56, 1933

In the Privy Council.

No. 72 of 1932.

ON APPEAL FROM THE SUPREME COURT OF CANADA.

BETWEEN

THE MINISTER OF NATIONAL REVENUE (*Respondent*) *Appellant*

AND

MRS. CATHERINE SPOONER - - - (*Appellant*) *Respondent.*

CASE FOR THE APPELLANT.

RECORD.

1. This is an appeal by special leave from a Judgment of the Supreme Court of Canada dated 28th day of April, A.D. 1931, reversing a Judgment of the Exchequer Court of Canada. p. 41. p. 35. p. 16.

2. Under and in accordance with the provisions of "The Income War Tax Act, 1917" (Canada) and amendments thereto

(*a*) Mrs. Catherine Spooner of the City of Calgary in the Province of Alberta, Dominion of Canada, the Respondent herein, filed on the 28th April, 1928, an Income Tax Return for the calendar year 1927 in which no income was disclosed.

(*b*) Upon investigation the Minister of National Revenue duly determined that the said Respondent was liable to be assessed in respect of an income in the sum of $9,570·41, being monies received by her as royalties under an oil production agreement with Vulcan Oils, Limited, hereinafter referred to, and that the tax payable by the said Respondent was $301·07. p. 3.

(*c*) Notice of Assessment demanding payment of the said tax was, by direction of the Minister of National Revenue, mailed by registered post to the Respondent on the 24th day of September, 1929.

(*d*) The Respondent by Notice dated 21st October, 1929, appealed against the said assessment on the ground that the monies p. 6.

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in respect of which she was assessed were in reality a return of capital and were not income within the meaning of the Income War Tax Act. In the alternative the Respondent claimed that if the said monies were income and taxable in her hands she was entitled to an allowance for exhaustion of the oil under the provisions of the said Act.

p. 8, l. 20.
p. 9, l. 1.
p. 9, l. 7.

(*e*) Upon receipt of the said Notice of Appeal the Minister of National Revenue considered the same and duly affirmed the assessment subject to an adjustment as to depletion to which the Respondent was entitled.

p. 9.
p. 10, l. 4.

(*f*) After receipt of a Notice of Dissatisfaction from the Respondent and the filing of security for costs of the appeal in accordance with the said Act and after the Reply of the Minister confirming the assessment as amended by the granting of an allowance in respect of depletion had been issued, the documents were transferred to the Exchequer Court of Canada, after which pleadings were filed in the said Court and the action was ready for trial and hearing on the 17th September, A.D. 1930.

p. 10, l. 27.
p. 11, l. 1.
p. 12, l. 20 to end p. 14.

(*g*) At the trial of the said appeal in the Exchequer Court of Canada, a statement of facts was agreed upon by counsel for the parties, and this is set forth in full in the record at page 15.

p. 15, l. 1 to p. 16, l. 4.

(*h*) The Deed of Agreement under which the royalties in question were paid is set forth in full in the record commencing at page 3.

p. 3, l. 1 to p. 6, l. 20.

3. Argument of the case having been heard, the Honourable Mr. Justice Audette of the Exchequer Court of Canada on the 23rd day of October, 1930, ordered and adjudged that the appeal of Mrs. Spooner be and the same was dismissed, the learned Judge finding that Mrs. Spooner was liable for Income Tax on the royalty received by her. He held that the royalty mentioned in the agreement was a reservation, operating as an exception out of the demise, in favour of Mrs. Spooner; that the profit was derived from the working and development of the land and was in its very nature income and could not amount in any sense to capital. It is quite variable in quantity and is taxable as income under the Act. His reasons for judgment are printed in full commencing at page 17 of the record, the reasons proper commencing at page 20, line 45.

p. 16, l. 34.
p. 22, l. 3.
p. 21, l. 19.
p. 21, l. 22.
p. 21, l. 25.

