LOUIS J. HARRIS ..... APPELLANT;

AND

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

1966

*Mar. 8
Apr. 28

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

*Taxation—Income tax—Capital cost allowance—Lease-option agreement—Option to purchase property for stated price after 200 years—Rule against perpetuities—"Price fixed by contract or arrangement"—Artificial reduction of income—Income Tax Act, R.S.C. 1952, c. 148, ss. 11(1)(a), 18, 137(1).*

In April 1960, a service station, recently purchased by company D for a sum of $31,000, was leased to an oil company for a period of 25 years at an annual rental of $3,900. The oil company was given the right to renew its lease or purchase the property under certain conditions. In October 1960, the appellant, a physician, was granted by company D a concurrent lease on the service station property. This lease was for a term of 200 years at an annual rental of $3,100 and contained an option exercisable by the appellant to purchase the property for $19,500 at the expiration of the 200-year period. The appellant deposited $10,000 with company D as a security for the performance of his covenants. The appellant authorized company D to collect the $3,900 rent from the oil company, deduct the $3,100 rent payable by the appellant and remit the $800 balance to him.

In his income tax return for 1960, the appellant included in his income from investments the amount representing the rental for 3 months, and, relying on s. 18 of the *Income Tax Act*, R.S.C. 1952, c. 148 (repealed in 1963), contended that by his "contract or arrangement" he was deemed to have acquired the property at a capital cost of $639,516. This amount was made up of the rent of $3,100 for 200 years plus the option price of $19,500, minus the value of the land. This would entitle him to a deduction of capital cost allowance of $30,425.80 from his other income for that year. The Minister disallowed the deduction of capital cost and allowed a deduction for the rent paid in the year. The Exchequer Court ruled that the capital cost at which the appellant was deemed to have acquired the property was $19,500. The taxpayer appealed to this Court.

*Held*: The appeal should be dismissed.

The transaction embodied in the lease to the appellant was not one to which s. 18 of the *Income Tax Act* applied. The applicability of that section depends on the existence of a valid option pursuant to which, on the satisfaction of a condition, the demised property will vest in the lessee. The clause purporting to give the appellant an option to purchase the property at the end of 200 years offended the rule against perpetuities and was void.

On this view of the matter, the Exchequer Court was right in refusing to interfere with the allowance of $775.02 as rental expense.

On the assumption that s. 18 of the Act applied, the Exchequer Court was right in ruling that the "price fixed by the contract or arrangement" at

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

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which the appellant should "be deemed to have acquired the property" was $19,500.

Furthermore, on the assumption that s. 18 of the Act applied and that on its true construction, the appellant was *prima facie* entitled to make the deduction of the capital cost allowance claimed by him, such a deduction would be in respect of an expense incurred in respect of a transaction that, if allowed, would artificially reduce the appellant's income, and, consequently, would be forbidden by the terms of s. 137(1) of the Act.

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*Revenu—Impôt sur le revenu—Coût en capital à titre d'allocation—Convention de bail avec option—Option d'acheter une propriété pour un prix déterminé après 200 ans—Règle contre la perpétuité—«Prix fixé par le contrat ou arrangement»—Réduction de façon factice du revenu—Loi de l'Impôt sur le revenu, S.R.C. 1952, c. 148, arts. 11(1)(a), 18, 137(1).*

Durant le mois d'avril 1960, une station-service, récemment achetée par la compagnie D pour une somme de $31,000, fut louée à une compagnie d'huile pour une période de 25 ans à un loyer annuel de $3,900. La compagnie d'huile avait le droit de renouveler son bail ou d'acheter la propriété sous certaines conditions. En octobre 1960, la compagnie D a concédé à l'appelant, un médecin, un bail sujet à la servitude du premier bail sur la même propriété. Ce bail était pour un terme de 200 ans à un loyer annuel de $3,100 et contenait une option en faveur de l'appelant d'acheter la propriété pour $19,500 à l'expiration de la période de 200 ans. L'appelant a déposé une somme de $10,000 entre les mains de la compagnie D comme garantie de l'exécution de sa convention. La compagnie D fut autorisée par l'appelant à percevoir le loyer de $3,900 de la compagnie d'huile, à déduire le $3,100 de loyer payable par l'appelant et à lui remettre la balance de $800.

