1954
*Oct. 29
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JOHN HAROLD WILSON ..... APPELLANT;

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Revenue—Income Tax—Business and business premises inherited subject to personal covenant to pay annuity—Premises also charged with payment—Whether such payments allowable as Income Tax deductions—The Income War Tax Act, R.S.C. 1927, c. 97, ss. 6 (1) (a), (b), (c)—The Income Tax Act, S. of C. 1948, c. 52, s. 12 (1) (a), (b), (d).

T by his will gave his business and the land on which it was carried on to his son, the appellant, subject to the son's entering into a covenant to pay T's widow an annuity and to maintain two residences for her lifetime, the land being charged with the performance of the covenant. The appellant claimed the disbursements made by him in fulfilling the covenant as deductions from his income for the years 1946, '47, '48 and '49. The respondent disallowed them on the grounds that they were not as regards *The Income War Tax Act*, R.S.C. 1927, c. 97 as amended, "disbursements and expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning income" within the meaning of s. 6(1) (*a*) of that Act but were "capital expenses" within the meaning of s. 6(1) (*b*) and that as regards *The Income Tax Act*, S. of C. 1948, c. 52 as amended, the disbursements were not "an outlay or expense incurred by the appellant for the purpose of gaining or producing income" within the meaning of s. 12 (1) (*a*) but a "capital outlay" within the meaning of s. 12 (1) (*b*) of that Act.

Held (Estey and Locke JJ. dissenting): That for the purpose of determining the appellant's taxable income the receipts from the business should be reduced to the extent of the rental value of the land charged. *Raja Bejoy Singh Dudhuria* v. *Commsr. of Income Tax* (1933) 1 I.T.R. 135; 60 Ind. App. 196, followed.

*PRESENT: Rand, Kellock, Estey, Locke and Fauteux JJ.

Per Estey and Locke JJ. (dissenting): As the payments were made in discharge of personal covenants entered into to obtain the business and the business premises, they were not deductions allowable under s. 6(1) (*a*) or s. 12(1) (*a*) of the respective Acts. The *Raja Bejoy Singh Dudhuria* case, *supra*, distinguished.

Per Locke J. (dissenting): There was no charge upon the business or the income from that business but upon the land alone. The income was accordingly not diverted to the widow nor did the appellant receive any part of it on her behalf. As the payments were not incurred in earning the income of the business no deduction was allowable for the annual value of the business premises under s. 6(1) (*c*) of the first Act or s. 12 (1) (*b*) of the second, and as the payments were on account of capital within the meaning of clause (*b*) of s. 6(1) and 12(1) of the respective Acts they were not properly deductible from income.

Judgment of the Exchequer Court of Canada, Cameron J., [1954] Ex. C.R. 36, reversed.

APPEAL from a judgment of the Exchequer Court of Canada (1), Cameron J., dismissing the appellant's appeal from the judgment of the Income Tax Appeal Board (2) which dismissed the appellant's appeal from assessments for income tax for the 1946, '47, '48 taxation years under *The Income War Tax Act* and an assessment for the 1949 taxation year under *The Income Tax Act*.

D. K. MacTavish, Q.C. and *G. Perley-Robertson* for the appellant.

W. R. Jackett, Q.C. and *T. Z. Boles* for the respondent.

RAND J.:—This appeal is from an income tax assessment (3). The question is whether the payment of an annuity and certain outgoings by the devisee of premises and a business owned and conducted on them by the testator can be deducted in the ascertainment of the taxable income of the business.

The taxpayer was the son of the testator and the effect of the provisions of the will dealing with the property can be shortly stated. The premises and business were given subject to the son's complying with certain terms. These included (*a*) the payment of succession and probate duties; (*b*) the assumption and discharge of all debts and liabilities related to the premises or business; (*c*) the payment of four small legacies to named employees; (*d*) a covenant

(1) [1954] Ex. C.R. 36; 53 D.T.C. 1242.
(2) 53 D.T.C. 68; 8 Tax A.B.C. 37.
(3) [1954] Ex. C.R. 36.

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to pay to his mother during her lifetime the sum of $500 a month; (*e*) a covenant, during her lifetime, to maintain a residence in which she was given a life interest.

The land was charged with the payments under (*d*) and (*e*), to secure which the title during the life of the widow was to remain in the names of the trustees. On the request of the son the trustees were to sell the premises on terms approved by them; the moneys realized, if the son so desired, were to be used to purchase other premises; if not, they were to be invested and the income paid to the son, subject to the performance of the covenants. On the mother's death, the capital was to be paid him. If the son within three months of his father's death did not elect to take the property on the terms stipulated, the trustees were to sell both land and business, make the payments under (*a*), (*b*) and (*c*), set aside a sum sufficient to produce the the annuity and the outgoings, and pay the balance of the proceeds to the son. On the mother's death, the retained portion of the proceeds was likewise to be paid over to him.

At the outset it is desirable to consider the relation of the possession of premises to a business which they carry. That possession by the owner is an income value to his business has long been recognized. In *Russell* v. *Town and County Bank* (1), Lord Herschell used this language:—

> Now it is not disputed that the annual value of premises exclusively used for business purposes is properly to be deducted in arriving at the balance of profits and gains. I am, of course, speaking, for the moment, of premises which are not used in any way as a place of dwelling, but are exclusively business premises. But there may be a question where the right to make that deduction is to be found. I am myself disposed to think that it is allowed because it is an essential element to be taken into account in ascertaining the amount of the balance of profits.

This language was quoted with approval in *Stevens* v. *Boustead & Co.* (2), where Warrington L.J. said:—

> Secondly, I think that if for any reason it should be held that the deduction in question is not in terms allowed by any of the rules, then it ought on general principles to be allowed, using the words of Lord Herschell . . . "because it is an essential element to be taken into account in ascertaining the amount of the balance of profits."

(1) (1888) 13 App. Cas. 418 at 425.

(2) [1918] 1 K.B. 382 at 389.

