

In the Privy Council.

ON APPEAL

FROM THE SUPREME COURT OF CANADA.

BETWEEN

PIONEER LAUNDRY & DRY CLEANERS
LIMITED - - - - - *Appellant*

AND

THE MINISTER OF NATIONAL REVENUE - *Respondent.*

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Case on behalf of the Appellant.

1. This is an appeal from the Judgment of the Supreme Court of Canada dated 12th December, 1938, affirming the Judgment of Mr. Justice Angers in the Exchequer Court dated the 4th day of November, 1937, dismissing the Appellant's appeal from the decision of the Minister of National Revenue whereby he refused the Appellant's claim for an allowance for depreciation (wear and tear) on machinery included in its Income Tax Return for the fiscal year ending 31st March, 1933.

RECORD.—

20 2. The appeal to the Minister was under Section 58 of the Income War Tax Act, Revised Statutes of Canada, 1927, ch. 97, and was transmitted by him to the Exchequer Court pursuant to Section 63 of the same enactment.

3. The Appellant, Pioneer Laundry & Dry Cleaners Limited is a Company incorporated under the Companies Act of British Columbia on the 23rd day of March, 1932. Pursuant to an agreement in writing dated the 1st day of April, 1932 (Exhibit I) it purchased a large quantity of second-hand laundry machinery and motor cars from the Home Service Company Limited for a total consideration of \$180,826.93. This price was fixed by an appraisal of an independent appraisal company. p. 89.

p. 96.

4. The machinery in question had been owned by two companies (one of which was of the same name as the Appellant) which went into liquidation. Their Liquidator (Wm. H. Cotter, who was a witness) transferred the machinery to a new company, the Home Service Co. Limited, which in turn transferred them to the Appellant under the circumstances set out in the Memorandum of Mutual Admissions (Exhibit A). The previous owners had, whilst they were owners of the machinery, been allowed depreciation in full upon it at the valuation at which it was entered up in the books of such predecessors.

5. In July, 1933, the Appellant, pursuant to Section 33 of the Income War Tax Act, filed its Income Tax Return for the fiscal year ending on 31st March, 1933 (Exhibit 2) upon a printed form supplied by the Department of National Revenue, the use of which is obligatory. To comply with the Act and with the form of Return the taxpayer must set out its gross income, claim any and all proper deductions, calculate the amount of tax payable by it and forward the tax (or a specified portion) with the Return. One of the permitted deductions from taxable income is an allowance for depreciation on the property used in earning the income and the printed form contains a blank space in which the allowance claimed must be inserted. 20

6. The right to a depreciation allowance is given by Section 5 (a) of the Act, which reads as follows :

Deductions and Exemptions Allowed.

“Section 5. ‘Income’ as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions :

(a) Such reasonable amount as the Minister, in his discretion, may allow for depreciation, and the Minister in determining the income derived from mining and from oil and gas wells and timber limits shall make such an allowance for the exhaustion of the mines, wells and timber limits as he may deem just and fair : 30

And in the case of leases of mines, oil and gas wells and timber limits, the Lessor and the Lessee shall each be entitled to deduct a part of the allowance for exhaustion as they agree and in case the Lessor and the Lessee do not agree, the Minister shall have full power to apportion the deduction between them and his determination shall be conclusive.”

p. 79
pp. 22 and 93.

7. The Minister had fixed and determined a “reasonable amount” of depreciation upon various kinds of personal property by a regulation, ruling or circular known as Circular No. 20 (Exhibit 3) dated the 30th day of August, 1918, which had been amended by appendices dated 11th May, 1927 and 15th May, 1933 (Exhibits 4 and 5). 40

8. The Appellant in its said Income Tax Return disclosed gross earnings of \$171,122.04 and claimed various deductions including certain allowances for depreciation as follows :—

Depreciation :—

Machinery and Equipment :	10 %	\$14,131.15
Automobiles :	20 %	2,935.08
Horses and Wagons :	10 %	135.25
Furniture and Fixtures	10 %	574.07
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		\$17,775.55

10 The percentages are those fixed by the Minister pursuant to the Statute and set out in Exhibits 3, 4 and 5.

9. The Department did nothing for 18 months, but on the 19th day of February, 1935, the Commissioner of Income Tax sent to the Appellant a Notice of Assessment (Exhibit 7) containing an " adjustment of income declared " in which (and without any stated reasons) he deducted from the depreciation allowance the above items of \$14,131.15 (Machinery), \$574.07 (Furniture), \$135.25 (Horses and Wagons), and \$2,680.00 of the item of \$2,935.08 (Automobiles). In other words he allowed only the following depreciation :—

