1965

*Nov. 5
9, 10
Dec. 14

FALCONBRIDGE NICKEL MINES LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

FALCONBRIDGE NICKEL MINES LIMITED ..... RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Deductions—Prospecting, exploration and development expenses—Mining and exploration companies—Work done under agreements with other companies—Income Tax Act, 1949 (Can.), (2nd Sess.), c. 25, s. 53(4)—Income Tax Act, R.S.C. 1952, c. 148, s. 83A(7) [as enacted by 1955 (Can.), c. 54, s. 22].

The appellant company, whose chief business was that of mining or exploring for minerals, claimed to deduct from its income for the years

*PRESENT: Abbott, Judson, Ritchie, Hall and Spence JJ.

1950, 1951 and 1952 certain prospecting, exploration and development expenses which it had incurred in searching for minerals pursuant to agreements entered into with different companies and individuals on properties owned by those companies and individuals. Twelve items of these expenses were disallowed by the Minister on the grounds that some of them did not meet the requirements of s. 53(4) of the *Income Tax Act*, 1949 (Can.) (2nd Sess.), c. 25, and that the others came within the provisions of s. 83A(7) of the *Income Tax Act*, R.S.C. 1952, c. 148, as enacted by 1955 (Can.), c. 54, s. 22. The Exchequer Court held that three items of expenses were not deductible and that the nine others were. Both the company and the Minister appealed to this Court.

Held: The company's appeal should be dismissed; the Minister's appeal should be allowed, subject to his admission that two items of expenditures and part of a third should be allowed as deductions.

A detailed analysis of the agreements led to the conclusion that the remaining items of exploration expenses came within the provisions of s. 83A(7)(*c*), and accordingly their deduction should be disallowed.

Revenu—Impôt sur le revenu—Déductions—Dépenses de prospection, d'exploration et de mise en valeur—Compagnie d'exploitation et d'exploration minières—Travaux faits en vertu d'ententes avec d'autres compagnies—Loi de l'Impôt sur le revenu, 1949 (Can.), (2e Ses.), c. 25, art. 53(4)—Loi de l'Impôt sur le revenu, S.R.C. 1952, c. 148, art. s. 83A(7)(*c*), and accordingly their deduction should be disallowed.

La compagnie appelante, dont l'entreprise principale était l'exploitation minière ou l'exploration pour la découverte de minéraux, a prétendu déduire de son revenu pour les années 1950, 1951 et 1952, certaines dépenses étaient couvertes par les dispositions de l'art. 83A(7)(*c*), et en elle pour la recherche de minéraux aux termes d'ententes conclues avec différentes compagnies et individus sur des propriétés appartenant à ces compagnies et individus. Le Ministre a rejeté douze rubriques de ces dépenses pour les motifs que certaines ne rencontraient pas les exigences de l'art. 53(4) de la *Loi de l'Impôt sur le revenu*, 1949 (Can.), (2e Ses.), c. 25, et que les autres entraient dans les cadres de l'art. 83A(7) de la *Loi de l'Impôt sur le Revenu*, S.R.C. 1952, c. 148, telle que décrétée par 1955 (Can.), c. 54, art. 22. La Cour de l'Échiquier a refusé la déduction de trois de ces rubriques de dépenses et a permis la déduction des neuf autres. La compagnie et le Ministre en ont tous deux appelé devant cette Cour.

Arrêt: L'appel de la compagnie doit être rejeté; l'appel du Ministre doit être maintenu, sujet à sa reconnaissance que la déduction de deux des rubriques de dépenses et partie d'une troisième devait être accordée.

Une analyse détaillée des ententes démontre que les autres rubriques de dépenses de prospection, d'exploration et de mise en valeur faites par conséquence leur déduction devait être rejetée.

APPEL de la compagnie et APPEL du Ministre d'un jugement du Juge Cattanach de la Cour de l'Échiquier du Canada[1], en matière d'impôt sur le revenu. Appel de la compagnie rejeté; appel du Ministre maintenu.