Dans son rapport d'impôt sur le revenu pour l'année 1960, l'appelant a inclus le montant représentant le loyer de 3 mois dans son revenu de placements, et, se basant sur l'art. 18 de la *Loi de l'Impôt sur le revenu*, S.R.C. 1952, c. 148 (abrogé en 1963), a prétendu qu'en vertu de son «contrat ou arrangement» il était réputé avoir acquis la propriété à un coût en capital de $639,516. Ce montant était formé du loyer de $3,100 pour 200 ans en plus du prix de l'option de $19,500, et moins le montant de la valeur du terrain. Ceci lui accorderait une déduction du coût en capital à titre d'allocation de $30,425.80 de ses autres revenus pour l'année en question. Le Ministre a rejeté la déduction du coût en capital et a permis la déduction pour le loyer payé durant l'année. La Cour de l'Échiquier a jugé que l'appelant était réputé avoir acquis la propriété à un coût en capital de $19,500. Le contribuable en appela devant cette Cour.

*Arrêt*: L'appel doit être rejeté.

La convention incorporée dans le bail de l'appelant n'était pas une à laquelle l'art. 18 de la *Loi de l'Impôt sur le revenu* s'appliquait. L'applicabilité de cet article dépend de l'existence d'une option valide en vertu de laquelle, dès qu'il a été satisfait à une condition, la propriété transmise sera attribuée au locataire. La clause censée donner à l'appelant une option d'acheter la propriété à l'expiration de 200 ans violait la règle contre la perpétuité et était nulle.

Dans ces vues, la Cour de l'Échiquier a eu raison de refuser d'intervenir dans l'allocation de $775.02 comme dépense de loyer.

Dans l'hypothèse que l'art. 18 de la Loi s'applique, la Cour de l'Échiquier a eu raison de juger que «le prix fixé par le contrat ou arrangement» auquel l'appelant devait «être réputé avoir acquis la propriété» était $19,500.

De plus, dans l'hypothèse que l'art. 18 de la Loi s'applique et qu'en vertu de l'interprétation qu'on doit lui donner, l'appelant avait droit *prima facie* à la déduction du coût en capital à titre d'allocation qu'il réclamait, une telle déduction serait à l'égard d'une dépense contractée relativement à une affaire qui, si elle était permise, réduirait de façon factice le revenu de l'appelant, et, en conséquence, serait prohibée par les termes de l'art. 137(1) de la Loi.

APPEL d'un jugement du Juge Thurlow de la Cour de l'Échiquier du Canada[1], rejetant un appel d'une décision de la Commission d'appel de l'impôt. Appel rejeté.

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APPEAL from a judgment of Thurlow J. of the Exchequer Court of Canada[1], dismissing an appeal from a decision of the Tax Appeal Board. Appeal dismissed.

*John J. Robinette, Q.C.*, for the appellant.

*D. S. Maxwell, Q.C.*, and *D. G. H. Bowman*, for the respondent.

The judgment of the Court was delivered by

CARTWRIGHT J.:—This is an appeal from a judgment[1] of Thurlow J. dismissing an appeal from a decision of the Tax Appeal Board which dismissed the appellant's appeal from an assessment whereby income tax in the sum of $18,690.42 was levied in respect of his income for the 1960 taxation year.

The appellant practises medicine in the City of Toronto specializing in obstetrics and gynaecology. He has a substantial income from his practice and some income from investments.

In his income tax return for the year 1960 the appellant included in his income from investments $975 being rental for three months from a service station on Lorne Park Road in the Township of Toronto hereinafter sometimes referred to as "the service station", and claimed in respect of the same property a deduction by way of depreciation or capital cost allowance of $30,425.80. The Minister disallowed this claim *in toto* and allowed instead a rental

[1] [1965] 2 Ex. C.R. 653, [1964] C.T.C. 562, 64 D.T.C. 5332.

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expense of $775.02. This appeal relates solely to these two items.

By deed dated March 31, 1960, one Charles Gotts conveyed the service station to Douglas Leaseholds Limited. The property conveyed has a frontage of 150 feet on the south side of Lorne Park Road by a depth of 100 feet. The total consideration was $31,000, one half of which was paid in cash and the other secured by mortgage.

By an indenture dated April 4, 1960, Douglas Leaseholds Limited leased the service station to BP Canada Limited for the term of twenty-five years to be computed from the first day of the month following the installation by the lessor of two 2,000 gallon tanks which together with certain other equipment were to be supplied by the lessee and installed by the lessor. The rent was $3,900 a year payable $325 on the first of each month. The lessee covenanted to pay taxes and to make repairs. This lease gives the lessee a right of preemption in the event of the lessor receiving an offer to purchase the demised premises during the term which it is willing to accept. It also contains a provision that if during the term the lessor receives an offer to lease the demised premises upon the termination of the lease, which it is willing to accept, it will first offer to lease the premises to the lessee on the terms contained in the offer except that the rent payable by the lessee shall be 90 per cent of the rent set out in the offer.

