1951
Oct. 31 &
Nov. 2
1952
Apr. 28

BETWEEN:

SEVEN UP OF MONTREAL LIMITED ..... } APPELLANT;

AND

MINISTER OF NATIONAL REVENUE ..... } RESPONDENT.

Revenue—Income War Tax Act 1927, c. 97, s. 6(1) (a) (b)—Expenditure on account of capital or revenue—Outlay on account of capital not deductible from income as a "disbursement or expense wholly, exclusively and necessarily laid out for earning the income"—Appeal dismissed.

Held: That the purchase by appellant of the goodwill of another's business, and the covenant by the vendor to go out of business together with the property and assets of the vendor's business as a going concern, is an outlay of money on account of capital and not on revenue account, and as such is not deductible from income by virtue of s. 6(1) (*b*) of the Income War Tax Act R.S.C. 1927, c. 97, and is not a disbursement or expense wholly, exclusively and necessarily laid out for the purpose of earning the income as provided for in s. 6(1) (*a*) of the Act.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Cameron at Montreal.

H. H. Stikeman, Q.C. and *E. A. L. Bissonnette* for appellant.

C. Provost, Q.C. and *R. G. Decary* for respondent.

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

CAMERON J. now (April 28, 1952) delivered the following judgment:

This is an appeal by the taxpayer from a decision of the Income Tax Appeal Board dated September 28, 1950, affirming the income tax assessment made upon the appellant for the taxation year 1947. In assessing the appellant, the respondent had disallowed as a deduction the sum of $28,725 (including $225 legal expenses) which the appellant claimed was a disbursement or expense wholly, exclusively

and necessarily laid out for the purpose of earning its income, and therefore deductible under the provisions of s. 6(1) (*a*) of the Income War Tax Act, R.S.C. 1927, c. 97, as amended.

The appellant company manufactures and distributes a carbonated beverage known as "Seven Up," of which sugar is a very important ingredient. During the war years and for some time thereafter, sugar was rationed by the Government of Canada and was under the control of the Sugar Administrator of the Wartime Prices and Trade Board. For industrial purposes—such as that of the appellant—sugar was rationed on a basis of declaration of user in the year 1941; then from time to time and consistent with the available supplies, a percentage of that quota basis was given as a quarterly quota. If at the end of the year it was found that an industrial consumer had been receiving a quota substantially in excess of his normal requirements, his subsequent quotas could be reduced to a lesser percentage of the quota basis.

The appellant had been in business in 1941 and therefore was in receipt of quarterly quotas of sugar ration permits, and its output of "Seven Up" was limited by the amount of sugar which it could purchase with those permits. Lack of sugar alone prevented it from meeting the increased demands for its product, its plant facilities being capable of greatly increased output. Under the regulations established by the Sugar Administrator, the only way in which an industrial user of sugar could increase its quota basis was by purchasing as a going concern the business of another industrial user of sugar and thereafter by applying to the Sugar Administrator to add to its quota basis that formerly held by the vendor.

Having in mind the desirability of placing itself in a position to secure more sugar, the appellant entered into negotiations with another beverage manufacturer in the Montreal area, Rocket Cola Co. Ltd. (hereinafter to be called "Rocket"), which also had an industrial quota for sugar, but which desired to discontinue its business. In the result, the appellant and Rocket, on February 6, 1947,

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entered into a bulk sales agreement (Ex. 1) by which for the expressed consideration of $30,699.61, Rocket sold, conveyed and transferred to the appellant:

The ownership of and all its rights and title to the assets presently used by the vendor as a going concern under the name of Rocket Cola Co. Ltd., carrying on the business of manufacturing and bottling soft beverages at 3870 Cote St. Michel, Ville St. Michel, Quebec, including goodwill, sugar supplies and rights to sugar quota and contracts, the whole as more fully described on the sheet attached hereto, marked "A" and signed by the parties.