20	25 % for 10 months on \$815.00 being the cost of One Willy-Knight Coupe purchased by Appellant from Consolidated Motors Ltd. on or about the 17th day of May, 1932	\$186.77
	25 % for 8 months on \$230.75 being the price of One Truck Body purchased by Appellant from Pioneer Carriage Company Ltd. on 14th July, 1932	38.46
30	25 % for 5 months on \$286.50 being the price paid by Appellant to Consolidated Motors Ltd. on 22nd November, 1932, for One Essex Coupe . .	29.85
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		\$255.08

These allowances are those set out in Exhibit 3 (Circular No. 2).

p. 80.

10. On the 9th day of March, 1935, the Appellant, under Section 58 of the Act, gave Notice of Appeal to the Minister (Exhibit 8). The Minister rendered his Decision on the 30th day of May, 1935, (Exhibit 11), dismissing the appeal. p. 2. p. 4.

p. 5.
p. 7.

11. The Appellant, pursuant to Section 60 filed a Notice of Dissatisfaction (Exhibit 12) on the 24th day of June, 1935. The Minister sent his Reply (Exhibit 13) pursuant to Section 62 and in pursuance of Section 63 transmitted the papers to the Exchequer Court.

p. 10.
p. 17.

12. Pleadings were ordered and the Appellant filed its Statement of Claim on the 11th day of January, 1936, and the Minister filed his Defence on the 27th day of February, 1936. The appeal was tried before Mr. Justice Angers at Vancouver on the 8th day of September, 1936. Judgment was reserved and was rendered on the 4th day of November, 1937, dismissing the Appellant's appeal.

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13. The Appellant on 29th November 1937 appealed to the Supreme Court of Canada. The appeal was heard on 28th and 29th April, 1938, before the Chief Justice of Canada and Justices Crockett, Davis, Kerwin and Hudson.

On 12th December, 1938, the Court gave judgment, dismissing the appeal, the Chief Justice of Canada and Mr. Justice Davis dissenting.

pp. 38-41.

14. The learned Trial Judge decided:—

(a) That every taxpayer has a statutory right to his or its appropriate depreciation allowance and (inferentially) that this right extends to and includes the purchasers of second-hand 20 articles equally with the purchasers of new articles.

(b) That the Minister's power is limited to the fixing of the rate of depreciation.

(c) That the Minister did, in Exhibits 3, 4, 5 and 6, fix the rates of depreciation.

(d) That the Appellant claims only such depreciation as these regulations provide.

(e) That the Appellant is a "successor" to the Pioneer Laundry & Dry Cleaners Limited (in Liquidation), and (being such successor) is not entitled to a depreciation allowance because 30 such "predecessor" has received full depreciation on the same property.

In the Supreme Court of Canada Mr. Justice Hudson (with whom Mr. Justice Crockett concurred) held that the Minister had the right to determine that the Appellant was the alter ego of the former company bearing the same name, and having so determined had an absolute and unfettered discretion to refuse the Appellant an allowance for depreciation. Mr. Justice Kerwin held that the Minister, in granting the Appellant \$255.08 as and for depreciation, had exercised the discretion vested in him by the statute and that there was no ground upon which his determination 40 could be challenged.

The Chief Justice and Mr. Justice Davis were of opinion that the Appellant was entitled to a "reasonable amount of depreciation" and

that the Minister was not entitled to refuse a reasonable allowance because the beneficial owners of Appellant Company were the same as those of another company from which the Appellant, indirectly, purchased the machinery in question. They would have allowed the appeal and remitted the case to the Minister for reconsideration of the subject matter stripped of the wrong principles which he had allowed to influence him in exercising his discretion.

15. The Appellant submits that the last finding (E) of Mr. Justice Angers is erroneous because the Statute does not say :—

- 10 (A) That an owner of an article or the owner of a concern is to be identified with and treated as one with a previous owner; or
 (B) That a predecessor company and a successor company shall be deemed one because their shareholders are the same.

On the contrary the Statute does say :—

That every taxpayer is entitled to his appropriate depreciation.
 (Sections 9 and 5.)

Appellant denies that it is a successor of the Pioneer Laundry and Dry Cleaners Limited (in Liquidation) ; and alternatively submits that even if it were, there is nothing in the Statute which deprives " successors " 20 of their rights because " predecessors " have exercised theirs.

