1964
Sept. 18
Oct. 19

BETWEEN:

CRYSTAL SPRING BEVERAGE CO. LTD. ..... APPELLANT;

AND

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

Revenue—Income—Income tax—Disallowance of capital cost allowance in respect of payment for franchise—Legal and accounting expense incurred in obtaining franchise—Payment made to obtain franchise or purchase goodwill—Deduction of amount in respect of cost of purchasing goodwill—Income Tax Act, R.S.C. 1952, c. 148, s. 11(1)(a), Regulation 1100(1)(c) and Schedule B of Class 14.

This is an appeal from the income tax assessment of the appellant for 1961 by which the respondent disallowed the appellant's claim for capital cost allowance in respect of cost of a franchise or concession for which it had paid the capital sum of $18,000, and added to the appellant's income a sum of $200 for legal expense. The appellant also claimed the sums of $225 and $200 paid to accountants and solicitors in connection with the acquisition of the franchise or concession.

It was agreed by the parties that what the appellant claimed to be a franchise is a franchise within the meaning of the *Income Tax Act*.

The appellant had for about seven years bottled and sold Seven-Up beverages throughout South Vancouver Island under a sub-franchise agreement between it and Seven-Up Vancouver Ltd., the holder of the franchise for that area from The Dominion Seven-Up Co. Ltd. During this period the appellant had purchased assets in Victoria, B.C. from Seven-Up Vancouver Ltd. and had substantially developed sales of Seven-Up in South Vancouver Island.

Because the sub-franchise agreement with Seven-Up Vancouver Ltd. was terminable by either party on 60 days' notice the appellant attempted to obtain a direct franchise for the same area from The Dominion Seven-Up Co. Ltd. The appellant was informed that The Dominion Seven-Up Co. Ltd. would not consider granting it a franchise while Seven-Up Vancouver Ltd. held a franchise for the South Vancouver Island area. Consequently, after negotiation, the appellant paid $18,000 to Seven-Up Vancouver Ltd. in consideration of its relinquishing its franchise for the South Vancouver Island area. The appellant then obtained a franchise from The Dominion Seven-Up Co. Ltd. for the area of South Vancouver Island for a term of five years, renewable for an additional five years.

The issue is whether the $18,000 paid by the appellant to Seven-Up Vancouver Ltd. is money paid for a franchise or, in other words, is part of the capital cost to the appellant of the franchise.

The evidence established that the appellant would not have received the franchise from The Dominion Seven-Up Co. Ltd. if it had not caused Seven-Up Vancouver Ltd. to relinquish its franchise rights and that

Seven-Up Vancouver Ltd. would not have relinquished its franchise without the payment to it of $18,000 by the appellant.

Held: That there is a direct causal connection between the issuance of the franchise to the appellant and the payment of $18,000 by the appellant to Seven-Up Vancouver Ltd. The appellant paid this sum for the purpose of earning income and the capital cost of this payment should be allowed pursuant to s. 11(1)(*a*), Regulation 1100(1)(*c*) and Schedule B of Class 14 of the *Income Tax Act*.

2. That the payment of $18,000 was not for the purchase of goodwill of Seven-Up Vancouver Ltd. because all that Company had to give was control of the right to market Seven-Up in the territory of South Vancouver Island.

3. That the appeal is allowed.

APPEAL under the *Income Tax Act*.

The appeal was heard by the Honourable Mr. Justice Gibson at Victoria.

J. Alan Baker, Q.C. for appellant.

Alan B. Macfarlane for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

GIBSON J. now (October 19, 1964) delivered the following judgment:

This is an appeal by the appellant from the income tax assessment for the year 1961, by which the Minister disallowed the appellant's claim for the cost of a franchise or concession for which it allegedly had paid the capital sum of $18,000; and from the Minister's addition to the appellant's income of $200 for legal expense; and for the further claim for an allowance as a deductible expense of $225 for a fee paid to accountants of the appellant and of a $200 fee paid to the solicitor of the appellant, both of which fees being incurred in connection with the acquisition of the franchise or concession.

