282,079 42

The Company proposed to amortize these expenses over the life of the new bonds, the amortized amount sought to be deducted in the year 1936 (the year about which this litigation arose) amounting to $104,596.04.

In addition to the amount so amortized in 1936, there was an expenditure in that year of $79,166.64 representing the overlapping interest between the date of the calling of the old bonds and the date of their retirement, interest during that period of sixty days having been paid on both sets of bonds. The appellant claimed the right to deduct this amount from its taxable income for the year 1936.

In the assessment which followed, the deduction of both the amortized amount and of the amount representing the overlapping interest was disallowed.

The above facts were all admitted.

In the case of Montreal Coke and Manufacturing Company, the following facts were all admitted:

In 1935 the Company had outstanding $3,457,000 par value of first mortgage 5½% bonds maturing in 1947 and payable, both as to principal and interest, in Canadian or

United States funds, at the holders' option. It was found that the coupon rate was unduly high at the time, having in view the credit standing of the Company and, moreover, that the taxable earnings of the Company had been seriously reduced each year through the heavy exchange rate which the Company had been obliged to pay upon its half-yearly instalments. After consultation with the Company's investment bankers, it was decided that the most economical way of reducing the annual outgo for interest and exchange charges would be by the issue of \$1,200,000 of 3½% serial bonds maturing yearly from 1936 to 1940 inclusive, and \$2,200,000 of 4% fixed term bonds maturing on September 16th, 1947. The prices obtained were 99½ and accrued interest for the 3½% serial bonds and 99 and accrued interest for the 4% fixed term bonds, or a discount of ½ of one per cent in the case of the serial bonds and 1% in the case of the fixed term bonds.

The result of the operation was to reduce the fixed interest charges, to eliminate the United States pay option and to substitute Canadian pay only, thus doing away with the exchange charge. This effected a total saving of over \$40,000 per annum. The taxable annual income of the Company was increased by a corresponding sum.

The particulars of the disbursements made by the Company in connection with this operation were as follows:

(i) Interest on new bonds from September 16, 1935, to December 31, 1935, until when interest had to be paid on both the old and new bonds........	\$ 23,207 54
(ii) Various expenses on retiring the old bonds and issuing the new bonds........................	12,484 92
(iii) Discount on issue of new bonds...............	28,000 00
(iv) Premium paid upon retirement of issue of old bonds	69,140 00
(v) Exchange premium paid on retirement of old bonds	36,744 81
	\$169,577 27

The first two items of expenses mentioned above were charged directly against the earnings for 1935. It was proposed to amortize the other items over the life of the new bond issue. Amortization over the twelve years life of the term bonds which the appellant expressed the willingness to do would represent an amount of \$14,131.44, to be deducted annually. As already mentioned, the total saving would amount to something over \$40,000 per annum, with a corresponding increase in taxable income.

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All the items were disallowed by the Minister in the assessment of the appellant for the income tax.

As to both assessments, the Minister of National Revenue decided that the deductions claimed by the appellant should not be allowed, because they were not in respect of disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning the income, as provided in sec. 6 (*a*) of the *Income War Tax Act*.

A further ground for the decision was found in sec. 6 (*b*) of the Act, whereby it is provided that

a deduction shall not be allowed in respect of any outlay, loss or replacement of capital, or any payment on account of capital, or any depreciation, depletion or obsolescence, except as provided in this Act;

and that the amounts claimed by the appellant as deductions from its income represented cost to it on the redemption of its old bonds and the issuing of a new series of bonds. It was decided that they were, in fact, expenditures on account of capital which fell within the specific provisions of the said section 6.

In the case of Montreal Light, Heat & Power Consolidated, it was further decided that part of the deductions were properly disallowed in the exercise of the statutory discretion provided for in section 5 (*b*) of the Act, on the ground that

a reasonable rate of interest has been allowed on borrowed capital used in the business of the taxpayer;

and section 6 (*g*) was further invoked. That section has reference to " taxes paid under the *Special War Revenue Act*."

Each appellant having filed a notice of dissatisfaction, the matter came up before the Exchequer Court of Canada, where the learned President gave judgment against the contentions of the appellants. He found that the

savings reflected a corresponding increase in the net income of the appellants; that the action taken by the appellants would seem to be amply justified by sound business and accountancy practice, and the results would seem to have verified the expectations of the appellants.

The learned President further stated that the law in England is different and

English decisions could have no application here * * * In the United States, expenses incurred in connection with the refunding or retirement of bond issues are governed by a set of rules issued by the Treasury Department in 1938, and it is probable that there, under such rules, the disbursements here would be allowed as deductions.

