

In the Privy Council.

No. 35 of 1939.

ON APPEAL FROM THE SUPREME COURT  
OF CANADA.

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BETWEEN

PIONEER LAUNDRY AND DRY CLEANERS LIMITED *Appellant*

AND

THE MINISTER OF NATIONAL REVENUE - - *Respondent.*


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CASE FOR THE RESPONDENT.

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1. This is an appeal by special leave from a judgment of the Supreme Court of Canada dated the 12th December 1938 dismissing, by a majority, the appellant's appeal from a judgment of the Exchequer Court of Canada dated the 4th November, 1937 which had dismissed an appeal from a decision of the respondent affirming an assessment of income tax (not printed in the Record) made upon the appellant for the taxation year ended the 31st March, 1933. RECORD  
p. 67.  
p. 20.  
p. 4.

2. The question for determination is whether or not the appellant in being assessed to income tax for the year ending the 31st March 1933 had a right to a depreciation allowance in respect of certain assets. The Income War Tax Act, being chapter 97 of the Revised Statutes of Canada, 1927, provides that in computing the amount of profits and gains to be assessed no deduction shall be allowed for any depreciation except such reasonable amount as the respondent in his discretion may allow. The material provisions (which are not affected by amendments of the Act) are as follows :

“ 3. For the purposes of this Act, ‘income’ means the annual  
“ net profit or gain or gratuity, whether ascertained and capable  
“ of computation as being wages, salary, or other fixed amount, or  
“ unascertained as being fees or emoluments, or as being profits from  
20 “ a trade or commercial or financial or other business or calling,

RECORD.

“ directly or indirectly received by a person from any office or  
“ employment, or from any profession or calling, or from any trade,  
“ manufacture or business, as the case may be whether derived  
“ from sources within Canada or elsewhere ;.....  
“ .....

“ 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 10  
“ 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 ;.....  
“ .....

“ 6. In computing the amount of the profits or gains to be  
“ assessed, a deduction shall not be allowed in respect of  
“ .....

“ (b) any outlay, loss or replacement of capital or any pay-  
“ ment on account of capital or any depreciation, depletion  
“ or obsolescence, except as otherwise provided in this Act; 20  
“ .....

3. Prior to the 1st April 1932 a company of the same name as the  
appellants, (hereinafter called “ the old company ”) carried on the business  
of laundering and dry cleaning in Vancouver and owned certain machinery,  
equipment, automobiles, horses, wagons, furniture and fixtures in respect of  
which the old company had received in its income-tax assessments to the  
full original cost of these assets, so that no further depreciation allowance  
in respect thereof could properly have been claimed by the old company.

*depreciation allowances*

p. 97, ll. 9-16.

p. 97, ll. 28-36;  
Petition for Special leave to appeal, paragraph 20.

p. 101, l. 18-p. 103, l. 44.

p. 53, l. 46.

pp. 89-91.

4. By an agreement dated the 1st April 1932 the liquidator in the  
voluntary liquidation of the old company sold to Home Service Company  
Limited the whole of the old company’s business and assets in return for  
shares in and the assumption of the old company’s liabilities (amounting to  
\$10,277.23) by Home Service Company Limited; and on the same day  
Home Service Company Limited resold the business and assets (other  
than the real property) to the appellant in return for shares in the appellant,  
cash and the assumption of the old company’s liabilities by the appellant. 30

5. These transactions were of an unusual nature. The whole business  
with its assets passed from one company (the old company) to another  
company of the same name (the appellant); and by virtue of their respective  
shareholdings in a company which had owned the old company and in the  
Home Service Company Limited the same individuals retained in precisely  
the same proportions the ultimate beneficial interest in the business and  
its assets. Evidence was given of an independent appraisal of the assets  
with which this appeal deals and a fixing of the purchase price on the basis 40

p. 59, ll. 8-43; p. 97, l. 37-p.98, l. 7.

p. 51, ll. 6-18.

of the appraisal; but the cash part of the purchase price was not paid over and only becomes payable when, if ever, Home Service Company Limited demands payment. RECORD. p. 90, ll. 20-22; ll. 26-39.