Between March 31, 1960, and October 1, 1960, Douglas Leaseholds Limited expended about $8,500 on improvements to the property. Mr. Douglas the president of Douglas Leaseholds Limited stated that the property was carried in the company's books at $39,000, apportioned $30,000 to the building and $9,000 to the land.

By indenture dated October 1, 1960, Douglas Leaseholds Limited demised the service station to the appellant for a term of two hundred years from the date of the lease at an annual rental of $3,100.08 payable $258.34 on the first day of each month commencing with October, 1960. The lessee covenants to pay taxes and to make repairs. This lease contains the following provisions:

> PROVIDED always and it is expressly agreed between the Lessor and Lessee that this lease is subject in all respects to a lease dated the 4th day of April, 1960, entered into between Douglas Leaseholds Limited and BP Canada Limited.

The Lessee convenants and agrees to deposit with the Lessor the sum of $10,000.00 as security for the performance of all his covenants contained in the within lease. The Lessor agrees that if the Lessee observes and performs all the covenants herein contained it will return to the Lessee the said sum of $10,000.00 at the expiration of the term hereby demised.

At the expiration of the term hereby demised, and provided the Lessee is not in default hereunder, said Lessee shall have the option of purchasing the demised premises from the Lessor at the price of Nineteen Thousand Five Hundred ($19,500.00) Dollars. The Lessee may exercise the said option by giving to the Lessor three (3) months' notice in writing that he intends to purchase the demised premises and upon the exercise of the said option the sale shall be completed within a thirty (30) day period after the option has been exercised.

In the event that the demised premises are expropriated by any municipal or governmental authority or in the event the Tenant Oil Company should exercise any option contained in its lease hereinbefore referred to which would result in the Tenant Oil Company becoming the owner of the demised premises, then the Lessor agrees that it will lease to the Lessee a similar gasoline service station, such lease to comply with the following requirements, that is to say:

The lease shall be in the same form as the within lease, save for the following:

i. The Term of the lease shall be for the unexpired portion of the within lease.

ii. The rental payable under the new lease shall be $800.00 per annum less than the annual rental payable by the Oil Company leasing the premises from Douglas Leaseholds Limited.

iii. The lessee shall have the option of purchasing the premises demised under the new lease at a purchase price equal to five times the annual rental provided for in the lease between Douglas Leaseholds Limited and the Tenant Oil Company, the said option to be subject to the same conditions as the option hereinbefore set out.

By a document dated October 1, 1960, the appellant authorized Douglas Leaseholds Limited as his agent to collect the rent falling due from BP Canada Limited under the lease of April 4, 1960.

The appellant's claim to the capital cost allowance of $30,425.80 is based on s. 11(1)(*a*) of the *Income Tax Act*, the regulations made thereunder and section 18 of the *Income Tax Act*.

Section 11(1)(*a*) reads as follows:

11(1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

(*a*) such part of the capital cost to the taxpayer of property, or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation;

It is common ground that if the appellant's claim is well founded the capital cost allowance in respect of the building on the demised premises is fixed by regulation at five

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per cent of the undepreciated capital cost thereof to him as of the end of the taxation year.

Section 18 has since been repealed but as in force during the taxation year with which we are concerned sub-section (1) thereof read as follows:

> 18. (1) A lease-option agreement, a hire-purchase agreement or other contract or arrangement for the leasing or hiring of property, except immovable property used in carrying on the business of farming, by which it is agreed that the property may, on the satisfaction of a condition, vest in the lessee or other person to whom the property is leased or hired (hereinafter in this section referred to as the 'lessee') or in a person with whom the lessee does not deal at arm's length shall, for the purpose of computing the income of the lessee, be deemed to be an agreement for the sale of the property to him and rent or other consideration paid or given thereunder shall be deemed to be on account of the price of the property and not for its use; and the lessee shall, for the purpose of a deduction under paragraph (*a*) of subsection (1) of section 11 and for the purpose of section 20, be deemed to have acquired the property,
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> (*a*) in any case where, at the time the contract or arrangement was entered into, the lessee and the person in whom the property was vested at that time (hereinafter referred to as the 'lessor') were persons not dealing at arm's length, at a capital cost equal to the capital cost thereof to the lessor, and
>
> (*b*) in any other case, at a capital cost equal to the price fixed by the contract or arrangement minus the aggregate of all amounts paid by the lessee
>
> (i) in the case of a contract or arrangement relating to movable property, before the 1949 taxation year, and
>
> (ii) in the case of any other contract or arrangement, before the 1950 taxation year,
>
> under the contract or arrangement on account of the rent or other consideration.

