Privy Council Appeal No. 64 of 1946

Minister of National Revenue *Appellant*

v.

Wrights' Canadian Ropes Ltd. - - - - *Respondents*

FROM

THE SUPREME COURT OF CANADA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 11TH DECEMBER, 1946

Present at the Hearing:

VISCOUNT SIMON
LORD MACMILLAN
LORD WRIGHT
THE MASTER OF THE ROLLS (LORD GREENE)
LORD SIMONDS

[*Delivered by* LORD GREENE]

This appeal relates to three assessments made against the Respondent Company Wrights' Canadian Ropes Limited under the Income War Tax Act and the Excess Profits Tax Act of the Dominion of Canada for the Respondents' fiscal years 1940, 1941 and 1942. The questions in issue are the same for all three years and the relevant statutory provisions are the same under both Acts. It is accordingly sufficient to refer to the Income War Tax Act alone. The only matter upon which the assessments were challenged by the Respondents was the disallowance by the Appellant of part of certain sums which had admittedly been paid in the years in question by the Respondents to an English Company, Wrights' Ropes Limited of Birmingham, by way of commission under an existing contract dated the 12th September, 1935. These sums were claimed by the Respondents to be properly deductible in computing the amount of their taxable income.

The contract by clause 1 was expressed to supersede an earlier contract dated the 19th May, 1931. The parties to both contracts were Wrights' Ropes Limited (referred to as "Wrights"), another English Company named Charles Hirst & Sons Limited (referred to as "Hirsts") and the Respondents whose name at the date of the earlier contract was William Cooke & Co. (Canada) Ltd. The earlier contract provided for the assignment to the Respondents of the business and sales agencies of Wrights in Western Canada and for the performance by Wrights of certain services for the benefit of the Respondents together with a restrictive covenant by Wrights against the sale by Wrights of wire rope in Western Canada. The consideration payable by the Respondents to Wrights for the latter's performance of its obligations was to be a commission at the rate of 5 per centum upon all cash received in respect of the net selling price of all wire ropes both manufactured and sold by the Respondents since the 1st March, 1931. While this earlier contract was still current the later agreement of the 12th September, 1935 (which was expressed to supersede it), was entered into and by clause 8 it was to continue until determined by twelve calendar months notice in writing given by any party to the other parties. Apart from the provision for the transfer by Wrights of its business and sales agencies in Western Canada (which had already been carried into effect) the terms of this contract were substantially of the same character as those of the earlier contract. There was a similar restrictive covenant by Wrights (clause 2 (*a*)) and the services to be performed by Wrights for the benefit of the Respondents were substantially the same as before. These services may be briefly summarised as follows: under clause 2 (*e*) Wrights were to act as technical advisers to the Respondents in the purchase installation and operation of machinery for the manufacture of wire ropes and in the

design and manufacture of wire ropes; under clause 2 (*f*) Wrights were to furnish to the Respondents all information whether of a technical or a commercial nature known to them which might be helpful in the manufacture and sale of wire ropes and generally to place at the disposal of the Respondents the accumulated experience of Wrights and the benefit of their future experiments and investigations. Wrights were also to supply copies of catalogues and advertising matter; under clause 2 (*g*) Wrights were to supervise the supply of wire to the Respondents by Hirsts who (save when unwilling or unable to supply) were by clause 3 to be the exclusive suppliers to the Respondents of wire for use by the Respondents in the manufacture of wire rope. By clause 5 the same commission at the rate of 5 per centum was payable to Wrights by the Respondents as had been payable under the earlier agreement.