It has received like approval in several Australian decisions. In *Moffatt* v. *Webb* (1) both Griffith C.J. at p. 125 and Isaacs J., at p. 137 express agreement with it. In *Egerton-Warburton* v. *Deputy Federal Commr. of Taxation* (2) where, under an arrangement between a father and two sons lands were sold to the latter in consideration of a life annuity to the father, an annuity after his death to his widow, and after the death of both, the sum of £10,000 to the three daughters and the descendants of another, an arrangement looked upon as a family settlement, the annuity was held deductible by the sons in determining their income from farming operations on the land. Lord Herschell's quoted words and those of Lord Sumner in *Usher's Wiltshire Brewery Ltd.* v. *Bruce* (3) were referred to with this concluding comment:

> It is thus fully recognized that revenue loss or expenditure suffered by a taxpayer through appropriating land to the purposes of trade is a proper allowance against trade profits, but that a sum having been allowed as a deduction must be taxed as notional income from property. In the Commonwealth Act this discrimination is not adopted, but somewhat unfortunately, perhaps, the provision forbidding a deduction of sums not wholly laid out or expended for the purpose of the trade has been adopted with no greater modification than the substitution for the reference to trade of the words "for the production of assessable income" . . .. In the case of income from property, it is difficult to suppose that an obligation to pay an annual charge incurred as a necessary condition of acquiring the property does not amount to a deductible expenditure as money laid out for the production of assessable income.

It is clear, then, that on principle the use of one's property for the purposes of one's business involves the appropriation to the business of an economic value which is consumed in carrying on the business. The deduction of rent paid for premises owned by another, which under our statute is allowed, exhibits that value in its true nature. The taxation decision on any question of this kind must, indeed, depend upon the statutory provisions which are applicable, but that does not affect the principle or the fact of the economic values used up in the course of producing profits.

We have no separate taxation of the annual value of land, as in Schedule "A" of the English Income Tax Act;

(1) [1913] 16 C.L.R. 120. (2) [1934] 51 C.L.R. 568 at 579.
(3) [1915] A.C. 433 at 469.

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and since no deduction is allowed an owner of both land and business for that value, it operates by rendering the income so much the greater than otherwise it would be.

That value is included in the income reported by the taxpayer here. Charged against it, however, as a current annual payment, is the annuity and the other outlays. Are these payments wholly, exclusively and necessarily paid out in earning the income? Although the covenants are a condition for receiving both the land and the business, yet the charge is reserved only against the premises. In that situation, the outgoings, wholly, exclusively and necessarily related to the enjoyment of the possessory value, are as equally so related to the income as current charges for the use of a machine would be. The personal liability for the payments is merely a collateral remedy which does not affect the economic realities. The deductions are thus within ss. 6(1) (*a*) and 12(1) (*a*) of the statute.

Certain authorities were cited by Mr. Jackett, among them the following: *Grant* v. *Commr. of Taxation (N.Z)* (1); *Bern* v. *Commr. of Taxation (N.Z)* (2); *Colonial Mutual Ass. Co.* v. *Commr. of Taxation* (3) and *Calvert* v. *Commissioner of Taxes* (4) in the same court. In *Grant, Calvert* and *Colonial Mutual,* the facts involved an agreement whereby the taxpayer purchased property on which he carried on business for a price which included the payment of an annuity. I see nothing in that that touches the question before us. The purchase price of capital property is itself capital in whatever form it may take though it may be paid out of income. In *Bern,* the property of the taxpayer had been devised to him subject to an annuity in favour of his mother. The income was derived from farming and a contracting business, for which the devised as well as other land was used. It was held by Callan J. that the payment of the annuity was a capital item not deductible and that it was not an expenditure exclusively incurred in the production of assessable income. The judgment purported to apply *Tata Hydro-electric Agencies Ltd., Bombay* v. *Commr. of Income Tax* (5). There the taxpayer company had purchased a business as

(1) (1948) 8 A.T.D. 403.
(2) (1950) 9 A.T.D. 148.
(3) (1953) 10 A.T.D. 274.
(4) (1927) 40 C.L.R. 142.
(5) [1937] A.C. 685.

managing agents of a principal company for carrying on which they were entitled to a percentage of the annual net profits of the principal. A prior purchase of this agency by the vendor of the taxpayer had called for certain payments which the predecessor vendor had obligated itself to make to two other interests as part of that prior price. The question was whether these payments, the liability for which the taxpayer had assumed, could be deducted and it was held that they could not. The reason is evident: they were capital payments as part of the price paid for the agency. In *Bern,* the property came charged with the annuity as a reservation: there was no question of price or a capital outlay as the means of acquisition. The difference between the two situations is, I think, basic.

Another aspect of the question is presented by *Raja Bejoy Singh Dudhuria* v. *Commr. I.C.,* (1) decided by the Judicial Committee. There, on the death of the taxpayer's father, his stepmother brought suit for maintenance against him in which a consent decree was entered for a monthly payment of a fixed sum charged on the ancestral estate in his hands. The effect of that charge was held to be to intercept the maintenance payment so that it was never received by the taxpayer as his own income, and for that reason was deductible .

The case of a gift by will subject to a charge is similar. The benefit conferred is what remains after the deduction of what is reserved. Here the possessory value is transmuted into the income of the business, charged, by way of reservation, with the annual payment: there is constituted in substance an equitable rent charge which never becomes income, in the beneficial sense, of the taxpayer in whose revenue it appears. It lies, then, either within a broad but justified interpretation of the word "rent", as the annual value was taken to be a disbursement or expense by Lord Herschell in *Russell's* case (*supra*) at p. 425; or it is to be treated as the property or interest of the beneficiary mother throughout its process of coming into existence. In the prima facie or formal aspect of the income, the payment is within s. 6(1) (*d*), 12(1) (*d*); beneficially it never becomes income of the taxpayer.

(1) (1933) 1 I.T.R. 135.