Ex. A to that agreement, which was signed by both parties, was as follows:

ASSETS OF ROCKET COLA CO. LTD.

Right to purchase sugar under sugar quota SA 013119 Q of the Wartime Prices and Trade Board.

A. *STOCK*		
Sugar on hand	2,500 lbs.	172.50
Sugar purchased from and on order for delivery from Canada & Dominion Sugar Co. Ltd. under sugar quota SA 013119 Q being balance of last quarter of 1946 and first quarter of 1947	29,450 lbs.	2,027.11
B. *Sundry Inventories*		
Supplies	358.69	
Fuel	50.00	
Finished Goods	398.40	
Bottles & Cases	3,031.80	3,838.89
C. *Bottling Equipment*	19,721.97	
Less allowance for depreciation	10,144.35	9,577.62
D. *Trucks & Equipment*	1,486.00	
Less allowance for depreciation	1,485.00	1.00
E. *Furniture & Fixtures*	1,436.85	
Less allowance for depreciation	517.16	919.69
F. *Shop Equipment*		1,508.48

Lease on manufacturing premises at 3870 Cote St. Michel, Montreal, Quebec.

Finally, by para. 6 it was provided:

6. The vendor undertakes to cease carrying on its business described above and to take immediate steps to wind up its affairs.

On the same date the appellant and Rocket executed Form 445 supplied by the Sugar Administrator of the Wartime Prices and Trade Board, entitled: "Industrial Sugar Quota Transfer Declaration" (Ex. 5). Therein, Rocket stated by the oath of its president:

Effective on the 6th day of February, 1947, I/we Rocket Cola Co. Ltd. hereby transfer and assign all present, past and future sugar and preserve rights as applied to my/our authorized respective quotas, to Seven Up of Montreal, Ltd.

I/we also advise that my/our business was transferred as a going concern.

This declaration was duly forwarded to the Sugar Administrator who, on February 8, 1947, wrote the appellant as follows:

We have received from your solicitors, Messrs. Bumbray & Carroll, the Industrial Sugar Quota Transfer Declaration confirming to us that you purchased on February 6th, 1947 the soft drink business of Rocket Cola Co. Ltd. 3870 Cote St. Michel, Montreal.

We are transferring to you the sugar quotas of Rocket Cola Co. Ltd.

At the time of the sale, a balance of 29,450 coupons remained at the credit of Rocket Cola Co. Ltd. at their bank for which a ration cheque of same amount has been handed to us. In order to replace this cheque, we enclose a Supplementary Industrial Sugar Quota Authorization for 29,450 coupons, which kindly deposit at once at your bank, entitling you to use this quantity of sugar during the present quarter.

That, however, did not conclude the matter. The appellant, having received the administrator's letter of February 10, 1947, wrote Rocket on the same date as follows (Ex. 2):

In respect to the Bulk Sale Agreement entered into on February 6th, 1947 between yourselves as vendors and ourselves as purchasers, it is agreed that in consideration of the sum of $1.00, we hereby waive all claim and title to items (*b*), (*c*), (*d*), (*e*) and (*f*) of the assets mentioned in the said agreement, all said items to remain your property for all legal purposes.

We are also waiving all rights for the lease for the premises presently occupied by your company at 3870 Cote St. Michel Road, Ville St. Michel.

It will be seen, therefore, that as a result of all the transactions with Rocket, the appellant retained as tangible assets only sugar on hand and sugar in transit, of an aggregate agreed value of $2,199.61. In addition, the appellant's sugar quota basis was increased to the extent of Rocket's former quota basis and it was therefore in a position, while rationing remained in effect, to purchase larger amounts of sugar than it could otherwise have done. Sugar was decon-

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trolled in November, 1947. The appellant says that this right to acquire additional sugar was obtained at a cost of $28,500, that is, the difference between the total consideration of $30,699.61 and the value of the sugar on hand and in transit; that it represented the actual additional cost of acquiring additional sugar and is just as much a deductible expense as the cost of the sugar itself. It says that in substance it purchased a rating to acquire further sugar, which rating, by reason of the regulations of the Wartime Prices and Trade Board, was an absolute prerequisite to the purchase of sugar.

