BETWEEN:

BRITISH COLUMBIA POWER CORPORATION, LIMITED ..... APPELLANT;

AND

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

Vancouver 1966
July 5-8, 11-12
July 26

Income tax—Costs of litigation—Provincial statute expropriating holding company's shares in subsidiary—Action to declare expropriation ultra vires—Whether costs deductible—Income Tax Act, s. 12(1)(a) and (b).

Appellant incurred litigation costs of more than $1,150,000 in 1962 and 1963 in connection with an action which it brought against the Attorney General of British Columbia and others to declare *ultra vires* a British Columbia statute expropriating the common shares of B.C. Electric Co, all of which were owned by appellant (constituting over 90% of its assets). The action was successful and appellant obtained in consequence a much higher price for the shares.

Held, the litigation costs were barred from deduction by paragraphs (*a*) and (*b*) of s. 12(1) of the *Income Tax Act* in computing appellant's income for 1962 and 1963.

Sutton Lumber & Trading Co. Ltd. v. M.N.R. [1953] 2 S.C.R. 77; *M.N.R. v. Dominion Natural Gas* [1941] S.C.R. 19; *M.N.R. v. The Kellogg Co. of Canada, Ltd.* [1943] S.C.R. 58; *M.N.R. v. L. D. Caulk Co. of Canada Ltd.* [1954] S.C.R. 55; *B.C. Electric Railway Co. v. M.N.R.* [1958] S.C.R. 133; *Montreal Coke and Mfg. Co. v. M.N.R.* [1944] A.C. 126; *Siscoe Gold Mines Ltd. v. M.N.R.* [1945] Ex. C.R. 257; *Farmers Mutual Petroleums Ltd. v. M.N.R.* [1966] C.T.C. 283; *Evans v. M.N.R.* [1960] S.C.R. 391; *Premium Iron Ores Ltd. v. M.N.R.* [1966] S.C.R. 685; *Imperial Oil Ltd. v. M.N.R.* [1947] Ex. C.R. 527; *Rolland Paper Co. v. M.N.R.* [1960] Ex. C.R. 334; *Hudson's Bay Co. v. M.N.R.* [1947] Ex. C.R. 130; *British Insulated & Helsby Cables, Ltd. v. Atherton* [1926] A.C. 205; *Southern v. Borax Consolidated, Ltd.* [1941] 1 K.B. 111; *Portland Cement Mfg. Co. Ltd. v. I.R.C.* [1946] 1 All E.R. 68, referred to.

APPEAL from income tax assessments.

D. McK. Brown, Q.C., H. H. Stikeman, Q.C. and *D. M. M. Goldie* for appellant.

P. N. Thorsteinsson and *D. G. H. Bowman* for respondent.

SHEPPARD D.J.:—The appeal is by the British Columbia Power Corporation, Ltd. (called B.C. Power) against an assessment by the Minister of National Revenue; a cross-appeal by the Minister has been withdrawn.

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The B.C. Power was incorporated by Letters Patent of Canada of the 9th of May, 1928 (Ex. A-12) to engage in the utility business through the ownership of shares in public utility companies, and to engage in similar or associated activities. At material times B.C. Power had as a subsidiary the British Columbia Electric Company Ltd. (called B.C. Electric), a public utility incorporated in 1926 under the *Companies Act* of British Columbia, which generated and distributed electricity, distributed gas, and operated a railway, motor bus and trolley coach systems in the lower mainland and Vancouver Island.

The B.C. Power held all the common shares of B.C. Electric; the preference shares and the debentures, including Debenture Series B were issued to the public. The value of the common shares of the B.C. Electric represented over 90% of the assets of B.C. Power, and the B.C. Electric supplied all dividends paid by B.C. Power to its shareholders (Ex. A-14). B.C. Power had other subsidiaries ancillary to such public utility of the approximate value of $11,000,000.00.

On 3rd August, 1961, the Provincial Legislature by Statute (*Power Development Act, 1961,* B.C. 1961 (2nd Sess.) Cap. 4) expropriated all the common shares of B.C. Electric at the fixed price of $110,985,045.00, vested such shares in the Crown, terminated the appointment of the existing directors to be replaced by others appointed by the Lieutenant-Governor-in-Council and also created an option to B.C. Power to sell its remaining undertaking worth $11,000,000.00 at approximately $68,500,000.00 (Ex. A-19), that is, $38.00 per share less the sums paid for the expropriated shares.

The expropriation was reported to the meeting of directors of the 3rd August, 1961 (Ex. A-17) and these directors decided to improve the terms of the compensation as they considered the price paid inadequate (Ex. A-18), and later outlined a plan for full compensation for the expropriated shares and decided to look into new lines of business.