The appellant submits that the lease from Douglas Leaseholds Limited to himself is "a lease-option agreement or other contract or arrangement for the leasing of property by which it is agreed that the property may, on the satisfaction of a condition, vest in the lessee", that pursuant to s. 18(1) it is, for the purpose of computing his income, to be deemed an agreement for the sale of the demised premises to him, that the rent paid shall be deemed to be on account of the price of the property and not for its use and that he must, pursuant to s. 18(1)(*b*) be deemed to have acquired the property at a capital cost equal to the price fixed by the contract or arrangement, that is to say, by the lease. It will be observed that the deductions contemplated by sub-clauses (i) and (ii) of clause (*b*) of s. 18(1) have no application on the facts in the case at

bar. The case has been dealt with throughout on the assumption that the appellant and Douglas Leaseholds Limited were dealing at arm's length.

The condition on the satisfaction of which the demised premises may vest in the lessee is his performance of all the lessee's covenants contained in the lease throughout the term of 200 years, the giving of the necessary notice to exercise the option and the payment of the price of $19,500.

The appellant submits that as the rent paid "shall be deemed to be on account of the price of the property and not for its use" the price should for the purpose of computing his income be deemed to be $608,516, this amount being arrived at as follows:

| | |
|---|---|
| Annual rental of $3100.08 for 200 years | $620,016.00 |
| Option price to purchase property | 19,500.00 |
| | $639,516.00 |
| Less land at fair market value as of October, 1960 | 31,000.00 |
| | $608,516.00 |

Five per cent of this amount is $30,425.80 which is the capital cost allowance claimed by the appellant.

The above figures are taken from the appellant's income tax return. It would seem from the evidence that the fair market value of the land as of October, 1960, was $9,000 rather than $31,000 but the question of importance is whether the appellant's method of calculating the capital cost at which he is deemed to have acquired the demised property is correct.

Counsel for the respondent submitted that s. 18 has no application to the appellant's lease on the following grounds:

(*a*) that it was not established that the price of $19,500 was less than 60 per cent of the fair market value of the demised property at the time the lease was entered into and consequently the application of s. 18 was excluded by sub-section (4);

(*b*) the transaction evidenced by the lease was not really a lease at all and the appellant at the relevant time was not a lessee of the property but merely the holder of an *interesse termini*;

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(c) that the option contained in the lease is void as it offends the rule against perpetuities.

If, contrary to these submissions, it should be held that s. 18 did apply to the transaction counsel for the respondent argued that the appellant was not entitled to the allowance of $775.02 for rental expense but at most to a capital cost allowance of $525 (being 5 per cent of $10,500, the price fixed by the lease, $19,500, less the value of the land, $9,000) on the following grounds:

(d) that the transaction was not entered into for the purpose of gaining income but solely, or in the alternative primarily, for the purpose of reducing the appellant's income tax and thus fell within the prohibition or exception provided by Regulation 1102(1)(c);

(e) that the deduction claimed represented an expense made or incurred in respect of a transaction which, if allowed, would unduly and artificially reduce the appellant's income and its deduction was therefore prohibited by s. 137(1) of the Act;

(f) (i) that on the correct interpretation of s. 18, as applied to the transaction, the deduction must be based on a capital cost of $19,500 for the property since this is the price fixed for it by the contract, and (ii) that in the event of this contention being upheld the re-assessment should be referred back to the Minister to allow the proper deduction on this basis and to disallow the rental expense item.

Thurlow J. gave effect to the first contention of the respondent set out in ground (f) and so found it unnecessary to deal with grounds (a), (b), (c), (d) or (e).

For reasons that will appear, I do not think that the transaction embodied in the lease to the appellant is one to which s. 18 applies. On the assumption that the section does apply I would agree with the view of Thurlow J. that on the true construction of s. 18 as applied to the lease in question the "price fixed by the contract or arrangement" being the capital cost at which under s. 18(1)(b) the appellant should "be deemed to have acquired the property" is $19,500 and not the figure contended for by the appellant.