[1] [1965] 2 Ex. C.R. 77, [1965] C.T.C. 82, 65 D.T.C. 5046.

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APPEAL by the company and APPEAL by the Minister from a judgment of Cattanach J. of the Exchequer Court of Canada[1], in a matter of income tax. Appeal of the company dismissed; appeal of the Minister allowed.

Allan Findlay, Q.C., and *A. S. Kingsmill,* for Falconbridge Nickel Mines Ltd.

G. W. Ainslie and *D. G. H. Bowman,* for the Minister of National Revenue.

The judgment of the Court was delivered by

JUDSON J.:—The issue in this appeal is the claim of Falconbridge Nickel Mines Limited to deduct from its income for the years 1950, 1951 and 1952 certain prospecting, exploration and development expenses. Throughout the proceedings the expenses have been classified into 12 items and I will maintain that classification. The money was all spent on properties owned by others under the terms of written agreements, which I shall have to analyse later. To obtain these deductions Falconbridge must show that they come within s. 53(4) of the 1949 *Income Tax Amending Act,* (1949), Second Session, c. 25. This section must be read with an explanatory amendment enacted in 1955 and made to apply retroactively to the years in question (Statutes of Canada 1955, c. 54, s. 22(1)).

In full the sections read:

53 (4) A corporation whose chief business is that of mining or exploring for minerals may deduct, in computing its income for the purpose of the said Act for the year of expenditure, an amount equal to all prospecting, exploration and development expenses incurred by it, directly or indirectly, in searching for minerals during the calendar years 1950 to 1952, inclusive, if the corporation files certified statements of such expenditures and satisfies the Minister that it has been actively engaged in prospecting and exploring for minerals by means of qualified persons and has incurred the expenditures for such purposes.

* * *

83A (7) For the purposes of this section and section 53 of chapter 25 of the statutes of 1949 (Second Session), it is hereby declared that expenses incurred by a corporation, association, partnership or syndicate on or in respect of exploring or drilling for petroleum or natural gas in Canada or in searching for minerals in Canada do not and never did include expenses so incurred by that corporation, association, partnership or syndicate pursuant to an agreement under which it undertook to incur those expenses in consideration for

(*a*) shares of the capital stock of a corporation that owned or controlled the mineral rights,

[1] [1965] 2 Ex. C.R. 77, [1965] C.T.C. 82, 65 D.T.C. 5046.

(*b*) an option to purchase shares of the capital stock of a corporation that owned or controlled the mineral rights,

or

(*c*) a right to purchase shares of the capital stock of a corporation that was to be formed for the purpose of acquiring or controlling the mineral rights.

I will begin with an analysis of the Gull Lake and the Gullbridge agreements. The properties on which these expenditures were made were owned by Newfoundland Gull Lake Mines Limited. That company and Falconbridge on August 17, 1950, made an agreement, which I now summarize.

(*a*) Falconbridge agreed to pay to Gull Lake $2,500 for an exclusive option to purchase certain mining claims;

(*b*) Falconbridge was to have 60 days to make an examination of the mining claims;

(*c*) Falconbridge during the currency of the option was to have exclusive possession of the mining claims;

(*d*) If Falconbridge before the expiry of the 60 days notified Gull Lake that it wished to proceed with the agreement, a new company was to be incorporated;

(*e*) Upon the incorporation of the new company, Gull Lake and Falconbridge would transfer the mining claims to the new company and, as consideration for the transfer, the new company would allot to Gull Lake 500,000 of its Class "A" shares and would allot to Falconbridge such number of its Class "B" shares as could be purchased, at five cents per share, by a payment equal to $2,500 plus the amount that Falconbridge had expended in connection with the examination of the claims.

(*f*) After the incorporation of the new company, the parties would cause the new company to enter into an agreement with Falconbridge under which Falconbridge would subscribe for shares in the new company on a specified basis and the new company would grant to Falconbridge an exclusive right or option to purchase a specified number of its Class "B" shares.