6. From the evidence it appears that certain unidentified assets acquired by the appellant in a similar manner had not originally belonged to the old company, but to the company controlling the old company. These assets had also been fully depreciated and it is not suggested that the appellant's rights in respect of them differ from its rights in respect of the assets of the old company. p. 57, ll. 29-33; p. 97, ll. 16-18; 28-36; p. 98, ll. 7-10.

10 7. The assets acquired from the old company were entered in the appellant's books at a much greater valuation than in the old company's books, balance-sheet and income-tax returns. p. 57, ll. 8-13; p. 60, ll. 9-40.

8. In May, July and November 1932 the appellant bought motor-cars and a truck body and in the appellant's assessment to income-tax for the year ended the 31st March 1933 an admittedly fair allowance for their depreciation was made. p. 98, ll. 11-28; p. 55, ll. 13-18.

9. Documents were put in evidence showing the instructions given to officials concerning allowances for depreciation, and the delegation of powers under the Income War Tax Act to the Commissioner of Taxation and to the Commissioner of Income Tax. pp. 79-81, 84-88; p. 93, ll. 28-42; p. 81, l. 18, p. 83, pp. 100, 101.

10. In the return made by the appellant for the taxation period ended the 31st March, 1933 the appellant claimed \$17,775.55 as depreciation based on the value placed on its assets in its books and on an allowance at the rate of 10 per cent. for machinery, equipment, houses, wagons, furniture and fixtures and of 20 per cent. for automobiles. In the assessment only \$255.08 was allowed for depreciation, being at the rate of 25 per cent. per annum on the assets mentioned in paragraph 8 of this case. No allowance was made in respect of the assets for which allowances totalling 100 per cent. had previously been made to the old company. p. 21, ll. 12-26.

30 11. The appellant on the 9th March, 1935 appealed to the respondent from the assessment on the grounds that the Commissioner of Income Tax had improperly disallowed, except for the sum of \$255.08, the amount claimed for depreciation; and by his decision dated the 30th May, 1935 the respondent affirmed the assessment on the ground that there was no actual change in ownership of the assets in respect of which no allowance was made and which had been set up in the books of the appellant at appreciated values, and that in the exercise of the statutory discretion a reasonable amount had been allowed for depreciation. p. 21, ll. 27-35; p. 25, ll. 32-36. pp. 2-3. p. 2, l. 29-3. l. 4. p. 4: p. 4, ll. 27-38.

40 12. The appellant gave notice of dissatisfaction and alleged that the respondent's decision was not an exercise of the statutory discretion but a refusal on grounds not allowed by the statute of the appellant's right to a depreciation allowance. p. 5, l. 17. p. 6, ll. 20-23.

## RECORD

pp. 7-8.  
p. 7, ll. 22-  
28.  
p. 7, ll. 29-  
39.

13. By his reply the respondent alleged that the sum of \$255.08 was a reasonable and fair allowance; that there was no jurisdiction in a court to inquire into the reasonableness of the allowance, and that regard might properly be had to the fact that the ultimate beneficial ownership of the assets had not changed with the change in ownership from one corporate entity to another.

pp. 10-19.

14. After pleadings the case came on for hearing in the Exchequer Court of Canada on the 8th and 9th September, 1936 and by a judgment dated the 4th November, 1937 the appellant's appeal was dismissed with costs.

p. 20.

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pp. 21-41.

p. 38, ll. 29-  
40.

p. 79, p. 84.

p. 39, ll. 1-  
16.

p. 40, ll. 25-  
32.

p. 40, ll. 33-  
41.

p. 41, ll. 1-  
24.

15. In his reasons for judgment the Honourable Mr. Justice Angers set out the facts and course of proceedings and held that the taxpayer's right to an allowance for depreciation is statutory and the discretion of the respondent exists merely in respect of amount; the rate is to be fixed by the respondent and, although he might change the rates so fixed, he had not changed the rates in circular no. 20 of the 30th August, 1918 and its appendix of the 11th May, 1927. The rates specified therein were binding on the respondent. The learned judge thought that a taxpayer was entitled to know the rates, and that every taxpayer is entitled to the deductions provided for in section 5 of the Act; but the question was whether the appellant has a right to claim for depreciation having regard to the circumstances in which the assets were acquired and appraised. Depreciation is to be computed not on the cost to the taxpayer but on the real value. In the circumstances proved in evidence he held that the appellant could not claim more allowance than the old company could have claimed, and therefore the appellant's appeal failed.