I am in substantial agreement with the reasons of Thurlow J. for reaching this conclusion and wish to add only a few words on this point. If the submission of the appellant were given effect it would bring about the result that for the purpose of calculating his income tax he would be deemed to have acquired a property in 1960 at a capital cost of $639,516 although on the evidence the highest value which could be attributed to that property was $39,500. The power of Parliament to so enact is not doubted, but to bring about so extraordinary a result it would be necessary to use explicit words which admitted of no other interpretation. I have already indicated my agreement with the conclusion of Thurlow J. that far from requiring such an interpretation the words of the statute properly construed necessitate its rejection.

This would be sufficient to dispose of the appeal if it were not for the contention pressed by counsel for the respondent that Thurlow J. should have held that the rental allowance of $775.02 ought not to have been made, that a capital cost allowance of $525 should have been made instead and that the re-assessment should have been referred back to the Minister accordingly. On this point I agree with the conclusion of Thurlow J. but prefer to base my decision on a different ground.

In my view, the position taken by counsel for the respondent in ground (*c*) set out above is well taken. The clause in the lease giving the option to purchase has been quoted above. It creates an equitable interest in the land demised which would vest on the giving of the required notice and payment of the purchase money. This interest will not necessarily vest within the period prescribed by law for the creation of future estates and interests, indeed it cannot vest until long after the expiry of that period which in the case at bar, since no life is specified, is 21 years. The right to exercise the option does not arise until the expiration of 200 years from the date of the lease. The grant of the option therefore offends the rule and is void. The effect of this is that the lease takes effect as if the void limitation created by the option were omitted. The applicability of s. 18(1) depends on the existence of a valid option pursuant to which, on the satisfaction of a condition, the

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demised property will vest in the lessee. The purported option being void the section has no application.

That an option to purchase land gives rise to a contingent equitable interest in the land, the contingency being the election to exercise the option and payment of the price, is settled by the judgment of Judson J., speaking for the majority of the Court in *Frobisher Ltd. v. Canadian Pipe-Lines and Petroleums Ltd.*[1]. The accepted rule in regard to such an option contained in a lease is succinctly and accurately stated in Gray, The Rule Against Perpetuities, 4th ed., p. 234, s. 230.3, as follows:

> An option to a tenant for years to purchase the fee, exercisable at a remote time, is bad as violating the Rule against Perpetuities.

For the appellant, however, it is argued that even if the clause giving the option in so far as it creates a limitation of land is bad for perpetuity it also evidences a personal contract between Douglas Leaseholds Limited and the appellant which is unaffected by the rule against perpetuities and can be enforced by the lessee or his personal representatives against the lessor so long as it has not disposed of the property. The argument proceeds that in the year 2160, Douglas Leaseholds Limited may still own the property in question and if so Dr. Harris' descendants or assigns could on duly exercising the option obtain a decree of specific performance against the lessor and that this possibility brings the case within s. 18(1), stress being laid on the use of the word "may" in the sub-section. It is argued that the suggested circumstances may occur and therefore the property may vest in the lessee and that this is sufficient to satisfy the requirements of the sub-section.

This argument is based chiefly on the following cases: *South Eastern Railway Co. v. Associated Portland Cement Manufacturers Ltd.*[2], a decision of the Court of Appeal in England, affirming, on different grounds, a judgment of Swinfen Eady J.; *Hutton v. Watling*[3], a decision of Jenkins J., as he then was, and *Kennedy v. Beaucage Mines Limited*[4], a decision of the Court of Appeal for Ontario.

The decision in the first of these cases, usually referred to as the *Cement Company's* case has been the subject of much adverse criticism; See Williams on Vendor and

[1] [1960] S.C.R. 126 at 169, 171, 21 D.L.R. (2d) 497.
[2] [1910] 1 Ch. 12. [3] [1948] Ch. 26. [4] [1959] O.R. 625.

Purchaser, 4th ed., vol. 1, p. 424, note (i); Gray op. cit. page 366 et seq, ss. 330.2 and 330.3; Articles by Mr. T. Cyprian Williams in 42 Sol. J. 628 and 650 and in 54 Sol. J. 471 and 501; and articles by Mr. Charles Sweet in 27 L.Q.R. 150 and 32 L.Q.R. 70.

The decision in *Hutton v. Watling,* which followed and was founded on that in the *Cement Company's* case, has been criticized by Dr. Walford in an article "Options to Purchase and Perpetuities" (1948) Conv. (N.S.) 258.

