

**Radio Engineering Products Limited v. Minister of National
Revenue.**

73 DTC 5071

Federal Court -- Trial Division

January 17, 1973

Deductions -- Expenses covered by government grant -- Grant allegedly to cover capital expenses -- Business losses -- Carry forward or backward -- Income Tax Act, R.S.C. 1952, ss. 12(1)(a) and (b), 27(1)(e), 46 and 60(1) [see ss. 18(1)(a) and (b), 111(1), 111(3), 152 and 172(1) of the new Act].

The appellant company was engaged in the design and development of certain communications equipment. In 1960 the Department of Defence Production entered into a contract with the appellant by virtue of which it undertook to contribute up to \$450,000 towards the cost of the production of the equipment, subject to certain provisions for possible repayment or amortization. This amount was paid during 1961. In its 1961 taxation year the appellant reported a loss of over \$500,000, which it later carried forward to its 1962 taxation year to reduce a reported profit of over \$600,000. The Minister originally assessed the appellant for 1962 by adding the \$450,000 to its income, but later notified the appellant that the basis of the assessments for 1961 and 1962 was being changed. The Minister disallowed \$450,000 of the 1961 loss carried forward to 1962 on the ground that the appellant was not entitled to deduct as expenses the amount covered by the government payment. The appellant objected that the payment was a capital payment and was related to expenditures on capital account and not on revenue account. When the Appeal Board dismissed its appeal (70 DTC 1417), the appellant took its case to the Federal Court.

Held: The appeal was dismissed. The Minister had correctly taxed the appellant. The character of the payment of the \$450,000 was that of a contribution towards the costs of the project -- and although there were provisions for repayment and contingencies, it was not a loan or an advance in the nature of a loan of capital or a payment on capital account. On the whole, it was not demonstrated that the assessment of tax for the appellant's 1962 taxation year was incorrect or greater than it should be. Consequently, the \$450,000 payment received by the appellant in its 1961 taxation year should be shown in the computation of its taxable income for 1962 either as a receipt on income account or as a reduction in the expenses claimed by the appellant in 1961 as deductions in computing its income and loss carried forward to 1962.

Counsel: Michael Vineberg for the appellant. W. J. A. Hobson for the Minister.

KERR, J.: This is an appeal taken to the Exchequer Court of Canada by the appellant from a judgment of the Tax Appeal Board dated June 10, 1970 [70 DTC 1417]. It relates to an assessment of income tax for the appellant's 1962 taxation year in the amount of \$189,813.98.

Involved in the assessment is an amount of \$450,000 paid by Her Majesty the Queen to the appellant in its 1961 taxation year under an agreement dated December 29, 1960, as modified by an amendment dated February 8, 1961, which will be referred to later herein. The amount of the tax liability in issue is dependent upon the treatment accorded in respect of that \$450,000.

Before coming to this Court the assessment was the subject of lengthy and contentious proceedings before the Tax Appeal Board, for an appeal from the assessment was taken to that Board by a Notice of Appeal dated June 5, 1965, there was a hearing by the court on a motion in the proceedings in December 1966 on which a judgment was rendered on November 28, 1968, and it was followed by another hearing in November 1969 on which the judgment now on appeal to this Court was given on June 10, 1970. The appeal in this Court was heard at Montreal commencing on September 27, 1972.

Facts of case

The major portion of the evidence of facts and documents before this Court is contained in a Notice to Admit Facts and Documents, Exhibit A-1 (which, including the documents, runs to 141 pages), in respect of which the parties agreed to the admission of the documents and to the facts being as stated in the said Notice, with the exception of Clauses 13, 18 and 25. The facts and documents thus agreed are as follows:

[DTC Printed Version Reference: YEAR = 73 PAGE = 5072]

1. The Appellant is a body corporate, incorporated on the 11th day of March, 1946, by Letters Patent pursuant to the laws of Canada and at all relevant times herein was carrying on the business of manufacturing, selling and dealing in industrial and military electrical apparatus.

2. The Appellant has engaged in many research and development programs in tactical communications equipment for The United States armed forces, including in the years prior to 1959.

3. On or about March, 1959, The United States Army encouraged, directed and requested the Appellant to initiate development of a new 24 channel military multiplex terminal telephone system compatible with the then existing 12 channel telephone terminal system used by the United States Army. The new system was designated by the Appellant as REP Type F1430 whereas it was designated as AN/TCC-49 by the United States Army.

4. The Appellant carried on business in Canada at the City of Montreal, in the province of Quebec, in each of the years from 1958 to 1962 inclusive, and duly filed an income tax return, including financial statements for each of the said years as required by the Income Tax Act.

5. The profit of the Appellant in each of the said years was calculated on the basis of its fiscal period ending on June 30th.

6. The Appellant, during its 1958 to 1961 taxation years, reported the following losses:

Year	Loss
1958	\$346,176.00
1959	\$ 38,301.00
1960	NO PROFIT
1961	\$578,616.00

7. Copies of the financial statements for the Appellant for its fiscal period ending the 30th day of June, 1959, are attached hereto as

Doc. 1,
p. 16.

8. Copies of the financial statements for the Appellant for its fiscal period ending the 30th of June, 1960, are attached hereto as

Doc. 2,
p. 26.

9. A copy of a schedule attached to the Appellant's 1962 income tax return, Reconciliation of Profits and Losses per Financial Statements with Loss for Tax purposes, prepared by the Appellant, attached hereto as

Doc. 3,
p. 36.

PAYMENT FROM THE DEPARTMENT OF DEFENCE PRODUCTION

10. On February 29th, 1960, a proposal was made by the Appellant to Her Majesty the Queen in Right of Canada represented and acting through the Minister of Defence Production (hereinafter referred to as Her Majesty) for a contribution to its costs of the development of the said 24-channel military multiplex ter-

minal telephone system known as REP Type F1430 to meet the United States Army Operational Requirements.