On the 21st September, 1961, B.C. Power submitted for fiat a proposed petition of right asking that full and complete compensation of the shares be determined by the Court but the Provincial Secretary refused it.

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On the 13th November, 1961, B.C. Power issued a writ in the Supreme Court of British Columbia against the defendants, the Attorney-General of B.C., the B.C. Electric, the Royal Trust Company and C. James Copithorne, which asked a declaration of the rights in respect of the Series B Debentures and of the effect of the option contained in the Statute of August, 1961.

In December of 1961, B.C. Power reduced its capital and paid its shareholders $18.70 per share. On the 29th March, 1962, the Legislature enacted two statutes:

(*a*) 1962, Cap. 50 which amended the Statute of 1961 by increasing the compensation for the expropriated shares in B.C. Electric to $171,833,052.00, and by vacating the option of the remaining undertaking (Ex. A-42);

(*b*) 1962, Cap. 8, which created the B.C. Hydro and Power Authority and amalgamated in one corporation the assets of the B.C. Electric and of the other utilities under that Commission (Ex. A-44).

In April of 1962, the B.C. Power amended the Statement of Claim and asked for a declaration that the 1961 Statute was *ultra vires* and complete compensation for the expropriated shares, and a declaration of the rights in regard to the Series B Debentures.

After numerous interlocutory motions of which two went to the Court of Appeal and one to the Supreme Court of Canada, the action went to trial on the 1st May, 1962 before Chief Justice Lett of the Supreme Court of British Columbia, who sat for 144 days until the 25th February, 1963, and on the 29th July, 1963 (44 W.W.R. (N.S.) 65) delivered reasons for judgment holding all three Statutes to be *ultra vires* of the Legislature and the value of the expropriated shares to be $192,828,125.00.

By telegram of the 29th July, 1963, the B.C. Power informed the Premier of British Columbia that their principal concern was to obtain fair compensation. By telegram 1st August, 1963, the Premier replied that he accepted the amount found due by the Chief Justice (Ex. A-68). Eventually under date of 26th August, 1963, by agreement between B.C. Power, B.C. Electric and the B.C. Hydro and Power Authority, the parties referred to Chief Justice Lett the question ,"What amount of money should be paid to

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B.C. Power for the common shares of the capital of the Electric Company?" That amount he found to be $197,114,-358.00, and by agreement of the 27th September, 1963, between those same three parties the B.C. Power recited that the expropriated shares were entered on the register of members of the B.C. Electric and owned and controlled by the Crown (Recital B, Ex. A-81), and that the operations, undertaking and property of the B.C. Electric were in the possession and control of the directors appointed under the 1961 Statute (Recital C, Ex. A-81), and in consideration of the sum paid released and quit claimed to Her Majesty the expropriated shares with a general release to Her Majesty and Servants for all acts pursuant to the Statute of 1st August, 1961.

On the 1st November, 1963, the shareholders resolved that B.C. Power be wound up and by the Order of the 6th November, 1963, the Royal Trust Company was made liquidator.

A. Bruce Robertson gave evidence which may be summarized as follows. The expropriation was considered by B.C. Power, its directors and shareholders, to be a sum below the fair value and therefore the immediate desire was to obtain an adequate or fair compensation. Also, Debenture Series B provided that the debenture holders could surrender their debentures for shares in B.C. Power, that B.C. Power would receive therefor shares in B.C. Electric. Hence, B.C. Power had some concern over its liability after B.C. Electric had been expropriated, particularly after a notice to convert had been received by the trustee. Under those circumstances, the petition of right was drafted and when received B.C. Power began action alleging the expropriation to be *ultra vires* of the province and asking a declaration of *ultra vires* or, alternatively, value of the shares; that the writ was begun with more courage than hope of success; that the possibility of the expropriation being held *ultra vires* was discussed.

After the two Statutes of 1962 the hopes of B.C. Power to a declaration of *ultra vires* increased considerably and after April, 1962, the discussion was not merely of compensation but of a desire for a declaration of *ultra vires* to improve the bargaining position of B.C. Power. If the Statutes were so declared, the Company was prepared to settle at a fair compensation, but if the Province would not

pay that sum, then the Company would continue to operate B.C. Electric though it would prefer not to do so. Further, the public relations people had frequently warned B.C. Power against publicizing any intention to operate B.C. Electric. However, B.C. Power was prepared to agree to B.C. Electric continuing to be a government owned utility provided B.C. Power received what it considered fair compensation.

B.C. Power contends that the costs of such litigation should be deducted from income, while the Minister contends the costs are not so deductible.