It submits that having duly and properly claimed the appropriate depreciation allowance in its Income Tax Return, a right to that allowance vested in it, and that the attempt of the Minister in the Notice of Assessment to take away this allowance on ground not within the Statute, is an invasion of a vested right.

The Appellant further submits that the learned Judge's decision will allow the Minister to escape from compliance with a fundamental rule applicable to those who have the duty of exercising a statutory discretion, which is that he must apply his mind to the facts of the case 30 and exercise his power in good faith so as to carry out the purposes for which the power was conferred upon him, and must not allow his mind to be influenced by extraneous or irrelevant considerations. He must not misdirect himself or misread the Statute.

16. The Appellant submits that the decision of the majority of the Judges in the Supreme Court of Canada that the Minister has an uncontrolled and unfettered discretion to grant or refuse any allowance for depreciation is wrong, and respectfully adopts the view held by the Chief Justice and Mr. Justice Davis that the exercise of this discretion was one which had to be based upon proper legal grounds. It was a discretion limited to fixing 40 such allowance as is reasonable having regard to the amount of actual depreciation or wear and tear during the year.

In the Supreme Court of Canada the Minister relied on a passage in the Judgment of Lord Justice Farwell in *Rex v. Board of Education* (1910) 2 K.B. 165 at 179. It is submitted the language used by the Lord Justice is opposed to the Minister's argument, and Appellant will rely on this case in the Court of Appeal and in the House of Lords, *sub. nom.*, *Board of Education & Rice* (1911) A.C. 179.

The Minister also relied on the Judgment of the Supreme Court of Canada in *The King v. Minister of Finance* (1935), S.C.R. 70. The Appellant submits that there is nothing in the Judgments in that case which is counter to the Appellant's submissions. 10

17. It is regrettable that there is (apparently) no Canadian authority on the question as to whether purchasers of second-hand property are entitled to deduct depreciation if their vendor had been allowed it in full. It is necessary to turn to the decisions under the English Act so far as they are applicable.

The undersigned submits that the case most in point is *Hall v. Rickman* (1906) 1 K.B. 311. The Act there in question was the Customs and Inland Revenue Act of 1878, 41 Vic. c. 15, Section 12 gives the taxpayer a right to deduction in these words:—

“Such deductions as the Commissioners should think just 20
and reasonable as representing the diminished value by reason of
wear and tear.”

The property in question was a ship. It had been depreciated by annual allowances totalling 96% of its cost, and these allowances had, in error, been greater than the actual diminution of the vessel's value. The vessel was still worth more than 4% of its cost. Nevertheless the owners claimed that the depreciation allowance should still continue, and the Court agreed with them.

The Court held that they were entitled to a continuance of depreciation because the Statute allowed an annual depreciation and did not provide for 30
its discontinuance when the total deductions had reached 100% of cost.

The case in effect decides that the Commissioners cannot say that because the taxpayer has been allowed 100% depreciation it is therefore “just and reasonable” that he shall have no more.

This part of the decision, although illustrative, is not directly in point here because we are not concerned with a claim by one taxpayer to a depreciation allowance exceeding 100% of cost to that person.

It is however of decisive importance in another point which it also decides: It holds that if there is a change in the ownership of an article the new owner is entitled to his depreciation allowance no matter 40
what amount of depreciation has been allowed to the former owner.

This case appears decisive in Appellant's favour, because the Canadian Act is, on this point, identical with the English Act.

The right of an owner in England to receive more than 100% of depreciation was immediately taken away by the Finance Act 1907, 7 Edw. VII, c. 13, Section 26 (2), which enacts that depreciation allowed to any taxpayer shall not exceed the actual cost to that person.

Note however that it does not enact that the total depreciation allowed to a preceding and a subsequent owner shall not exceed the actual cost. On the contrary, by not so enacting, it makes it plain that Parliament intended each owner to stand alone and that each should have his own depreciation on his own cost.

Appellant also relies on *Birmingham v. Barnes* (1935) A.C. 292. In determining the "allowance for wear and tear of machinery" (depreciation) it was necessary to fix the "actual cost to that person" of the machinery. The taxpayer had been recouped part of the cost out of the Unemployment Grants Committee funds and other sources but the Court nevertheless held that the "actual cost to that person" was the actual original cost, not deducting the aforesaid contributions from the Unemployment Grants fund, etc. Lord Atkin who gave the judgment for the House of Lords quotes the decision of Walton, J. in *Hall v. Rickman* (1906) 1 K.B. 311 and at p. 299 proceeds:—

"But I find the reference 'to the person' fully satisfied when I remember that, as pointed out by Walton J. in the case that gave rise to the new limitation, the person claiming a reduction may vary from time to time and that with each successive purchaser you are to begin again."