11. A copy of a letter from the Appellant to the Department of Defence Production dated February 29th, 1960, attached hereto as

Doc. 4,
p. 37.

12. On September 20th, 1960. the Chief Signal Officer of the United States Army directed the United States Army's Agency at Fort Monmouth to assist the Appellant in developing the necessary content and format for the publications that were to accompany the AN/TCC-49 system. At this time the United States Army requested production data from the Appellant and such data was furnished.

13. On the 29th of December, 1960, the Appellant entered into a contract with Her Majesty which was subsequently amended by a contract dated the 8th of February, 1961, providing for the payment of \$450,000.00 by Her Majesty to the Appellant as a contribution to the development of the 24-channel multiplex terminal known as REP Type F1430.

14. A copy of an Agreement between Her Majesty and the Appellant dated the 29th of December, 1960, hereinafter referred to as the original contract, attached hereto as

Doc. 5,
p. 44.

15. A copy of an Agreement between Her Majesty and the Appellant dated the 8th of February, 1961, hereinafter referred to as the amending contract, attached hereto as

Doc. 6,
p. 60.

16. In accordance with the direction and consent of the Appellant the \$450,000.00 payment pursuant to the provisions of the original and amending contracts was made to the Appellant in its 1961 taxation year and was reflected in the Appellant's account with the Canadian Commercial Corporation in partial liquidation of that Corporation's loan to the Appellant.

17. A copy of the statement of account between the Canadian Commercial Corporation and the Appellant as at 30th June, 1961, attached hereto as

Doc. 7,
p. 62.

18. The development of the F1430 (AN/TCC-49) equipment was financially assisted by Her Majesty for the prime reason that production of the equipment in Canada was envisaged. It was considered that such assistance would enhance and encourage this aim. The original and amending contracts allowed Radio Engineering Products Ltd. to retain such proprietary rights as may be embodied in the development but allows the Canadian Government a control over the sale of such rights.

19. The funds to pay the amount to the Appellant pursuant to the original and amending

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contracts were provided for by Vote 71 (of the Department of Defence Production) of the Appropriation Act No. 6, 1960, for the year ending the 31st day of March, 1960, being chapter 48 of the Statutes of Canada 1960, which reads as follows:

To sustain technological capability in Canadian industry by supporting selected defence development programs, on terms and conditions approved by Treasury Board, and to authorize commitments against future years in the amount of \$7,000,000.00.'

20. A copy of the minutes of a meeting of the Honourable the Treasury Board, held at Ottawa, on October 28th, 1960, attached hereto

Doc. 8.
p. 63.

21. A copy of the minutes of a meeting of the Honourable the Treasury Board, held at Ottawa, on February 2nd, 1961, attached hereto as

Doc. 9,
p. 66.

22. A copy of Directive No. 124 dated November 28th, 1960, with respect to the Administration of the Department of Defence Production Fund in support of the Development Aspects of the Production Sharing Programme, attached hereto as

Doc. 10,

p. 69.

23. Notes 3 and 4 to the Balance Sheet for the Appellant's fiscal period ending the 30th of June, 1961. are as follows:

3. Under date of September 7th, 1957. the company entered into a contract through Canadian Commercial Corporation in the amount of approximately \$5,000,000.00 and this contract was extended and amended to approximately \$11,000,000.00 and to the latter amount claims for extras, etc. increased the final figure to approximately \$15,000,000.00.

This contract was not completed until early in 1961 and due to its many complexities and difficulties only sufficient revenues to offset direct expenses were allocated from 1957 to 1961, and the balances were carried forward until this fiscal year into which all remaining costs and revenues, including claims, were carried.

During the same period Engineering Development 'as carried forward since there were no ascertainable profits against which to write off these charges. During this fiscal year these charges totalling \$3,981,258.26 were written off and Engineering Development is shown at \$1.00 for record purposes only.

4. In connection with the development by the Company of its carrier telephone terminals the Department of Defence Production of Canada has contributed \$450,000.00 toward the Engineering Development costs which amount is carried in the accounts of the Company as a Contributed Surplus since, under certain conditions as outlined in the contract between the Company and the Department. The contribution must be repaid by the Company.

24. Copies of the financial statements for the Appellant for its fiscal period ending the 30th day of June, 1961, are attached hereto as

Doc. 11,

p. 76.

25. The expenditures of \$450,000.00 for which Her Majesty made her contribution pursuant to the provisions of the original and amending contracts were included in the Engineering Development costs of \$3,981,258.26 which were charged against income in the Appellant's 1961 taxation year.

26. A copy of a letter from Mr. Guimond of the Department of National Revenue to the Appellant dated January 7th, 1966, attached hereto as

Doc. 12,
p. 86.

27. A copy of a letter from the Appellant to Mr. P. Guimond of the Department of National Revenue dated January 13th, 1966, attached hereto as

Doc. 13,
p. 87.

28. A copy of a Department of Defence Production memorandum dated October 5th, 1962, to Mr. D. A. Hall, attached hereto as

Doc. 14,
p. 88.

29. In July 1961, the United States Army advised the Appellant that it was expected that the AN/TCC-49 would be procured in early 1962.

30. At a meeting in March of 1962 the United States Army warned the Appellant that it did not have a contract with the United States Army and that any work in anticipation of a possible order was entirely at its risk and any given item might never reach the procurement stage. The Appellant pressed for reimbursement of the costs which it had incurred or for the issuance of a production contract.

31. Note 2 to the Balance Sheet for the Appellant's fiscal period ending the 30th of June, 1962, is as follows:

2. In connection with the development by the Company of its carrier telephone terminals the department of Defence Production of Canada has contributed \$150,000.00 toward the Engineering Development Costs, which amount is carried in the accounts of the company as a Deferred Liability since under certain conditions as outlined in the contract between the Company and the Department the contribution must be repaid by the Company.'