These cases are not binding upon us but the *Cement Company's* case was one of those referred to in a passage in Halsbury's Laws of England, 2nd ed., vol. 25 at p. 109, which has been referred to with approval in two recent judgments of this Court. The passage is as follows:

> A contract relating to a right of or equitable interest in property *in futuro* may be intended to create a limitation of land only, in which case, if the limitation is to take effect beyond the perpetuity period, the contract is wholly void and unenforceable; or the contract may, upon its true construction, be a personal contract only, in which case the rule does not apply to it; *or it may, upon its true construction, be, as regards the original covenantor, both a personal contract and a contract attempting to create a remote limitation, in which case the limitation will be bad for perpetuity, but the personal contract will be enforceable, if the case otherwise admits, against the promisor by specific performance or by damages,* or against his personal representatives in damages only. In all cases it is a question of construction whether the contract is intended to create a limitation of property only, or a personal obligation only, or both.

The *Cement Company's* case is quoted in the footnote as authority for the words in the passage which I have italicized. It may be observed in passing that in the 3rd Edition of Halsbury, the corresponding passage is found in volume 29, page 297, and is in the same words except that for the concluding words of the penultimate sentence "or against his personal representative in damages only" there have been substituted the words "or against his personal representative in damages or possibly by specific performance".

The cases in this Court referred to above in which this passage was quoted are the *Frobisher* case, *supra,* at page 147 and *Prudential Trust Company v. Forseth*[1]. In my opinion neither of these cases binds us to accepting the passage quoted in its entirety or to approving the decision in the *Cement Company's* case. In the Frobisher case the

[1] [1960] S.C.R. 210 at 226, 30 W.W.R. 241, 21 D.L.R. (2d) 587.

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passage was quoted in the course of rejecting an argument sought to be based upon a supposed analogy with some of the cases upon which it was founded. In *Forseth,* Martland J. delivering the unanimous judgment of the Court said at page 226: "The law regarding the subject of contracts relating to rights in the future has been well summarized in Halsbury's Laws of England, 2nd ed., vol. 25, at p. 109, as follows"; and then quoted the passage; but, immediately before this he had said:

> Finally it was contended that, in any event, the provision of the assignment regarding the option to lease was void as offending against the Rule against Perpetuities.
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> In view of the fact that there are eight producing oil wells on this property, it would seem to me that this issue is really academic, since the option can only be exercised after the termination of the Imperial Oil Limited lease. We are being asked, therefore, to determine questions of law which are unlikely to arise and which, if they arise at all, can only arise in the remote future.
>
> It is sufficient to say that at this stage I would not be prepared to hold that the option is void.

and following the quotation he continued:

> I am not prepared to say that the assignment did not constitute a personal contract by Forseth, especially when it is borne in mind that the agreement contemplates a future petroleum and natural gas lease to be granted, not by Forseth only, but by both Forseth and Prudential as co-owners. The real effect of his covenant was to give assent to a leasing of his share of the petroleum and natural gas rights along with the share of his co-owner Prudential.

This judgment appears to me to have left open the question whether the clause regarding the granting of an option was void; it was not necessary to decide it in order to dispose of the appeal and it appeared unlikely that it would ever require decision.

In *Hutton v. Watling, supra,* at pp. 35 and 36, Jenkins J., as he then was, said:

> The *Associated Portland Cement Manufacturers* case therefore, appears to me to provide clear authority, which is, of course, binding on me, to the effect that an option to purchase land without limit as regards time is specifically enforceable as a matter of personal contract against the original grantor of the option, and that the rule against perpetuities has no relevance to such a case, as distinct from a case in which such an option is sought to be enforced against some successor in title of the original grantor, not by virtue of any contractual obligation on the part of the successor in title, but by virtue of the equitable interest in the land conferred on the grantee by the option agreement.

The judgment of Jenkins J. was affirmed in the Court of Appeal but, in that Court, the question of the effect of the

Rule against Perpetuities was neither argued nor considered.

In my respectful opinion, the passage last quoted above, whether or not it finds support in what was said in the judgments in the *Cement Company's* case, is not a correct statement of the law. The Rule against Perpetuities is founded on grounds of public policy and by it a contract by the owner of property to convey the property on such terms that it will not vest until the happening of a contingent event beyond the period permitted by the rule is not allowed to be made.