4. Mrs. Spooner by special leave granted the 14th November, 1930, appealed to the Supreme Court of Canada and that Court, composed of Judges Duff, Newcombe, Rinfret, Lamont and Cannon, delivered judgment on the 28th April, 1931, unanimously allowing the appeal. Judgment was delivered by Mr. Justice Newcombe and is set forth in full commencing at page 36, line 10 of the record. The judgment proceeds generally on the ground that the Income War Tax Act does not, in terms, charge either royalties or annuities (although the definition Section of the said Act includes the general provision that income means the annual profit or gain from any other source) therefore the Court concludes that the monies in question do

p. 22, l. 26.
p. 35.
p. 39, l. 14.

not come within the provisions of the said Act. The case of *Jones* vs. *Commissioners of Inland Revenue*, 1920, 1 K.B. 711 and particularly at pages 714 and 715 where Mr. Justice Rowlatt discussed the various cases, was distinguished by the Supreme Court of Canada on the ground that these observations were applicable only to the statute under consideration in that case and were not applicable under the Canadian Act. The judgment of the Supreme Court, however, admits that the case is not without its difficulties and concludes by saying that the Court is not satisfied that the Crown has made out its claim. RECORD. p. 40, l. 38.

The Supreme Court entirely overlooks the provisions of Section 27 of the Income War Tax Act which clearly contemplates " royalties or other similar payments " as being within the definition of income inasmuch as the said Section specifically provides for the taxation of such income against non-residents. There is not one definition of income for non-residents and another for residents. Hence the mention of royalties in Section 27 is not a re-definition of income even in part—it merely mentions royalties because the monies received thereby were already included in the definition of income, particularly in the sweeping up clause " also the annual profit or gain from any other source."

5. On behalf of the Appellant it is submitted that the judgment of the Supreme Court is wrong in that it is not in accord with the correct interpretation of the definition of income as contained in Section 3 of the Income War Tax Act, Chapter 97, R.S.C. 1927. Income as there defined is not exclusive of incomes not specifically referred to, but inclusive, i.e. includes not only the incomes mentioned in the definition but " also the annual profit or gain from any other source." It is submitted that the judgment of the Exchequer Court is in the result correct and should be restored.

6. Section 3 of the Act which defines income was originally enacted by Section 3 of Chapter 28 of the Statutes of 7–8 George V. (1917) and may now be found in Section 3, Chapter 97, R.S.C. 1927, which reads as follows :—

> " 3. (1) 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 a trade or commercial or financial or other business or calling, 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; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source; . . . with the following exemptions and deductions :—
>
> (*a*) . . . and the Minister, in determining the income derived from mining and from oil and gas wells, shall make an allowance for the exhaustion of the mines and wells."

RECORD. The royalties or percentage of profits contingent upon mining operations in question in this appeal are, it is submitted, an " annual net profit or gain " within the above definition and a profit " from any other source ".

That royalties were regarded as income within the definition of income set forth above, the following is quoted from a Section enacted in the Income War Tax Act in 1924 by Section 3 of Chapter 46 of the Statutes of 14–15 George V. and now to be found as Section 27 of Chapter 97, R.S.C. 1927. The Section hereinbelow quoted was in force during the year in question in this appeal.

The following is the Section referred to :— 10

> " Any non-resident person soliciting orders or offering anything for sale in Canada through an agent or employee, and whether any contract or transaction which may result therefrom is completed within Canada or without Canada, or partly within and partly without Canada, or any non-resident person who lets or leases anything used in Canada, or who receives a royalty or other similar payment for anything used or sold in Canada, shall be deemed to be carrying on business in Canada and to earn a proportionate part of the income derived therefrom in Canada."

The underlined portion is not underlined in the original Act but has 20 been underlined for the purpose of pointing out the particular portion of the Section dealing with royalties, and to show that it was the understanding of the Legislature that royalties were income inasmuch as Parliament specifically stated that a non-resident taxpayer receiving royalties shall be deemed to earn " a proportionate part of the income derived therefrom in Canada." This language, it is submitted, was used on the understanding that all persons in receipt of royalties were in receipt of income.

