GLADYS (GERALDINE) EVANS .....APPELLANT;

AND

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

1960

*Jan. 26, 27
Mar. 8

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Right to life income under will contested—Legal fees incurred to have right determined—Whether fees deductible expenses or capital outlay—The Income Tax Act, R.S.C. 1952, c. 148, s. 12(1)(a) and (b).

Exercising a power of appointment conferred upon him by the will of his father, the appellant's first husband bequeathed her the income for life of a one-third share of the father's estate. The trustee of the father's estate applied to the Court for advice and direction as to whether she was entitled to the income. In 1955, the matter was finally decided by this Court in favour of the appellant who had been represented by counsel in all the proceedings. In computing her income tax return for 1955, she deducted the legal fees she had paid her solicitors. The deduction was disallowed by the Minister. The Income Tax Appeal Board allowed the deduction, but the Minister's assessment was affirmed by the Exchequer Court of Canada.

Held: (Fauteux and Judson JJ. dissenting): The appellant was entitled to the deduction.

Per Taschereau, Cartwright and Ritchie JJ.: The outlay in question was not a payment on account of capital within s. 12(1)(*b*), but an expense, within s. 12(1)(*a*), properly incurred for the purpose of gaining an income to which she was at all relevant times entitled but of which she was unable to obtain payment without incurring the outlay. Although she became entitled to be paid the income

*PRESENT: Taschereau, Cartwright, Fauteux, Judson and Ritchie JJ.

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from the one-third share, the legal ownership of the share was to remain in the trustee and in no circumstances could she ever become entitled to any part of that capital. Her right was solely to require the trustee to pay the income. The payment of the legal fees did not bring this right or any asset or advantage into existence. Her right to receive the income was derived not from the judgment of the Court but from the combined effect of the wills. The fact that a bare right to be paid income can be sold or valued on an acturial basis at a lump sum does not require or permit that right, while retained by the beneficiary, to be regarded as a capital asset.

Per Fauteux and Judson JJ., *dissenting*: The judgment of the Exchequer Court rightly decided that the outlay was on account of capital and non-deductible by virtue of s. 12(1)(*b*) of the Act.

APPEAL from a judgment of Cameron J. of the Exchequer Court of Canada[1], reversing a judgment of the Income Tax Appeal Board and affirming the Minister's assessment.

Appeal allowed, Fauteux and Judson JJ. dissenting.

T. Sheard, Q.C., and *F. S. Burbidge*, for the appellant.

D. Guthrie, Q.C., and *J. D. C. Boland*, for the respondent.

The judgment of Taschereau, Cartwright and Ritchie JJ. was delivered by

CARTWRIGHT J.:—This is an appeal from a judgment[1] of Cameron J. allowing an appeal from a decision of the Income Tax Appeal Board delivered by W. S. Fisher, Esquire, Q.C. and affirming an assessment made upon the appellant.

The facts are not in dispute.

Thomas Alexander Russell died on December 29, 1940, leaving a large estate; his son, John Alexander Russell who was the first husband of the appellant, died on August 8, 1950; the appellant re-married on July 27, 1953; the widow of Thomas Alexander Russell died on September 20, 1953.

By the combined effect of the wills of Thomas Alexander Russell and John Alexander Russell the appellant became entitled on September 20, 1953, for the remainder of her lifetime to the income from a one-third share of the residue of the estate of Thomas Alexander Russell. We were informed by counsel that the income from this one-third share is approximately $25,000 a year. The surviving trustee of the will of Thomas Alexander Russell applied on

[1] [1959] Ex. C.R. 54, [1958] C.T.C. 362, 59 D.T.C. 1001.

originating notice to the Supreme Court of Ontario for the opinion, advice and direction of the Court as to the following questions arising in the administration of his estate:

(1) What is the extent of the power of appointment given by the donor, the late Thomas Alexander Russell by the said Will to the late John Alexander Russell in respect of the disposition of income on the share of the said John Alexander Russell? and

(2) Has the said John Alexander Russell as donee of the power properly appointed and executed the same under the terms of his Will?

The motion came on for hearing before Lebel J., as he then was, and counsel for Mrs. Andersen, the only surviving child of Thomas Alexander Russell, submitted that the appellant was not entitled to the income from the one-third share. The learned judge gave judgment on June 2, 1954, holding that the appellant was entitled to the income. Mrs. Andersen appealed from this judgment to the Court of Appeal for Ontario; her appeal was dismissed by a unanimous judgment delivered on September 10, 1954; she appealed further to this Court[1] and, on April 26, 1955, her appeal was dismissed by a unanimous judgment.

In all these proceedings the present appellant was represented by solicitors and counsel; she received her party and party costs out of the estate of Thomas Alexander Russell but had to pay personally the sum of $11,974.93, the difference between her party and party costs and her solicitor and client costs; this was paid for her by the trustee of the Thomas Alexander Russell estate out of the income which she would otherwise have been entitled to receive during the year 1955. The question in this appeal is whether in computing the income of the appellant for the year 1955 she was entitled to deduct this sum of $11,974.93.