What, then, is the true nature of this outlay of $28,500? The respondent submits that it is a disbursement or expense which is not deductible by reason of the provisions of s. 6(1) (*a*) and (*b*) of the Income War Tax Act, while the appellant contends that it was a disbursement wholly, exclusively and necessarily laid out for the purpose of earning the income and was not a capital outlay. Those sections are 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.

There are two main reasons why the appellant's outlay of $28,500 cannot be said to have been for the purchase from Rocket of a rating or right to acquire sugar. The first is that such a purchase would have been illegal and the second is that there is no admissible evidence to establish that such was the case.

It is abundantly clear from the evidence that "the rights to purchase sugar under Sugar Quota SA013119Q" (the first item in Schedule A) was not something which could be sold by Rocket to the appellant. It was a right, issued by the Sugar Administrator, to a particular industrial user and for his own use only. At the trial I asked for the production of the applicable regulations and orders, but they were not produced. Since then, however, I have found certain orders

of the Wartime Prices and Trade Board which appear to be applicable. For example, Order No. 242 of the Wartime Prices and Trade Board respecting sugar rationing, dated February 27, 1943, provided as follows:

> 41. No person, except as provided by this order, shall
>
> (a) forge, counterfeit, utter, *endorse, transfer, traffic in,* alter, deface, mutilate, obliterate or destroy any sugar coupon, canning sugar coupon, ration book, ration card, requisition, certificate, permit, ration cheque, transfer voucher, or any other document relating to a purchase or use of sugar, or anything printed or written thereon;"

From the evidence as a whole, I am satisfied that that order or a similar order or regulation remained in effect throughout. It would have been illegal to sell such a quota or for the purchaser thereof to make any use of it. Rocket therefore could not sell and the appellant could not purchase any right to purchase sugar. All that the appellant could do to increase its sugar quota basis was to buy the assets of Rocket as a going concern, satisfy the Sugar Administrator that that had been done, and then make application to the administrator—not to transfer Rocket's sugar quota authorization to it, but—to increase its own to the extent formerly enjoyed by Rocket. These were the actual steps taken by the appellant. In the result, its application was approved. Rocket's former quota SA013119Q was surrendered for cancellation and the appellant's quota basis was increased. What the appellant had to purchase and did, in fact, purchase, were the assets and property of Rocket. It was upon the appellant as purchaser of such assets that the Sugar Administrator conferred the additional rights to purchase sugar.

On the second point, the evidence clearly establishes that for a consideration of $30,699.61, the appellant bought out all the assets of Rocket Cola Co. Ltd. as a going concern. Their contract was embodied in the Bulk Sales Agreement (Ex. 1) which was not an agreement to sell but an actual sale, transfer and conveyance of all Rocket's right and title to the assets mentioned in Schedule A thereto, the details of which have been set out above. In argument, counsel for the appellant admitted that the Bulk Sales Agreement

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did, in fact, constitute a sale to the appellant of the assets set out therein; and also that the letter of February 10, 1947 (Ex. 2) constituted a resale by the appellant to Rocket of the assets therein mentioned for a consideration of one dollar. He submitted, however, that the results of the sale and resale made it apparent that the true intent of the parties was the sale and purchase of sugar and rights to purchase sugar, and that it was never the intention that the appellant should ever acquire the ownership of anything else. At his request, but under reserve of objections raised by counsel for the respondent as to its admissibility, I heard evidence by officials of the appellant who took part in the negotiations with Rocket.

By s. 35 of the Canada Evidence Act, the Laws of Evidence in force in the province of Quebec are made applicable to these proceedings. By Articles 1206 and 1234 of the Civil Code of that province, it is provided:

1206. The rules declared in this chapter, unless expressly or by their nature limited, apply in commercial as well as in other matters.