The remaining issues arose under the following circumstances. Prior to the expropriation of B.C. Electric shares, B.C. Power had neither office space nor employees. These were supplied by B.C. Electric, a wholly owned subsidiary which provided offices and services generally as required and without charging therefor. After the expropriation, B.C. Power had numerous expenses formerly paid by B.C. Electric, and the issue arises over the deductibility of those expenses. B.C. Power contends that they are properly deductible under Section 12(1)(*a*). The Minister contends that they are not deductible by reason of Section 12(1)(*b*) or 12(1)(*a*), as for example, being incidental to expenses of litigation.

B.C. Power made income tax returns for the years 1962 and 1963, and the Minister made assessments refusing to allow various sums as deductible. B.C. Power served notice of objection and the Minister, by notification of the 15th December, 1964, confirmed the assessments. B.C. Power thereupon appealed to this Court and the Minister cross-appealed but the cross-appeal has now been abandoned (Ex. R-24).

As to the costs of litigation, the Minister in his assessment has disallowed their deduction which amounted to, for the year 1962, $742,023.85 (Ex. A-1), and for the year 1963, $414,199.81 (Ex. A-1). From that disallowance B.C. Power has appealed on the ground that such expenses are deductible under the exception in Section 12(1)(*a*) of the *Income Tax Act*. The Minister contends that such expenses are not deductible expenses but excluded by Section 12(1)(*a*), and alternatively as capital outlays excluded by Section 12(1)(*b*).

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There is considerable evidence as to whether the purpose of the action was to recover the shares, which was the contention of B.C. Power, or to recover damages as contended by the Minister. It is immaterial which view is taken, as the shares were capital assets of B.C. Power within the express objects of the Letters Patent (Ex. A-12), and by the litigation B.C. Power obtained a declaration of the right to those shares by reason of the expropriating Statute of 1961 being held to be *ultra vires* of the Province, and that right B.C. Power released for the sum paid pursuant to the finding of Chief Justice Lett, which sum B.C. Power has treated as capital, as was done in *Sutton Lumber & Trading Company Ltd. v. Minister of National Revenue.*[1]

Legal expenses are recoverable on the same basis as other expenses: *Minister of National Revenue v. Dominion Natural Gas*[2]. Duff C.J. at p. 25:

> In the ordinary course, it is true, legal expenses are simply current expenditure and deductible as such; but that is not necessarily so.

and *Minister of National Revenue v. The Kellogg Company of Canada, Ltd.*[3] Duff C.J. at p. 60:

> It was held by this Court that the payment of these costs was not an expenditure "laid out as part of the process of profit earning," but was an expenditure made "with a view of preserving an asset or advantage for the enduring benefit of the trade," and, therefore, capital expenditure.

and at p. 61:

> It was pointed out in the *Minister of National Revenue v. The Dominion Natural Gas Company, supra,* at p. 25, that in the ordinary course legal expenses are simply current expenditures and deductible as such.

In the following judgments litigation costs were held to be capital outlays and therefore now excluded by Section 12(1)(*b*) and not for the purpose of gaining or producing income within the exception to Section 12(1)(*a*).

In the *Minister of National Revenue v. Dominion Natural Gas, supra,* the company's right under a franchise to supply natural gas to an area then a part of the City of Hamilton was challenged by an action which the company successfully defended and it was held that the costs were

[1] [1953] 2 S.C.R. 77.
[2] [1941] S.C.R. 19.
[3] [1943] S.C.R. 58.

not to be deducted from its taxable income. That action arose under Section 6 of the *Income War Tax Act* which reads:

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.

Duff C.J. for himself and Davis J., held that it was capital expenditure as follows (p. 24):

Again, in my view, the expenditure is a capital expenditure. It satisfied, I think, the criterion laid down by Lord Cave in *British Insulated v. Atherton* [1926] A C 205 at 213. The expenditure was incurred "once and for all" and it was incurred for the purpose and with the effect of procuring for the company "the advantage of an enduring benefit". The settlement of the issue raised by the proceedings attacking the rights of the respondents with the object of excluding them from carrying on their undertaking within the limits of the City of Hamilton was, I think, an enduring benefit within the sense of Lord Cave's language. As Lord Macmillan points out in *Van den Berghs Ld. v. Clark* [1935] A C. 431, at 440:

> "Lord Atkinson indicated that the word "asset" ought not to be confined to 'something material' and, in further elucidation of the principle, Romer L.J. has added that the advantage paid for need not be "of a positive character" and may consist in the getting rid of an item of fixed capital that is of an onerous character: *Anglo-Persian Oil Co. v. Dale* [1932] 1 K.B. 146."

Kerwin J. also held it to be capital expenditure and at p. 31 said:

It was a "payment on account of capital," as it was made (to use Viscount Cave's words) "with a view of preserving an asset or advantage for the enduring benefit of a trade".

