IN RE THE WALLACE REALTY COMPANY LIMITED

1930
*March 13.
*April 10.

THE WALLACE REALTY COMPANY LIMITED ..... } APPELLANT;

AND

THE CORPORATION OF THE CITY OF OTTAWA ..... } RESPONDENT.

ON APPEAL FROM THE APPELLATE DIVISION OF THE SUPREME COURT OF ONTARIO

Income assessment (municipal)—Assessment Act, R.S.O., 1927, c. 238—Ascertainment of "income" (as defined in s. 1 (e))—Allowance of deduction, from company's gross revenue, of sum paid for interest on moneys borrowed for investment—Exemption claimed for dividends received on shares in another company whose revenue derived from real estate rentals—Deduction for overhead expenses; proportionate allowance, having regard to amount of non-taxable income.

The appellant company's business, carried on in Ottawa, Ontario, included the leasing and managing of real estate owned by it in Ottawa, and the buying and selling on its own account of stocks, bonds, etc. In the year in question it derived a gross revenue of $12,288 from rents (exempt from assessment for income tax), and a gross revenue of $27,091 from dividends and interest upon stocks, bonds, etc. From the latter sum it claimed, in respect of income assessment, deductions or exemptions as follows: (1) $8,004.83, being interest paid to a bank for money borrowed to pay off a balance of stock and bond purchase price and to buy certain bonds; (2) $6,622, being dividends on shares held by it in another company, whose revenues were derived

*PRESENT:—Anglin C.J.C. and Duff, Newcombe, Smith and Cannon JJ.

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exclusively from real estate rentals; and (3) in respect of salaries and general expenses. The County Court Judge disallowed deduction or exemption of items (1) and (2). As to certain "overhead expenses" (item (3)) he allowed a deduction, in fixing which he adopted as a guide the proportion which appellant's revenue from rentals bore to its total revenue. His judgment was affirmed by the Appellate Division, Ont., 64 Ont. L.R. 265.

Held, that the judgment below (*supra*) should be affirmed as to items (2) and (3), but reversed as to item (1); the appellant being entitled to the deduction of $8,004.83.

"Income," as defined in s. 1 of the *Assessment Act,* R.S.O., 1927, c. 238, discussed. A year's income from a business cannot be properly determined without deducting from the gross receipts of that business for that year expenditures legitimately incurred during that year in the business for the purpose of earning such receipts as a whole; such expenditures to include those made in the hope of earning receipts for the business, although such hope has been disappointed. The $8,004.83 in question was expended, by way of interest to the bank which advanced the money required by the appellant, to enable it to obtain an investment within its powers and earn from it any receipts that might be had therefrom.

Mersey Docks v. *Lucas,* 8 App. Cas., 891; *Gresham Life Assur. Soc.* v. *Styles,* [1892] A. C., 309; *Russell* v. *Town & County Bank,* 13 App. Cas., 418; *City of Kingston* v. *Can. Life Assur. Co.,* 19 Ont. R., 453, at p. 458; *Lawless* v. *Sullivan,* 6 App. Cas., 373; *Farmer* v. *Scottish North American Trust Ltd,* [1912] A.C. 118, and (judgment below) 1909-10 Sess. Cas., 966; *Bryon* v. *Metropolitan Saloon Omnibus Co. Ltd.,* 3 DeG. & J., 123, and other cases, referred to.

APPEAL by the Wallace Realty Co. Ltd. from the judgment of the Appellate Division of the Supreme Court of Ontario (1) on an appeal by the said company in the form of a special case, under s. 84 of the *Assessment Act,* R.S.O., 1927, c. 238, from the decision of His Honour Judge O'Brian, a judge of the County Court of the County of Carleton, upon an appeal by the said company from a decision of the Court of Revision for the City of Ottawa, confirming the assessment of the appellant for income on the assessment roll of Wellington Ward in the City of Ottawa in the year 1926, for the purpose of taxation in the year 1927. (In the city of Ottawa the assessment is made in the year preceding the year in which the tax is imposed, under the provisions of what is now s. 60 of the *Assessment Act.*)

The appellant is a company incorporated under the Ontario *Companies Act,* having its chief place of business at

(1) (1929) 64 Ont. L.R. 265.

the city of Ottawa. Its business consists in part, in leasing, administering and managing certain real estate owned by it in the city of Ottawa, and in part, in buying and selling on its own account stocks, bonds and other securities.