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Evidence was given of the annual value of the premises, but in the view taken by Cameron J., it was unnecessary for him to ascertain its amount: nor, for a similar reason, was it determined either by the Income Tax Appeal Board or by the Minister. Since the only question raised on this appeal is the right to deduct and the evidence shows the annual value to have been greater than the amount sought to be deducted, I think we should conclude the controversy by a finding to that effect.

I would, therefore, allow the appeal, refer the assessment back to the Minister with the direction that these outgoings including the annuity are properly deductible from the income returns for the years in question. The appellant will be entitled to his costs throughout.

KELLOCK J.:—The appellant acquired certain lands in the City of Victoria and the business carried on therein by the testator, the late J. E. Wilson, who died on the 2nd of January, 1945, under the terms of the latter's will, the relevant provisions of which are as follows:

I GIVE, DEVISE AND BEQUEATH to my said son Joseph Harold Wilson the property and premises known as number 1221 Government Street in said City of Victoria and more particularly described as Lot 166, Block 13, City of Victoria, and the business carried on by me therein under the name of W. & J. Wilson and the goodwill thereof, all goods, stock-in-trade, furniture, machinery, store fittings and plant together with the benefit of all contracts subsisting in relation to the said business, all book debts owing to me in connection with said business and all securities for money, cash and money in bank to the credit of the said business subject to my said son complying with the following terms, namely:

(*d*) Entering into a covenant under seal with my wife binding himself and his executors and administrators to pay to her during her lifetime the sum of $500 each and every month on the first day thereof in advance, the first of such payments to be made on the 1st day of the month next following my death;

(*e*) Entering into a covenant under seal with my said wife and my Trustees, binding himself and his executors and administrators, whereby he shall covenant that during the lifetime of my wife or until the same be sold, whichever event shall the earlier happen, he or they will pay all taxes, local improvement charges, insurance premiums and expenses of all ordinary repairs to the upkeep of the fabric of my residence known as number 811 St. Charles Street in the said City of Victoria and of the buildings situated on my summer residence property at Finnerty's Beach in the Municipality of Sannich;

(*f*) The said Lot 166 shall be and is hereby charged with the performance by my said son's covenants required above by paragraphs (*d*) and (*e*) to be entered into by him and accordingly, during the lifetime of my wife the title to the said Lot 166 shall

be in the names of my said Trustees with the right to my said son, should he desire that the same be sold, to require my Trustees to sell the same provided the sale price thereof and the terms of sale meet with their approval and the moneys to be realized from any such sale shall, if my said son so desires, be used in the purchase of other business premises for my said son, and unless so used shall be invested and the income to be derived therefrom shall be paid to my said son, subject to the performance by him of his covenants as above mentioned, and on the death of my said wife the capital thereof shall be paid to my said son;

(*g*) Upon my son complying with the terms of this bequest and devise to him within three months from the date of my death my Trustees are authorized to turn over the said business to my said son as a going concern as of the date of my death, but should my son fail to carry out the above terms within the said period of three months or thereafter within a period of one month from the giving of written notice to my said son requiring him to elect as to whether he will take the said business over or not, then my Trustees are to sell and convert the said business and land into money, and pay the moneys required to be paid under paragraphs (*a*), (*b*) and (*c*) hereof and to set aside a sufficient amount which when invested will in the opinion of my Trustees produce a sufficient income to pay to my wife the said sum of $500 as provided by paragraph (*d*) hereof, and the other outgoings provided by paragraph (*e*) hereof, and apply such income for such purpose and to pay the balance of said proceeds to my said son, and on the death of my said wife to pay to my said son the capital retained and invested as above required to be invested. I AUTHORIZE AND EMPOWER my Trustees until the said business be turned over to my son or sold and converted as above provided, to manage and carry on the said business and for such purpose in their discretion to appoint my said son to act in the full management thereof.

The appellant complied with these terms and accordingly became the owner of the business and the beneficial owner of the real property subject to the charge of the annuity, which, in the years in question, namely, 1946 to 1949 inclusive, was duly paid to the widow of the testator.

The point at issue in this appeal is as to whether or not the amounts so paid are taxable as income in the hands of the appellant. The first period, from 1946 to 1948 inclusive, is governed by *The Income War Tax Act,* R.S.C., 1927, c. 97, as amended, and the last period, namely, 1949, by *The Income Tax Act,* being 11-12 George VI, c. 52, as amended. The two statutes are cast in somewhat similar terms.

Considerable discussion took place on the argument as to the effect of s. 6(1) (*a*) and (*b*) of the earlier statute and the corresponding provisions of the later Act, namely,

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s. 12(1) (*a*) and (*b*), but in my view these provisions have no application in the circumstances of the present case for reasons which I shall state as shortly as possible.

It is always a question of construction as to whether, upon the terms of any instrument, a testator has made an annuity given by his will, a charge on property or a personal liability, or has set up a trust, or whether there has been created both a personal liability and either a trust or a charge; *in re Lester* (1). In the case at bar, the provisions of the will, which are not unlike those of the will in question in *Parker* v. *Judkin* (2), are beyond doubt. The testator has not only made the appellant personally liable but has expressly charged the annuity on lot 166. While the hand by which the widow receives payment may be that of the appellant, the annuity payable out of the land is her property and never at any time forms part of his income. She would in respect of arrears, be entitled to the appointment of a receiver; *Dalmer* v. *Dashwood* (3); *Cupit* v. *Jackson* (4).

In *London County Council* v. *Attorney General* (5), Lord Davey, in referring to the scheme of United Kingdom Income Tax Acts, said at p. 42:

> It was, no doubt, considered that the real income of an owner of incumbered property, or of property charged, say, with an annuity under a will, is the annual income of the property less the interest on the incumbrance or the annuity; and the mortgagee or annuitant and the owner of the property are, in a sense, entitled between them to the income. . . .