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32. Copies of the financial statements for the Appellant for its fiscal period ending the 30th day of June, 1962, are attached hereto as

Doc. 15,
p. 89.

33. The Appellant, in computing its income, did not and in its books of account did not, include as a receipt, or part of its gross sales, the amount of \$450,000.00 referred to in paragraphs 13, 16, 23, 25 and 31 hereof and it did not deduct that amount from its costs of \$3,981,258.26 which it charged against income.

34. The Appellant had no hope whatever at any time of selling the REP Type F1430 24-Channel terminal to any buyer except the United States Army.

35. In January, 1963, the United States Army advised the Appellant that a decision had been made not to procure the AN/TCC-49 (F1430).

36. To date no sales of F1430 equipment have been made to the U.S. Army and no amount pursuant to paragraph 5A of the amending contract has been paid by the Appellant to Her Majesty the Queen in Right of Canada.

CLAIM FOR COSTS

37. After being notified of the United States Army's decision not to procure the AN/TCC-49 the Appellant promptly filed a claim for payment of its costs of development.

38. Notes 1 and 2 to the Balance Sheet for the Appellant's fiscal period ending the 30th of June, 1963, are as follows:

1. The Company has presented a claim to the Government of the U.S.A. in excess of \$2,000,000.00 in connection with the development of carrier telephone terminals, type AN/ TCC-49. No amount has been taken into the accounts in respect to this claim.
2. The Department of Defence Production of Canada has contributed \$450,000.00 toward the costs of the development by the Company of its 24-channel carrier telephone terminals. In its financial statements dated June 30th, 1962, the Company treated this amount as a Deferred Liability since, under certain conditions as outlined in the contract between the Company and the Department the contribution must be repaid by the Company out of sales revenue. In its financial statements dated June 30th, 1963, this amount is shown as Contributed Surplus since. In the opinion of the Directors there will be no sales of the 24-channel carrier telephone terminal out of which repayments might be required.'

39. The Appellant's claim to the Government of the U.S.A. referred to in paragraphs 37 and 38 hereof was with respect to the costs it incurred over a four-year period (January 1959 to December 1962) plus profit. for the development, testing. and evaluation of the terminal known as REP Type F1430. The terminal

which was the subject of this claim was the same project for which the Appellant received the \$450,000.00 contribution to costs from Her Majesty.

40. A copy of the schedule prepared by the Appellant of its costs incurred in the Development, testing and Evaluation of AN/TCC-49 Terminal for the U.S. Army, attached hereto as

Doc. 16,
p. 101.

41. The claim for payment was denied by the Army Contract Adjustment Board on December 30th, 1965, on the grounds that the Appellant's efforts on the F1430 project were merely those of a contractor putting his wares forward to a likely buyer and carrying out whatever sales effort and expense was necessary in order to convince that buyer to buy its equipment. On February 3rd, 1966, the Appellant requested the Deputy Assistant Secretary of the Army to review the decision of the Army Contract Adjustment Board and he did so, however, he could find no basis upon which the relief sought could be granted and informed the Appellant of his decision in this regard on March 15th, 1966. The Appellant subsequently abandoned its claim.

42. A copy of a letter from the Deputy Assistant Secretary of the Army to S. T. Fisher dated March 15th, 1966, attached hereto as

Doc. 17,
p. 102.

43. A copy of a letter from Mr. S. T. Fisher to Theodore M. Kostos dated May 25th, 1967, attached hereto as

Doc. 18,
p. 105.

CONTRIBUTION TO COSTS UNDER A SUBSEQUENT CONTRACT

44. On the 27th day of August, 1965, the Appellant entered into a contract with Her Majesty the Queen in Right of Canada represented and acting through the Minister of Industry, which was subsequently amended on the 1st day of August, 1967, providing for the payment of costs up to \$1,044,000.00 for the development of multiplex units.

45. A copy of an Agreement between Her Majesty and the Appellant dated the 27th of August, 1965, attached hereto as

Doc. 19,
p. 107.

46. A copy of an Agreement between Her Majesty and the Appellant dated the 1st of August, 1967, attached hereto as

Doc. 20,
p. 115.

47. Note 3 to the Balance Sheet for the Appellant's fiscal period ending the 30th of June, 1966. refers to the payment of costs pursuant to the contract mentioned in paragraph 44 hereof as follows:

3. From July 1st, 1964, to June 30th, 1966, the company had billed a total of \$438,816.00 under a Canadian Government

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contract for Engineering Development. In return for this, the government has obtained certain rights, which will revert to the company when it has invested an equal amount in future developments on which the cost is not shared by the government.'

48. Copies of the financial statements for the Appellant for its fiscal period ending the 30th of June, 1966, are attached hereto as

Doc. 21,
p. 123.

49. Note 5 to the Balance Sheet for the Appellant's fiscal period ending the 30th of June, 1967, refers to the payment of costs pursuant to the contract mentioned in paragraph 44 hereof as follows:

5. The Company has taken into income in the fiscal year ended June 30th, 1967, a contribution for research and development from the Canadian Government of \$522,000.00. This amount is repayable by way of a fee of \$522.00 on future sales of Multiplex units until 1,000 have been sold.'

50. Copies of the financial statements for the Appellant for its fiscal period ending the 30th day of June, 1967, are attached hereto as

Doc. 22,
p. 133.

At this point I will set forth certain clauses of the contract between Her Majesty the Queen, in which the appellant is called 'the Contractor', under which the payment was made, as follows:

WHEREAS the Contractor has been and is engaged in the design, development and manufacture of Carrier Telephone Terminals; and

WHEREAS the Contractor is presently attempting to design and develop a 24 Channel Tactical Telephone Terminal Equipment which will meet United States Army Operational Requirements; and

WHEREAS to encourage the continuance of this development in Canada, Her Majesty is prepared to make a contribution to the Contractor upon the terms and subject to the conditions set out in this agreement.

...