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16. While respectfully submitting that Mr. Justice Angers reached the right result the respondent contends that he misconstrued the Act in holding that the respondent is under any duty to fix rates for depreciation allowances of general application, and that he is bound by the rates laid down for the general guidance of officials. Section 5 empowers the respondent in his discretion to fix not a rate but an amount, and the amount is the particular sum to be allowed to the individual taxpayer. The respondent respectfully submits that the statutory discretion cannot be clogged by any indication by the respondent of the method by which he will normally ascertain the amount to be allowed.

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p. 67.

17. The appellant appealed to the Supreme Court of Canada which by a judgment dated the 12th December 1938 by a majority dismissed the appeal.

pp. 68-73.

p. 68, l. 28.

p. 68, l. 36.

18. The Right Honourable the Chief Justice of Canada (Sir Lyman Poore Duff) and the Honourable Mr. Justice Davis would have allowed the appeal. In their reasons for judgment delivered by Mr. Justice Davis it was stated that the correctness of values set out in the appellant's return was not questioned nor was fraud or improper conduct alleged and that the

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respondent's case was that by reason of the old company having been allowed 100% depreciation the appellant was not entitled to any deduction. Admittedly the assets were set up on the appellant's books at a greater sum than that at which they had been carried on the books of the old company but the prices had been fixed by independent appraisal. The appellant is a separate legal entity, taxable by section 3 of the Act on its annual net profit or gain which cannot fairly be arrived at without taking into account depreciation. The appellant was entitled to such reasonable amount as the respondent might allow, exercising his discretion as a quasi-judicial administrative duty on proper legal principles. The decision was appealable but would not be interfered with unless manifestly unsound. The ground that there was no actual change of ownership and that the assets were set up in the books at appreciated values was not a proper ground upon which to exercise the discretion, because it wrongly disregarded the separate legal existence of the appellant, who was a new owner. Its predecessor's allowance was immaterial. Many great judges had insisted on the impropriety of ignoring the separate legal status of a company. After citing authority their lordships concluded that the discretion had been exercised on wrong principles and that the court should remit the case for reconsideration of the subject-matter stripped of the application of these wrong principles.

19. The reasons for the judgment of the Honourable Justices Crocket and Hudson were delivered by Mr. Justice Hudson. After summarising the contentions of the parties and setting out the relevant parts of the charging section of the Act (section 9) and other sections, the learned judges held that Parliament intended that there should be no depreciation allowance unless the respondent in his sole discretion decided that there should be. There is nothing to indicate the principle or basis for ascertaining the allowance, or to prevent the respondent from looking beyond the legal facade to the realities of ownership or the possibilities of avoiding taxation. The intention of Parliament was that the respondent alone should estimate the different factors. The statute does not define or limit the field of discretion. The regulations were merely directions to local officers for their general guidance and could not be binding in any way on the respondent. The appeal should therefore be dismissed.

20. The Honourable Mr. Justice Kerwin after referring to the Act and the reasons of the respondent for not allowing the appellant's claim held that the statutory discretion had been exercised without disregarding any statutory provision and that there was no ground upon which the respondents' determination could be challenged.

21. The respondent respectfully submits that the judgment of the Supreme Court of Canada was right and should be affirmed for the following amongst other

## R E A S O N S

1. Because in the circumstances of this case the discretion conferred by Parliament on the respondent was properly exercised.
2. Because Parliament intended and provided that the exercise of the discretion should be unfettered and therefore not subject to review in a court of law.
3. Because the Chief Justice of Canada and Mr. Justice Davis were wrong in holding that the respondent is precluded by law from regarding as relevant to his exercise of the statutory discretion the relationship between the appellant and former 10 owners of the assets on which depreciation was claimed.
4. Because the respondent, notwithstanding general instructions governing allowances, is entitled to exercise his discretion, as he did in this case, with regard to the particular circumstances.
5. Because of the other reasons given by the majority in the Supreme Court of Canada.

FRANK GAHAN.

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CASE FOR THE RESPONDENT.

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