In my view the law is accurately stated in the following passage in the judgment of Jessel M.R. in *London and South Western Railway Co. v. Gomm*[1]:

> It appears to me therefore that this covenant plainly gives the company an interest in the land, and as regards remoteness there is no distinction that I know of (unless the case falls within one of the recognised exceptions, such as charities) between one kind of equitable interest and another kind of equitable interest. In all cases they must take effect as against the owners of the land within a prescribed period.
>
> It was suggested that the rule has no application to any case of contract, but in my opinion the mode in which the interest is created is immaterial. Whether it is by devise or voluntary gift or contract can make no difference. The question is, what is the nature of the interest intended to be created? I do not know that I can do better than read the two passages cited in argument from Mr. Lewis's well-known book on Perpetuities at page 164. He cites with approbation this passage from Mr. Sanders' Essay on Uses and Trusts: 'A perpetuity may be defined to be a future limitation, restraining the owner of the estate from aliening the fee simple of the property discharged of such future use or estate before the event is determined or the period is arrived when such future use or estate is to arise. If that event or period be within the bounds prescribed by law it is not a perpetuity'. Then Mr. Lewis adds these words: 'In other words, a perpetuity is a future limitation whether executory or by way of remainder and of either real or personal property, which is not to vest until after the expiration of, or will not necessarily vest within, the period fixed and prescribed by law for the creation of future estates and interests; and which is not destructible by the persons for the time being entitled to the property subject to the future limitation. except with the concurrence of the individual interested under that limitation'.
>
> Now is there any substantial distinction between a contract for purchase, or an option for purchase, and a conditional limitation? Is there any difference in substance between the case of a limitation to A. in fee, with a proviso that whenever a notice in writing is sent and One Hundred Pounds paid by B. or his heirs to A. or his heirs the estate shall vest in B. and his heirs, and a contract that whenever such notice is given and such payment made by B. or his heirs to A. or his heirs, A. shall convey to B. and his heirs? It seems to me that in a Court of Equity it is impossible to

[1] (1882), 20 Ch. D. 562 at 581, 582.

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suggest that there is any real distinction between these two cases. There is in each case the same fetter on the estate and on the owners of the estate for all time, and it seems to me to be plain that the rules as to remoteness apply to one case as much as to the other.

It is true, of course, that in *Gomm's* case the Railway Company was seeking to enforce the option not against Powell who had granted it but against Gomm to whom the subject matter of the option had been conveyed and who had taken with full notice of the option; but, properly understood, there is not a word in the judgment of Jessel M.R. or the other judgments delivered in the Court of Appeal to support the suggestion that the option could have been enforced against Powell had he still retained the property.

In the *Cement Company's* case, by an accommodation works agreement of May 31, 1847, the plaintiff Railway Company who were purchasing a strip of land for their line, agreed that the landowner, his heirs, appointees or assigns might at any time thereafter make a tunnel thereunder to join the lands severed thereby. The purpose of the tunnel was to enable the landowner to excavate chalk from the land on the south side of the railway after that on the north side had been worked out. On December 31, 1847, the landowner conveyed the strip to the Railway Company by deed poll, reserving to himself, his heirs, appointees and assigns the privilege of making a tunnel. The landowner died in 1880. The tunnel was not required by the lessees of the land to whom the privilege of making it had been duly assigned, until some time after the year 1900 when they proposed to construct it. The Railway Company objected and brought an action to restrain the making of the tunnel. The action was dismissed by Swinfen Eady J. and his judgment was affirmed by the Court of Appeal. Other points were raised and dealt with but we are concerned only with those parts of the judgments which deal with the Railway Company's submission, that the provision as to the tunnel was void for perpetuity. Swinfen Eady J. rejected this argument on the ground that what was reserved to the landowner was not a right to arise at some future time but an immediate right which arose directly the conveyance was executed.

In the Court of Appeal the opinion was expressed that the right to construct the tunnel could be enforced against

the Railway Company which was still the owner of the strip of land. At page 29 of the report, Cozens-Hardy M.R. after stating the facts in *Gomm's* case said that as he read that case it was a clear and distinct authority for the view that the contract there under consideration could have been enforced against Powell.

He continued at pp. 29 and 30:

> Kay J. from whom the appeal was brought, says 'A contract to buy or sell land and covenants restricting the use of land, though unlimited, are not void for perpetuity.' That means as between the contracting parties, and Sir George Jessel expressly draws the distinction in these words: 'If it is a bare or mere personal contract it is of course not obnoxious to the rule, but in that case it is impossible to see how the present appellant can be bound. He did not enter into the contract, but is only a purchaser from Powell, who did. If it is a mere personal contract it cannot be enforced against the assignee. Therefore the company must admit that it somehow binds the land.' And Lindley L.J. says: "How is Gomm to be held bound by this covenant? He did not enter into it, he is not bound at law.' So far from that being an authority that Powell would not have been bound by the covenant, and that the London and South Western Railway Company could not have enforced the covenant against Powell, I think the observations of all the members of the Court plainly indicate that in that case there would have been a perfectly enforceable covenant by Powell at the instance of the London and South Western Railway Company, and the whole doctrine of the rule against perpetuities would have had absolutely nothing to do with it. So that, if Mr. Calcraft were now alive, I think there could be no answer to an action by him against his living covenantor claiming to enforce the rights under the covenant in the agreement of 1847.