The facts are that in the taxation year 1961, the appellant claimed as a capital cost allowance a portion of a sum which it alleged it paid to obtain a franchise from the parent company of Seven-Up beverages, The Dominion Seven-Up Co. Ltd. The Minister disallowed the claim on the basis that this expenditure by the appellant was not a cost of the franchise.

The franchise of the appellant is dated April 17, 1961, and was filed as Exhibit A-1 on this appeal.

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The parties agree that this Exhibit A-1 is a franchise within the meaning of the *Income Tax Act*.

The allegation of the appellant is that in order to obtain this franchise from The Dominion Seven-Up Co. Ltd. it was necessary for it to arrange for and pay a company known as Seven-Up Vancouver Ltd. to relinquish a franchise it had for the area known as South Vancouver Island.

The appellant had for a period of seven years before the date of the franchise, Exhibit A-1, bottled and sold Seven-Up beverages under a sub-franchise agreement between it and the said Seven-Up Vancouver Ltd.

After arranging for Seven-Up Vancouver Ltd. to relinquish its franchise with the Dominion parent company, the appellant alleges it negotiated this new franchise for itself with The Dominion Seven-Up Co. Ltd.

In the course of negotiations with Seven-Up Vancouver Ltd., a sum of money was requested by it from the appellant and in the result the appellant paid to it the sum of $18,000.

The issue is whether this $18,000 paid by the appellant to Seven-Up Vancouver Ltd. allegedly for the relinquishment of the franchise by Seven-Up Vancouver Ltd. with the Dominion Seven-Up Co. Ltd. is money paid for a franchise or, in other words, is part of the capital cost to the appellant of the franchise. If it is, the provisions of section 11(1)(*a*), Regulation 1100(1)(*c*) and Schedule B of Class 14 of the *Income Tax Act* are applicable and the appellant is entitled to a capital cost allowance prorated over the term of the franchise agreement.

The franchise agreement, Exhibit A-1, is for five years plus a five-year option, which for the purpose of the *Income Tax Act* would result in an apportionment for capital cost allowance over a ten-year period.

Counsel for the Minister concedes that the monies paid to accountants and solicitors of the appellant in the sum of $225 and $200 respectively are proper expenses against income if, in fact, on the true interpretation of the *Income Tax Act* in relation to the facts of this case the appellant is permitted to charge a capital cost allowance for the payment made to Seven-Up Vancouver Ltd. in connection with this franchise.

The appellant adduced evidence through its President and General Manager, Mr. Eric Brinkworth.

According to his evidence, the appellant bottled and distributed Seven-Up in the southern part of Vancouver Island under a sub-franchise from Seven-Up Vancouver Ltd. since May 1953, until 1960.

Prior to May, 1953, Seven-Up Vancouver Ltd. had a plant in South Vancouver Island but the evidence was that it could not make any money on such a small operation and the officials of it approached the appellant and as a result rented its plant to the appellant; and the appellant also bought certain chattels and equipment from Seven-Up Vancouver Ltd.

At the time of this arrangement the appellant had its own plant and was bottling Orange-Crush, and for about a year the appellant operated in both plants, but after one year found that this method of carrying on business was uneconomical and consolidated the operations into the plant then owned by and leased from Seven-Up Vancouver Ltd.

At that juncture the appellant bought this plant from Seven-Up Vancouver Ltd., but continued to operate under a sub-franchise from it, buying syrups, and joining in certain advertising and promotional activities with it.

At all material times after this, the plant which was located at 540 John St., Victoria, B.C., was owned and operated by the appellant company and Seven-Up Vancouver Ltd. owned none of the assets in that plant.

This arrangement continued for about seven years when the appellant built up its business and in the year 1960 it appears that it was buying about a hundred gallons of extract at a cost latterly of about $204 per gallon. The cost, if the appellant had a direct franchise at this stage, would have been approximately $100 per gallon according to the evidence.