In fact, the President of the Exchequer Court of Canada, MacLean, J., in the case of *Pope Appliances Corp., Ltd.* vs. *The Minister of Customs and Excise*, 1927 Exchequer Court Reports 17, at page 20 in dealing with this 30 very Section and royalties, which were the subject of dispute in the case, stated :—" These payments are clearly income within the Statute." They are " not a capital sum but a sum dependent on the volume of paper produced and which would vary according to market demands and other factors."

7. The particular paragraphs of the agreement between Mrs. Spooner and Vulcan Oils Limited which are pertinent to this appeal are as follows :—

p. 3, l. 17. > " 1. That the Vendor hereby sells, assigns, transfers and sets over unto the company, its successors and assigns, all her right, title and interest in and to the following property (the property is then described) which includes all mines and minerals on, in or under the 40 said lands, subject to the provisoes, conditions and royalties hereinafter reserved.

p. 4, l. 6. > " 2. The company hereby agrees in consideration of the said sale to it, to pay to the said Vendor the sum of $5,000·00 in cash upon

the execution of this agreement by the company, and to issue to the Vendor or her nominee certificates of stock of the company to the aggregate amount of 25,000 shares of the par value of $1·00 each, and the said shares shall be deemed to be and are hereby declared to be fully paid shares and not liable to any call thereon. RECORD.

" 3. The company hereby further agrees in consideration of the said sale to deliver to the order of the said Vendor the royalty hereby reserved to the Vendor, namely : ten per cent. of all the petroleum, natural gas and oil produced and saved from the said lands free of cost to the said Vendor on the said premises . . . p. 4, l. 14.

" 7. In the event of oil or gas being discovered in commercial quantities on the said lands the Vendor . . . covenants to transfer to the said company by good and sufficient transfer in fee simple the said . . . land freed and discharged from all encumbrances . . . and such transfers shall be completed and delivered forthwith after oil or gas is discovered in commercial quantities by the said company, reserving always however to the Vendor the said royalty of ten per cent. of all petroleum, natural gas and oil . . ." p. 5, l. 5.

8. Mrs. Spooner does not deny that she received from Vulcan Oils Limited the sum of $9,570·41 representing her one-tenth of the oil recovered from the property. p. 8, l. 41.

9. The last sentence in the first paragraph of the facts agreed upon by Counsel that Mrs. Spooner " was not and is not a dealer in, or in the business of buying and selling oil lands or leases " is not an admission on behalf of the Minister of National Revenue that Mrs. Spooner is not liable for Income Tax on the royalty received by her as contended for by her Solicitors, but is only an admission that she is not taxable on the $5,000·00 cash and the 25,000 shares of the par value of $1·00 each of Vulcan Oils Limited which she received in full payment for the lands and interest which she sold to Vulcan Oils Limited under the said agreement. p. 15, l. 6. p. 4, ll. 7–13.

10. It is submitted that even if the royalty received by Mrs. Spooner is considered to be part of the purchase price paid by Vulcan Oils, nevertheless Mrs. Spooner is taxable on the royalties so received in accordance with the decision in *Jones* vs. *The Commissioners of Inland Revenue*, 1920, 1 K.B. 711, at pages 714–715, in that she sold her property for a share of the profits of the business and in that case, while the royalty representing the share of the profits of the business would be part of the price, nevertheless it would bear the character of income in Mrs. Spooner's hands as Vendor. *Chadwick* vs. *Pearl Life Assurance Company*, 1905, 2 K.B. 507 at 514. If this is the case Mrs. Spooner bargained to have, not a capital sum but an income secured to her and consequently is taxable on the royalty.