In the Respondents' profit and loss accounts attached to their returns under the Income War Tax Act and the Excess Profits Tax Act the sums paid in respect of this commission were set out as follows: For 1940 $17,381.94, for 1941 $29,325.85 and for 1942 $39,480.91. It is admitted that these sums were duly payable by the Respondents under the contract and that they were in fact paid. Nevertheless the Respondents, acting according to what their Lordships were informed by counsel was an arrangement made with the Revenue in previous years, voluntarily offered in their returns to submit to a reduction for tax purposes of the figure of 5 per centum to that of 3½ per centum so that the sums claimed as deductions in arriving at their taxable income for the years in question were reduced as follows: in 1940 by $5214.58, in 1941 by $8797.75 and in 1942 by $11,844.27. In their Lordships' opinion this offer has no relevance to the questions which fall for decision and cannot be used in any way to the prejudice of the Respondents in this appeal. The offer was not accepted by the Appellant and the Respondents are accordingly entitled to stand upon their strict rights.

Assessments in respect of the three years in question were made on the 10th May, 1944. In these assessments the only sums allowed as deductions for the purpose of arriving at the net taxable income of the Respondents in respect of the commission paid by the Respondents to Wrights were the sum of $7500 for each of the three years that is to say for the year 1940 $9881.94 out of $17,381.94 actually paid was disallowed, for the year 1941 $21,825.85 out of $29,325.85 actually paid was disallowed and for the year 1942 $31,980.91 out of $39,480.91 actually paid was disallowed.

In making these disallowances the Appellant purported to act under section 6 sub-section 2 of the Income War Tax Act which provides (in reference to deductions in computing assessable profits) as follows:—

> " The Minister may disallow any expense which he in his discretion may determine to be in excess of what is reasonable or normal for the business carried on by the taxpayer, or which was incurred in respect of any transaction or operation which in his opinion has unduly or artificially reduced the income."

It appears from a letter written on the 13th August, 1943, by the Inspector of Income Tax to the Respondents printed on page 34 of the Record that of the various grounds for disallowance specified in the sub-section the particular ground upon which the Minister purported to act was that the commissions paid were " in excess of what is reasonable for the business ". No question therefore arises as to the payments not having been " normal " for the business nor as to their having " unduly or artificially reduced the income ".

Their Lordships find it convenient at this point to dispose of two arguments which found favour in some of the judgments of the Supreme Court and were repeated before the Board. It was said in the first place that the payments in question were not " expenses " within the meaning of the sub-section since they were payments made under a valid contract as consideration for the contractual benefits thereby conferred. The word " expense " as used in the sub-section has, it was said, a narrow meaning and does not extend to payments of this character. Their Lordships are unable to accept this argument. It appears to them that the word " expense " as used in the sub-section has a quite general meaning and is wide enough to cover any expenditure by the taxpayer whether made under

or as a condition of obtaining a contract or otherwise. There is in the opinion of their Lordships no justification for drawing a distinction between different kinds of contractual payment and this view is confirmed by the use of the word " expense " in other parts of section 6 where its meaning can only be of a general nature. It is sufficient in this connection to refer to sub-sections 4 and 5 of section 6.

The other of the two arguments to which reference has been made appears at first sight to be more substantial but in their Lordships' opinion it also must be rejected. It is said that the payments in question are dealt with exclusively by paragraph (i) of sub-section (1) of section 6, that on the true construction of that paragraph they must be allowed as deductions and that the powers of disallowance vested in the Minister under sub-section 2 do not extend to payments which are thus covered by paragraph (i) of sub-section (1).

The relevant words of paragraph (i) of sub-section (1) of section 6 are as follows:—

> " In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> > (i) any sums charged by any company . . . outside of Canada to a Canadian Company . . . in respect of management fees or services . . . irrespective of whether a price or charge is agreed upon or otherwise; but only if the company . . . . to which such sums are payable, or the company in Canada, is controlled directly or indirectly by any company . . . within or without Canada."

The argument was that the sums here in question were of the nature described in the paragraph, that on the true construction of the paragraph sums of this nature are to be allowed as deductions save in the sole case where the required control exists, that on the admitted facts in the present case no such control existed and that sums thus imperatively directed to be allowed cannot be made the subject-matter of a discretionary disallowance in whole or in part by the Minister under sub-section 2.