2. SUBJECT MATTER

(1) The Contractor shall continue and complete to the best of its skill, knowledge and ability its project for the design and development in Canada of a 24 Channel Tactical Telephone Terminal Equipment known as REP Type F1430, to meet United States Army Operational Requirements (which are currently being defined) together with a requisite number of prototypes for evaluation.

...

4. PRICE

Her Majesty will pay the Contractor the costs reasonably and properly incurred, as determined in accordance with the Costing Memorandum DDP-31 (Rev. 11/55) and verified by the Audit Services Division, Office of the Comptroller of the Treasury, by the Contractor in the performance of the work, without profit or fee; provided, however, that the costs payable by Her Majesty hereunder shall not exceed the sum of four hundred and fifty thousand dollars (\$450,000.00). It is understood by the parties hereto that sales tax shall not be exigible on the design and development work covered by this agreement. It is further understood and agreed by the parties hereto that all sums paid by Her Majesty to the Contractor in accordance with this section shall be subject to repayment by the Contractor in accordance with the provisions hereinafter contained.

5. PAYMENT

The Contractor shall furnish to the Audit Services Division, Office of the Comptroller of the Treasury, Department of Finance, Ottawa, Ontario, certified statements and progress claims covering the costs of the project incurred by the

Contractor. Such certified statements and progress claims shall cover such periods and phases of the work as the parties hereto may determine and shall be prepared in such manner and accompanied by copies of such vouchers, invoices, payrolls and other documents or information as the Audit Services Division may require. If such statements and progress claims are satisfactory to Her Majesty, Her Majesty shall promptly pay to the Canadian Commercial Corporation, for the credit of the Contractor the amount thereof; such payments being subject to the total limitation of four hundred and fifty thousand dollars (\$450,000.00) referred to in Section 4 hereof, and their receipt by the Canadian Commercial Corporation shall constitute a full discharge to Her Majesty of any claim the Contractor may have arising from this contract.

5A. REPAYMENT

(1) In the event a production contract for the 24 Channel Tactical Telephone Terminal Equipment is obtained, the contribution of Her Majesty to the development cost will be amortised on a pro rata basis with the Contractor's contribution and repayment of Her Majesty's contribution will be made on that basis.

(2) Should the amortisation rate referred to in sub-section (1) of this Section 5A be insufficient to repay in full the contribution of Her Majesty, the terms of repayment shall be renegotiated by the parties hereto, such renegotiation to provide as a minimum that the Contractor shall, on all production orders for the 24 Channel Tactical Carrier Telephone Terminal Equipment, repay 25% of all profits under 10% and all profits over 10% until the contribution of the Contractor shall equal that of Her Majesty.

6. ACCOUNTS

The Contractor shall keep proper accounts and records of the cost to the Contractor of the project and of all sales of any articles derived therefrom whether made by the Contractor or by a licensee under license from the Contractor and of all expenditures or commitments made by the Contractor in connection therewith and the invoices, receipts and vouchers relating

[DTC Printed Version Reference: YEAR = 73 PAGE = 5076]

thereto. Such accounts, records, invoices, receipts and vouchers shall at all times be open to audit and inspection by the authorized representatives of the Minister (who may make copies thereof and take extracts therefrom) and the Contractor shall afford all facilities for such audits and inspections and shall furnish the Minister and his authorized representatives with all such information as he or they may from time to time require with reference to such accounts, records, invoices, receipts and vouchers. The Contractor shall, unless otherwise agreed to by the Minister, cause all such accounts, records, invoices, receipts and vouchers

as aforesaid to be preserved and kept available for audit and inspection at any time until the amount contributed herein by Her Majesty shall have been repaid.

...

13. CANADIAN PRODUCTION

It is recognized by the Parties hereto that one of the main purposes of this agreement is deemed to be the stimulation of the production of Tactical Terminal Telephone Equipment, in Canada. Should the Contractor fail, in the opinion of the Minister, to make reasonable efforts to sell such Canadian produced Equipments or should the Contractor abandon the production of this Equipment while a market for such Canadian produced Equipment exists, the purpose of this agreement from the viewpoint of the Canadian Government may have failed: in which event the Contractor shall, upon the request of the Minister, refund to Her Majesty the balance of the said sum of \$450,000.00 still owing. In such amounts and at such times as the Minister may direct.

...

19. PAST EXPENDITURES

Any expenditure reasonably and properly made by the Contractor prior to the date hereof which, if it had been made after the date hereof, would have been covered by the terms of this agreement, shall be treated for all purposes as if it had been made after the date hereof pursuant to such terms.

Testimony by appellant's comptroller

Mr. Noodelman, a chartered accountant and Comptroller of the appellant company testified that the project was commenced in 1959 as a result of proposals made to the United States army going back to 1957, and that the bulk of the expenses were incurred prior to December 1961, and were written off in 1961 against revenue as research and development costs, including expenses incurred prior to 1961 and deferred for financial purposes; that in the company's 1961 income tax returns the \$450,000 was carried as a contributed surplus re engineering development with an explanation in paragraph 4 of the Notes to the Balance Sheet as at June 30, 1961, as follows:

4. In connection with the development by the Company of its carrier telephone terminals the Department of Defence Production of Canada has contributed \$450,000.00 toward the Engineering Development costs which amount is carried in the accounts of the Company as a Contributed Surplus since, under certain conditions as outlined in the contract between the Company and the Department, the contribution must be repaid by the Company.

and that in the 1962 returns the auditors corrected their presentation and showed the amount as a deferred liability with the explanation in the Notes to Financial Statements as at June 30, 1962:

since, under certain conditions as outlined in the contract between the Company and the Department, the contribution must be repaid by the Company.

In respect of the company's treatment of amounts received under subsequent agreements with the Canadian Government, referred to in Clauses 44 to 50 of the Notice to Admit Facts, Mr. Noodelman said that the company has filed an amended tax return for 1967, Exhibit A-6, in which a sum of \$1,044,000 of Government contributions previously shown as income (see Clause 49 of the Notice) is treated as a loan and shown as repayable.