18. Appellant also relies on the opinion of Lindley, J., in *Ryhope Coal Company Ltd. v. Foyer* (1881) L.R. 7 Q.B. 485 at 498:—

"This company was incorporated and formed on the 21st of December, 1875, under the Companies Act of 1862, by persons who had for many years previously carried on and worked the colliery which the company was formed to continue to work and carry on. The Income Tax Commissioners have assessed the company upon the principle that the company is in substance, and for legal purposes, the same as the old partners. In my opinion, at starting, that cannot be right in point of law. A company incorporated under the Act of 1862 is for no legal purpose the same as the persons who have become a corporation with distinct rights and distinct liabilities, and whether the shares are bought by those who form it seems to me for that purpose utterly immaterial; and I think, therefore, the principle on which the

Commissioners have proceeded from first to last in assessing this corporation of five, six, or seven old partners, is to be regarded as erroneous and fundamentally wrong.”

This case was followed (although on a different point) by the Court of Appeal in *Elliott v. Duchess Mill* (1927) 1 K.B. 182 at 199.

Appellant will also refer to *Scottish v. Lethem* (1912) 6 T.C. 91 : at p. 99 :—

“ A predecessor’s depreciation allowance is immaterial when considering that of a successor.”

19. The Minister’s argument of identity between a former and a later owner is also opposed to the principle of one Canadian case at least, which is a tax case although not an income tax case. I refer to *King v. B.C. Brick & Tile Co.* (1936) Ex. Ct. 71. 10

The question was whether sales tax was payable on the price paid by a manufacturing company to a subsidiary, or on the increased price at which the subsidiary resold the article.

The question of the identity of the manufacturing company and the subsidiary sales company was directly in point. I quote from the Judgment of the President, at p. 74 :—

“ While the same person may control the two companies yet they are separate entities, and even the shareholders are not precisely the same ; their respective business operations are really quite distinct and were intended, I think, so to be. Each company finances and conducts its own operations, each hires and pays its own employees, and their business records are separately maintained ; there is no division of profits or sharing of losses between the two companies. During the period in question the Defendant company sold its annual production of bricks to the Victoria company at the current wholesale price just as other manufacturers of bricks would sell their product to similar business concerns. There is no evidence to show that the business of the Victoria company was in fact influenced, controlled or directed, by the Defendant company, and in all the circumstances here that would seem improbable . . . 20 30

“ It would be going to dangerous limits to say, that because the officers and shareholders of the two companies were much the same, and because the companies had business relations the one with the other, that therefore the one was the mere agent of the other ; there must, in my opinion, be a state of facts established outside that disclosed here, to make the Defendant company liable for the sales tax on the basis of the price received by the Victoria company, and not upon the price at which in fact the Defendant company sold its bricks to the Victoria company.” 40

REASONS.

20. The Appellant submits that the Judgment of the Supreme Court of Canada is erroneous in the following respects:—

- (1) In deciding that it was the intention of the Canadian Parliament that there should be no depreciation allowance unless the Minister in his sole and unfettered discretion granted one.
- 10 (2) In holding that it was the intention of the Canadian Parliament that the Minister in deciding to grant or not to grant a depreciation allowance was to be entitled to look beyond the established facts of ownership for the purpose of ascertaining realities of ownership or possible schemes to avoid taxation.
- 20 (3) In holding that the Canadian Income War Tax Act does not define or limit the field within which the Minister's discretion must be exercised with regard to depreciation.
- (4) In holding that the Minister did not in Exhibits numbered 3, 4, 5 and 6 fix the rates of depreciation on the various classes of property therein described.
- 30 (5) In deciding that the Appellant was not entitled to the depreciation allowance claimed in its Income Tax Return.

MARTIN GRIFFIN.

No. 35 of 1939.

In the Privy Council.

ON APPEAL

From the Supreme Court of Canada.

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CLEANERS LIMITED** - *Appellant*

AND

**THE MINISTER OF
NATIONAL REVENUE** - *Respondent.*

Case

ON BEHALF OF THE APPELLANT.

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