That judgment was referred to in *Minister of National Revenue v. L. D. Caulk Co. of Canada Ltd.*[1] by Rand J. at p. 57 as follows:

The judgment of this Court in *The Minister v. Dominion Natural Gas,* is clearly distinguishable as having been a case of expenses to preserve a capital asset in a capital aspect.

While Section 6(*a*) of the *Income War Tax Act* has been said to be "less stringent" under Section 12(1)(*a*) by omitting the words "not wholly, exclusively and necessarily":

[1] [1954] S.C.R. 55.

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B.C. Electric Railway Co. v. Minister of National Revenue[1] nevertheless Section 6(*b*) is the equivalent of Section 12(1)(*b*) and therefore those legal expenses are capital outlays whose deductibility is prohibited by Section 12(1)(*b*).

In *Montreal Coke and Manufacturing Company v. Minister of National Revenue*[2] the company redeemed certain bonds before maturity and reissued them at a lesser rate of interest which increased the net revenue, and the Court held that the company could not deduct expenses of those financial operations.

In *Siscoe Gold Mines Ltd. v. Minister of National Revenue*[3] the company was engaged in gold mining and incurred legal expenses in retaining its title to mines which expenses it sought to offset against its income, but the Court held these to be capital expenditures, and in *Farmers Mutual Petroleums Ltd. v. Minister of National Revenue*[4] the company incurred legal expenses in defending 250 actions attacking the company's title to mineral claims, and in appearing on a Royal Commission to inquire into its method of obtaining the titles. Those legal expenses were held to be a capital expenditure.

On the other hand, litigations costs have been allowed as deductible from income under Section 12(1)(*a*) in two instances:

(1) When the taxpayer has to sue to recover the income. In *Gladys Evans v. Minister of National Revenue*[5] Evans deducted from revenue the costs of recovering from trustees the income bequeathed to her by will. It was held not an expenditure on account of capital within Section 12(1)(*b*) but an expenditure properly incurred for the purpose of gaining an income, of which she was unable to obtain payment without incurring the outlay. The case was referred to in *Premium Iron Ores Limited v. Minister of National Revenue*[6] by Martland J. as follows:

> Such expense was made in order to protect her right to receive income, not only in 1955, but in each of the years in which income became available for distribution from the estate. This right was held not to be a capital asset, and the expense in question did not fall within s. 12(1)(*b*).

[1] [1958] S.C.R. 133.
[2] [1944] A.C. 126.
[3] [1945] Ex. C.R. 257.
[4] [1966] C.T.C. 283.
[5] [1960] S.C.R. 391.
[6] [1966] S.C.R. 685 at 705.

Such expense was held to be properly incurred within s. 12(1)(*a*) for the purpose of gaining an income to which the appellant was entitled.

(2) When the taxpayer as defendant has incurred the expenditure for an alleged liability in contract, tort or otherwise created by an act done in the course of normal operations to produce income, and hence "made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business" within Section 12(1)(*a*).

In *Minister of National Revenue v. The Kellogg Company of Canada, supra,* the company was permitted to deduct from income its costs of successfully defending an action for selling its goods under the term "shredded wheat". Duff C.J. at pp. 60-61 said:

> The right upon which the respondents relied was not a right of property, or an exclusive right of any description, but the right (in common with all other members of the public) to describe their goods in the manner in which they were describing them.

In *Minister of National Revenue v. L. D. Caulk Company of Canada Ltd., supra,* Rand J. at p. 30 said about the *Kellogg* judgment:

> The payment arose from what were considered the necessities of the practices to the earning of the income . . . . That use was likewise part of the day-to-day usage in marketing the company's products and the expenses were held to be deductible.

In *Imperial Oil Limited v. Minister of National Revenue*[1] the company was permitted to deduct from revenue the amount paid for damage claims and "fees" arising out of collision at sea through the negligent operation of its tanker. Thorson P. in stating the rule at pp. 545-6 said:

> This means that the deductibility of a particular item of expenditure is not to be determined by isolating it. It must be looked at in the light of its connection with the operation, transaction or service in respect of which it was made so that it may be decided whether it was made not only in the course of earning the income but as part of the process of doing so.

and at p. 546 said:

> The fact that a legal liability was being satisfied has, by itself, no bearing on the matter. It is necessary to look behind the payment and enquire whether the liability which made it necessary—and it makes no

[1] [1947] Ex. C.R. 527.

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difference whether such liability was contractual or delictual—was incurred as part of the operation by which the taxpayer earned his income.

In *Rolland Paper Company v. Minister of National Revenue*[1] the company defended charges of selling by illegal trade practices contrary to *Code* Section 498(1)(*d*) which it was allowed to set off, and in *Minister of National Revenue v. L. D. Caulk Company of Canada Ltd., supra,* the company was represented by a solicitor on investigation under the *Combines Investigation Act* of charges of selling contrary to *Code* Section 498. It was held that the right upon which the company relied was the right to conduct its operations in a certain manner and was not a right of property or any exclusive right of any description.