In 1925 the company derived a gross revenue of $12,288 from its real estate business. This amount represented rent received from real estate exclusively, and consequently was exempt from income assessment. The company also received in the same year a gross revenue of $27,091, by way of dividends and interest upon stocks, bonds and other securities owned by it, including an item of $6,622, being dividends or interest upon certain securities held by the appellant in another company known as the Ottawa Building Co. Ltd., carrying on a real estate business in the city of Ottawa, and the appellant company claimed exemption from assessment for this item. In his stated case the County Court Judge assumed, for the purpose of the appeal, that the business carried on by the Ottawa Building Co. Ltd. was a real estate business exclusively, and that its revenues were derived from the rental of real estate exclusively.

The appellant company also claimed exemption by way of deduction from its gross revenue derived from stocks and bonds, an item of $8,004.83, which might be described as a "carrying charge." The item was set out in the company's return to the Assessment Commissioner as follows:

> Interest paid Bank of Montreal for money borrowed to pay off $120,000 of T. Ahearn unpaid balance of stock and bond purchase price and to buy $290,000 bonds of The Auditorium Ltd., interest on which bonds not being paid to us until 1st June, 1926.....$8,004.83

The company also claimed deductions in respect of salaries and general expenses, hereinafter referred to as "overhead expenses."

The County Court Judge held that the "carrying charge" of $8,004.83 could not be deducted, and that exemption could not be claimed for the income derived from the Ottawa Building Co. Ltd., but in respect of certain "overhead expenses" he allowed a deduction, in fixing which he adopted as a guide the proportion which the company's revenue from rentals bore to its total revenue.

He submitted the following questions for the opinion of the Appellate Division:

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"Question 1. Was I right in holding that no part of the sum of $8,004.83, in respect of the interest paid by them to the Bank of Montreal (and which I have designated as the "carrying charge"), should be deducted from the gross receipts of $27,091?

"Question 2. Was I right in over-ruling the appellant company's claim to deduct the revenue derived by them from the Ottawa Building Company Limited, amounting to $6,622?

"Question 3. Was I right in holding that the amount of the allowance for so-called overhead expenses, should be fixed and determined in the proportion which the amount of their non-taxable [taxable?] income bore to their total gross income?

"Question 4. If question 3 is answered in the negative, what amount if any, should have been deducted for overhead expenses, so-called?"

The Appellate Division (1) answered questions 1, 2 and 3, each in the affirmative (Orde J.A. dissenting as to the first question), and dismissed the company's appeal with costs.

Leave to appeal to the Supreme Court of Canada was granted by the Appellate Division.

By the judgment of this Court now reported, the appeal was allowed as to question No. 1, which this Court held must be answered in the negative, the appellant being entitled to the deduction of $8,004.83 from its gross receipts of $27,091 for assessment purposes. The appeal was dismissed as to the other questions.

Redmond Quain for the appellant.

F. B. Proctor K.C. for the respondent.

The judgment of the court was delivered by

ANGLIN C.J.C.—This is an appeal by the Wallace Realty Company, Limited, against the judgment of the Second Appellate Divisional Court (1), answering in the affirmative certain questions submitted to them by a County Court Judge under s. 84 of the *Assessment Act* (R.S.O., 1927, c. 238). Mr. Justice Orde dissented as to the first question only.

(1) (1929) 64 Ont. L.R. 265.