Two incidental questions were raised in connection with this argument. One was as to whether the required control of the Respondents by Wrights existed in fact. As to this their Lordships are of opinion that the admission signed on behalf of both parties on the 1st June, 1945, and printed on page 57 of the Record to the effect that Wrights held only 49.86 per cent. of the shares of the Respondents is conclusive that it did not.

The other question was whether the sums in question, payable as they were in respect of a variety of considerations including the restrictive covenant by Wrights, could be said to be of the nature specified in paragraph (i) of sub-section (1). Their Lordships do not find it necessary to express an opinion upon this question since in their view the main argument fails. Their reasons may be shortly stated. The disallowance prescribed by section 6 (1) (i) is compulsory (save in so far as a provision at the end of the paragraph allows the Minister to mitigate it in a limited class of case) and does not come into operation as the result of a determination by the Minister as is the case where disallowance is effected under sub-section 2. The direction in paragraph (i) beginning with the words " but only " does no more than lay down the limits within which this compulsory disallowance is to operate; it cannot in their Lordships' opinion be construed as meaning that in cases not falling within those limits no disallowance is to take place under sub-section 2. There does not appear to their Lordships to be any real difficulty in reconciling a provision which says that the compulsory disallowance is only to take place in certain stated circumstances with the provision in sub-section 2 which provides in quite general terms for a disallowance to be effected in different circumstances and in a different manner viz. as the result of a determination by the Minister. The language is insufficient to require the two provisions to be read as mutually exclusive as is in effect contended by the Respondents.

There is one more argument advanced on behalf of the Respondents which can conveniently be dealt with before coming to the substantial question in the case. On the 29th May, 1944, the Respondents served on

the Appellant a notice of appeal against the asessments under section 58 of the Income War Tax Act. Section 59 of the Act provides that notices of appeal are to be considered by " the Minister " who is to " affirm or amend the assessment appealed against ". Under section 75 (2) of the Act the Minister is empowered by regulation to authorise the Commissioner of Income Tax " to exercise such of the powers conferred by this Act upon the Minister, as may, in the opinion of the Minister, be conveniently exercised by the Commissioner of Income Tax ". On the 8th August, 1940, the Appellant made a regulation authorising the Commissioner of Income Tax to exercise without exception the powers conferred upon the Minister by the Act. At the date of this regulation Mr. C. Fraser Elliott K.C. was the Commissioner of Income Tax. Under section 1 of Chapter 24 of the Statutes of 1943-44 power was given to the Governor in Council to appoint a " Deputy Minister of National Revenue for Taxation " and that title was to be substituted for the title " Commissioner of Income Tax ". Mr. Fraser Elliott was duly appointed Deputy Minister of National Revenue for Taxation. It was Mr. Elliott as the Appellant's delegate who made the disallowances complained of and signed the assessments and it was he who dealt with and rejected the appeal of the Respondents under section 59. It was contended on behalf of the Respondents that although the power to make disallowances under section 6 (2) and to sign assessments could validly be delegated by the Minister it was not competent to him to delegate the duty to consider appeals under section 59 and that accordingly the appeal of the Respondents under that section had never been considered as the section requires. This argument is based on a suggested distinction between powers and duties which their Lordships so far as the present case is concerned are unable to accept. The distinction if well founded would mean that the Minister himself would be bound to hear all Income Tax and Excess Profits Tax appeals, a burden which it is not to be supposed that the Legislature can have intended to place upon his shoulders. Indeed the making of assessments is as much a matter of duty as the hearing of an appeal and the argument that duties as distinct from powers are to be excluded from the right to delegate given by section 75 (2) would, if accepted, render that right of little practical value.

Their Lordships will now proceed to deal with the main question which is in issue in the appeal.