The provisions of the *Income Tax Act*, R.S.C. 1952, c. 148, as amended, which are relevant to the issues in this appeal are:

2. (1) An income tax shall be paid as hereinafter required upon the taxable income for each taxation year of every person resident in Canada at any time in the year.

[1] [1955] 2 D.L.R. 721.

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(3) The taxable income of a taxpayer for a taxation year is his income for the year minus the deductions permitted by Division C.

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

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,

(*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part.

139 (1) In this Act

(*ag*) "property" means property of any kind whatsoever whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes a right of any kind whatsoever, a share or a chose in action.

Section 12(1)(*a*) and (*b*) was derived from s. 6(1)(*a*) and (*b*) of the *Income War Tax Act*, which provided 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.

Cameron J. was of opinion that the payment of $11,974.93 was an outlay on account of capital and so barred from deduction by the provisions of s. 12(1)(*b*); consequently he found it unnecessary to consider whether or not the payment

fell within s. 12(1)(*a*). The gist of the reasoning which brought the learned judge to this conclusion is contained in the following paragraphs:

> The answer to the question which I have posed depends upon the nature and quality of the right which the respondent had and in the defence of which the outlay was made. If it was a capital asset I am bound, I think, by the decision of the Supreme Court of Canada in *Dominion Natural Gas Co. Ltd. v. M.N.R.* (1941) S.C.R. 19, to find that such outlay was one on account of capital and therefore nondeductible. Further reference to that case will be made later.
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> Upon first consideration and since Mrs. Evans received only income from her right, the expenditures might seem to have been made not on account of capital but on account of income. That would, I think, have been the case had she in any year found it necessary to lay out money for legal expenses to enforce payment of the quarterly or annual income when the right to receive it was not in question but the trustees had failed to pay it over. Such a case would have been similar to one in which a landlord was required to pay legal expenses in collecting his rent. That, however, was not the case here. What was in dispute was not the *amount* of income to which she was entitled but whether or not she was entitled to anything. It was her right to income which was disputed on the ground that her father-in-law's Will did not confer on her husband the power to appoint the income to her in the circumstances; and even if it had done so the power was not validly exercised. In my opinion, what the respondent had was a life estate or a life interest in the income from a portion of the residue of her father-in-law's state. That right must be distinguished from the income which flowed therefrom to her as a result of her ownership of the right. While it was an intangible right, I think it would normally be considered a proprietary right—something which the respondent possessed to the exclusion of all others and quite apart from the fact that by the provisions of s. 139(1)(*ag*) the word "property" includes "a right of any kind whatsoever". That right was something capable of evaluation as, for example, by the succession duty officers or by actuaries. It could be sold or pledged. Had that right been purchased, for example, by an investment corporation, the right in its hands would, I think, have been considered as a capital asset. In my view, it was a capital asset and the source of her income.

With the greatest respect, I disagree with the conclusion set out in the last sentence of this paragraph that the appellant's right was a capital asset.

As I read the whole of his reasons, the learned judge was of opinion that if the decisions of the courts in England were applicable he would have decided the question in favour of the tax-payer but felt himself bound by the

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decision of this Court in *Dominion Natural Gas Ltd. v. M.N.R.*[1] to reach a contrary conclusion. That case was decided under s. 6(1) of the *Income War Tax Act*, quoted above. In giving the judgment of the majority of this Court in *B.C. Electric Ry. Co. v. M.N.R.*[2], my brother Abbott said:

> The less stringent provisions of the new section should, I think, be borne in mind in considering judicial opinions based upon the former sections.

Whether, in view of the later decisions of this Court in *M.N.R. v. The Kellogg Company of Canada Ltd.*[3] and *M.N.R. v. Goldsmith Bros. Smelting and Refining Co. Ltd.*[4], the *Dominion Natural Gas* case would be decided in the same manner if it arose to-day under the present section is a question which I do not have to consider. It is distinguishable from the case at bar.

In *B.C. Electric v. M.N.R., supra,* all members of the Court adopted as a useful guide in determining whether an expenditure is one made on account of capital the test formulated by Lord Cave in *Atherton v. British Insulated and Helsby Cables Limited*[5], as follows:

> . . . when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

The reasons for judgment in *Dominion Natural Gas* had the effect of adding as an alternative to the words "with a view to *bringing into existence* an asset or an advantage for the enduring benefit of a trade" in the passage quoted, the words "or with a view to *preserving* an asset or advantage for the enduring benefit of a trade".

[1] [1941] S.C.R. 19, [1940] 4 D.L.R. 657.
[2] [1958] S.C.R. 133 at 136, 12 D.L.R. (2d) 369, 77 C.R.T.C. 29.
[3] [1943] S.C.R. 58, 2 D.L.R. 62.
[4] [1954] S.C.R. 55, 2 D.L.R. 1.
[5] [1926] A.C. 205 at 214.