In so far as an annuity charged on land is concerned, this statement is in accord with the authorities above referred to and the principle was applied by the Judicial Committee in *Raja Bejoy Singh Dudhuria* v. *Commr. of Income Tax* (6) In that case the appellant had succeeded to his family ancestral estates upon the death of his father. A consent decree for maintenance had been pronounced in favour of the appellant's stepmother in a proceeding between them which, in the words of Lord MacMillan, at p. 136, (quoting the finding of the court in the litigation in which the decree had been pronounced):

(1) [1942] 1 Ch. 325.
(2) [1931] 1 Ch. 475.
(3) (1793) 2 Cox 378.
(4) (1824) 13 Price 721 at 733.
(5) [1901] A.C. 26.
(6) (1933) 1 I.T.R. 135; 60 Ind. App. 196.

Was a legal liability of the Raja (the appellant) arising by reason of the fact that the Raja is in possession of his ancestral estate, that it is payable out of such estate and that this Court had declared that the maintenance was a charge thereon in the hands of the Raja.

It was the view of the court below (57 Indian L.R. 918), with which the Judicial Committee concurred, that the liability of the Raja, by virtue of the decree, was the same as if he "had received his various properties . . . under a bequest from his father upon the terms that these assets were charged with an annuity for the maintenance of the widow". The court, however, held notwithstanding, that the amounts payable to the stepmother were taxable as income in the hands of the appellant. With this their Lordships did not agree, holding that:

when the Act by s. 3 subjects to charge "all income" of an individual, it is what reaches the individual as income which it is intended to charge . . . It is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands.

I am unable to distinguish the present case in principle and there is nothing in the legislation here in question which prevents its application in the circumstances of the case at bar. On the contrary, the legislation taxes only the income of the taxpayer and not income which is not his. The charge created upon the land devised to the present appellant by the testator operates to divert from him to the widow income to that extent and such diverted income does not form part of the income of the appellant.

It is unquestioned, of course, that there can be no deduction of the annuity from the taxpayer's income from sources other than the land charged. But to the extent that the land charged does produce income, the charge operates to prevent such income becoming income of the taxpayer.

In the present case the land in question does produce income, as it is used by the taxpayer in carrying on business thereon. The income from the land is thus merged, in the hands of the appellant, with the gross receipts from the business. The amount of the income from the land is clearly ascertainable, however, and is an amount equal to the rentable value of the land. Evidence was given that the annuity is less than that amount. S. 6(1) (*a*) of the earlier statute and s. 12(1) (*a*) of the later, which permit the deduction of "disbursements or expenses" in the one

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case, and "an outlay or expenses" in the other, apply only in the ascertainment of the income of the taxpayer. They therefore have no application to revenue coming to his hands which forms no part of his income.

For the same reason that s. 6(1) (*a*) and (*b*) do not apply, s. 6(1) (*c*) equally does not apply. Morever, while "the annual value" of property may not, by reason of s. 6(1) (*c*) be deducted by a taxpayer in the ascertainment of income, and in consequence of that provision, such annual value forms part of the income of the taxpayer and is subject to tax, that is not to say that where the taxpayer does not receive a part of the annual value by reason of the existence of a charge such as that here in question, nevertheless he is to be taxed as though he were in receipt of the whole, as well as the person entitled to receive the charged income. In so far as the annual value of the lands here in question exceeds the annuity, it forms part of the taxable income of the appellant.

This aspect of the matter does not appear to have been argued below.

I would therefore allow the appeal with costs throughout.

ESTEY J. (dissenting):—The father of the appellant, by his last will, devised and bequeathed Lot 166, Block 13, City of Victoria, and the business conducted thereon to his son, the appellant, subject to his "complying with the following terms," which may be summarized:

That the appellant

(*a*) pay succession and probate duties in respect of benefits received by himself and others under this will;

(*b*) pay the testator's debts and liabilities in respect of the business and premises;

(*c*) pay certain legacies to five employees of the business totalling $2,000;

(*d*) enter into a covenant to pay his mother, during her lifetime, $500 per month;

(*e*) enter into a covenant to pay, during his mother's lifetime or until the same be sold, all taxes, local improvement charges, insurance premiums and expenses of all ordinary repairs to the upkeep of the fabric of her residence.

The will also provided, in part:

Upon my son complying with terms of this bequest and devise to him within three months from the date of my death my Trustees are authorized to turn over the said business to my said son as a going concern as of the date of my death, . . .

The said Lot 166 shall be and is hereby charged with the performance by my said son's covenants required above by paragraphs (*d*) and (*e*) to be entered into by him and accordingly, during the lifetime of my wife the title to the said Lot 166 shall be in the names of my said Trustees with the right to my said son, should he desire that the same be sold, to require my Trustees to sell the same. . . .

The appellant accepted the foregoing terms, entered into the covenants with his mother and the trustees and has discharged his obligations to date.

It is not contested that at all times material hereto the appellant owned and carried on the business under the name of W. & J. Wilson, under which it had remained since 1864. With respect to Lot 166, I respectfully agree with Mr. Justice Cameron that

> . . . the appellant became the beneficial owner . . . immediately upon complying with the conditions laid down in his father's will. . . .

In this litigation we are concerned only with the payments made under paras. (*d*) and (*e*) by the appellant to and on behalf of his mother, which were as follows:

1946	$6,927.77
1947	7,132.91
1948	6,950.53
1949	6,798.62

It is contended that these amounts were never part of appellant's income. This submission is made largely upon the authority of *Raja Bejoy Singh Dudhuria* v. *Commissioner of Income Tax* (1). In that case when the father died his son succeeded to the family ancestral estate. Thereafter his stepmother brought a suit for maintenance in which by consent an order was directed which, though not produced to the Court, was described by the Chief Justice in the Calcutta High Court, at p. 136, in part, as follows:

> . . . it was not disputed that the lady's maintenance was a legal liability of the Raja (the appellant) arising by reason of the fact that the Raja is in possession of his ancestral estate, that it is payable out of such estate and that this Court had declared that the maintenance was a charge thereon in the hands of the Raja.