(*g*) Falconbridge was under no obligation to cause any examination to be made, to expend any moneys or to perform any other act other than the payment of the $2,500.

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Falconbridge notified Gull Lake on October 20, 1950, that it wished to proceed with the agreement, with the result that a new company, Gullbridge Mines Limited, was incorporated on November 14, 1950, and on December 27, 1950, Falconbridge made with it the agreement contemplated in the Gull Lake agreement. These are the features of this Gullbridge agreement with which we are concerned:

(*a*) Falconbridge subscribed and agreed to purchase 60,241 Class "B" shares of Gullbridge at a price of 5 cents per share and 119,880 Class "B" shares for 10 cents per share. This was in accordance with the Gull Lake agreement and was an application of the $2,500 and the expenses to date on the purchase of shares.

(*b*) Gullbridge granted Falconbridge 7 separate options to purchase a total of 2,059,638 Class "B" shares at specified times and prices.

The following clause gave Falconbridge the right to pay for the shares under option by the application of the moneys expended for exploration and development expenses:

> 4. The parties hereto agree that instead of the Optionee (Falconbridge) taking up and paying for the shares the Optionee (Falconbridge) may expend the monies required to keep this option in force on diamond drilling and on other exploration, development and mining work on the said mining claims . . . and the Optionee (Falconbridge) shall be reimbursed for all expenditures made by it on behalf of the Optionor (Gullbridge), such reimbursement being in the form of shares of the Optionor issued in accordance with the terms of this agreement.

GULLBRIDGE

There are four items of expenditure relating to these agreements:

Item	Period of Expenditure	Departmental Decision	Decision in Exchequer Court
I. $ 10,512.05	Prior to November 14, 1950, date of incorporation of Gullbridge	Disallowed	Allowed
II. $ 4,953.73	From November 14, 1950, to December 31, 1950	Disallowed	Allowed
III. $247,243.88	1951	Disallowed	Disallowed
IV. $ 56,047.26	1952	Disallowed	Disallowed

The Minister appeals the allowance of the first two items and Falconbridge appeals the disallowance of the second

two. Falconbridge applied all these expenditures on the purchase of shares under option at the specified prices.

On items I and II the learned trial judge[1] held:

> In my view, this was not an agreement by which the appellant "undertook" to incur the expenses in question if the word "undertook", as used in s.s. (7) of Sec. 83A, implies, as I think it does, a legal liability enforceable by legal action.
>
> This new company was incorporated with the name of Gullbridge Mines Limited on November 14, 1950 and the expenditures in question were incurred between that date and the end of that year. It would appear that these expenditures were not made pursuant to, or contemplated by, an agreement. What I have said with reference to the first item therefore applies with even greater force to the second item.

On Items III and IV the learned trial judge held:

> On the other hand, s.s. (4) of s. 53 does require that the expenditures must have been "incurred" by the taxpayer before the taxpayer can deduct them under that subsection. I think it must follow from this that the expenditures must have been incurred by the taxpayer on its own account—that is, as a principal and not merely as an agent or contractor for somebody else.
>
> . . . it is sufficient to say that in my view an exploration company cannot be said to be carrying on such a programme on its own behalf when it is carrying it on under a contract under which it is to be reimbursed for the total expenses of the programme as such or under which it carries on the programme as a means of obtaining a credit for the amount of the expenses against an amount which it would otherwise have to pay in cash.

The Minister argues here that the learned trial judge was correct on items III and IV and that there is no difference between these and items I and II. The first question is were any of these items within the terms of s. 53(4)? Falconbridge undoubtedly spent its own money for prospecting, exploration and development. The first item was spent on the property when it belonged to Gull Lake, the next three on the property when it belonged to Gullbridge. When it expended this money it did not intend to confer a gratuitous benefit on these companies. Unless it took up the options this is what it would have been doing.