He was, however, of opinion that

> substantially, what took place here was the redemption and renewal in part of an existing capital obligation from the proceeds of a fresh capital obligation * * * Therefore,

(he thought)

> all the expenses in question must be held to have been essentially of a capital nature, an outlay made on account of capital * * * The original capital which was the proceeds of the old bonds was now in the form of fixed capital assets or working capital, and whatever was the net result of the financial operations that took place, they related to and were on account of the capital * * * even though, on equitable grounds, the appellants' view seems attractive and in many ways quite just.

Further, the learned judge said:

> It did not increase the revenue but it decreased the fixed capital charges of the business, and could not, therefore, have been incurred exclusively to earn the net profits or gains to be assessed.

And later:

> If the expenses incurred in raising a portion of the initial capital of a company by an issue of bonds is not permissible as a business deduction, and I do not think the contrary has ever been held, then it seems to me to follow that expenses incurred in redeeming, refunding or reducing that borrowed capital, even if the results be beneficial to the net revenues of the company concerned, constitute an outlay or payment on account of capital and falls within the prohibition of s. 6 (*b*), in computing the amount of the profits or gains to be assessed * * * The expenses were not, I think, wholly or exclusively incurred for the purpose of earning the annual net profit or gain of the trade or business of the appellant company. The principle is that it is expenses necessary to earn future profits that are allowable deductions, and this principle has been extended to include expenditure to avoid future trading expenses. The profits of a trade or business is the surplus by which receipts from the trade exceed the expenditure necessary for the purpose of earning the receipts.

For the above reasons, the appeal was, therefore, disallowed with costs.

For the purpose of the *Income War Tax Act,* " income "

> means the annual net profit or gain or gratuity, whether ascertained or capable of computation * * * as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person * * * from any trade, manufacture or business, as the case may be, etc.

(N.B. I have omitted such parts of the definition contained in section 3 of the Act as were not material in the premises).

"Income", as so defined, is, by force of section 5, subject to the following, amongst other, exemptions:

> (*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 paid by the taxpayer; but to the

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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;

Then comes, in the Act, section 6 which is the main section to be considered here:

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;

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

The word "profit" or the word "gain" is not defined in the interpretation clause of the *Income War Tax Act*. It follows that, wherever it is used in the Act, it must be understood as being used according to its usual meaning in ordinary common language. As such, it means the amount by which the gross earnings exceed the expenses.

It is clear that, in the several sections of the Act under consideration, the word "gain" is used interchangeably for "profit".

There are two ways of increasing the profits from a trade or commercial or other calling: either by increasing the earnings while the expenses remain the same, or by decreasing the expenses while the earnings remain the same. Of course, if the expenses diminish at the same time as the gross earnings are increased, the profits will be correspondingly larger, and the proposition just mentioned is only made more evident.

Now, it seems to me, with due respect, that it is sufficient to look at the operations under discussion to reach the conclusion that the amounts for which the appellants claimed deductions come strictly and literally within that class of disbursements or expenses which are contemplated by section 6 (*a*) and which, by application of the section, are to be considered as deductions which should be allowed in computing the profits or gains. To paraphrase the words of Sir Montague Smith, in *Lawless* v. *Sullivan* (1):

The intention of the Legislature should be clearly shown to justify an interpretation of the word "income" which would require that, in

(1) (1881) 6 App. Cas. 373, at 379.

the account for the year, the items of profit only should be included and the expense excluded, although but for the operations which occasioned the expenses, the apparent profits could not have been made.

As stated in Shaw and Baker, "The Law of Income Tax," at page 147:

> The profits are to be arrived at on ordinary commercial principles subject to such provisions as require a departure from such ordinary principles, e.g., the prohibition of certain deductions.

And, at page 183:

> The general rule as regards trade expenses is that a deduction is permissible which is justifiable on business and accountancy principles; but this rule is affected by certain specific statutory provisions. To the extent that ordinary business and accountancy principles are not invaded by statute, they prevail.

See also Halsbury, vol. 17, at p. 149, par. 309 and at p. 155, par. 316.

Now, what took place in the present instance is that the interest on the bonds was found unduly high, and the exchange rates were equally heavy in the circumstances; and that both these items of expenses had such an effect on the gross earnings of the Company that they seriously diminished the net profits or gains. It was evident that, if the interest and exchange charges could be made lower, "for the purpose of earning the income" (which, in the Act, is defined as meaning "the annual net profit or gain"), the net profit or gain would be accordingly higher.