The tax assessed for the appellant's 1962 tax year is \$189,813.98, as shown in a Notice of Reassessment dated June 5, 1964. The Notice was accompanied by a form T7W-C dated May 7, 1964, reproduced next herein, which shows (a) an addition of \$450,000 to the company's net income reported, and (b) losses carried forward from 1959, 1960 and 1961, the last mentioned loss being \$528,831.92.

[DTC Printed Version Reference: YEAR = 73 PAGE = 5077]

DEPARTMENT OF NATIONAL
REVENUE
TAXATION DIVISION
DISTRICT TAXATION OFFICE

[CREST]
CANADA
MONTREAL

T7W-C
REV. 12-57 22.
MINISTERE DU REVENU
NATIONAL
BUREAU DE DISTRICT
D'IMPOT

Radio Engineering Products Ltd..
P.O. Box 460,

Snowdon Postal Station,

Montreal 29, Que.

TAXATION
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ADJUSTMENTS TO DECLARED INCOME -- AJUSTEMENTS DU REVENU DECLARE

Net Income reported \$ 610.292.44

Add:

Expenses disallowed -- Write-off of loan to R. B. Douglas. ..	13,500.00
Expenses capitalized -- Class 8	5,005.00
Foreign Exchange adjustment	79,329.64
Receipt re: 24 channel carrier	450,000.00

	1,158,127.08

Deduct:

Additional Capital Cost allowance Class 8	2,724.20

	1,155,402.88

Deduct:

Donations	\$ 1,847.00
Losses -- 1959	117,124.00
-- 1960	7,690.00
-- 1961	528,831.92
	655,492.92

Taxable income assessed	\$ 499,909.96
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B. J. Ilon/yg,
Section F.
Montreal, May 7, 1984.

For further information or explanation of
expli-
these adjustments consult the District
consultez le
Taxation Office indicated above.
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Pour plus amples renseignements
ou
cations sur ces ajustements,
Bureau de l'Impt du District

The appellant filed a Notice of Objection to the assessment, principally in respect of the treatment of the \$450,000. The Minister confirmed the assessment by a notice dated April 21, 1965

... as having been made in accordance with the provisions of the Act and in particular on the ground that the amount of \$450,000.00 received by the taxpayer from the Department of Defence Production of the Government of Canada pursuant to an Agreement dated 29th December, 1960 has been properly taken into account in computing the taxpayer's income in accordance with the provisions of sections 3 and 4 of the Act.

whereupon the company appealed to the Tax Appeal Board on June 5, 1965.

Some months after the appellant gave its Notice of Appeal to the Tax Appeal Board the Department of National Revenue sent 2 income tax forms T7W-C, each dated February 4, 1966, one of which, Exhibit A-3, relates to the 1961 taxation year, and the other, Exhibit A-4, relates to..the 1962 year. Those exhibits are reproduced next herein:

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DEPARTMENT OF NATIONAL
REVENUE

[CREST]

MINISTERE DU RE-
VENU
NATIONAL

TAXATION DIVISION
DISTRICT TAXATION OFFICE

CANADA
MONTREAL

DIVISION DE L'IMPOT
BUREAU DE DISTRICT
D'IMPOT

TAXATION
YEAR 1961

ANNEE
D'IMPO-
SITION

Radio Engineering Products Ltd.,
P.O. Box 460,
Snowdon Postal Station,
Montreal 29, Que.

Your notice of reassess-
ment is

En-
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to you.

Votre avis de nouvelle a

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ADJUSTMENTS TO DECLARED INCOME -- AJUSTEMENTS DU REVENU DECLARE

Loss previously assessed	\$528,831.92
Add: Expenses now disallowed on 24 channel telephone equipment	450,000.00
Loss revised:	----- \$78.831.92

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P. Guimond/nb,
Section 'P',
February 4, 1966.

For further information or explanation of
expli-
these adjustments consult the District
consultez le
Taxation Office indicated above.
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Pour plus amples renseignements
ou
cations sur ces ajustements,
Bureau de l'Impt du District

EXHIBIT A-4

T7W
REV.
9-64

DEPARTMENT OF NATIONAL
REVENUE
TAXATION DIVISION
DISTRICT TAXATION OFFICE

[CREST]
CANADA
MONTREAL

MINISTERE DU REVENU
NATIONAL
DIVISION DE L'IMPOT
BUREAU DE DISTRICT
D'IMPOT

TAXATION
YEAR 1962

ANNEE
D'IMPO-
SITION

Radio Engineering Products Ltd.,
P.O. Box 460,
Snowdon Postal Station,
Montreal 29, Que.

Your notice of reassess-
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En-
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to you.

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ADJUSTMENTS TO DECLARED INCOME -- AJUSTEMENTS DU REVENU DECLARE

Taxable Income previously assessed \$499,909.96
 Deduct: Receipt re: 24 channel telephone equipment 450,000.00 ----- \$ 49,909.96
 Add: 1961 loss previously allowed \$528,831.92
 1961 loss now revised 78,831.92 -----
 Net loss disallowed: 450,000.00 -----
 Taxable income \$499,909.96 =====

P. Guimond/nb,
 Section 'P',
 February 4, 1966.

For further information or explanation of ou expli-these
 adjustments consult the District consultez le Taxation
 Office indicated above. susindiqu.