The questions submitted by the learned County Court Judge are as follows:

(1) Was I right in holding that no part of the sum of $8,004.83, in respect of the interest paid by them to the Bank of Montreal, (and which I have designated as the "carrying charge") should be deducted from the gross receipts of $27,091?

(2) Was I right in over-ruling the appellant company's claim to deduct the revenue derived by them from the Ottawa Building Company, Limited, amounting to $6,622?

(3) Was I right in holding that the amount of the allowance for so-called overhead expenses, should be fixed and determined in the proportion which the amount of their non-taxable income bore to their total gross income?

(4) If Question 3 is answered in the negative, what amount, if any, should have been deducted for overhead expenses, so-called?

With regard to questions 2, 3 and 4, as was intimated to counsel in the course of the argument, the Court entirely agreed with the conclusions reached below for, substantially, the reasons on which those conclusions were based. Judgment was reserved, however, on the first question; and upon it we are unable to accept the view that prevailed in the Appellate Division.

In our opinion, the determination of this question rests entirely on the proper view to be taken of the definition of the word "income" in s. 1 of the *Assessment Act*, which reads as follows:

(*e*) "Income" shall mean the profit or gain or gratuity, wages, salary, bonus or commission, or other fixed amount, or fees or emoluments, or profits from a trade or commercial or financial or other business or calling directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and also profit or gain from any other source.

We are, with great respect, unable to understand how

the profit or gain . . . from a trade or commercial or financial or other business or calling,

for "the year ending on the 31st of December then last past," (s. 10 (2)) can be arrived at without deducting from the gross receipts of such trade, business or calling, during that year, expenditures legitimately incurred during the same year in the business for the purpose of earning such receipts as a whole.

(1) (1929) 64 Ont. L.R. 265.

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Mersey Docks v. *Lucas,* in the House of Lords (1), is authority for the general principle that in ascertaining the "profits and gains" of any trade, manufacture, adventure or concern for the purpose of the Income Tax Acts, the taxpayer is entitled to deduct from the gross profits of his trade or business the expenses necessary to earn them.

Gresham Life Assurance Soc. v. *Styles* (2), another decision of the House of Lords, established that, in Income Tax Acts, the words "profits or gains" are, where the context does not otherwise require, to be construed in their ordinary signification.

"Profits" generally mean the gain which is made upon any business or investment when both receipts and payments are taken into the account. *The People* v. *The Supervisors of Niagara* (3).

In the *Gresham* case (*ubi supra*) (2) the company was held entitled to deduct the amount paid out by it for annuities in ascertaining its profits or gains for income tax purposes. Lord Herschell said, at p. 323,

Whether there be such a thing as profit or gain can only be ascertained by setting against the receipts the expenditure or obligations to which they have given rise.

Lord Fitzgerald said in *Russell* v. *Town and County Bank* (4),

"Profits" I read on authority to be the whole of the incomings of a concern after deducting the whole of the expenses of earning them—that is, what is gained by the trade.

In *City of Kingston* v. *Canada Life Assurance Company* (5), Boyd C., delivering the judgment of a Divisional Court, said,

"income", as commercially used, means the balance of gain over loss in the fiscal year or other period of computation.

The Privy Council, in *Lawless* v. *Sullivan* (6), dealing with a taxing Act of the Province of New Brunswick (31 V, c. 36), held that

The tax imposed by s. 4 (of the statute) upon "income" is leviable in respect of the balance of gain over loss made in the fiscal year, and where no such balance of gain has been made there is no income or fund which is capable of being assessed. There is nothing in the said section or in the context which should induce a construction of the word "in-

(1) (1883) 8 App. Cas. 891.
(2) [1892] A.C. 309.
(3) (1842) IV Hill, 20, at p. 23.
(4) (1888) 13 App. Cas. 418, at p. 429.
(5) (1890) 19 Ont. R. 453, at p. 458.
(6) (1881) 6 App. Cas., 373.

come," when applied to the income of a commercial business for a year, otherwise than its natural and commonly-accepted sense, as the balance of gain over loss.