Their Lordships of the Privy Council stated at p. 138:

> In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his step-mother has to that extent diverted his income from him and has directed it to his step-mother; to that extent what he receives for her is not his income. It is

(1) (1933) 1 I.T.R. 135.

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not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands.

In that case the maintenance was the primary responsibility of and payable out of the estate. This is emphasized by the Chief Justice where, in describing the order, he states the maintenance "is payable out of such estate and that this Court had declared that the maintenance was a charge thereon in the hands of the Raja." It is in these circumstances that Lord Macmillan, speaking on behalf of the Privy Council, states that to the extent of the charge in favour of his step-mother the decree of the Court "diverted his income from him and has directed it to his step-mother; to that extent what he receives for her is not his income." In the case at bar the circumstances are quite different. The testator under the will gave to the appellant the option to acquire the business and Lot 166, upon his agreeing to make the payments under paras. (*a*), (*b*) and (*c*) and upon his entering into certain personal covenants under paras. (*d*) and (*e*), and the charge provided for under the will is security for the performance of the covenants under paras. (*c*) and (*d*). It is not a case of the appellant acquiring Lot 166 subject to a mortgage or charge, but rather the acquisition by him of that lot and the business in consideration of which, *inter alia,* he gave his personal covenants under paras. (*d*) and (*e*), and, when he had done so, the will then provides "the said Lot 166 shall be and is hereby charged with the performance" of his personal covenants. These personal covenants constitute the primary obligation which he must discharge irrespective of whether Lot 166 is used by him, or whether he derives any benefit therefrom, or, indeed, whether he continues to carry on the business or not. The payments, when made in the discharge of these covenants, are, as indicated in the foregoing quotation, an "application by the appellant of part of his income in a particular way" and not the payment or delivery of funds which had never become part of his income.

Moreover, the language of the will in paras. (*d*) and (*e*) contemplates a relationship of debtor and creditor between the appellant and his mother and does not contemplate that any sum derived by the use or otherwise of Lot 166 shall be paid to the mother, at least until such time as the appellant makes default and the mother takes appropriate

proceedings to realize out of this security. Under such a charge it cannot be said that there has been any diversion of income, at least prior to the taking of the proceedings already suggested.

That the foregoing is in accord with the intention of the testator would seem to follow from the fact that the testator provided in his will that the appellant might require the trustees to sell Lot 166 and that the proceeds be either used to purchase other business premises or invested, in which latter event the income therefrom was to be paid to the appellant. All of which was "subject to the performance by him of his covenants" under para. (*d*), which suggests that the trustees, while they might release the charge against the lot, would be under an obligation to see that other appropriate security was provided therefor. This provision would appear quite inconsistent with any intention to divert income, as contended by the appellant.

On the basis that the payments were made out of his income, appellant submits that they should be deducted in computing his income tax for 1946, 1947 and 1948 under s. 6(1) (*a*) of *The Income War Tax Act* (R.S.C. 1927, c. 97), which reads:

> 6(1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of
>
> (*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income;

and for 1949 under s. 12(1) (*a*) of *The Income Tax Act* (S. of C. 1948, 11-12 Geo. VI, c. 52), which reads:

> 12(1) In computing income, no deduction shall be made in respect of
>
> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.

These payments, as already stated, were made in the discharge of his personal covenants entered into in order that he might obtain the business and Lot 166. They were not made for the purpose of acquiring goods, services or equipment in the ordinary course of buying and selling merchandise, or can they in any relevant sense be said to have been made in the course of operations of the business for the purpose of earning income. The payments here in question do not come within the meaning of s. 6(1) (*a*). Sir Lyman Duff C.J., with whom Davis J. agreed, in construing this section, stated that "in order to fall within

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the category 'disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning the income,' expenses must, I think, be working expenses; that is to say, expenses incurred in the process of earning the 'income,'" *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (1).

Moreover, it would seem the position of the appellant is somewhat similar to that described by Lord Macmillan:

> In short, the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business. If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business. *Tata Hydro-Electric Agencies, Bombay* v. *Income-Tax Commissioner, Bombay Presidency and Aden* (2).

Moreover, these payments, for the same reason, could not be regarded as an expense "for the purpose of gaining or producing income from property or a business of the taxpayer" within the meaning of the above s. 12(1) (*a*).

I respectfully agree with Mr. Justice Cameron that the payments cannot be regarded either as rent, or payments in the nature of rent. There was not only no lease, but neither in the will nor in any other document is there language which suggests that the amounts were ever paid as, or in lieu of rent, or in any sense for the use of the building. The nature and character of the payments must be determined from the circumstances under which the obligation was incurred and, therefore, the fact that in the books of W. & J. Wilson the sums as paid to the mother were charged to the Augusta A. Wilson account and at the end of the year transferred to the rent account does not establish that they were, in fact, rent. Moreover, the fact that evidence was adduced to the effect that the fair rental value for the premises known as Lot 166 would be about $800 per month does not, apart from evidence that the testator intended to create such a relationship, assist in the solution of this problem.

Our attention was directed to three Australian cases and the appellant particularly relied upon *Egerton-Warburton*

(1) [1941] S.C.R. 19 at 22. (2) [1937] A.C. 685 at 695.

and Others v. *Deputy Federal Commissr. of Taxation* (1). The first of the three cases was decided in 1927, *Calvert* v. *The Commissioner of Taxes for Victoria* (2). There Lewis G. Calvert and his wife, Jessie Irvine Calvert, entered into an agreement with their son, the appellant, Lewis N. Calvert, whereby they conveyed to him certain land in the State of Victoria. Lewis N. Calvert covenanted to pay to his father, Lewis G. Calvert, an annuity of £666 and after his death to his widow, Jessie Irvine Calvert, an annuity of £333. The land was transferred to Lewis N. Calvert and a charge duly registered against the land to secure the payment of the respective annuities. In this litigation the appellant contended that the £333 paid to his mother should be deducted as an expense. The High Court of Australia held that such an amount could not be deducted under s. 19(2) (*g*) of the legislation of Victoria, which provided that only such disbursements or expenses as were "wholly and exclusively laid out or expended for the purpose of such trade" might be deducted. The appellant, in the case at bar, sought to distinguish this case on the basis that Calvert was the registered owner, did not make the payments out of the business and they were not regarded as rent. The appellant in the case at bar being the beneficial owner, it is not material that he is not the registered owner, nor does the fact that he saw fit to make the payments to his mother by cheques issued out of the business of which he was the sole owner involve any distinction in principle. Furthermore, having regard to the language of the will, the above amounts cannot be accepted as payments made for the use of the land or in any sense payments analagous to rent.