The legal position of Falconbridge in making these expenditures is easily defined. First, it was under no legal obligation to make any of them. Second, it was under no legal obligation to apply them on the purchase of shares under option although it had the right to do so. Third, it did not make them as agent or contractor for anyone. I cannot accept the characterization of the relationship found later in the judgment of the Exchequer Court as that of agent or contractor on behalf of the owner.

[1] [1965] 2 Ex. C.R. 77, [1965] C.T.C. 82, 65 D.T.C. 5046.

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As to the first two items, I differ from the opinion of the learned trial judge. I do not think that the word "undertook" as used in s. 83A(7) means that there must be a legal liability enforceable by legal action. The words "pursuant to an agreement under which it undertook to incur those expenses in consideration for etc." mean no more than this. If Falconbridge takes it upon itself to spend this money on the property of another and it does so pursuant to an agreement which gives it that right, then the case is within s. 83A(7) if the consideration is as stated in the section.

Further, the trial judgment holds that the expenditures under item II were not made pursuant to any agreement. The Gullbridge agreement is dated December 27, 1950, and the money was spent between the date of incorporation of Gullbridge and the date of the agreement. There is no doubt that the parties treated these expenditures as having been made under the Gullbridge agreement and they were applied on the purchase of shares. Falconbridge was not making a gift of these expenditures. The Gullbridge agreement was contemplated and spelled out in the prior Gull Lake agreement which had as a schedule the proposed agreement with the new company. The new company issued shares for these expenditures when the option was exercised. What more is needed? It was not necessary to wait until the agreement was formally executed.

I am therefore of the opinion that there was twofold error in allowing Falconbridge to deduct items I and II.

As to items III and IV, in my opinion there was error in holding that these expenditures were reimbursed when Falconbridge applied them on the purchase of shares instead of paying cash, and that Falconbridge consequently did not incur these expenditures within the meaning of s. 53(4). If A spends money on the strength of a promise of B to reimburse him, he expects to receive money in return. Where B only promises an option on its share capital if A chooses to apply the expenditure in this way, then there is no reimbursement and I say that notwithstanding the use of the word in paragraph 4 of the Gullbridge agreement. If the expenditure is not applied on the purchase of shares, Gullbridge is under no obligation. I can get no help either way from *Okalta Oils Limited v. Minister of National Revenue*[1],

[1] [1955] Ex. C.R. 66, [1955] C.T.C. 39, 55 D.T.C. 1029.

and *Corporation of Birmingham v. Barnes*[1]. In the *Okalta* case a Crown corporation had advanced the money for exploration. The company was under no obligation to repay except out of production from the well. The well was unproductive. The oil company tried to include this subsidy in its drilling costs for the purpose of claiming a tax credit, which at that time was 26⅔ per cent of its costs. The Exchequer Court held that the oil company had not incurred those costs. In this Court[2], the point was not considered. On the other hand, in the *Birmingham* case, the corporation received a subsidy from the government to cover part of the cost of the reconstruction of certain tramlines. This came from the Unemployment Grants Committee. It also received a contribution towards the cost of a new line from a company that the new line was intended to serve. The question in issue was whether the corporation was entitled to include these two contributions in its cost when claiming a capital cost allowance in making its Income Tax Return. The House of Lords held that it was. Neither case touches the present problem.

Another ground given in the Exchequer Court for the disallowance of items III and IV was that Falconbridge had not incurred these expenditures on its own account. The reasoning is given in the extracts above quoted. Falconbridge did not incur these expenditures as agent or contractor for somebody else and the right to apply the expenditure on shares, which, I have said, was erroneously called reimbursement, cannot turn the operation into one carried on on behalf of somebody else.

In conclusion then I say that all these four items represent expenditures for exploration and were incurred by Falconbridge within the meaning of s. 53(4). I would disallow all four solely under the provisions of s. 83A(7)(*c*).

