1962
Sept. 28
Oct. 12

BETWEEN:

THE MINISTER OF NATIONAL REVENUE .... APPELLANT;

AND

E. H. POOLER AND COMPANY LIMITED .... RESPONDENT.

Revenue—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 12(1)(a)—"Outlay or expense incurred for the purpose of gaining or producing income from a business of the taxpayer"—Amount of fine imposed by Board of Governors of Toronto Stock Exchange not deductible from income—Appeal allowed.

1962

MINISTER OF NATIONAL REVENUE v. E. H. POOLER AND CO. LTD.

Respondent was fined $2,000 by the Board of Governors of the Toronto Stock Exchange and a claim that such sum was deductible in computing income of the year such fine was imposed was allowed by the Tax Appeal Board. From that decision the Minister appeals to this Court.

Held: That respondent as a member of the Toronto Stock Exchange became a party to or at any rate subject to punishment by the Exchange for acts of one of its employees which were not part of respondent's business or for the purposes of that business and such outlay or expense was not incurred for the purpose of gaining or producing income from respondent's business within the meaning of the *Income Tax Act,* R.S.C. 1952, c. 148, ss. 3, 4, 12(1)(*a*) and therefore the amount of the fine was not deductible in computing respondent's income from its business.

APPEAL under the *Income Tax Act.*

The appeal was heard by the Honourable Mr. Justice Thurlow at Toronto.

N. A. Chalmers for appellant.

D. Andison for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

THURLOW J. now (October 12, 1962) delivered the following judgment:

This is an appeal from a judgment of the Tax Appeal Board allowing an appeal by the respondent and vacating a re-assessment of income tax for the year 1958. The matter in issue is the deductibility in computing income for income tax purposes of a fine of $2,000 which was imposed on the respondent by the Board of Governors of the Toronto Stock Exchange.

The respondent since its incorporation in 1954 has carried on business on a considerable scale as a stock broker and throughout this period has been the owner of a seat held by its president or one of its members on the Toronto Stock Exchange. The revenues of its business to the extent of about 90 per cent consist of commissions on the purchase and sale of stocks and bonds on behalf of clients, the remainder being interest on balances owed by clients, proceeds of occasional underwritings and sundry amounts from other minor sources. From June 1956 until September 1957 the respondent had in its employ as a branch manager William H. Ramsay whose functions included the soliciting

1962

MINISTER OF NATIONAL REVENUE
v.
E. H. POOLER AND CO. LTD.

Thurlow J.

and obtaining of orders from members of the public for execution on the Exchange. Mr. Ramsay was also a vice president of the respondent company.

In May 1957 customers' accounts obtained by Mr. Ramsay were opened in the names of Clifford J. Butler, Joseph Beaudry, and John Fauquier all of whom were concerned in trading on margin in the stock of Aconic Mining Corporation which had been listed towards the end of 1956 for trading on the Exchange. By May 29th as a result of transactions carried out in the meantime Mr. Butler had become indebted to the respondent in an amount exceeding $100,000 and at that point the respondent's president, Mr. E. H. Pooler, advised Mr. Ramsay that Mr. Butler's credit was thenceforth to be restricted to $100,000 and that he would be obliged to comply with margin requirements which were much more severe than those usually exacted. These instructions appear to have been carried out but on August 6, 1957 the price of shares of Aconic which had been traded for some time at $9 to $11 a share, fell to $1.90 and as a result the respondent and others suffered substantial losses. An investigation by the Ontario Securities Commission followed and ultimately criminal proceedings were instituted against Mr. Butler and Mr. Beaudry. An investigation was also undertaken by the Board of Governors of the Exchange as a result of which on October 1, 1957 the Board found "that Mr. Ramsay, while a Vice President and Director of the member corporation of E. H. Pooler & Company Limited, was guilty of conduct detrimental to the interest of the Exchange in inducing the opening by member firms or member corporations (other than E. H. Pooler & Co. Limited) of accounts in the name of C. J. Butler, Joseph Beaudry and E. H. Fauquier, or any of them for the purpose of carrying on margin certain shares of Aconic Mining Corporation" and thereupon imposed on the respondent the fine of $2,000 which is in question in these proceedings.