In *Premium Iron Ores Limited v. Minister of National Revenue, supra,* the company was allowed to deduct the cost in the United States of America of defending a claim of that government for income tax. Martland J. at p. 5 said:

> I have great difficulty in seeing how, in principle, this expense for legal services, made as it was for the purpose of protecting the appellant's income, can be regarded as being different from that which was held to be properly deductible in the Kellogg case and also in the Evans case. The disbursement made was not an outlay or replacement of capital, nor a payment on account of capital, within s. 12(1)(*b*). The claim of the American government was not in respect of the appellant's capital, but a claim which, if established, would have created a liability in relation to its income.

At p. 7 he said:

> The resistance of the claim is an attempt to protect Canadian income, and it matters not, so far as the Canadian taxing authority is concerned, that the nature of the claim is one for income tax.

and at p. 8:

> In my opinion a payment made for legal services in an attempt to protect income against encroachment by a third party is, in principle, on the authority of the Kellogg and Evans cases in this Court, properly deductible.

On the other hand, in *Hudson's Bay Company v. Minister of National Revenue*[2], the company incurred costs of an action in the United States of America to restrain another marketing its goods under a name which included Hudson's Bay, and the Court held that they were deductible

[1] [1960] Ex. C.R. 334.

[2] [1947] Ex. C.R. 130.

from current income under Section 6(*a*) of the *Income War Tax Act*. Angers J. at p. 176 said:

> The legal expenses and costs laid out by the appellant to protect its trade name, business and reputation were not incurred with the object of creating or acquiring any new asset but were incurred in the ordinary course of protecting and maintaining its already existing assets. On the other hand, I do not believe that these expenses and costs can be considered as being a capital outlay or loss.

There Angers J. in holding that the expenses were not incurred with the object of creating or acquiring any new asset were therefore not a capital outlay, appears not to have observed that under the Canada *Income Tax Act* to preserve an asset was sufficient to create a capital expenditure: *Minister of National Revenue v. Dominion Natural Gas, supra,* Kerwin J. at p. 31; *Minister of National Revenue v. The Kellogg Company of Canada Ltd., supra,* at p. 61 and *Minister of National Revenue v. L. D. Caulk Company of Canada Ltd., supra,* Rand J. at p. 57.

Further, in the *Kellogg* case the taxpayer was not asserting an exclusive right and therefore it was held to be deductible, but in the *Hudson's Bay* case the taxpayer was asserting an exclusive right. In any event, assuming that an expenditure is not within Section 12(1)(*b*), it does not follow that it is deductible under the exception to Section 12(1)(*a*). Accordingly, the *Hudson's Bay* case does not appear to conform to the other judgments and today would probably be held a capital expenditure following *Minister of National Revenue v. Kellogg Company of Canada Ltd., supra,* at p. 60.

In the present instance, the litigation costs claimed by B.C. Power were not incurred for the recovery of income but for the recovery of the shares in B.C. Electric, a capital asset of B.C. Power, nor were the costs incurred in defending an action alleging liability from an act occurring in the normal course of carrying on the business. Here the outlay could rather be described in the words used by Martland J. in *Premium Iron Ores Limited v. Minister of National Revenue, supra,* as:—

> . . . . a payment on account of capital, within s. 12(1)(*b*).

not in respect of "a liability in relation to its income". Hence on the authorities it would appear that the litigation costs in question are a capital outlay unless there is good reason to the contrary.

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B.C. Power contends as a first and principal submission:

> .... that money that you spend in defending your title to a capital asset which is assailed unjustly is obviously revenue expenditure.

Counsel for B.C. Power cited *British Insulated and Helsby Cables, Limited v. Atherton*[1] where Lord Cave at p. 213 said:

> But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital

and contended that the shares were claimed by B.C. Power in the same form as when taken and nothing was acquired or added thereto, therefore it was not a capital outlay but an expense deductible from income.

Counsel for B.C. Power also cited *Southern v. Borax Consolidated, Limited*[2] where the company through a subsidiary owned land with buildings and wharves thereon which title the City of Los Angeles attacked and the company was held entitled to take from revenue the costs of defending such action, and *Portland Cement Manufacturing Company Ltd. v. Inland Revenue Commissioners*[3], where the company paid to two retiring directors sums of monies for their covenants not to compete, which sums the company was held entitled to deduct from revenue as a revenue expenditure.

Those cases and the result are distinguishable from the case at bar for the following reasons:

(1) Two cases, the *Southern* case and the *Portland Cement* case are distinguishable on the facts. In those cases the judgment did not confer "the advantage of an enduring benefit". In the case at bar the judgment did acquire and add a material benefit to B.C. Power's right to the shares.