By notice dated the 26th September, 1944, the decision of the Appellant dismissing their appeal was communicated to the Respondents pursuant to section 59 of the Income War Tax Act. The notice stated that the decision was " based on the facts presently before the Minister ". What these facts were was stated in unambiguous language by the Deputy Minister in his examination for Discovery in the action which ensued. They were " the financial statements of the company for each of the years concerned, the income tax returns for the company and all documents attached to these two documents ". This clearly included copies of the two agreements mentioned which had been forwarded to the Inspector by the Respondents on the 8th September, 1945. In addition, the Deputy Minister had before him a report by the Inspector of Taxes to the Minister.

On receipt of the notice of dismissal of their appeal the Respondents served a notice of Dissatisfaction pursuant to section 60 of the Income War Tax Act. The Minister served a reply under section 62 and transmitted certain documents to the registrar of the Exchequer Court under section 63. Thereupon under sub-section 2 of that section the matter was to be " deemed to be an action in the said Court ready for trial or hearing ". The appeal was heard by Mr. Justice Cameron in the Exchequer Court. The only witness called was Mr. Joseph Gordon Chutter the Managing Director of the Respondents.

Cameron J. dismissed the appeal. The Respondents thereupon appealed to the Supreme Court who by a majority (diss. Kerwin J.) allowed the appeal with costs. The formal order directed the assessments to be " referred back to the Minister of National Revenue under the provisions of section 65 (2) of the Income War Tax Act to be dealt with by him in accordance with the reasons for judgment of the majority of the members of this Court ". Their Lordships will have some comments to make upon this order later in this judgment.

In the reasons for judgment in the Supreme Court and in the argument before their Lordships' Board considerable discussion took place with regard to the Report made by the Inspector of Income Tax to the Minister. The contents of this document were not communicated to the Respondents at any stage and when upon his examination for discovery Mr. Elliott was asked by counsel for the Respondents to produce it he declined to do so. It was not produced nor was the nature of its contents disclosed either before the Supreme Court or before their Lordships' Board. The non-production of the document was put forward as a ground for allowing the appeal in the Supreme Court and was relied on by counsel for the Respondents in the present appeal. It was argued that the Report ought to have been filed in the Exchequer Court under paragraph (*g*) of section 63 (1) of the Act which includes among the documents to be filed by the Minister " all other documents and papers relative to the assessment under appeal ". Their Lordships do not find it necessary to express a concluded opinion on the question whether this language is sufficiently wide to cover what would normally be regarded as a confidential communication made to a Minister by one of his subordinates and as such privileged from production. If indeed paragraph (*g*) did cover the Report the proper method to secure its production before the Exchequer Court would have been by interlocutory application to that Court. No such application was however made and the non-production of the Report could not by itself assist the Respondents.

Their Lordships now return to a consideration of the language of section 6 (2). They cannot help thinking that some confusion has been caused throughout the history of this controversy by the phrase contained in the sub-section " in his discretion ". The word " discretion " is in truth scarcely appropriate in the context since what the Minister is required to do before he can make a disallowance is to " determine " that an expense is in excess of " what is reasonable or normal for the business carried on by the taxpayer ". The reference to " discretion " in this context does not in the opinion of their Lordships mean more than that the Minister is the judge of what is reasonable or normal. If the matter had stood there and there had been no right of appeal against the decision of the Minister the position would have been different from what it is. But in contrast to cases arising under sub-sections 3 and 4 of section 6 where the decision of the Minister is to be " final and conclusive " a right of appeal to the Exchequer Court is given and the appeal is to be regarded as an action in that Court. This right of appeal must, in their Lordships' opinion, have been intended by the Legislature to be an effective right. This involves the consequence that the Court is entitled to examine the determination of the Minister and is not necessarily to be bound to accept his decision. Nevertheless the limits within which the Court is entitled to interfere are in their Lordships' opinion strictly circumscribed. It is for the taxpayer to show that there is ground for interference and if he fails to do so the decision of the Minister must stand. Moreover, unless it be shown that the Minister has acted in contravention of some principle of law the Court, in their Lordships' opinion, cannot interfere: the section makes the Minister the sole judge of the fact of reasonableness or normalcy and the Court is not at liberty to substitute its own opinion for his. But the power given to the Minister is not an arbitrary one to be exercised according to his fancy. To quote the language of Lord Halsbury in *Sharp* v. *Wakefield* [1891] A.C. 173 at page 179 he must act " according to the rules of reason and justice, not according to private opinion; according to law and not humour. It is to be not arbitrary, vague and fanciful, but legal and regular ". Again in a case under another provision of this very section 6 (section 6 (1)) where a discretion to fix the amount to be allowed for depreciation is given to the Minister, Lord Thankerton in delivering the judgment of the Board said " The Minister has a duty to fix a reasonable amount in respect of that allowance and, so far from the decision of the Minister being purely administrative and final, a right of appeal is conferred on a dissatisfied taxpayer; but it is equally clear that the Court would not interfere with the decision unless—as Davis J. states—' it was manifestly against sound and fundamental principles ' ". (*Pioneer Laundry and Dry Cleaners Ltd.* v. *Minister of National Revenue* [1940] A.C. 127 at page 136.)

