1958

Jun. 6 & 7

Dec. 22

BETWEEN:

HALIFAX OVERSEAS FREIGHTERS, LIMITED ..... APPELLANT;

AND

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

Revenue—Income tax—Income Tax Act 1948, S. of C. 1948, c. 52, s. 12(1)(a)—"An outlay or expense ... made ... for the purpose of gaining or producing income from property or a business of the taxpayer"—Money paid to obtain cancellation of charter-parties in order to enter into new lucrative ones is properly deductible from income—Appeal allowed.

Appellant, engaged in the business of chartering ships for hire, entered into agreements with charterers covering some of its ships. By paying to the charterers a certain sum of money appellant procured cancellation of the charter-parties in order that appellant might enter into new charter-parties with other charterers at greatly enhanced prices per ton with consequent greater profits to appellant. Appellant deducted the sum paid to the original charterers from its income for 1952. This deduction was disallowed by the Minister of National Revenue and an appeal from that decision to the Income Tax Appeal Board was dismissed. Appellant now appeals to this Court.

Held: That the sum paid for cancellation of the charter-parties was "for the purpose of gaining or producing income from the property or a business of the taxpayer" within s. 12(1)(*a*) of the *Income Tax Act*.

2. That appellant in taking advantage of the possibility of buying its way to greater profits acted within the scope of ordinary business activities and the amount paid by it to obtain cancellation of the charter-parties is properly deductible from its income for 1952.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Halifax.

H. B. Rhude for appellant.

A. G. Cooper, Q.C. and *W. R. Latimer* for respondent.

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

DUMOULIN J. now (December 22, 1958) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board[1] dismissing an appeal against the income tax assesment of appellant for taxation year 1952.

Before proceeding further, I might point out a close similarity between this and two other cases, namely those of *Falaise Steamship Co. Ltd.* (*post* page 86), and *Bedford Overseas Freighters Ltd.* (*ante* page 71), the latter factually distinguishable from this instant one insofar as the outlay incurred reduced or stemmed a loss instead of enhancing profits.

The relevant data may be summarized as hereunder.

Halifax Overseas Freighters Limited, whose President is also that of Falaise Steamship Co. and of Bedford Freighters Ltd., obtained corporate existence in 1947, under the provincial laws of Nova Scotia, with Head Office at Halifax.

Among several objects enumerated in its Memorandum of Association (ex. 1), the company is empowered to pursue those of owning and chartering ships for hire (p. 1, para. 2(*a*)).

In or about 1950, the Halifax company acquired ten cargo vessels, three of which respectively received the new appellations of *Sycamore Hill, Pine Hill* and *Maple Hill.*

These three ships, and the seven others, were put to one single use, being chartered to various maritime firms during the years 1950 to 1956 inclusive.

It is not seriously contested that charter hire, particularly, of course, during 1952, constituted appellant's sole source of revenue (cf. Reply to Notice of Appeal, para. 2); nor does any doubt subsist regarding its ownership of the vessels during all material time as, for instance, a perusal of exhibit 5 will show (ex. 5: an agreement instituting

[1] 17 Tax A.B.C. 422.

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The Counties Ship Management Co. Ltd., of London, England, managers of the vessels; especially clause 2 and clauses 5 to 8 inclusive).

On May 9, 1951, Counties Ship Management Company, pursuant to its agency undertaking, and Chartering and General Agency Inc. "entered into a Time Charter by which the appellant [as principal] agreed to let and General Agency agreed to hire the 'SYCAMORE HILL' for a period of twelve months at a charter hire of Four Dollars and Twenty Five Cents ($4.25) United States Funds per Dead Weight Ton per month" (cf. Notice of Appeal, para. 5, and ex. 7). Identical arrangements were concluded concerning the S.S. *Pine Hill* (ex. 8) and S.S. *Maple Hill* (ex. 9). Paragraph 9 of the Notice of Appeal mentions that this sum of $4.25, U.S. funds, for 1952, "equalled approximately Thirty Shillings (30/-d) Sterling".

Furthermore, s. 10 particularly emphasizes:

> *THAT* following the execution of the Charter Parties the freight market rose to such a degree that, had the vessels not been already chartered, the Appellant could have entered into charters in respect of each of the Vessels which would have provided for a much greater charter hire per Dead Weight Ton than was provided for in the Charter Parties.

As yet the three ships had not been delivered to their charterers, a factor which facilitated an attempt on the Halifax company's part to avail itself of this sudden upsurge in rates.

Negotiations to this effect turned out successfully; on January 1, 1952, the charterers released the ship-owners from those several charter-parties then in force, against a forfeit indemnity of $40,000 in respect of each contract (U.S. currency), a total of $120,750.03, when computed in Canadian Funds (cf. exhibits 7, 8, 9, cancellation agreement inscribed diagonally across the indenture, and also exhibits 10, 12, 13). On January 19, 1952, the foregoing obligations were duly implemented through payment of $120,750.03, Canadian money, to the erstwhile lessees (exhibits 10, 12, 13).

From now on, the recital of facts remaining reaches the evidential stage, but before reverting to it, I will outline the moot question under consideration, as read in para. 16 of the Notice of Appeal:

> 16. . . . in calculating its income for the taxation year 1952 the Appellant deducted from its gross revenues the said payment to General Agency of $120,750.03.

Such a view of the transaction met with successive disallowances from the Minister and the Income Tax Appeal Board.

Before this Court, the respondent counters that the amount of $120,750.03, "was not an outlay or expense made or incurred . . . for the purpose of gaining or producing income . . . (para. 11);" or "In the alternative . . . the said amount of $120,750.03, if paid, was an outlay of capital or a payment on account of capital (para. 12)."