   (i) The judgment by declaring the Statutes to be *ultra vires* settled the issues of the right to the shares and therefore such judgment did bring into existence an asset or advantage that was enduring.

[1] [1926] A.C. 205. [2] [1941] 1 K.B. 111.
[3] [1946] 1 A.E.R. 68.

In *Minister of National Revenue v. Dominion Natural Gas, supra,* Duff C.J. at p. 24 said:

> The settlement of the issue raised by the proceedings attacking the rights of the respondents with the object of excluding them from carrying on their undertaking within the limits of the City of Hamilton was, I think, an enduring benefit within the sense of Lord Cave's language.

That equally applies here in that the judgment of Lett C.J. had the effect of providing the B.C. Power with "the advantage of an enduring benefit", that is, a favourable judgment determining the issue raised on the pleadings and which judgment was once and for all in determining the Statutes invalid and that the B.C. Power was entitled to the shares.

(ii) Following the expropriating Statute of 1961, the Crown in place of B.C. Power was registered on the register of B.C. Electric as the owner of all the outstanding common shares of B.C. Electric (Recital B. Ex. A-81), and thereafter B.C. Power was deprived of asserting the rights of owner of those shares, and particularly could not vote the shares to elect directors or otherwise, could not collect dividends in respect thereof and could not sell the shares. The judgment of Lett C.J. gave B.C. Power the right to go on the register and hence restored those rights previously divested. That was "an advantage for the enduring benefit".

(iii) While registered as owners of the shares, B.C. Power received dividends from B.C. Electric which were free from income tax. In 1960 the dividends received amounted to $7,790,000.00 of which B.C. Power paid out $6,711,728.00. The purchase price received when lent at interest incurred liability to income tax. By the declaration of *ultra vires* B.C. Power had the right to revert to the former position which right B.C. Power released pursuant to the finding of Lett C.J. (Ex. A-80, September 27, 1963) for the sum of $197,-114,358.00 less the amount which had previously been received, and therefore by the judgment and consequential reference B.C. Power received an additional sum of $25,281,306.00.

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The judgment did bring into existence "an asset or an advantage for the enduring benefit" within the definition of Lord Cave in the *Atherton* case.

(2) The two judgments cited are distinguishable in law. The cited cases were decided under the English Act and under the words appearing therein, "money wholly and exclusively laid out and expended for the purposes of trade", whereas the words now in question are those under Section 12(1)(*a*) of the Canada *Income Tax Act* reading in part: "an outlay or expense . . . made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer", and under the Canada *Income Tax Act* an expenditure to preserve a capital asset is a capital outlay.

The word "preserving" was used by Kerwin J. in *Minister of National Revenue v. Dominion Natural Gas, supra,* at p. 31, and in the *Minister of National Revenue v. The Kellogg Company of Canada, Ltd., supra,* Duff C.J. in delivering the judgment of the Court said at p. 60:

> It was held by this Court that the payment of these costs was not an expenditure "laid out as part of the process of profit earning" but was an expenditure made "with a view of preserving an asset or advantage for the enduring benefit of the trade" and therefore capital expenditure.

In *Minister of National Revenue v. L. D. Caulk Company of Canada Ltd., supra,* Rand J. at p. 57 said:

> The judgment of this Court in *The Minister v. Dominion Natural Gas* is clearly distinguishable as having been a case of expenses to preserve a capital asset in a capital aspect.

Hence, assuming that *Southern v. Borax Consolidated, Limited, supra,* and *Portland Cement Manufacturing Company Ltd. v. Inland Revenue Commissioners, supra,* did correctly state for England the meaning of the words in the English Act, it does not follow that they purported to give the meaning of those other words in Section 12(1)(*a*) of the Canada *Income Tax Act.* Under the Canada *Income Tax Act* a capital outlay may be made either to acquire or to preserve a capital asset: *Minister of National Revenue v. Dominion Natural Gas* and *Minister of National Revenue v. The Kellogg Company of Canada, Ltd.,* both *supra.*

Moreover, it is of no advantage to B.C. Power to have escaped the prohibited deduction of capital outlay under Section 12(1)(*b*) unless it bring itself within the exception to Section 12(1)(*a*) "to the extent . . . made or incurred . . . for the purpose of gaining or producing income", otherwise the deduction would be preluded by the general words of Section 12(1)(*a*).

The word "income" in Section 12(1)(*a*) also appears in Section 2(3) to define taxable income. Under the *Income War Tax Act,* Lord Macmillan in *Montreal Coke and Manufacturing Company v. Minister of National Revenue, supra,* at p. 133 said:

> Expenditures to be deductible must be directly related to the earning of the income.