In the present case the Minister's decision is attacked on the ground that there was before him no material upon which he, as a reasonable

man, could determine that any part of the commissions in question was in excess of what was reasonable for the business carried on by the Respondents. The ground of attack is different from that which was successful in the *Pioneer Laundry* case. There the Minister had given a reason for his decision which was in law incapable of supporting it, whereas in the present case no reason was given by the Minister although certain suggestions were made in the hearing before their Lordships by counsel as will presently appear. Their Lordships find nothing in the language of the Act or in the general law which would compel the Minister to state his reasons for taking action under section 6 (2). But this does not necessarily mean that the Minister by keeping silence can defeat the taxpayer's appeal. To hold otherwise would mean that the Minister could in every case or at least the great majority of cases render the right of appeal given by the Statute completely nugatory. The Court is, in their Lordships' opinion, always entitled to examine the facts which are shown by evidence to have been before the Minister when he made his determination. If those facts are in the opinion of the Court insufficient in law to support it the determination cannot stand. In such a case the determination can only have been an arbitrary one. If, on the other hand, there is in the facts shown to have been before the Minister sufficient material to support his determination the Court is not at liberty to overrule it merely because it would itself on those facts have come to a different conclusion. As has already been said, the Minister is by the sub-section made the sole judge of the fact of reasonableness and normalcy but as in the case of any other judge of fact there must be material sufficient in law to support his decision.

So far as the evidence goes the only material before the Appellant consisted of the documents mentioned by Mr. Fraser Elliott in his examination. All these documents with the exception of the Report of the Inspector were before the Courts in Canada. Their Lordships are unable to find in any of these documents any material upon which the determination of the Appellant could lawfully be founded. Counsel for the Appellant, when invited to point to anything in these documents which could justify the disallowances, referred to two matters only viz. that the receipts of the Respondents on which the commission was paid were on a rapidly rising scale, due no doubt to war contracts; and that the rise in the amounts paid away in commission was not accompanied by a corresponding rise in the net profits of the Company. In their Lordships' opinion neither of these suggested reasons affords any support for a finding that the commissions paid in these years were in excess of what was reasonable for the business carried on by the Respondents. The contract was admittedly a bona fide one. It is not to be assumed nor is it now suggested that the commissions were other than reasonable having regard to the benefits obtained by the Respondents under the contract. The mere fact therefore that as the receipts increased the commission automatically increased can provide no ground for saying that the increase was unreasonable. It was due to nothing but the operation of the terms of the contract which ex hypothesi were reasonable terms.

The other reason suggested by counsel is equally without substance. The fact that the net profits of the Respondents were not in step with the rising amounts of the commission may have been due to a variety of causes and can have no possible bearing on the reasonableness of the commission payments.