There was no definition of the word "income" in the Act.

Sir Montague Smith, in delivering the judgment of the Court, said, that the Chief Justice of Canada had erred in treating

> every particular earning as irrevocably subject to taxation, so soon as it is received, though the period of assessment is postponed to the end of the fiscal year. But the Act does not impose a tax on each individual earning or gain, but on the income of the year, which can only be ascertained on taking an account for the whole year. (P. 379.)

and he added,

> Again, suppose a bank, in order to increase its resources for lending and discounting, takes up money, say at 4 per cent., and, owing to a fall in the rate of interest, can only employ it at 3 per cent., is the amount which the bank receives for interest and on discounts at 3 per cent. to be treated as taxable income, without reference to the loss it has sustained by borrowing at the higher rate? Their Lordships cannot think that, on a reasonable construction of the Act, these questions ought to be answered in the affirmative (pp. 379-80).

and,

> So, a trader who keeps a general store may gain on some of the articles in which he deals and incur losses on others. In these cases, though the losses balanced or exceeded the gains, and consequently no income was or could be received from the business of the year, it would follow from the construction contended for by the Respondents that the gain on the particular sales which yielded a profit would still be subject to taxation. Such a construction implies, as already observed, that the tax would attach on each sale producing profit, which is not the ordinary or fair meaning of a tax upon the income of the fiscal year (p. 380).

In *Farmer* v. *Scottish North American Trust, Ltd* (1), the House of Lords confirmed the decision of the Court of Sessions (2). The Courts were there called upon to deal with the right of a tax-paying investment company to deduct from its gross receipts interest paid to a bank on loans made by the bank to the company to enable it to buy certain securities which it was part of the company's business to deal in. Under the Income Tax Acts this interest was deductible if it was

> money wholly or exclusively laid out or expended for the purpose of such trade.

At p. 127 of [1912] A.C., Lord Atkinson, delivering the unanimous judgment of the House of Lords, says,

(1) [1912] A.C. 118.
(2) 1909-10 Sess. Cas. 966. (Reported also as to both decisions in 5 Tax Cas., 693).

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The interest is, in truth, money paid for the use or hire of an instrument of their trade, as much as is the rent paid for their office or the hire paid for a typewriting machine. It is an outgoing by means of which the company procures the use of the thing by which it makes a profit, and, like any similar outgoing, should be deducted from the receipts to ascertain the taxable profits and gains which the company earns. Were it otherwise they might be taxed on assumed profits when, in fact, they made a loss.

Bryon v. *Metropolitan Saloon Omnibus Co., Ltd.* (1), cited in *General Auction Estate & Monetary Co.* v. *Smith* (2), is, as Stirling J. points out, at p. 441 of the latter case, direct authority that the borrowing of money, as was done in the case at bar, is not in any sense an increase of capital.

At p. 970 of the report of *Scottish North American Trust, Ltd.* v. *Inland Revenue* (3), Lord Salvesen, presiding at the Court of Session, said,

> If the question had arisen for the first time for decision it would appear to me to present no difficulty whatever. From an ordinary business point of view it seems preposterous to suggest that the money which a trader pays to a bank upon overdraft or on a secured loan forms part of the profits or gains of his business. Money which he receives by way of interest will no doubt, in the ordinary case, go to swell his profits; but how payments which in fact diminished his receipts should be regarded as in any sense part of his income it is at first sight very difficult to understand. * * * The interest which a trader pays to a bank with which he deals for financial accommodation is not in any sense payable out of profits. It is an ordinary claim of debt with which the whole assets of the company or trader are chargeable.

At p. 971, His Lordship quotes from the decision of the Lord President of the Court of Sessions in *Inland Revenue* v. *Stewart & Lloyds* (4), as follows:

> * * * it all depended on whether this expenditure was really an outlay to earn profit or was an application of profit earned.