In the *Egerton-Warburton* case, *supra,* pursuant to an agreement for sale, certain property was transferred by the father, R.E., to his two sons, P.E. and G.G., under terms that required the sons to pay an annuity to the father during his lifetime of £1,200 and a further annuity and payments after his death. The two sons formed a partnership and carried on the business and in filing their respective income tax returns each deducted the sum of £329, 10s. In the High Court of Australia this sum was allowed on the basis that "so far as the taxpayer is concerned it is an

(1) (1934) 51 C.L.R. 568. (2) (1927) 40 C.L.R. 142.

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expenditure incurred to create his assessable income" and, therefore, deductable under the provisions of s. 25(*e*) of the *Income Tax Assessment Act,* 1922-1933 which forbids the deduction of money not wholly or exclusively laid out for the production of assessable income. In the course of the judgment it was stated that the transaction bore "all the marks of a family settlement" and then the Court stated:

> We think it is impossible to treat the annuity of £1,200 a year as mere instalments of purchase money.

The Court referred to the *Calvert* case and distinguished it on the basis that it was decided under language of other legislation enacted in another state (Victoria).

The last of three cases decided in the High Court of Australia was *Colonial Mutual Life Ass. Society Ltd.* v. *Commr. of Taxation* (1). The appellant, a life insurance company, owned a block of land in Adelaide. Just Brothers owned an adjoining lot. The appellant entered into an agreement with Just Brothers whereby it purchased from Just Brothers their lot on terms that the appellant would erect an office building on both lots, 7% of which would be occupied by the appellant, rent free, and that Just Brothers would receive 90% of the rents collected from the balance, or 93%, of the building for fifty years. This 90% in the taxation period amounted to £1,183, which amount the appellant sought to deduct in the computation of its income tax. The Court held that this money was expended for the purpose of obtaining a fixed capital asset and, therefore, "the payment under appeal is an outgoing of a capital nature within the meaning of s. 51(1) of the *Income Tax Assessment Act.* The payment represents one of a series of annual payments which the appellant agreed to make to Just Brothers for the acquisition of their land."

Mr. Justice Williams, in referring to the *Egerton-Warburton* case, *supra,* after stating that the payments to Just Brothers were of a capital nature, continued at p. 279:

> In these circumstances their Honours evidently considered that the annuities, being charged on the land and payable during the lives of the father and mother, were in the nature of rents which the sons had to pay during this period in order to occupy the land and carry on their business.

(1) (1953) 10 A.T.D. 274.

Mr. Justice Fullagar, with whom Mr. Justice Kitto and Mr. Justice Taylor agreed, referring to the *Egerton-Warburton* case, stated:

> This was a case of a very exceptional character. . . . It is simply that in the particular circumstances the annuity was not regarded as part of a purchase price payable by the sons to the father for the land.

In these Australian cases the facts are quite distinguishable and do not appear to assist the appellant, more particularly as in Australia the *Egerton-Warburton* decision is regarded as one that apparently ought not to be extended beyond its particular facts. The appellant's acquisition of the lot and business is not in the nature of a purchase, as we ordinarily understand that term, but that does not detract from the fact that once he elected to take the lot and business he was required to enter into covenants and to make large payments, including those to his mother, and, however these payments may be technically described, they were made for the acquisition "of the right and opportunity to earn profits" rather than laid out or expended for the purpose of earning income.

The appeal should be dismissed with costs.

LOCKE J. (dissenting):—Joseph E. Wilson, the father of the appellant, had carried on business in Victoria for a long period of years under the firm name of W. & J. Wilson and died on January 2, 1945. The appellant has continued to carry on business under the same name since his father's death, in the same premises on Government Street in Victoria, and it is from the income derived from that business, treating it as a separate entity, that the payments in question are claimed to be deductible as an expense of operation.

By the will, the testator bequeathed to the appellant:

> the property and premises known as No. 1221 on Government Street in said City of Victoria and more particularly described as Lot 166, Block 13, City of Victoria, and the business carried on by me therein under the name of W. & J. Wilson and the goodwill thereof, all goods, stock-in-trade, furniture, machinery, store fittings and plant, together with the benefit of all contracts subsisting in relation to the said business, all book debts owing to me in connection with the said business and all securities for money, cash and money in bank to the credit of the said business.

Subject to his complying with the following terms:—paying all succession and probate duties chargeable against the estate and the legatees in respect of the bequests to himself, his mother and five named employees to whom a

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total of $2,000 was given, assuming and discharging all the debts and liabilities of the business and the premises referred to and entering into a covenant with his mother, binding himself to pay her $500 on the first day of each month during her lifetime, and a further covenant with her and with the trustees to pay all taxes, insurance premiums and the expenses of upkeep of the testator's former home at 811 St. Charles Street in Victoria and of a summer residence at Finnerty's Beach in the Municipality of Saanich. It was a term of the will that, should the appellant fail to carry out these conditions, the trustees were to sell the business and the premises, retain and invest such portion of the proceeds as they considered necessary to provide for the $500 payable monthly to Mrs. Wilson Sr. and to pay the balance to the appellant, the capital so retained to be paid to him on Mrs. Wilson's death.