While Section 12(1)(*a*) may be less stringent than the former section it at least requires that the deductible expenditure shall be made "for the purpose of gaining or producing income" and the Statute intends that the "income" after the permitted deduction is the taxable income under Section 2(3). That is, the deduction is to be made from taxable income.

In all the cases where the deduction of costs of litigation was allowed against income the expenditure was related to the earning of the income, as for example, where the litigation was to recover the income, as in the *Evans* case, or to protect the income from alleged liability from an act which occurred in the normal course of gaining or producing the income, for example, in *Minister of National Revenue v. The Kellogg Company of Canada Ltd., Imperial Oil Limited v. Minister of National Revenue, Minister of National Revenue v. L. D. Caulk Company of Canada Ltd., Premium Iron Ores Limited v. Minister of National Revenue,* all *supra.*

In the case at bar the expenditure was not for the purpose of gaining or producing income but to recover a capital asset.

It was contended by B.C. Power that the purpose of the action was in substance to receive the dividends from the shares. That is not the evidence. The primary purpose of the action was to obtain fair compensation for the shares.

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By telegram of the 29th July, 1963, A. Bruce Robertson to the Premier (Ex. A-65), stated in part:

> Their principal concern has been to obtain fair compensation for the common shares in the B.C. Electric . . . . They continue willing, as they have been since August, 1961, to enter into negotiations looking toward a mutually satisfactory arrangement for the acquisition by the Province of the common shares in the B.C. Electric.

and Robertson in his Discovery said in questions 44 and 45:

> 44. We felt, and our public relations people were hammering at me all the time on this, that if we were to retake possession it must only be after the government had turned down the chance to make a fair deal for the shares, and so I felt it was not necessary or wise for me to draw attention to the claim for repossession.
>
> 45.Q What was the ultimate purpose of the action?
>
> A. I think I can sum it up this way, that if the government wished to continue its power policy it would have to deal with B.C. Power as the owner of the largest utility. Failing that, we would resume operations.

In their evaluation by Lett C.J. at trial (44 W.W.R. (N.S.) 198) the shares were not valued on the basis of future dividends but on the basis of the value of the assets of B.C. Electric both as organized into a system and the value in breaking up, the possible future earnings of B.C. Electric, and that was not restricted to the part thereof used for dividends. Further, the purpose of the action was to acquire the shares in order to obtain a declaration of *ultra vires* of the Province to provide a basis for negotiation for a reasonable settlement.

Notwithstanding the contention of B.C. Power to the contrary, Section 12(6) does not authorize the deduction of litigation costs. This section merely removes the restriction of Section 12(*c*), and when that restriction is removed the onus remains on B.C. Power to bring the litigation costs within the permitted deduction under Section 12(1)(*a*).

The Minister has contended that the primary purpose of B.C. Power in continuing its existence after the expropriating Statute of 1961 was to obtain more compensation for the shares or to recover the shares, but in either instance it would be a capital purpose, therefore all the expenses in issue should be disallowed under Section 12(1)(*a*) and (*b*) as made for such purpose. That contention should not succeed.

The alleged purpose of the continued existence of B.C. Power is merely a motive for continuing in business. Under the exception to Section 12(1)(*a*) the questions are:

(1) Did the company carry on business?

and

(2) Was the expenditure for the purpose of earning income?

One may go into business for many reasons, as for example, to make capital gains or merely to provide succession, but those are merely preceding motives. Having gone into business the question then arises whether an outlay or expense is "for the purpose of gaining or producing income". If for such purpose the expense is deductible from income, otherwise it is excluded by Section 12(1)(*a*) or (*b*), or may be prohibited by both sections as appears to have been the case in *Minister of National Revenue v. Dominion Natural Gas* and *Montreal Coke and Manufacturing Company Ltd. v. Minister of National Revenue,* both *supra.*

Here, B.C. Power did continue in business and the question therefore is whether the expenditures in issue were for the purpose of gaining or producing income within the exception to Section 12(1)(*a*), of which the onus is on B.C. Power.

There remains to order a reference with the requisite direction as the parties have agreed that the assessment be referred back to the Minister (Ex. R-24), and the expenditures in issue will be those mentioned in Exhibit A-2.

The onus is on B.C. Power to prove error of the Minister in disallowing all or some part of each expenditure. That onus is subject to the following:

(*a*) The parties have agreed "that the said expenditures were incurred in the taxation years indicated, and that the nature of the expenses is as described, subject to amplification by oral testimony to be adduced at trial". (Ex. A-1)

(*b*) Certain expenses are admitted or abandoned (Exs. A-2, R-24). Apart from the expenditures not in issue the onus is on B.C. Power to prove error in the assessment

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by proving the purpose of the expenditure when not shown by the heading, or that some greater allowance should be made than appears in the assessment.

The only issue affirmatively raised by the Minister is that found against.