The appellant became concerned that the Seven-Up Vancouver Ltd. might cancel his sub-contract which it was entitled to do by giving to the appellant sixty days notice.

It happened that the President of the appellant attended a convention in San Francisco during the spring of 1960

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and spoke with certain officials of the parent company of Seven-Up and explained his worry to them but got no satisfaction or indication that they would deal with the appellant so long as Seven-Up Vancouver Ltd. held a direct franchise but was told that under a sub-bottler's franchise or contract the appellant "was just building a roof on another man's house".

After returning, the President of the appellant negotiated with Seven-Up Vancouver Ltd. about relinquishing its franchise so that the appellant could obtain a direct franchise from the parent company of Seven-Up. At this stage, Seven-Up Vancouver Ltd. requested $50,000 for relinquishing their franchise but the appellant was not agreeable to paying that sum and as a consequence, in order to bring the matter to a head, it served sixty days notice of cancellation of its sub-franchise with it. It did this about July 1, 1960.

Subsequent to that, the appellant and Seven-Up Vancouver Ltd. negotiated to settle their conflict as to the quantum of payment to be made and towards the end of August, 1960, they eventually settled on the price of $18,000 to relinquish this franchise.

At this time, also, the President of the appellant contacted the parent company of Seven-Up Vancouver Ltd. and informed it of the arrangement and was given substantial assurance that it would receive a direct franchise once the Seven-Up Vancouver Ltd. vacated or relinquished its right to the franchise in South Vancouver Island.

Seven-Up Vancouver Ltd. authorized its solicitor, Sidney Halter of Winnipeg, Manitoba, to draw up a contract evidencing this settlement between it and the appellant and on October 3, 1960, the President of the appellant attended the office of Seven-Up Vancouver Ltd. and handed it a cheque for $18,000 and received the draft contract which had been prepared by Mr. Halter. The President of the appellant signed the same but took it with him saying that he wanted to consult his solicitor and accountant before delivering it to Seven-Up Vancouver Ltd.

In the result, the contract was never delivered because the solicitors for the two parties could not agree on its form.

It was apparent that each had the provisions of the *Income Tax Act* in mind, but it is patent, according to the evidence, that the principals involved really were unaware at the material time of the precise relevant provisions which would produce to each the maximum tax advantage. The principals, however, were at one in their understanding that the payment of $18,000 was for relinquishing the franchise.

The appellant apparently felt that by obtaining this relinquishment of this territory franchise from Seven-Up Vancouver Ltd. so as to enable it to get the direct franchise with the parent company that it got protection and would be in a position to earn a greater income than had heretofore been the case. This in fact was the case.

The evidence was that the first draft agreement of franchise which came from the parent company to the appellant was unlimited as to time and it was not acceptable to the appellant who returned it to the parent company and then after negotiations the present form of contract, Exhibit A-1, was executed which provided for a term of five years plus a renewal for an additional five years.

The appellant alleged on this appeal that the rights that he was buying and paying $18,000 for to Seven-Up Vancouver Ltd. were for relinquishing the relevant territory; and all that Seven-Up Vancouver Ltd. could do and did do with reference to this new franchise which the appellant negotiated with the parent company, was to inform the parent company that it had relinquished its franchise with it.

The appellant submitted that the question of whether the $18,000 was paid for the relinquishment of a franchise was a settled question of fact because in paragraph 3 of the Reply to the Notice of Appeal of the respondent it was admitted "that the appellant agreed to pay and did pay Seven-Up Vancouver Ltd. the sum of $18,000 in consideration of relinquishing certain territory".

The only question to be decided, therefore, counsel for the appellant submitted, was the question of whether the payment made under these circumstances can be considered a cost of the franchise within the meaning of the *Income Tax Act*.