While the record does not contain any evidence of the extent and nature of the assets bequeathed to the appellant on these conditions, these may, I think, properly be estimated from the balance sheet of W. & J. Wilson as of January 31, 1946, filed as an exhibit. This shows assets consisting principally of the business premises, cash, accounts receivable, inventories and Dominion of Canada bonds, of a value of $317,537.94. Of this amount, the business premises accounted for $118,316.45. The liabilities for accounts payable and amounts owing to sundry employees approximated $31,000.

Within a period of three months, the appellant entered into the required covenants with Mrs. Wilson, Sr. and with her and with the trustees and complied with the other stipulated conditions, thereupon becoming entitled to his bequest. Title to the store premises (as distinct from the business carried on therein and all the other assets mentioned) has remained, however, in the name of the trustees of Mr. Joseph E. Wilson's estate by reason of the following provision in the will:—

> The said Lot 166 shall be and is hereby charged with the performance by my said son's covenants required above by paragraphs (*d*) and (*e*) to be entered into by him and accordingly, during the lifetime of my wife the title to the said Lot 166 shall be in the names of my said Trustees.

This clause further provided that should the appellant desire the business premises to be sold, he might require

the trustees to do so, providing the price offered was approved by them and the moneys realized might, at the option of the appellant, be used for the purchase of other business premises and:—

unless so used shall be invested and the income to be derived therefrom shall be paid to my said son, subject to the performance by him of his covenants as above mentioned, and on the death of my said wife the capital thereof shall be paid to my said son.

Having entered into the required covenants and received the assets bequeathed to him, the appellant, in reckoning the income of the business of W. & J. Wilson, has charged as an expense of that business for each of the years 1946 to 1949, both inclusive, the amounts paid to Mrs. Joseph E. Wilson and the amounts expended for taxes and the upkeep of the two house properties. In the accounts of the business these were charged as rent amounting for the year 1946 to $6,427.77, for 1947 to $7,132.91, for 1948 to $6,950.53 and for 1949 to $6,798.62.

While W. & J. Wilson is simply the trade name under which the appellant carries on the business referred to, the income in respect of which the assessments complained of were made was that of this business alone and did not include the income of the appellant from other sources.

In respect to the taxation years 1946, 1947 and 1948, the liability is to be determined under *The Income War Tax Act* (c. 97, R.S.C. 1927 as amended): and for the year 1949 under the *Income Tax Act* (11-12 Geo. VI, c. 52). S. 6 of *The Income War Tax Act* reads in part as follows:

6. (1) In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

(*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income;

(*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence, except as otherwise provided in this Act;

(*c*) the annual value of property, real or personal, except rent actually paid for the use of such property, used in connection with the business to earn the income subject to taxation.

In *The Income Tax Act* of 1948, these paragraphs of s-s. (1) of s. 6 appear as paragraph (*a*), (*b*) and (*d*) of s-s. (1) of s. 12, with some slight changes. Thus para. (*a*) reads:—

(*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.

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Para. (*d*) which replaced para. (*c*) of the earlier Act reads:

> (*d*) the annual value of property except rent for property leased by the taxpayer for use in his business.

As appears from the provisions of the will to which I have referred, on the death of his father the appellant was given the option of entering into the covenants mentioned or to receive from the trustees the proceeds of the sale of the business and the premises after they had deducted from the amount realized sufficient to provide for the obligations referred to, and on his mother's death to receive the amount retained to provide for the monthly payments to her. The appellant, while thus being under no obligation to do so, entered into the covenants and, in consequence, obtained the business as a going concern with the benefit of the goodwill which, it is clear from the evidence, was of great value, and was thus enabled to continue the business. While, under the terms of the will, the trustees were required to retain title to the store premises in their names until the death of the widow unless the appellant should elect to require that they be sold and used for the purchase of other premises, the appellant was, it is quite clear, from the time he entered into the covenants the beneficial owner of the property, subject only to the charge imposed upon it by the terms of the will.

In my opinion, the provisions of s. 6 (1) (*a*) of *The Income War Tax Act* and s. 12 (1) (*a*) of *The Income Tax Act* are fatal to the appellant's claim. While it is true that the monthly payments to Mrs. Wilson, Sr. and for the upkeep of the properties were made out of the earnings of the business carried on upon the store premises in question, these sums were paid in consequence of the obligations voluntarily assumed by the appellant and formed part of the consideration paid or agreed to be paid by him as a term of receiving, in addition to the lands and premises, all of the assets of his father's business valued in the 1946 balance sheet at roughly $200,000 and the valuable goodwill of that business. I think the situation to be no different than if, instead of stipulating for the payment of these monthly amounts and providing for the upkeep of the properties, the will had required that a lump sum should be paid to the widow and that the appellant had

agreed to pay and had paid such sum. In my opinion, the amounts so paid were neither "wholly, exclusively and necessarily laid out for the purpose of earning the income" of the business carried on under the name of W. & J. Wilson, within the meaning of *The Income War Tax Act*, nor did they constitute "an outlay or expense . . . for the purpose of gaining or producing income from . . . a business of the taxpayer" within the meaning of *The Income Tax Act*. Had the appellant ceased to carry on the business the day following that upon which he entered into the covenants, the monthly amounts would still have been payable by him as they would have been had he elected to request the trustees to sell the business premises.

In the evidence tendered at the hearing before Cameron J., Mr. Watt, a chartered accountant whose firm were the auditors for the appellant's business, said that the amounts paid to Mrs. Wilson, Sr. and the further amounts paid for the upkeep and the taxes payable in respect of the Victoria House property and the property at Finnerty's Beach were entered in the business accounts of the firm as payments for rent. However, no relationship of landlord and tenant existed since the appellant was the beneficial owner of the property and, indeed, the property, both land and the buildings erected on it, was shown as an asset of W. & J. Wilson in the balance sheet and annual depreciation claimed upon the building and fixtures.