Pour plus amples renseigne-
 ments cations sur ces ajuste-
 ments, Bureau de l'Impt du
 District

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Mr. Guimond, an Appeals Officer with the Department, who prepared the documents A-3 and A-4, was examined for discovery and portions of his examination were put in evidence. They add little to what the documents show, namely, that a 1961 tax year loss of \$528,831.92, allowed as a deduction from income as shown in the T7W-C dated May 7, 1964, was reduced by \$450,000 to give a revised loss for 1961 of \$78,831.92; and Exhibit A-4 in respect of 1962 reflects that reduction or disallowance of \$450,000 from the 1961 loss previously allowed and also shows a deduction from income for 1962 of the same amount of \$450,000 which had been, as shown in the T7W-C dated May 7, 1964, previously added to the net income reported by the company. In other words, in the T7W-C dated May 7, 1964, the sum of \$450,000 was added to the company's income for 1962 and a deduction of a 1961 loss (which included the \$450,000) was allowed, resulting in 'taxable income assessed' in the sum of \$499,909.96 (on which there was an assessment of tax of \$189,813.98 for 1962); whereas T7W-C, Exhibit A-4, for 1962, deducted from income the \$450,000 that had been previously added, and at the same time disallowed a like amount of expenses on the project which had been previously allowed in the 1961 loss carried forward to 1962, thereby arriving at taxable income in the amount of \$499,909.96. In the result no change was made in the amount of taxable income for 1962, although there was a difference in its computation; and neither was there a change in the tax assessed for that year.

Appellant's arguments

In its Notice of Appeal the appellant says, inter alia, that the taxability of the \$450,000 is not in issue in view of the fact that the Department cancelled and annulled its claim on that score in respect of the taxation year 1962; if that amount is to be considered as taxable income it would have been taxable income only in the 1960 year when the contract was established, as the appellant is on the accrual system of accounting; under the Defence Production Act, R.S.C. 1952, c. 62, section 15(f), the \$450,000 was only an advance for a loan and not a grant or subsidy; there was no cancellation of the indebtedness of the appellant in respect of its obligation to repay the amount in 1961 or

1962, and even if there had been any such cancellation it would constitute capital and not income; and there was not any re-assessment for 1961 or 1962.

Minister's arguments

In the respondent's Reply to the Notice of Appeal the respondent says, inter alia. that the assessment for the appellant's 1962 year, notice of which was dated June 5, 1964, was an assessment of the tax payable for that year, and the appeal is from that assessment; the respondent has at no time admitted or acknowledged that the assessment is incorrect; the \$450,000 was paid to the appellant in its 1961 taxation year and was income for the appellant for that year; in making the assessment dated June 5, 1964, the respondent included the \$450,000 in the computation of the appellant's income for 1962, and, on objection, confirmed the assessment on the basis that the sum was income of the appellant for 1962, but he subsequently sent forms T7W-C, Exhibits A-3 and A-4, indicating that he considered the sum should be reflected in the computation of the appellant's loss for 1961, and therefore in the computation of its taxable income for 1962, and no change was made in the assessment of tax for 1962; the sum is to be included in computing the appellant's income for 1962 or its loss for 1961 (and therefore its taxable income for 1962) because (a) it was received by the appellant in 1961 as income to be used in its business and to enable it to meet expenses which it treated as deductible in computing its income; (b) to the extent that expenses claimed by the appellant were defrayed or reimbursed by means of that sum it is obliged to reduce the expenses claimed by it in 1961 as deductions in computing its income: (c) the sum was paid as a contribution to the expense of development of the 24 Channel Equipment and Her Majesty was entitled to be paid an amount equal to part or all of that contribution only if a production contract for the Equipment was obtained, none was obtained and the project was abandoned by the end of the appellant's 1962 year. In the alternative, if the sum was a payment on capital account, the expenses which it was intended to defray are capital expenditures and not deductible; also the respondent denies that the sum was a payment in the nature of a loan of capital, and says it was a contribution to expenses and must be reflected in the income of the appellant either as a receipt on income

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account or a reduction in the expenses claimed as deductions.

Appellant's further submissions

At the hearing counsel for the appellant argued principally that following the appellant's appeal to the Tax Appeal Board objecting to the addition of the \$450,000 to its taxable income for 1962, the Department acceded to that objection and removed the \$450,000 from income, and thus the only item in dispute was abandoned or cancelled by the Department; the basis on which the assessment of tax for 1962 was made was the inclusion of the \$450,000 as income for that year, that basis was wrong and was abandoned by the Department, and there is no assessment for 1962 based on inclusion of that sum as income for that year; there has been no re-assessment for either 1962 or 1961, and the Income Tax Act does not allow the Department to revise an assessment and leave the taxpayer without a reassessment on which he can appeal; also on the merits otherwise, the fundamental character of the \$450,000 received by the appellant is that of a repayable loan, even if in certain circumstances the full amount is not repayable; section 15 of the Defence Production Act provides that the Minister may:

- (f) make loans or advances . . .

and section 16 envisages a Revolving Fund for specified purposes, including:

- (2) (c) for loans or advances . . .

and a loan is implied in those provisions.

Minister's further submissions

Counsel for the respondent argued along the lines of the position taken by the respondent in his Reply to the Notice of Appeal, and to the effect that the Minister assessed tax for the appellant's 1962 year in the amount of \$189,813.98 by an assessment, notice of which was dated June 5, 1964; the obligation of the Minister under the Income Tax Act is to assess the tax payable and there is no obligation to assess the amount of income or loss; there is a distinction between an assessment and a Notice of Assessment; a Notice of Assessment wherein the Minister indicates that no tax is payable is not an assessment, but merely notice that no tax is payable; a person can only object to an assessment and cannot appeal or object to a 'nil assessment', for no tax has been assessed; the Minister properly fixed the tax liability of the appellant as per the Notice of Re-assessment dated June 5, 1964, and has not vacated that assessment; the T7W-C form dated June 5, 1964, attached to the Notice of Assessment, and the form Exhibit A-4, dated February 4, 1966, are merely explanations of the computation of taxable income and do not constitute the assessment; Exhibit A-4 should not be construed as evidence of an assessing or as a vacating of the previous assessment, and no question of an estoppel or binding admission arises; the Minister is entitled for the purpose of computing the appellant's taxable income for 1962 to calculate or re-calculate the 1961 loss to be carried forward to 1962; the \$450,000 was not a loan of capital but was a contribution towards expenses which the appellant has purported to deduct in their entirety, and an amount not exceeding the \$450,000 was in accordance with the agreement to be paid to Her Majesty only on the occurrence of events that did not in fact take place, and the amount must be reflected in the income of the appellant either as a receipt on income account or a reduction in the expenses claimed by the appellant as deductions (and hence loss carried forward) in computing its income.