11. In the alternative, if the royalty is not part of the capital sum received by Mrs. Spooner in payment for what she sold but is a reservation

RECORD. operating as an exception out of the demise in her favour, of the profits derived from the working and development of this land, it is submitted that such royalty " is in its very nature income and could not amount, in any sense, to capital," as was held by Mr. Justice Audette of the
p. 21, l. 25. Exchequer Court. The learned Exchequer Court Judge proceeded further " it is quite variable in quantities and is taxable as income under the Act, 20 Halsbury pages 559 and 560, 11 Halsbury page 219, *Edmonds* vs. *Eastwood*, 2 Hurlstone and Norman 811; *Commissioner of Inland Revenue* vs. *Marine Turbine Company* 1920, 1 K.B. 193; *Commissioner of Inland Revenue* vs. *Sangster* 1920, 1 K.B. 587. The reservation of ten per cent. in the agreement was never sold and never passed out of the hands of the appellant."

It is submitted that Mrs. Spooner would be taxable on the monies received from the sale of the oil, just as a farmer is taxable on the monies received by him from the sale of gravel from a gravel pit on his property, or from the sale of wheat grown out of his soil.

12. As to the United States cases referred to in the factum of the Minister of National Revenue before the Supreme Court of Canada and set forth in the record commencing at page 28, the case of *Alexander* vs. *King* referred to on page 30, line 12, which had not been reported when that factum was prepared, may now be found in 46 Federal Reporter, second series, page 235. A writ of certiorari in this case of *Alexander* vs. *King* was denied by the Supreme Court of the United States reported in 283 United States Reports 845 and 51 United States Supreme Court Reporter 492. The report in 46 Federal Reporter gives a comprehensive summing up of the law as it is interpreted in the United States in cases such as this.

In the case of *Rosenberger* vs. *McCaughn*, 25 Federal Reporter, second
p. 30, l. 8. series, page 699, referred to in the Minister's factum, the United States Court stated " such being the question, the Supreme Court itself construed the instrument there in question in order to determine whether the payments that were made under it were proceeds of sale, capital or income. Wholly aside from the construction which the Minnesota Courts had passed upon instruments of that kind, and solely because of the nature of the payment itself the Supreme Court, as we read its opinion, held that the instrument there in question did not effect the sale of the property, that is, of the ore in place (*U.S.* vs. *The Biwakik Mining Company*, 247 U.S. 116; 38 Supreme Court Reporter 462, 62 Lawyer's Edition 1017) and that the monies derived from mining and paid under the instrument were not converted capital, but were royalties or rents, and as such were income, proper to be included in measuring taxes under the applicable Revenue Act, within the rule of *Stratton's Independence* vs. *Howbert* (231 United States Reports 399, 34 Supreme Court Reporter 136, 58 L. ed. 285) and *Stanton* vs. *Baltic Mining Company* (240 U.S. 103, 36 Supreme Court Reporter 278, 60 L. ed. 546)."

13. It is submitted that owing to the vagrant and fugitive nature of the oil underneath the soil, constituting a sort of subterranean feræ naturæ, a

land owner has no absolute right of title to the oil which might permeate the strata underlying his land as opposed to the case of coal or other solid minerals which are fixed in and form a part of the soil itself. Consequently, until oil has been actually reduced into possession, it cannot be said to have been owned by the land owner, and consequently, the physical oil itself could not be sold before it had been reduced to possession. Therefore, it is submitted that Mrs. Spooner cannot be said to be receiving a capital payment for something which she did not own and which had not been reduced to possession when she made her agreement with Vulcan Oils Limited, and consequently, the sums received by her are not capital in her hands. This point is taken in the factum of the Minister of National Revenue at page 30, line 21. All that Mrs. Spooner sold to Vulcan Oils and for which she received payment in full in the form of $5,000·00 cash and 25,000 shares, was the right to drill for oil and gain such oil from the soil if there was any oil underneath it. The royalty which she receives is either a portion of the profits from the sale of the oil gained and sold, and consequently income, or in the alternative, is oil which has been gained for her and reduced to possession and which she sells and the proceeds from such sale are income, as she has entered into the business of selling oil as opposed to the selling of oil lands which is covered by the admission referred to above.

RECORD.