The "asset" or "advantage" under consideration in *Dominion Natural Gas* was a valuable, exclusive perpetual franchise; this franchise did not of itself yield any income to the Company which held it; it was a permanent right used and useful in the earning of the company's income by the sale of its product to the persons residing in the territory covered by the franchise; it was rightly regarded as an item of fixed capital.

In *M.N.R. v. Goldsmith Bros., supra,* at p. 57 Rand J. succinctly explained the judgment in *Dominion Natural Gas* as having been based on the view that the legal fees there in question were "expenses to preserve a capital asset in a capital aspect". The judgment in *Dominion Natural Gas* is not of assistance in deciding whether the right to income possessed by the appellant in the case at bar should be regarded as a capital asset.

In the case at bar, as has already been pointed out, the appellant, on September 20, 1953, became entitled for the remainder of her life-time to be paid the income from the one-third share. The legal ownership of that share remains at all times in the trustee and the capital of which it consists will be paid on the appellant's death, to those entitled under the will of Thomas Alexander Russell. In no circumstances can the appellant ever become entitled to any part of that capital; her right is solely to require the trustee to pay the income arising from the share to her; this is a right enforceable in equity and everything received by the appellant by virtue of the right will be taxable income in her hands. The payment of the legal fees in question did not bring this right or any asset or advantage into existence. Her right to receive the income is derived not from the judgment of the Court but from the combined effect of the wills of Thomas Alexander Russell and John Alexander Russell. Wrongly, as it turned out, the trustee entertained doubts, presumably engendered by the claims of Mrs. Andersen, as to whether it should pay to the appellant the income to which she was entitled and it would not pay anything until the matter had been passed upon by the Court.

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The precise form in which the matter was submitted to the Court appears to me to be of no importance; the legal expenses paid by the appellant were expended by her for the purpose of obtaining payment of income; they were expenses of collecting income to which she was entitled but the payment of which she could not otherwise obtain. So viewed, it could scarcely be doubted that the expenses were properly deductible in computing the appellant's taxable income. This, in my opinion, is the right view of the matter and is not altered by the circumstance that it was mistakenly claimed by Mrs. Andersen that the appellant was not entitled to any income at all.

With the greatest respect for the contrary view entertained by the learned Judge, I cannot agree that the fact that a bare right to be paid income can be sold or valued on an actuarial basis at a lump sum requires or permits that right, while retained by the appellant, to be regarded as a capital asset. I do not think that in ordinary language a right to receive income such as that enjoyed by the appellant would be described as a capital asset. If it were all that she possessed, I think that the natural and accurate answer to the question "Has she any capital?" which would be made by either the man on the Clapham omnibus or a professional accountant would be "No, but she has a substantial income".

If the circumstances of the case at bar are viewed in the light most favourable to the respondent it can be said that the legal expenses were incurred not only to collect the income to which the appellant was entitled and which was being wrongly withheld from her but also to prevent the right to receive that income being destroyed; the right in question remains throughout a right to income. In the *Dominion Natural Gas* case, on the other hand, the expenses were incurred in litigation the subject matter of which was an item of fixed capital.

In my opinion, in the circumstances of this case there are two relevant questions both of which must, on the admitted facts, be answered in the affirmative; (i) was the appellant's

claim in regard to which the expenses were incurred a claim to income to which she was entitled? (ii) were the legal expenses properly incurred in order to obtain payment of that income? It does not appear to me to be either necessary or relevant to inquire further as to what were the grounds (held by the Court to be without substance) upon which the payment of the income was withheld. It would be a strange result if the question, whether legal expenses incurred in enforcing or preserving a right should be regarded as an outlay on account of capital or on account of income, fell to be determined on a consideration not of the true nature of that right but of the nature of the ill-founded grounds on which it was disputed.

For the above reasons it is my opinion that the outlay of the legal expenses in question was not a payment on account of capital falling within s. 12(1)(*b*) but was an expense, falling within s. 12(1)(*a*), incurred by the appellant for the purpose of gaining income from property, to which income she was at all relevant times entitled but of which she was unable to obtain payment without incurring these expenses.

I would allow the appeal, set aside the judgment of the Exchequer Court and restore that of the Income Tax Appeal Board with costs throughout.

The judgment of Fauteux and Judson JJ. was delivered by

FAUTEUX J. (*dissenting*):—I respectfully agree with the reasons and the conclusion of Mr. Justice Cameron of the Exchequer Court[1] and would therefore dismiss the appeal with costs.

Appeal allowed with costs, FAUTEUX *and* JUDSON JJ. *dissenting.*

Solicitors for the appellant: Johnston, Sheard & Johnston, Toronto.

Solicitor for the respondent: A. A. McGrory, Ottawa.

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[1] [1959] Ex. C.R. 54, [1958] C.T.C. 362, 59 D.T.C. 1001.