With that purpose in view, each company adopted the plan recommended by its investment bankers: the outstanding bonds on which 5% per annum had to be paid were redeemable at a certain premium. They were redeemed at the prescribed premium; and they were replaced by bonds bearing a lower interest. Moreover, the new bonds by which they were redeemed were made payable only in Canada; and, as a result, the exchange rates were no longer payable on the bonds. Thus the Company saved the excess of interest as between the old and the new bonds, and it also saved entirely the amount required to pay the exchange rates.

The capital liability remained exactly the same as it was before. The expenses incurred were not made out of capital; the gross earnings of the Company may have remained the same; but the expenses having been decreased, the net profit was increased. And this expendi-

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ture helped in earning net profit in every succeeding year during which the old bonds would have been outstanding but for the operation.

The essential point is, with regard to the judgment *a quo,* that the operation did not alter the capital structure to the slightest extent. Such is the difference between expenses incurred in raising the initial capital of the Company by an issue of bonds and merely replacing the bonds at a reduced rate of interest and by elimination of exchange charges, but without in any way increasing the capital of the bonds. On the contrary, in the case of the Montreal Light, Heat & Power Consolidated, the capital of the bonds was reduced.

It need hardly be stated that, in an operation of this kind, the several elements thereof were essentially linked together and inseparable. In order to pay a lower interest and to get rid of the exchange rates, it was necessary to redeem the original bonds; and, therefore, the expenses required to achieve that result were wholly, exclusively and necessarily laid out or expended for the purpose of decreasing the fixed interest and exchange charges, and, accordingly, "for the purpose of earning the income."

It may be mentioned that it was not even a matter of renewing debentures as they came due, because the old ones were not maturing; but it was merely a question of refunding debentures to secure a lower interest rate and to completely eliminate the exchange charges. By doing as they did, the two Companies were relieved of an onerous obligation due upon the same capital liability.

In the circumstances, I am unable to find otherwise than that the disbursement or expense so incurred must be allowed as a legitimate deduction in computing the amount of the profits or gains of the appellants, within the meaning of section 6 (*a*) of the *Income War Tax Act;* and, as a consequence, in my view, the judgments appealed from should be reversed and the appeals of the two companies from the decision of the Minister should be allowed with costs throughout.

DAVIS J.—These appeals, which were heard together, come to us from the Exchequer Court of Canada, which heard appeals by the companies from the decision of the Minister of National Revenue on certain claims for deductions that the companies sought to have allowed in ascertaining the amount of their assessable income for income tax purposes.

Broadly speaking, what happened was that each of the companies had large bond issues outstanding carrying onerous provisions as to the rate of interest and as to payment in several currencies, particularly in United States currency, of principal and interest at the holder's option, when, in the case of one company in 1935 and in the case of the other company in 1936, the companies decided to call in these bonds (which they had the right to do on certain notice and on the payment of a certain premium) and, taking advantage of a favourable bond market then existing, issue and sell new bonds to the public bearing a much lower rate of interest and without the option of payment of principal or interest in United States currency. The new bonds were to run for twelve years, which was the period that the old bonds had to run had they not been called in. This plan was adopted and successfully carried out, with large annual savings in interest payments to the companies and consequent increase in the annual gross profits to the extent of the savings.

The amounts were very large. In the case of the Montreal Light, Heat & Power Consolidated in the beginning of the year 1936 the company had outstanding $27,615,000 par value of bonds maturing in 1951. The said outstanding issue was replaced as to $15,000,000 by a new bond issue; the balance was redeemed out of the proceeds of the sale of company investments. The Montreal Coke & Manufacturing Company in the year 1935 had outstanding $3,457,000 par value of its bonds maturing in 1947. These bonds were replaced by two issues totalling $3,400,000.

The companies seek to treat as proper deductions for purposes of income tax the expenses incidental to the changes, i.e., the discount on the sale of new bonds, the amounts of the premium paid in order to call in the old bonds, the amount of foreign exchange paid upon retirement of the old bonds, and incidental expenses of retiring the old and issuing the new bonds. In the Coke Company case the total is $23,207.54, while in the Light, Heat & Power Consolidated, the total deductions sought are $2,282,079.42.