In the argument addressed to us on behalf of the appellant, reliance was placed upon the decision of the Judicial Committee in *Raja Bejoy Singh* v. *Income Tax Commissioner* (1). With respect for differing opinions, I think that case is clearly distinguishable on its facts. That case came before the Judicial Committee by way of an appeal from the judgment of a court of appeal in India upon a reference under s. 66(2) of the *Indian Income Tax Act of 1922* (1930, 57 I.L.R.) The facts briefly were that the father of the appellant died intestate. The appellant, as his only son, inherited the estate. The widow, the appellant's stepmother, brought an action against him for a declaration that she was entitled to proper maintenance and suitable accommodation for her residence out of the properties in his hands forming part of the estate of her deceased husband. This

(1) (1933) 60 Ind. App. 196.

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suit was compromised, a consent decree being entered under the terms of which the appellant made over to his stepmother a place for her residence and agreed to pay a sum of Rs. 1100 monthly for her maintenance. The question referred to the Court was whether the Raja was entitled to deduct from his income the amounts so paid. Rankin C.J., who delivered the judgment of the Court, said in part (p. 924):—

> it was not disputed that the lady's maintenance was a legal liability of the Raja arising by reason of the fact that the Raja is in possession of his ancestral estate, that it is payable out of such estate and that this Court had declared that the maintenance was a charge thereon in the hands of the Raja.

Finding that there was no provision in the *Indian Income Tax Act* which permitted the appellant to deduct the amounts so paid from his taxable income, the Court found that they were taxable.

The judgment of the Judicial Committee which reversed the finding of the Court of Appeal was delivered by Lord McMillan. Referring to the judgment appealed from, he said in part (p. 200):—

> The learned Chief Justice in his judgment . . . deals with the case on the footing that, by the decree of the Court, the appellant's stepmother had a charge not only on his zamindari property from which his agricultural income was derived, but also on all his other sources of income included in the assessment. He rejects the suggestion that the appellant's liability to his stepmother was of the same kind as his liability to provide for his wives and daughter, and states that the position is the same as if the appellant "had received his various properties, securities and businesses under a bequest from his father upon the terms that these assets were charged with an annuity for the maintenance of the widow." The case was not one of "a charge created by the Raja for the payment of debts which he has voluntarily incurred." Their Lordships agree that this is the correct approach to the question.

and continuing:—

> It is not a case of the application by the appellant of part of his income in a particular way; it is rather the allocation of a sum out of his revenue before it becomes income in his hands.

The grounds upon which the judgment of the Court of Appeal were reversed are thus expressed (p. 200):—

> When the Act by s. 3 subjects to charge "all income" of an individual, it is what reaches the individual as income which it is intended to charge. In the present case the decree of the Court by charging the appellant's whole resources with a specific payment to his stepmother, has to that extent diverted his income from him and has directed it to his stepmother; to that extent what he receives for her is not his income. It is not a case

of the application by the appellant of part of his income in a particular way; it is rather the allocation of a sum out of his revenue before it becomes income in his hands.

The charge upon the estate in that case to which the stepmother was entitled under the Hindu law, the extent of which was declared by the decree, extended to the income derived from it. It was by reason of this that Lord MacMillan said that, to the extent of the amounts to which the stepmother was found entitled, the Raja received the income on her behalf.

In the present matter there was no charge upon either the business of W. & J. Wilson or the income from that business. The charge was upon the land alone and was not one to which it was subject by law but arose only upon the appellant electing to acquire the business, the property and the other assets mentioned and entering into the required covenants. The income was not accordingly diverted to Mrs. Wilson, Sr. nor did the appellant receive any part of it on her behalf. The money so paid were not for expenses incurred in earning the income of the business but in satisfaction of the appellant's obligations under his personal covenants.

It may be noted that while the Raja realized more than half of his total income from the business of agriculture carried on upon the estate and while s. 10(2)(XV) of the *Indian Income Tax Act* permitted the deduction from the profits of a business of:—

any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly or exclusively for the purpose of such business.

neither the report of the proceedings in the Court of Appeal or in the Privy Council indicate that the claim to deduct the payments made was attempted to be justified under this statutory provision.

I find nothing in this decision to support the appellant's contention in the present matter.

As the appellant was the owner of the business premises, he was not entitled to any deduction for their annual value by reason of the provisions of s. 6(1)(*c*) of the *Income War Tax Act* and s. 12(1)(*d*) of the *Income Tax Act*.

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I am of the further opinion that the payments made to Mrs. Wilson, Sr. were payments on account of capital, within the meaning of s. 6(1)(*b*) of the *Income War Tax Act* and s. 12(1)(*b*) of the *Income Tax Act* respectively, and are thus not proper deductions from income. Those payments were merely part of the consideration which the appellant agreed to pay as a term of acquiring all of the assets of the business theretofore carried on by his father. The fact that part of the agreed consideration was payable in instalments during his mother's lifetime cannot affect the true nature of the transaction or render such payments any the less "payments on account of capital."

I would dismiss this appeal with costs.

FAUTEUX J.:—The land charged and actually used in the business of the appellant did produce an income which, equal to the rental value of the land, was merged with the gross receipts of the business. But, as shown in the reasons for judgment of my brothers Rand and Kellock, the charge on the land, imposed as a condition precedent to the right of beneficial ownership, diverted from the business, in a measure equal to the amount necessary to its satisfaction, such income it produced and thus, and to this extent, prevented it becoming income to the appellant. In this view, the provisions of s. 6(1) (*a*) and (*b*) of the *Income War Tax Act,* R.S.C. 1927 c. 97, as amended, and s. 12(1) (*a*) and (*b*) of the *Income Tax Act,* 11-12 Geo. VI, c. 52, as amended, are of no application in this case.

I would therefore allow the appeal with costs throughout.

Appeal allowed with costs.

Solicitors for the appellant: *Haldane & Campbell.*

Solicitor for the respondent: *T. E. Jackson.*