Items in both years 1962-1963 (Ex. A-1)

Litigation Costs:—These are not deductible and are properly disallowed for the reasons given. It is to be observed that the costs of Bull, Housser and Tupper in the amount of $24,092.85 are agreed to be not deductible (Ex. A-2) but that is immaterial as the whole item is disallowed.

Public Relations for 1962-1963 (which includes such matters as shareholders' inquiries, press clippings):—These expenses have not been proven to be for the purpose of producing income within Section 12(1)(*a*) and therefore are properly disallowed.

Office and Equipment Rental:—Prior to the expropriating Statute, B.C. Power had neither office nor employees but those were supplied by B.C. Electric, a wholly owned subsidiary. When B.C. Electric had been expropriated it was then necessary for B.C. Power to rent offices and furniture from the Royal Trust Company. It is conceded that $2,955.94 was properly disallowed for 1962 as a public relations expense, but on the evidence, the balance in 1962 would appear to be properly deductible from the income.

In 1963 the item for office and equipment rental appears under the general administrative expenses. This item does not include anything for public relations and, therefore, is subject only to the contention of the Minister that it should be disallowed on account of the purpose of continuing in business. This contention is not upheld and the item is properly deductible.

Telephone and Telegraph:—The deduction for public relations is properly disallowed. The balance is subject only to the objection as to the purpose on behalf of the Minister and therefore should be allowed.

General Administration Expenses:—The objection of the Minister to that purpose is set out in Exhibit A-2, namely, that during the years in question they were directed

primarily or essentially to the conduct of the law suit and other matters flowing from the purported expropriation of the common shares of B.C. Electric.

The evidence does not support that contention and generally these items should be allowed save and excepting in respect of salaries and incentive bonuses which are really part of the salary. The onus is on B.C. Power to prove that the disallowance was in error either in whole or in part and the evidence does not permit the Court saying to what extent there has been error on the part of the Minister, but the evidence does indicate that there should be some disallowance of salaries, and as a reference back is necessary, therefore the salaries should be dealt with as follows:

As pointed out, prior to August, 1961, the B.C. Power had no staff. It relied for help upon officers and employees of the B.C. Electric. After August, 1961, it was necessary for B.C. Power to employ its own staff, and therefore it should be allowed the salaries of those employed to carry on its business in the normal manner, and hence for earning the income within the exception (Section 12(1)(*a*)). Hence if any of such employees who were employed for the purpose of the business in the normal manner did give additional assistance to the litigation but thereby caused no additional expense to B.C. Power, then the whole salary should be allowed. Such would appear to be the case of Robertson and McLean. On the other hand, if the employee be employed solely for the purpose of litigation or if he be employed in the normal manner but subsequently devote the whole of his time to litigation, then the amount of time so devoted to litigation should be disallowed as an expenditure. Such would appear to be Patterson, who was employed solely for litigation, and Goldie, who may have been secretary performing certain services for the company, but essentially during the period of litigation was acting as solicitor for litigation. Others may fall into either category and should be determined on the reference.

Items in the year 1962

Legal Fees:—Three are expressly abandoned by B.C. Power, namely, Stikeman Elliott, Linklater Paines and Sullivan Cromwell. The remaining two on the evidence have

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nothing to do with litigation but are part of the normal, general expense of B.C. Power and should be allowed.

Professional Fees:—It is conceded by Exhibit A-2 that $1,400.00 was properly disallowed. The balance is ordinary corporate auditing and the objection of the Minister is only to the purpose of expenditure which has been held against. The balance should be allowed.

Shareholders Committee Expenses:—The committee was formed in October of 1961 to obtain fair and appropriate terms for the shares expropriated. This item is properly disallowed as relating to capital assets and not for the purpose of income within Section 12(1)(*a*).

Special Shareholders Meeting expenses—$1,645.87:—This the Minister concedes should be allowed.

Letters to Shareholders:—That is on the evidence due to an extraordinary happening, namely, to inform the shareholders of the expropriation and inquiries. The item was properly disallowed as relating to capital and not to earning income within Section 12(1)(*a*).

Items in the year 1963

Legal Fees—$528.95:—This was conceded as not to be allowed (Ex. A-2).

Letters to Shareholders:—Properly disallowed as not within Section 12(1)(*a*).

Professional Fees:—These are subject only to the contention of the Minister which has not been upheld, therefore the balance should be allowed.

Loss of Office Payments:—These were abandoned by B.C. Power and are conceded to be properly disallowed (Ex. R-24).

The cross-appeal is abandoned (Ex. R-24).

As to costs of the appeal, the principal item was the costs of litigation on which the Minister has been successful, on the remaining items the success is divided. The costs should be 2/3 to the Minister and 1/3 to B.C. Power.