The penalty was imposed under By-Law No. 11 of the Exchange paragraphs 1 and 2 of which were as follows:

Sec. 1. If any member shall be adjudged by the Board of Governors guilty of a violation of any of the By-Laws or Rules or Regulations of the Corporation, or of failure to obey or conform to any decision of the Corporation or the Board, or of any conduct, proceeding or method of business which the Board in their absolute discretion deem unbecoming a member of the Exchange, or inconsistent with just and equitable prin-

ciples of trade, or detrimental to the interests of the Exchange;—the Board may impose any one or more of the following penalties, viz.: (1) a fine not exceeding $5,000, (2) suspension for such period or periods and upon such conditions if any as the Board may determine, and (3) expulsion; and, in addition thereto, may declare forfeit the seat and membership of any member expelled.

Sec. 2. A member shall be fully responsible for the acts and omissions of his employees, and if he carries on business as a member firm for the acts and omissions of his partners and the employees of such member firm, and if he carries on business as a member corporation for the acts and omissions of the directors, officers and employees of such member corporation, and if he operates an affiliated company for the acts and omissions of the directors, officers and employees thereof; and if any such act or omission be held by the Board of Governors to be one which, if done or omitted by the member, would subject him to any of the penalties above provided, then such member shall be liable therefor to such penalty to the same extent as if such act or omission had been done or omitted by him personally.

These by-laws were made under the authority of the Act of Incorporation of the Toronto Stock Exchange and supplementary letters patent issued under the Ontario *Companies Act*. Under s. 9 of the Act of Incorporation penalties incurred under the by-laws by any person bound thereby are recoverable by action.

By s. 3 of the *Income Tax Act* it is declared that the income of a taxpayer for a taxation year includes his income for the year from all businesses and by s. 4 it is provided that subject to the other provisions of Part I of the Act income for a taxation year from a business is the profit therefrom for the year. Speaking generally the profit from a business means the amount by which the revenues of the business exceed the expenses of carrying it on and this concept is not excluded by the other provisions of the Act but it is provided in s. 12(1)(*a*) that:

In computing income no deduction shall be made in respect of an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from . . . a business of the taxpayer.

In *Royal Trust Company v. M.N.R.*[1] the President of this Court discussed the approach to the question of the deductibility of an expense in computing income from a business under the provisions of the *Income Tax Act* at page 42 as follows:

Consequently, if the correct approach to the question of whether a disbursement or expense was properly deductible in a case under the *Income War Tax Act* was the one which I have outlined, it follows,

[1] [1957] C.T.C. 32.

1962

MINISTER OF NATIONAL REVENUE
v.
E. H. POOLER AND CO. LTD.

Thurlow J.

a fortiori, that it is the correct approach to the question of whether an outlay or expense is properly deductible in a case under the *Income Tax Act*. Thus, it may be stated categorically that in a case under the *Income Tax Act* the first matter to be determined in deciding whether an outlay or expense is outside the prohibition of Section 12(1)(*a*) of the Act is whether it was made or incurred by the taxpayer in accordance with the ordinary principles of commercial trading or well accepted principles of business practice. If it was not, that is the end of the matter. But if it was, then the outlay or expense is properly deductible unless it falls outside the expressed exception of Section 12(1)(*a*) and, therefore, within its prohibition.

Counsel for the Minister was not prepared to concede that the amount of the fine would be deductible in any case for the purpose of computing the profit from the respondent's business, but rested his case on the submission that it was not a normal risk or incident of the respondent's business that its vice president should be found guilty of objectionable conduct, that neither the conduct that incurred the fine nor the payment of the fine could result in income and that the amount so paid did not fall within the exception to the prohibition of s. 12(1)(*a*) as an outlay or expense incurred for the purpose of gaining or producing income from the respondent's business.

The respondent's submission on the other hand was that the liability that fell upon it to pay the fine arose out of one of the ordinary day to day risks incident to the carrying on of its business, that is to say the continuing risk of being fined by the Exchange (which regulates only the business activities of its members) for the acts of the respondent's employees, a risk which arises as soon as anyone is employed to carry out duties incident to the carrying on of the business, that the fine was therefore paid for the purpose of gaining or producing income from the business within the meaning of the exception to s. 12(1)(*a*) of the Act and was otherwise properly deductible in computing the profit from the business.

In the course of the argument reference was made to a number of cases on deductions decided under the English income tax statutes and under the *Income War Tax Act* including *C.I.R. v. Alexander von Glehn & Co. Ltd.*[1] and *Imperial Oil Ltd. v. M.N.R.*[2]. While a good deal of assistance may be derived from a study of these cases insofar as principles of general application are involved in them it

[1] 12 T.C. 232. [2] [1947] Ex. C.R. 527.

must I think be borne in mind that the law to be applied in this case is s. 12(1)(*a*) of the *Income Tax Act* the wording of which differs materially from the corresponding provisions of the English Acts as well as from s. 6(*a*) of the *Income War Tax Act* and that the result in any particular case may not necessarily be the same as it would have been if either the English or the earlier Canadian statute were applicable.