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Counsel for the appellant conceded that there was no decided case directly in point, but submitted in support of his argument that certain cases in certain respects were analogous, *viz*: *Lions Equipment Ltd. v. Minister of National Revenue*[1]; *Jan V. Weinberger v. Minister of National Revenue*[2]; *K. V. P. Co. v. Minister of National Revenue*[3]; *No. 283 v. Minister of National Revenue*[4]; *No. 614 v. Minister of National Revenue*[5]; and *E. Gordon Hudson v. Minister of National Revenue*[6].

Counsel for the respondent submitted that the $18,000 paid by the appellant to Seven-Up Vancouver Ltd. was either (a) a payment for goodwill, or (b) a payment made to a party who was not the franchise grantor and, therefore, the payment was not a part of the cost of a franchise within the meaning of the *Income Tax Act*.

He cited in support of his submission *Mark Crompton v. Minister of National Revenue*[7].

On the evidence adduced I am of opinion that the sole question of fact is whether the payment of $18,000 by the appellant to Seven-Up Vancouver Ltd. in consideration of the latter relinquishing certain territory is part of the legal cost of the franchise, Exhibit A-1.

(The matter of the addition to the appellant's income of $200 for legal expenses was abandoned by the respondent; and the matter of whether the $200 and $225 for legal and accounting fees respectively can be charged as expenses incurred in earning income has been agreed by counsel to be dependent on the determination of the above question of fact and the legal consequences flowing therefrom.)

I am of the opinion on the evidence adduced that the appellant would not have received the franchise, Exhibit A-1, from the parent company of Seven-Up if it had not caused Seven-Up Vancouver Ltd. to relinquish its franchise rights in the territory of South Vancouver Island; and that Seven-Up Vancouver Ltd. would not have relinquished the said franchise without the payment to it of $18,000 by the appellant.

[1] 64 D.T.C. 35; 34 Tax A.B.C. 221.
[2] 64 D.T.C. 5060; [1964] C.T.C. 103.
[3] [1957] Ex. C.R. 286; 57 D.T.C. 1208.
[4] 13 Tax A.B.C. 385; 55 D.T.C. 500.
[5] [1959] D.T.C. 238; 22 Tax A.B.C. 21.
[6] 58 D.T.C. 211; 19 Tax A.B.C. 95.
[7] 31 Tax A.B.C. 269, 17 D.T.C. 259

There is, in this case, therefore, in my opinion, direct casual connection between the issuance of the franchise, Exhibit A-1, to the appellant and the payment by the appellant to Seven-Up Vancouver Ltd. of the sum of $18,000. The appellant paid this sum for the purpose of earning income and in fact by reason of this payment resulting in the obtaining of the franchise, Exhibit A-1, the appellant did increase his income and as a consequence the capital cost of this payment should be allowed pursuant to the provisions of section 11(1) (a), Regulation 1100(1) (c) and Schedule B of Class 14 of the *Income Tax Act*.

I am of opinion that, in the circumstances of this case, the fact that the solicitors for the appellant and the solicitor for Seven-Up Vancouver Ltd. could not agree on the precise final form of a contract of relinquishment of franchise is not relevant to the decision herein because on the evidence adduced it is patent that the parties themselves were *ad idem*. The appellant paid to and Seven-Up Vancouver Ltd. received the $18,000 for the express and only purpose of the relinquishment of the latter's rights to the said franchise for the territory in South Vancouver Island.

I am further of the opinion that the payment of $18,000 made in this matter was not for the purchase of goodwill of Seven-Up Vancouver Ltd. because all that the vendor company had to give was control of the right to market the product Seven-Up in the said territory. In any event, even if this was considered to be goodwill, then payment for the same was made in this case for the purpose of getting Seven-Up Vancouver Ltd. out of the field and in these circumstances the capital cost of accomplishing this should be allowed by permitting a deduction from income each year for the whole of the sum paid pro-rated over the period for which the new franchise to the appellant was granted by the parent company Seven-Up. In this view of the transaction, the payment made by the appellant to Seven-Up Vancouver Ltd. was not a payment to a third party.

In the result, the appeal is allowed with costs.

Judgment accordingly.