United States cases have been referred to inasmuch as the appellant has been unable to find British cases dealing with oil or gas wells in the British Digest, due no doubt to the absence of oil and gas wells in Great Britain, and the American cases have been submitted in order that this Court might have the benefit of the reasoning of the United States Supreme Court, even though such decisions are not binding.

14. The appellant submits that the judgment of the Supreme Court of Canada is in error and should be reversed and that the judgment of the Exchequer Court of Canada is, in the result correct and should be restored for the following amongst other

REASONS.

1. Royalties are income within the definition of income as contained in the Income War Tax Act and accordingly, being income, are taxable in the hands of the recipients.

2. That the respondent herein is in receipt of a royalty under her agreement with Vulcan Oils Limited which is taxable under the provisions of the Income War Tax Act.

3. That if the royalty received by the respondent herein from Vulcan Oils Limited was a part of the purchase price from the sale of the lands, the respondent sold her property for certain fixed amounts, plus a share of the profits of Vulcan Oils Limited and that portion, namely a share of the profits of the

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business, while it represents part of the price, nevertheless bears the character of income in the respondent's hands in that she bargained to have not a capital sum, but an income secured to her. The royalty thus falls within the decision in *Chadwick* vs. *Pearl Life Assurance Company* as referred to by Mr. Justice Rowlatt in *Jones* vs. *Commissioners of Inland Revenue* 1920, 1 K.B. 711 at 714 and 715.

4. In the alternative, if the respondent herein did not sell her one-tenth interest in the oil, she is for the year in question and as subsequent years prove (although not now before the Court) in the business of selling oil and therefore is taxable on the profits of such business, namely, the monies received from the sale of the oil whether they be called royalty or not.

5. The monies received from the sale of the oil, whether they be a royalty or the selling price, are the product of capital labour and skill continuously applied and operated in a scheme of profit making. This is not an isolated matter having the character of capital arising once in point of time for all time.

6. That the admission of fact on behalf of the appellant that the respondent is not a dealer in, or in the business of buying and selling oil lands or leases, is not an admission of fact adverse to the appellant's contention herein, as it was construed to be by the Supreme Court of Canada in its reasons for judgment reported in the record at page 40, commencing at line 23.

7. That in view of the admissions contained in paragraphs 10, 11 and 12 of the facts agreed upon by Counsel, the respondent herein is in the business of selling oil either on her own account or in partnership with Vulcan Oils Limited and should be taxed on the profits derived from the sale of such oil in accordance with the Act.

p. 15, ll. 30–44.

8. That the respondent was not the owner of any oil when she entered into the agreement with Vulcan Oils Limited, and consequently is not receiving capital under the said agreement inasmuch as the oil was not her's until it had been reduced to possession, after which it is being sold by her or on her behalf while she is in the business of selling oil continuously over a series of years.

9. For such other reasons as Counsel may present to this Honourable Court on the hearing of the appeal.

As to costs, it is submitted on behalf of the appellant that while the appellant has agreed to pay the respondent's

costs on the appeal to the Privy Council as between Solicitor and client, whatever may be the result, if this Court should decide to allow the appellant's appeal and restore the judgment of the Exchequer Court, costs should be awarded to the appellant in the Exchequer and Supreme Courts of Canada, inasmuch as the original judgment of the Exchequer Court gave the Minister of National Revenue costs against Mrs. Spooner, and it was through Mrs. Spooner's application for special leave to appeal to the Supreme Court of Canada
10 on a case involving an amount less than the statutory amount on which an appeal could have been taken to the Supreme Court of Canada as of right that the original decision of the Exchequer Court was reversed, and consequently it is submitted that the appellant herein should receive his costs in the Supreme and Exchequer Courts of Canada.

C. F. Elliott.

W. S. FISHER.

In the Privy Council.

No. 72 of 1932.

On Appeal from the Supreme Court of Canada.

BETWEEN

THE MINISTER OF NATIONAL REVENUE
(*Respondent*) *Appellant*

AND

MRS. CATHERINE SPOONER
(*Appellant*) *Respondent.*

CASE FOR THE APPELLANT.

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