Lord Salvesen goes on to say that

> Assuming that to be the test, it would certainly be a strange abuse of language to say that interest which a trader has had to pay on money borrowed for the purposes of his business is an application of the profits earned, when it may be that the interest exceeds the total amount of the profits.

As Lord Halsbury said in the *Gresham* case (5),

> The thing to be taxed is the amount of profits and gains. The word "profits" I think is to be understood in its natural and proper sense—in a sense which no commercial man would misunderstand. * * * The tax is payable upon the profits realized, and the meaning to my mind is rendered plain by the words "payable *out of* profits."

and at p. 316,

(1) (1858) 3 De G. & J. 123.
(2) [1891] 3 Ch. 432.
(3) 1909-10 Sess. Cas., 966.
(4) (1906) 8F. 1129.
(5) [1892] A.C. 309, at p. 315.

Profits and gains must be ascertained on ordinary principles of commercial trading, and I cannot think that the framers of the Act could be guilty of such confusion of thought as to assume that the cost of the article sold to the trader which he in turn makes his profit by selling, was not to be taken into account before you arrived at what was intended to be the taxable profit.

Of course, in construing English Income Tax decisions, one must always bear in mind that they depend largely upon the phraseology of the statutes under consideration; but I find it impossible to understand how, where the word "income" is defined, as it is here, to be "profit or gain," not from any particular transaction, but from the whole business of an entire year carried on by the "person" upon whom the tax, in respect to it, is to be imposed, such "income" can be arrived at otherwise than by taking account of the receipts for the year and deducting therefrom at least all expenditure made in, and properly attributable to, the earning of such receipts as a whole, including therein expenditure made in the hope of earning receipts for the business or undertaking, although such hope has been disappointed.

Upon the evidence before us, it seems perfectly clear that, whether or not any receipts were actually had from the particular investment in question, there was expended, during the year in question, in respect of that investment, and for the purpose of enabling the company to earn from it any receipts that might be had therefrom, by way of interest paid to the bank which advanced the money required by the company to enable it to secure the investment, the sum of $8,004.83. This sum was not paid out of profits, because, until it was paid and deducted, the profits of the business could not be known. On the other hand, it was paid to enable the company to obtain an investment within its powers, from which, in the ordinary course, some return might be expected. In order to arrive at the "profit or gain" from the undertaking, or business of the appellant company for the year in question, it is certainly necessary to deduct from the receipts which it had from all sources, among other items, this sum of $8,004.83. As Lord Herschell said in the *Gresham* case (*ubi supra*) (1),

(1) [1892] A.C. 309, at p. 323.

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Whether there be such a thing as profit or gain can only be ascertained by setting against the receipts the expenditure or obligations to which they have given rise.

and, in the *Russell* case (1),

The profit of a trade or business is the surplus by which the receipts from the trade or business exceed the expenditure necessary for the purpose of earning those receipts. That seems to me to be the meaning of the word "profits" in relation to any trade or business. Unless and until you have ascertained that there is such a balance, nothing exists to which the name "profits" can properly be applied.

We are for these reasons of the opinion that the appeal must be allowed with respect to Question number One.

Since the appellant should have limited its appeal to the particular question in respect of which it has succeeded, as provided by s. 64 (2) of the *Supreme Court Act,* it should have only the costs of the appeal to this Court incurred in connection with that question, against which should be set off any costs incurred by the respondent in regard to the three questions upon which the appellant has failed. The appellant is entitled to its costs in the Appellate Division and before the County Court Judge.

Appeal allowed in part.

Solicitors for the appellant: *Quain & Wilson.*
Solicitor for the respondent: *F. B. Proctor.*

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*PRESENT:—Anglin C.J.C. and Duff, Newcombe, Rinfret and Lamont JJ.

(1) (1888) 13 App. Cas. 418, at p. 424.