Cases cited by the appellant

Counsel for the appellant cited the following cases:

Wilson v. Ward (1930) S.C.R. 212; *Saint John Dry Dock & Shipbuilding Company, Limited v. M.N.R.* 2 DTC 663; *Pure Spring Co. Ltd. v. M.N.R.* 2 DTC 844; *Morley v. M.N.R.* 49 DTC 29; *Provincial Paper, Limited v. M.N.R.* 54 DTC 1199; *Ocean View Development Limited v. M.N.R.* (1956) 15 Tax A.B.C. 204 [56 DTC 286]; *Laurin v. M.N.R.* 60 DTC 1143; *Lawrence B. Scott v. M.N.R.* 60 DTC 1273; *Anjulin Farms Limited v. M.N.R.* 61 DTC 1182; *Charos v. M.N.R.* 62 DTC 273; *New St. James Limited v. M.N.R.* 64 DTC 121; *Irving Brown v. M.N.R.* (1964) 35 Tax A.B.C. 197 [64 DTC 316]; *Bonavista Investment Corporation v. M.N.R.* 65 DTC 183; *Ontario Culvert and Metal Products Limited v. M.N.R.* (1965) 38 Tax A.B.C. 256 [65 DTC 379]; *Gardner v. M.N.R.* 65 DTC 591; *Forand Auto Lte v. M.N.R.* (1966) 40 Tax A.B.C. 302 [66 DTC 184]; *Coleman C. Abrahams (No. 1) v.*

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M.N.R. 66 DTC 5451; *Pivko v. M.N.R.* 69 DTC 99; *Gregg v. M.N.R.* 69 DTC 559; *Mary E. Walkem v. M.N.R.* 70 DTC 1749.

Cases cited by the Minister

Counsel for the respondent cited the following cases:

The King v. Deputy Federal Commissioner of Taxation ex parte Hooper (1926) 37 C.L.R. 368; Pure Spring Co. Ltd. v. M.N.R.(1946) Ex. C.R. 471 [2 DTC 844]; Lawrence B. Scott v. M.N.R. (1961) Ex. C.R. 120 [60 DTC 1273]; Okalta Oils Limited M.N.R. (1955) C.T.C. 271 [55 DTC 1176]; Newfoundland Minerals Limited v. M.N.R.69 DTC 5432; Maritime Electric Company Limited v. General Dairies, Limited (1937) A.C. 610; Woon v. M.N.R. (1950) C.T.C. 263 [50 DTC 871]; Johnston v. M.N.R. (1948) S.C.R. 486 [3 DTC 1182]; Lagac v. M.N.R. (1968) 2 Ex. C.R. 98 [68 DTC 5143]; M.N.R. v. W. T. Shaw Estate (1971) C.T.C. 15 [70 DTC 1138]; New St. James Ltd. v. M.N.R. 66 DTC 5241; Nuclear Enterprises Ltd. v. M.N.R. 71 DTC 5243; Atlantic Sugar Refineries Limited v. M.N.R. (1949) S.C.R. 706 [49 DTC 602]; Thompson v. Magnesium Elektron Ltd. (1943) 26 T.C. 1; Tip Top Tailors Limited v. M.N.R. (1957) S.C.R. 703 [57 DTC 1232]; Seaham Harbour Dock Co. v. Crook (1932) 16 T.C. 333; Charles Brown and Co. v. I.R.C.(1930) 12 T.C. 1256; Lincolnshire Sugar Company, Limited v. Smart(1937) A.C. 697.

The Income Tax Act is divided into parts, of which Part I deals with Income Tax and is divided into a number of Divisions. Divisions B, C, D, E, G and H contain various provisions by which the income, the taxable income and the tax liability are to be measured, and Division F, comprising sections 44 to 61, provides for returns of income, assessments of tax, times for payment of tax, and appeals. The Minister is charged with the duty of examining the taxpayer's return and of assessing the tax, and he is required to send the taxpayer notice of assessment. The taxpayer then has the right to object to the assessment and subsequently to appeal therefrom. For the purposes of this appeal the following provisions, in effect when the assessment was made and the appeal proceedings taken, are particularly pertinent:

46. (1) The Minister shall, with all due despatch, examine each return of income and assess the tax for the taxation year and the interest and penalties, if any, payable.

(2) After examination of a return, the Minister shall send a notice of assessment to the person by whom the return was filed.

(3) Liability for tax under this Part is not affected by an incorrect or incomplete assessment or by the fact that no assessment has been made.

(4) The Minister may at any time assess tax, interest or penalties under this Part or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the taxation year, and may

(a) at any time, if the taxpayer or person filing the return

(i) has made any misrepresentation or committed any fraud in filing the return or in supplying any information under this Act, or

- (ii) has filed with the Minister a waiver in prescribed form within 4 years from the day of mailing of a notice of an original assessment or of a notification that no tax is payable for a taxation year, and
- (b) within 4 years from the day referred to in subparagraph (ii) of paragraph (a), in any other case,

re-assess or make additional assessments, or assess tax, interest or penalties under this Part, as the circumstances require.

...

(6) The Minister is not bound by a return or information supplied by or on behalf of a taxpayer and, in making an assessment, may, notwithstanding a return or information so supplied or if no return has been filed, assess the tax payable under this Part.