When no provision is found in this code for the proof of facts concerning commercial matters, recourse must be had to the Rules of Evidence laid down by the laws of England.

1234. Testimony cannot in any case, be received to contradict or vary the terms of a valid written instrument.

I think there can be no doubt that the evidence of these witnesses, insofar as it tends to show that at the time of the execution of the main contract embodied in the Bulk Sales Agreement there was also an oral contract that after the happening of certain events the appellant would resell to Rocket a portion of the goods comprised in the original sale for the sum of one dollar, would be admissible. Such an agreement would not be inconsistent with or tend to vary or contradict the terms of Ex. 1 (*Phipson on Evidence,* 8th Ed., p. 568). But insofar as that evidence would tend to show that Rocket did not sell the whole of its business and assets as a going concern, or that the whole of the consideration of $30,699.61 was referable to sugar and the right to purchase sugar, and not to all the assets mentioned in the agreement and its schedule, or that the appellant did not, in fact, become the owner of all such assets upon executing the Bulk Sales Agreement, it is in my view

inadmissible as tending to contradict or vary the terms of that written agreement (Art. 1234 of the Civil Code), and I therefore reject it as inadmissible.

For the reasons which I have stated, therefore, I find that the appellant could not legally have purchased from Rocket the right to purchase sugar, and that there is no admissible evidence to establish that in attempting to acquire it, the appellant paid $28,500 or any other specific amount therefor. I think that it cannot now be disputed that for the outlay of $30,699.61, the appellant acquired not only the goodwill of Rocket's business and a covenant that Rocket would go out of business, but also the property mentioned in Schedule A to the agreement, including the lease, bottling equipment, trucks and equipment, furniture and fixtures, and shop equipment. (Nothing need be said about the value of the stock of sugar on hand and in transit totalling $2,199.61, the acquisition of which by the appellant was approved by the Sugar Administrator and which amount the respondent herein has quite properly treated as an expense attributable to the acquisition of stock). These physical assets were doubtless of considerable value as indicated by the amounts placed opposite them in Schedule A. The agreement and the schedule were both prepared by the appellant's solicitors, and signed by the appellant. There is no evidence that the values therein given were not, in fact the real market values of the various items. The value of the lease is not stated and there is no evidence whatever to indicate whether or not it had any real market value.

There can be no doubt, therefore, that on the admissible evidence the appellant's outlay was for the purpose of acquiring the assets of Rocket as a going concern. Its officers were told by their legal advisors that under the existing controls such a bona fide purchase would have to be made and that in no other way could it hope to increase its sugar quota basis, and that is what the appellant did.

The appellant's business was that of manufacturing and distributing beverages. The purchase of another business as a going concern with the assets I have mentioned, was made by it as owner and not as a trader and undoubtedly resulted in the acquisition of enduring assets. In my opinion, the outlay in respect thereof was just as much an

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outlay on account of capital as it would have been had the appellant been a new corporation formed for the purpose of acquiring Rocket's business as a going concern. As an outlay on account of capital, its deduction is barred by the provisions of s. 6(1) (*b*) of the Income War Tax Act (*supra*). In my opinion, the mere fact that within a few days the appellant made a resale of most of the assets for the price of one dollar cannot change the nature of the original outlay from one on capital account to one on revenue account. In so re-selling at a loss, the appellant incurred a capital loss.

In view of these findings, it is not necessary to consider the evidence of certain accountants as to what would have been proper accounting practice had the appellant, in fact, paid $28,500 for the right to purchase sugar. The outlay on account of capital being specifically debarred from deduction by the provisions of the Act, the question of proper accounting practice does not here arise.

For these reasons, I must affirm the conclusions of the Income Tax Appeal Board and dismiss the appeal therefrom. The respondent is entitled to be paid his costs after taxation.

Judgment accordingly.