The next four items of expenditure relate to agreements made with Rambler Mines Limited and Rambridge Mines Limited. They are similar in set-up to those made with Gull Lake and Gullbridge. The Rambler agreement is dated October 21, 1950. It gives Falconbridge the right to make an examination for a period of 60 days on certain mining claims. Falconbridge was not legally bound to proceed with

[1] (1933-35), 19 T.C. 195; [1934] 1 K.B. 484; [1935] A.C. 292.

[2] [1955] S.C.R. 824, [1955] C.T.C. 271, 55 D.T.C. 1176, 5 D.L.R. 614.

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this examination. If Falconbridge wished to proceed with the agreement, the parties would cause a new company to be incorporated to which the mining claims would be transferred. In consideration of the transfer, the new company would issue and allot all its shares, 40 per cent to Rambler and 60 per cent to Falconbridge. Then Rambler and Falconbridge would cause the new company to enter into an agreement providing for the deposit in escrow of the issued shares to be released on defined conditions. Falconbridge did notify Rambler of its intention to proceed. The new company Rambridge Mines Limited, was incorporated on January 10, 1951. On February 16, 1951, the parties entered into the Rambridge agreement, the form of which had already been settled as a schedule to the Rambler agreement, and under this agreement Falconbridge agreed to extend or advance to Rambridge the sum of $100,000 at certain intervals within twenty-four months subject to the right of Falconbridge to discontinue at any time on giving Rambridge 30 days' notice. Any moneys expended in excess of $100,000 would be treated as a loan by Falconbridge to Rambridge and would be repayable before any dividends could be declared.

There are four items of expenditure relating to these agreements:

RAMBRIDGE

Item	Period of Expenditure	Departmental Decision	Decision in Exchequer Court
V. $20,435.41	1950	Disallowed	Allowed
VI. $15,123.57	From January 1, 1951 to February 16, 1951, date of execution of Rambridge Agreement	Disallowed	Allowed
VII. $13,765.73	From February 1, 1951 to December 31, 1951		
VIII. $13,677.68	1952		

The learned trial judge in his reasons for judgment in dealing with items V and VI adopted the same reasoning as he did in dealing with items I and II. In this I think that there was the twofold error I have already noted. However, item V must be dealt with on different grounds. The Minister, in his exchange of documents when the taxpayer

filed an appeal, agreed with the taxpayer's contention on item V and agreed to vary his assessment accordingly. The same applies to part of item VI. That part amounts to $4,212.36, leaving the balance of item VI $10,911.21. These items, because of the Minister's notification, were not included in the company's Notices of Appeal to the Exchequer Court. I think that once he had agreed with the taxpayer's submission and agreed to vary the assessment, the assessment must be taken as varied. Consequently, these two amounts were not in issue in the Exchequer Court and nothing more needs to be said about them.

With regard to the balance of item VI, the whole of item VII, and the whole of item VIII, the same result must follow as under the Gull Lake—Gullbridge agreements. The learned trial judge was of the opinion that these expenditures were made pursuant to an agreement but not the kind of agreement dealt with in s. 83A(7). He thought that the consideration was "shares of the capital stock of a corporation that was to be formed for the purpose of acquiring or controlling the mineral rights, namely, 83A(7)(*c*)", and that this was not a right to purchase such shares within the subsection. I cannot understand this distinction. The right to purchase shares of the capital stock of a corporation to be formed to hold the claims includes the actual issue of the shares and their delivery in escrow just as it does an option to purchase. If Falconbridge carried out the terms of the agreement and expended the $100,000 within the times specified, then it would be entitled to purchase the shares and have them delivered free of the escrow.