So far therefore as these documents are concerned their Lordships cannot find any material which could have justified any disallowance. But it was suggested that there may have been other facts before the Minister which justified him in taking the course that he did and in particular it is said that the Report of the Inspector may have contained the requisite material. Their Lordships cannot accept this argument. The Appellant has not chosen to produce any evidence as to these alleged matters and their Lordships are quite unable to assume in the Appellant's favour that he had before him sufficient facts to support his determination when he neither condescends to state what those facts were nor attempts to prove that any such facts were in truth before him. The only inference which in their Lordships' opinion can legitimately be drawn from the available evidence is that, apart from the documents which were before the Court, the Minister had no material before him which influenced his mind in making the determination that he did. If he had in fact had such material it would in

their Lordships' opinion have been impossible to suppose that he would not have informed the Respondents of at least the substance of it when the matter was originally brought before him so as to give the Appellants a fair opportunity of meeting the case against them. The contrary supposition would involve that the Appellant had come to a decision adverse to the Respondents upon material of which, so far as he knew, the Respondents were completely ignorant and knowledge of which he deliberately withheld from them.

In their Lordships' opinion therefore the Supreme Court was right in allowing the appeal of the present Respondents although, as will have appeared, their Lordships' reasons are for the most part different from those that commended themselves to the several members of the Supreme Court. It remains to consider what the proper form of order should be. The order of the Supreme Court referred the matter back to the Minister under section 65 (2) of the Income War Tax Act. Their Lordships do not think that this reference to section 65 (2) was appropriate. The power conferred on the Court under that sub-section to " refer the matter back to the Minister for further consideration " is, in their Lordships' opinion, limited to cases of the kind referred to in sub-section 1 of Section 65, namely, where matters not referred to in the notice of appeal or notice of dissatisfaction are admitted by the Court. In such cases a reference back to the Minister might obviously be an appropriate procedure. Where, however, as in the present case, the issues are fought out and the taxpayer is successful on his appeal the sub-section does not, in their Lordships' opinion, apply. A fortiori it cannot apply in the manner and with the consequences contended for by counsel for the Appellant in the present case. They endeavoured to interpret the order as meaning that it would be open to the Minister to start as it were de novo and re-consider the whole matter of disallowance with power to come to the same conclusion as before or a different conclusion on the same or different material. This, in their Lordships' opinion, would plainly be inadmissible. The issues have been fought out by action in the Courts and the appeal of the Respondents was in terms allowed by the Supreme Court. The view submitted by the Appellant, if correct, would give the Minister a second opportunity of making a determination unfavourable to the Respondents and thus depriving them of the fruits of their victory.

On consideration of the reasons for judgment of the Supreme Court their Lordships are of opinion that in allowing the appeal it was intended to decide that the disallowances complained of were to be set aside once and for all and that the reason for referring the matter back to the Minister was merely to enable him to adjust the assessments in accordance with this decision. That, in the opinion of their Lordships, was the correct order to make, but the reference back to the Minister for this purpose could and should have been made under the inherent jurisdiction of the Court and not under section 65 (2). It cannot be doubted that when the Court has answered a question submitted to it in such a way as to necessitate a revision of the assessment it has inherent jurisdiction to send the assessment back for that purpose instead of being bound itself to make the consequential alterations.

The formal order of the Supreme Court should, in their Lordships' opinion, be varied by directing that the assessments be referred back to the Minister (without any reference to section 65 (2)) for an adjustment of the figures consequential on the allowance of the Respondents' appeal to the Supreme Court.

For these reasons their Lordships will humbly advise His Majesty that the appeal should be dismissed but that the order of the Supreme Court should be modified in the manner above indicated. The Appellant must pay the costs of this appeal.

(54376) Wt. 8013—5 100 1/47 D.L. G. 333

In the Privy Council

MINISTER OF NATIONAL REVENUE

v.

WRIGHTS' CANADIAN ROPES LTD.

DELIVERED BY LORD GREENE

Printed by His Majesty's Stationery Office Press.
Drury Lane, W.C.2.

1946