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What the companies say is, their annual gross profits during the twelve-year period will be increased by the amount of the corresponding savings in fixed interest charges. The Montreal Light, Heat & Power Consolidated estimates that annual sum in its own case at $303,119.18. To the extent of the tax leviable on such a sum the Government will reap a largely increased income tax revenue—it will reap where it has not sown unless, say the companies, the expenses of effecting the change in the bonded indebtedness of the companies are allowed as proper deductions. The Minister has, however, ruled against this claim and, on appeal to the Exchequer Court of Canada, his decision has been affirmed. The companies then appealed to this Court.

The companies were obviously faced with the difficulty of having the total amount of the expenditures incurred in making the changes treated as deductions in the particular taxation period in which they were incurred, and therefore contended that the proper method of dealing with them is to amortize them over the twelve-year period.

The relevant part of section 6 of the *Income War Tax Act* reads as follows:

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;

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

As Lord Hanworth said in *Thomas Merthyr Colliery Co. Ltd.* v. *Davis* (1), adopting the language of Lord Dunedin in the *Gliksten* case (2), "It is necessary to tread a narrow path in these income tax cases. It is that stern rule which must be followed." The Court must interpret the statute without reference to its own views of the fairness or unfairness, in a commercial sense, of the result in any particular case. Parliament has made the law; we are merely to interpret and apply it.

After much consideration of the able arguments presented to us by counsel on behalf of the companies, I cannot bring myself to the view that these expenditures

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

(2) *Gliksten & Son Ltd.* v. *Green* [1929] A.C. 381, at 385.

come properly under our statute as allowable deductions. Once the practical necessity appears for amortization over a period of years of any large expenditure actually incurred in a particular taxation year, the real character of the expenditure emerges as something quite different from those ordinary annual expenditures which fall naturally into the category of income disbursements. The expenditures here in question are, in my opinion, in the nature or of the character of capital expenditures and are not the sort of expenditures that the statute contemplated to be allowed as deductions under the language of section 6 (*a*) as "expended for the purpose of earning the income". The words "the income" must, I think, mean the assessable income of the taxation period.

I should dismiss the appeals with costs.

KERWIN J.—It is undoubted that the expenditures made by the appellant companies were prudent and have resulted, and will result, in a lessening of their annual outgoings, and that because of this the sums assessable for income taxes in each year during the currency of the bond issues will be increased. However, as much could be said in the case suggested in argument by Mr. Varcoe of a company replacing old furnaces with new in order to save a considerable sum annually in its coal bill, and in such circumstances it could not be suggested that the money expended for that purpose was not a capital expense.

The appellant companies have amortized the totals of some of the items in question over the period covered by the bond issues and have expressed a willingness to treat any remaining item in the same manner. The fact that their auditors considered this a proper business practice is not necessarily decisive but it does weigh against the contention now put forward on behalf of the appellants. What happened, in my view, is that there was an application of the profits of a certain year to prevent an annual expense arising thereafter and brings the cases within Viscount Cave's criterion in *British Insulated and Helsby Cables Limited* v. *Atherton* (1) of an expenditure made with a view of bringing into existence an advantage for the enduring benefit of the appellants' business. The

(1) [1926] A.C. 205, at 213.

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expenditures are outlays or payments on account of capital and, under clause (*b*) of section 6 of the *Special War Tax Act*, are not to be allowed in computing the amount of the profits or gains to be assessed.

The appeals should be dismissed with costs.

Appeal dismissed with costs.

An appeal of *Montreal Coke & Manufacturing Company and The Minister of National Revenue,* from the decision of the Exchequer Court of Canada, Maclean J. (1), dismissing an appeal by the appellant from a decision of the Minister of National Revenue which had affirmed an assessment levied against the appellant under the *Income War Tax Act,* was heard on the same date as the appeal of *The Montreal Light, Heat and Power Consolidated,* above mentioned, before the same members of the Court, the same counsel being engaged on the appeal.

The questions raised on the two appeals were identical, the only distinction being that in this case the outstanding bond issue, $3,400,000 par value, was replaced by a new issue for the same amount bearing a lower interest rate.

Judgment was delivered by the Supreme Court of Canada on the same date as the other appeal, also dismissing the appeal with costs.

Both appeals were disposed of by the members of the Court upon the same reasons for judgment, with the exception of the Chief Justice who delivered the following judgment: "In principle this appeal is governed by my judgment in *The Montreal Light, Heat and Power Consolidated* v. *The Minister of National Revenue* appeal. The appeal is dismissed with costs."

Appeal dismissed with costs.

Solicitors for the appellants: *Montgomery, McMichael, Common & Howard.*

Solicitor for the respondent: *W. A. Fisher.*

(1) [1941] Ex. C.R. 30.