Mr. Harry Isaac Mathers, the first of three witnesses called by appellant, is, as mentioned above, President of Halifax Overseas Ltd. Mr. Mathers succinctly enumerates his firm's maritime interests and shipping ventures, stressing its constant practice of resorting to the co-operation of specialized managers or shipbrokers in England. He files, with requisite comments, a number of documentary exhibits, explains the triple cancellation of former charter-parties, dated January 1, 1952, and the attending payments.

This witness goes on to say that from January 1, 1952, simultaneously with the sundering of contractual ties, several other time charters were concluded along the lines hereafter:

(*a*) The Sycamore Hill (or alternatively S.S. Poplar Hill) was chartered onto Alfred Holt and Co. for a price of fifty-seven shillings and six pence (57/6d) per Dead Weight Ton a month (exhibits 14, 15), instead of thirty shillings (30/-d) as formerly.

Mr. Mathers, figuring in terms of national currency, compares this latter rental, equivalent to $80,000 a month, with the preceding one of $42,000; a $38,000 monthly rise in receipts.

(*b*) A subsequent or third charter party, dated February 22, 1952, covering S.S. Sycamore Hill (ex. 15), at a practically doubled price.

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(c) The Pine Hill, on February 21, was let to Polish Ocean Lines, for a nine months' period, at a monthly hire of forty shillings (40/-d) (ex. 16).

In dollar terms, specifies the witness, this means $60,000 a month compared with $45,000, an additional gross profit of $135,000, spread over nine months.

(d) The chartering of S.S. Maple Hill, January 17, 1952, to undertake one voyage from some European port to Hong Kong at fifty-seven shillings and six pence (57/6d) monthly per ton, or $80,000 per month as against $45,000 previously (ex. 17).

This trip lasted from January 30 until April 18, 1952.

(e) Another Time Charter listing S.S. Maple Hill with the Far East Enterprising Company, as per February 25, 1952, which endured from April 22 until the 12th day of July, same year, at rates approximately doubled (ex. 18).

Mr. Mathers necessarily concludes these repeated dealings on the charter-party market brought about some very beneficial results.

James R. McGrath's evidence in the preceding matter of *Bedford Overseas Freighters v. Minister of National Revenue* (*supra*) was allowed by both parties to serve as an integral part of this and the *Falaise Steamship* case. In brief, this shipbroker from Richwood, N.J., had testified his firm, the Meridian Marine Company, handled no less than a hundred charter-parties each year, "with a cancellation percentage of two per centum"; a relief sought when a ship under charter suffered a disability or otherwise became unseaworthy. And whenever such a complication of costly consequence arose, as in *Bedford Freighters*, Mr. McGrath considered the annulment of a charter-party to be "a proper and admissible business practice". Possibly, it is a fair inference to hold he would have spoken to the same effect should the purport of a cancellation be an enhancement of profits and not an avoidance of loss.

Mr. George M. Murray, a chartered accountant, associated with the Halifax partnership of Nightingale, Hyman & Co., was the next and last witness heard, since respondent adduced no oral evidence.

Mr. Murray's brief examination in chief was a repetition of his previous testimony in *Bedford Overseas Freighters*, with the only exception that Halifax Freighters

ends its fiscal year on April 30. But, on cross-examination, he owned that no itemized mention of the annulment indemnities appeared in the company's Financial Statements for 1952, exhibit 19.

A deduction of $40,000 for each of those three vessels: *Sycamore Hill, Maple Hill* and *Pine Hill,* according to this witness, was calculated *"in abstracto"* before the figures shown opposite the respective ships, on p. 5 of exhibit 19, were arrived at in the Profit and Loss account.

With some degree of surprise the Court inquired whether this method might not be an over-simplification, eventually leading up to the production of a top and back cover enclosing a sheaf of blank sheets.

At all events, there is of record an admission that no discernible trace of the cancellation forfeits is to be found in the appellant's financial statement for 1952 (ex. 19).

Notwithstanding this too discreet whim of accountancy, the Court is satisfied that appellant preponderantly proved its main submissions of facts.

As for the legal aspect, it is entirely dependent upon an admissible connexity between the global indemnities of $120,750.03 and the company's regular scope of operating expenses. In statutory parlance, (s. 12(1)(*a*) of The 1948 *Income Tax Act*) was this cumulative outlay ". . . made for incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer?"

The mutual interplay of verbal and literal evidence points at practically a twofold increase of monthly receipts, consequent upon the speculative dealings engaged in. And these profitable transactions were achieved by means of normally exploiting the company's working assets. The requisite, though not correlative, characteristics of revenue income, accruing from some initial expense made with the object allowed by law, occur here conformably to statutory requirements.

One more word. Let us forget, momentarily, about the cancellation indemnities, and suppose the several time charters had just succeeded one another. Surely none would deny the income status of the ensuing receipts or operating quality of related expenditures.

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Then, if this assumption be correct, the mere occurrance of disbursements, required to ensure repeated profit-takings, could hardly fall, as argued by respondent, under the caption of ". . . an outlay of capital or a payment on account of capital". A possibility of buying its way to greater profits fortuitously loomed up. By availing itself of this alluring prospect, the appellant company did not overstep the limits of ordinary business activities.

Now, the points of law raised and the rather copious jurisprudence cited in the allied case of *Bedford Overseas Freighters Limited v. Minister of National Revenue* (*supra*) also apply, and should be considered as parts of these notes.

For the reasons above, the amount of $120,750.03 (Canadian) is properly deductible from appellant's income for taxation year 1952. This sum was incorrectly added to the assessment above which should be amended accordingly. Therefore, the appeal is allowed with costs.

Judgment accordingly