The next two items, items IX and X, arose from an agreement dated June 15, 1952, between Falconbridge and Jawtam Key Gold Zones (Rambler) Limited. There were minor differences in detail which do not affect the principles to be applied. The claims were transferred to a trustee pending transfer to a new company. There was the usual six months for the preliminary examination and then another 30 months during which time Falconbridge was required to expend $50,000. If it gave notice requiring the incorporation of the new company and had not spent the $50,000, the difference had to be paid to Jawtam. On the incorporation of the new company the claims had to be delivered by the trustee to it, whereupon it was to issue its shares—one-fifth to Jawtam and four-fifths to Falconbridge. Falconbridge

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never gave notice to require the incorporation of the new company and eventually abandoned its option on March 4, 1955. Particulars of the items are as follows:

JAWTAM

Item	Period of Expenditure	Departmental Decision	Decision in Exchequer Court
IX. $6,991.89	Until October 16, 1952		
X. $6,221.00	October 17, 1952 to the end of the year.		

As to both items, the learned trial judge held, as he had done with reference to items I and II, that Falconbridge had not undertaken these expenditures in the sense of entering into a legally enforceable agreement and that they were not made pursuant to any agreement. He consequently allowed the deductions. I have already expressed my disagreement with these propositions. However, item IX must be dealt with in the same way as item V and part of item VI. The Minister accepted the taxpayer's submission on item IX and agreed to vary the assessment. I would therefore allow the deduction on this ground alone. As to item X where there was no admission and agreement to vary the assessment, s. 83A(7)(*c*) applies and the deduction is disallowed.

STANMORE

Item XI $15,063.71.

This agreement is dated April 27, 1951, between Falconbridge, Stanmore Mining Smelting Limited and a number of other companies and individuals. The purpose was to get certain mining claims consolidated and transferred to a new company. Falconbridge advanced to Stanmore $5,000 for this purpose and had the right to purchase free treasury shares of the new company at 10 cents per share with this sum. The agreement went on to provide that Falconbridge would act as manager for a minimum period of three years; that it would receive shares at 10 cents per share for the first $10,000 expended on development and shares at the rate of 25 cents per share for the next $40,000 of expenditure. Falconbridge bound itself to expend up to this sum of $50,000. In 1951 and 1952 Falconbridge spent a total of

$65,063.71 in exploring and developing the claims. It is common ground between the parties that s. 83A(7) prevents any deduction for the first $50,000. However, Falconbridge sought, in computing its income for 1952, to deduct the balance of $15,063.71. The learned trial judge disallowed this deduction on the ground above stated, that these expenditures were made not on its own behalf and were therefore not expenses incurred by it within the meaning of s. 53(4). I disagree with this reasoning but I think the case is within s. 83A(7)(*c*) and the deduction is accordingly disallowed.

BRODIE

Item XII $3,603.14

This agreement is dated July 29, 1952 and was made with two individuals. It granted an option to purchase certain mining claims. Falconbridge had the usual 60 days to make an examination during which period it was to give the optionors notice that it wished to proceed. The agreement also provided that Falconbridge could have a new company incorporated to acquire and hold the claims and Falconbridge would be entitled to receive shares for its development expenses in this new company. In 1952 Falconbridge spent the above mentioned sum of $3,603.14 in conducting its examination. It did not proceed with the incorporation of the new company and it elected to abandon the option. The learned trial judge held, as he did with item I, that there was no "legally enforceable agreement" within s. 83A(7). On the contrary, I think that the item is within s. 83A(7)(*c*) and that the deduction must be disallowed.

The result is that all the items are disallowed as coming within s. 83A(7)(*c*) with the exceptions item V, item VI to the extent of $4,212.36, and item IX as to which there were admissions.

Falconbridge appealed the disallowance of items III, IV and XI. The Minister appealed or moved to vary on all the other items. The company's appeal fails and is dismissed with costs. The Minister's appeal succeeds on everything except item V, part of item VI and item IX. All the assessments made by the Minister stand with this exception. There should be no costs of the Minister's appeal. The issues discussed were the same as those involved in the appeal with the exception of quantum, date and detail.

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Appeal of the Company dismissed with costs; appeal of the Minister allowed without costs.

Solicitors for Falconbridge Nickel Mines Ltd: Tilley, Carson, Findlay & Wedd, Toronto.

Solicitor for the Minister of National Revenue: E. A. Driedger, Ottawa.