(7) An assessment shall, subject to being varied or vacated on an objection or appeal under this Part and subject to a reassessment, be deemed to be valid and binding notwithstanding any error, defect or omission therein or in any proceeding under this Act relating thereto.

58. (1) A taxpayer who objects to an assessment under this Part may, within 90 days from the day of mailing of the notice of assessment, serve on the Minister a notice of objection in duplicate in prescribed form setting out the reasons for the objection and all relevant facts.

...

(3) Upon receipt of the notice of objection, the Minister shall with all due despatch reconsider the assessment and vacate, confirm or vary the assessment or reassess and he shall thereupon notify the taxpayer of his action by registered mail.

...

59. (1) Where a taxpayer has served notice of objection to an assessment under section 58, he may appeal to the Tax Appeal Board constituted by Division I to have the assessment vacated or varied after either

- (a) the Minister has confirmed the assessment or re-assessed, or

- (b) 180 days have elapsed after service of the notice of objection and the Minister has not notified the taxpayer that he has vacated or confirmed the assessment or re-assessed;

but no appeal under this section may be instituted after the expiration of 90 days from the day notice has been mailed to the taxpayer under section 58 that the Minister has confirmed the assessment or reassessed.

...

60. (1) The Minister or the taxpayer may, within 120 days from the day on which the Registrar of the Tax Appeal Board mails the decision on an appeal under section 59 to the Minister and the taxpayer, appeal to the Exchequer Court of Canada.

...

61. An assessment shall not be vacated or varied on appeal by reason only of any irregularity, informality, omission or error on the part of any person in the observation of any directory provision of this Act.

...

139. (1) In this Act,

...

- (d) 'assessment' includes a re-assessment:

Issue of appeal

The issue, as I see it, is whether the tax assessed in the amount of \$189,813.98 for the appellant's 1962 taxation year is the amount, or not in excess of the amount, of tax contemplated by the Income Tax Act.

The Minister assessed the tax for the appellant's 1962 taxation year in that sum of \$189,813.98, and gave a Notice of Reassessment dated June 5, 1964, to that effect, with an explanatory Form T7W-C. Subsequently, following receipt of a Notice of Objection from the taxpayer, the Minister reconsidered the assessment and confirmed it, as per his Notification dated April 21, 1965. Still later, after the appellant had given a Notice of Appeal, dated June 5, 1965, to the Tax Appeal Board from the said assessment, Forms T7W-C, Exhibits A-3 and A-4, both dated February 4, 1966, were sent to the appellant. But, while these forms indicated adjustments in the computation of the loss for the year 1961 and in the taxable income for 1962, there was no change in the previously determined amount of taxable income for 1962, for in the T7W-C that accompanied the Notice of Reassessment dated June 5, 1964, the amount of taxable income was stated to be \$499,909.96, and it remained at that figure in the later T7W-C dated February 4, 1966, Exhibit A-4. That form does not refer to the amount of tax assessed. There is no evidence that the amount of tax assessed for the ap-

pellant's 1962 taxation year, namely, \$189,813.98 in the Notice of Reassessment dated June 5, 1964, was changed, or that the Minister vacated that assessment of tax. The merits of that assessment are before this Court, as I view the matter.

The T7W-C, Exhibit A-4, indicates a revised loss for the year 1961, disallowing from the 1961 loss previously allowed the sum of \$450,000 to give a revised loss of \$78,831.92. I think that the Minister had authority to make that revision in computing the appellant's taxable income for 1962, by virtue of section 27(1)(e) of the Act, which reads as follows:

27. (1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted from the income for the year such of the following amounts as are applicable:

. . .

(e) business losses sustained in the 5 taxation years immediately preceding and the taxation year immediately following the taxation year. . . .

This is so notwithstanding the 4 years limitation in section 46(4), as the revision was made, insofar as the taxation year 1962 is concerned, within that 4 years. See the judgment of Sheppard D.J. in *New St. James Ltd. v. M.N.R.* (66 DTC 5241. See also the judgment of Jackett P. (as. he then was) in *Abrahams (No. 1) v. M.N.R.* 66 DTC 5451.)

The agreement under which the \$450,000 was paid recites that the company is presently attempting to design and develop a 24 Channel Tactical Telephone Terminal Equipment and that to encourage the continuation of this development in Canada Her Majesty is prepared to make a 'contribution' to the company; section 4 of the agreement provides that Her Majesty will pay the company the costs reasonably and properly incurred by the company, not exceeding the sum of \$450,000, and that all sums paid by Her Majesty shall be subject to repayment by the company in accordance with the provisions therefor in the agreement; section 12 refers to Her Majesty's share of the costs; section 5A refers to the contribution of Her Majesty to the development cost.

\$450,000 payment not a loan

On all the evidence I think that the character of the payment of the \$450,000

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was that of a contribution towards the costs of the project, and that it was not a loan or an advance in the nature of a loan of capital or a payment on capital account, although there were provisions for repayment and contingencies. Engineering development costs of \$3,981,258.26 were charged against income in the appellant's 1961 taxation year and they included expenditures in respect of which the \$450,000 was paid. See, in that respect, the notes to the appellant's balance sheet as at June 30, 1961 (page 83 of Exhibit A-1) and the appellant's explanatory letter dated January 13, 1966 (page 87 of Exhibit A-1). The money was paid to be used in the appellant's business operations to meet expenses in the course of the project concerned, which expenses the appellant has treated as deductible in computing its income. Profits to the appellant from the project were contemplated, although as events turned out they were not realized.

Appeal dismissed

On the whole I think it has not been shown that the assessment of tax in the sum of \$189,813.98 for the appellant's 1962 taxation year was wrong or greater than it should be. The payment of the \$450,000 to the appellant in its 1961 taxation year should be reflected in the computation of its taxable income for 1962 either as a receipt on income account or as a reduction in the expenses claimed by the appellant in 1961 as deductions in computing its income and loss carried forward to 1962.

Therefore the appeal will be dismissed, with costs.