In applying the wording of s. 12(1)(*a*) to the present case it seems to me to be immaterial whether the fine is regarded as an "outlay" or as an "expense" but the problem which arises on the facts appears to be somewhat different depending on whether these words are coupled with the verb "was made" or with the verb "was incurred". I shall accordingly deal with the resulting expressions separately.

Viewing the fine as "an outlay or expense . . . made" ("expense" does not seem to fit naturally with "made" but the two words appear to be connected grammatically in the section) the question that arises on s. 12(1)(*a*) is whether or to what extent the outlay or expense was made for the purpose of gaining or producing income from the respondent's business. As I see it there is no conceivable way in which the payment of this fine could lead to the gaining or production of income from the respondent's business. Non-payment of it might possibly have led to suspension of the respondent's privileges as a member of the Exchange and thus to interference with the normal conduct of the business but I do not regard that as the reason for making the payment nor was it argued that that was the reason. In my opinion the respondent was liable to make the payment whether it continued to carry on its business or not and the making of it had no relation to the carrying on of the business. Viewed as an "outlay or expense . . . made" the payment thus does not meet the requirement of the exception to the prohibition of s. 12(1)(*a*).

Turning now to examine the fine as an "outlay or expense . . . incurred" the question that arises first is how the liability to pay it arose. The liability arose of course because the Board of Governors of the Exchange imposed the fine but that answer leads one immediately to inquire why the Exchange imposed it. The answer to this is that the Board had found that Mr. Ramsay while a vice president and director of the respondent was guilty of conduct detrimental

1962

MINISTER OF NATIONAL REVENUE
v.
E. H. POOLER AND CO. LTD.

Thurlow J.

to the interest of the Exchange in inducing other members of the Exchange to open margin accounts for Messrs. Butler, Beaudry and Fauquier. This then is the conduct which incurred the fine. It was not, as I view it, the employing of Mr. Ramsay which, even if regarded as something done in the course of the respondent's business and as involving a risk that he might by his conduct cause the respondent to be fined, was at most a remote circumstance having no real bearing on the question what it was that incurred the fine. In this view, apart from any broader principle which may or may not be applicable in the particular circumstances to exclude its deduction, the fine could not in my opinion escape the prohibition of s. 12(1)(*a*) unless the inducing by Mr. Ramsay of other members of the Exchange to open such accounts was an act done in the course of or for the purposes of the respondent's business.

The evidence falls short of satisfying me that this was the case. Primarily the business of the appellant was to act on behalf of customers in the execution of their orders to buy and sell stocks and bonds and thereby to earn commissions. To introduce Mr. Butler or his associates to competitors and induce them to do business with them was in my view not part of this business at all. It is not shown to have been a normal practice in the business nor did the respondent receive or become entitled to commissions on the transactions conducted by the other brokers for Mr. Butler or his associates. Nor has the conduct in question been shown to have been carried out for the purposes of the respondent's business. On this aspect of the matter, Mr. William Wismer, a vice president of the Exchange, indicated that the Board considered that Mr. Ramsay was a member of the group consisting of Messrs. Butler, Beaudry and others which was concerned in promoting Aconic as he had given them assistance in arranging for accounts to be carried by members of the Exchange. There is also the evidence of Mr. Pooler who said he believed that Ramsay having been prevented from doing all the business he could obtain from Butler introduced him to other members of the Exchange because he wanted to help Butler. Neither of these explanations suggests to me that in introducing Butler to other brokers Ramsay was endeavouring to earn or secure commissions for the respondent or to promote its business but rather that he was doing so for reasons of

his own. What these reasons were, however, remains unexplained. Ramsay was not called as a witness nor is there any further evidence on the point. It was suggested in argument that he may have made the introductions to other brokers in order to hold Mr. Butler's goodwill for the respondent and in that sense to promote the respondent's business but that in my view is mere speculation and I would infer no such conclusion. On the whole, the situation as disclosed appears to me to be simply one in which the respondent as a member of the Exchange became a party to, or, at any rate became subject to punishment by the Exchange for acts by Ramsay which were not part of the respondent's business or for the purposes of that business and in my opinion it has not been established that the outlay or expense in question was incurred to any extent for the purpose of gaining or producing income from the respondent's business within the meaning of s. 12(1)(*a*) of the Act. It follows that the fine is not deductible in computing the respondent's income from its business.

The appeal will therefore be allowed with costs and the re-assessment restored.

Judgment accordingly.