With respect this passage appears to me to indicate a misunderstanding of the judgment in *Gomm.* Jessel M.R. was distinguishing between contracts which are merely personal and contracts which create an interest in land, the former are not affected by the rule against perpetuities but the latter if the interest created will not necessarily vest within the permitted period are void just as much against the original covenantor as against his assigns.

Farwell L.J. at page 33 of the report of the *Cement Company's* case said:

> It is settled beyond argument that an agreement merely personal not creating any interest in land is not within the rule against perpetuities.

He then referred to *Witham v. Vane,* a decision of the House of Lords, (1883) Challis on Real Property, 2nd Ed. App. V, page 401, in which the covenant in question did not create any interest in land, and continued:

> But the fact that there is some connection with or reference to land does not make a personal contract by A. less a personal contract binding

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on him, with all the remedies arising thereout, unless the Court can by construction turn it from a personal contract into a limitation of land, and a limitation of land only. As regards the original covenantor it may be both; he may have attempted both to limit the estate, which may be bad for perpetuity, and he may have entered into a personal covenant which is binding on him because the rule against perpetuities has no application to such a covenant.

It appears that Farwell L.J., in the passage quoted, was considering two types of contract one "merely personal" and the other "creating an interest in land". The meaning of the phrase "an agreement merely personal" as he used it is simply an agreement which does not create an interest in land. So understood the only objection to accepting what he has said appears to me to be the difficulty of suggesting a single contract which could be at once "merely personal" and one creating an interest in land.

Be that as it may, I am satisfied that as a matter of construction the clause granting the option to the appellant which we are considering in the case at bar is one agreeing to create a contingent future interest in the land demised and nothing else and that it is void as infringing the rule against perpetuities. If the agreement to create the contingent future interest is taken out of the clause there is no agreement left to be described as a personal contract.

It is not necessary to express an opinion as to whether the actual result reached in the *Cement Company's* case was correct. It may well be supported on the ground on which Swinfen Eady J. proceeded, but, with respect, it does appear to me that *Hutton v. Watling, supra,* and *Kennedy v. Beaucage Mines Limited, supra,* which followed it, were wrongly decided and ought not to be followed.

In the case of *Auld v. Scales*[1], the question was raised whether an option contained in a lease was void as offending the rule against perpetuities. The Court was unanimous in holding that the grant of the option there under consideration did not offend the rule because the future interest which it created was, within the period permitted by the rule, destructible by the lessor without the concurrence of the lessee, but it appears to me to be implicit in all the reasons delivered that if this had not been so and the option had consequently offended the rule it would have

[1] [1947] S.C.R. 543, 4 D.L.R. 721.

been void and unenforceable although the action was between the original parties to the lease.

For these reasons I am of opinion that the clause in the lease to the appellant purporting to give him the option to purchase the demised premises at the expiration of the term of 200 years offends the rule against perpetuities and is void. On this view of the matter Thurlow J. was right in refusing to interfere with the allowance of $775.02 as rental expense.

While, in view of the conclusions at which I have arrived on the points dealt with above, it is not necessary to express an opinion upon the other grounds on which counsel for the respondent opposed the appeal, I propose to state briefly my opinion on the position taken in ground (*e*) set out above which was fully argued.

Section 137(1) of the *Income Tax Act* reads as follows:

> 137. (1) In computing income for the purposes of this Act, no deduction may be made in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce the income.

If, contrary to the views I have expressed, we had accepted the appellant's submission that the transaction embodied in the lease was one to which s. 18 applied and that on the true construction of the lease and the terms of that section the appellant was *prima facie* entitled to make the deduction of the capital cost allowance of $30,425.80 claimed by him, I would have had no hesitation in holding that it was a deduction in respect of an expense incurred in respect of a transaction that if allowed would artificially reduce the income of the appellant and that consequently its allowance was forbidden by the terms of s. 137(1). The words in the sub-section "a disbursement or expense made or incurred" are, in my opinion, apt to include a claim for depreciation or for capital cost allowance, and if the lease were construed as above suggested the arrangement embodied in it would furnish an example of the very sort of "transaction or operation" at which s. 137(1) is aimed.

I would dismiss the appeal with costs.

*Appeal dismissed with costs.*

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*Solicitor for the respondent: E. S. MacLatchy, Ottawa.*