1959

*Mar. 2
Apr. 28

WILLIAM EWART BANNERMAN .....APPELLANT;

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Company funds diverted by president—Legal, telephone and travelling expenses paid by other shareholder to obtain winding-up order—Whether deductible from shareholder's income—The Income Tax Act, 1948 (Can.), c. 52, ss. 2, 3, 4, 12, 81.

Some years ago, the appellant formed, with another man, a private company each of them acquiring half of the company's issued shares. The appellant's associate was appointed president and had the deciding vote. In 1951, the appellant discovered that the president had, during the past few years, converted to his own use a very large amount of the company's funds. The president undertook to make restitution but later took the position that he owed nothing to the company or to the appellant. He refused also to approve payment by the company for rental of a property of the appellant which the company was occupying. The appellant obtained a winding-up order after the president had refused to have the company placed in voluntary liquidation. A liquidator was appointed and subsequently the liquidator, the president, and the appellant agreed to submit certain

*PRESENT: Kerwin C.J. and Taschereau, Fauteux, Abbott and Judson JJ.

questions of accounting to arbitration. The arbitrators determined the amount owed by the president to the liquidator and the rental owed by the liquidator to the appellant.

The appellant sought to deduct from his 1952 income the legal expenses (solicitor's fees plus travelling and telephone expenses) incurred by him in securing the winding-up order. He contended that part of the expenses had been incurred for the purpose of earning rental income from his property and part of the expenses for the purpose of earning income from his shares in the company. The minister disallowed the deductions and this decision was affirmed by the Income Tax Appeal Board and the Exchequer Court.

Held: The appellant was not entitled to the deduction claimed.

The money spent by him to secure the winding-up order was not an expense incurred for the purpose of earning income from his rented property or from his shares in the company. As decided by the Exchequer Court, there was nothing to prevent the appellant from bringing an action to recover the rent. The purpose of the winding-up proceedings was to remove the president from his position of control in the company. As also decided by the Exchequer Court, a distribution under s. 81(1) of the Act was not inevitable and the receipt by the appellant of moneys "deemed to be a dividend" was very unlikely.

APPEAL from a judgment of Kearney J. of the Exchequer Court of Canada[1], affirming a decision of the Income Tax Appeal Board. Appeal dismissed.

J. A. Ogilvy, Q.C., and *A. J. Campbell, Q.C.*, for the appellant.

L. Lalande, Q.C., and *J. M. Poulin*, for the respondent.

The judgment of the Court was delivered by

THE CHIEF JUSTICE:—This is an appeal by William E. Bannerman against a decision of the Exchequer Court[1] affirming the judgment of the Income Tax Appeal Board which had dismissed his appeal to it from the assessment by the Minister of National Revenue for income tax with respect to the income of the appellant for the year 1952. There is no dispute as to the items shown by the appellant in his return as receipts but the question is as to $13,357.06 claimed by him as a deduction on the ground that the items comprising that sum fall within the exception in s. 12(1)(*a*) of the *Income Tax Act*, R.S.C. 1952, c. 148.

[1] [1957] Ex. C.R. 367, [1957] C.T.C. 375, 57 D.T.C. 1249.

1959

BANNERMAN v. MINISTER OF NATIONAL REVENUE

Kerwin C.J.

By s. 2 of that Act an income tax is to be paid upon the taxable income for each taxation year of every person resident in Canada at any time in the year. Sections 3 and 4 provide:

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.

Section 12(1)(*a*) and (*b*) enact:

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.

These are the only sections requiring consideration as there is no extensive description of "income" such as was found in the *Income War Tax Act*. In view of the disappearance of what was s. 6:

6. 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

many of the decisions under that Act are inapplicable. However, this Court held in *Riedle Brewery Ltd. v. The Minister of National Revenue*[1], that a certain degree of latitude must be allowed in determining the question whether the disbursements or expenses were laid out or expended for the purpose of earning the income, *i.e.*, with the object and intent that they should earn the particular gross income reported for the taxation period. Under s. 12(1)(*a*) of the present Act it is sufficient that an outlay be made or expense incurred with the object or intention that it should earn income, but since in one sense it might be said that almost every outlay or expense was made or incurred for that purpose, a line must be drawn in the individual case depending upon the circumstances and bearing in mind the provisions of s. 12(1)(*b*).

[1] [1939] S.C.R. 253, 3 D.L.R. 436.

It might first be noticed that in 1952 the appellant was not engaged in any business on his own account but was a salaried employee, *i.e.*, vice-president and assistant general manager of Page-Hersey Tubes, Limited. With his income tax return for 1952 the appellant sent the District Taxation Office a letter, dated April 27, 1953, reading as follows:

> From my investment dividend income from Canadian Corporations I have deducted expenses which I have paid out of that income to protect my interests in the income of another Canadian Company, whose income was being fraudulently dissipated by the operating head of that Company, and who, because of such action and expense on my part, has now been removed by Court Order from such position.
>
> The following is the make up of the amount deducted.
>
> | | |
> |---|---|
> | Legal expense | $10,000.00 |
> | Long distance Telephone expense | 340.00 |
> | Travelling expense | 3,016.26 |
> | | $13,357.06 |
>
> Upon your request I shall be pleased to furnish details and receipted bills, and such further information as you may require.

The "Canadian Company" referred to in this letter is Concrete Column Clamps Limited, which was incorporated some years ago under the *Dominion Companies Act*. At first the issued capital was $80,000, one half of which was contributed by the appellant and the other half by one Dominique Vocisano. It was taxed as a family corporation and dividends were paid in 1938, 1939 and 1940. No dividends were paid later and therefore none were received by the appellant from it in 1952, although his holdings had increased considerably in value.

Vocisano managed the affairs of the company and while he and the appellant had an equal investment, the former was president and had a casting vote as shareholder and director. In July 1951, the appellant, as a result of information divulged by investigators employed by the Department of National Revenue, became aware that during the years 1941 to 1950 inclusive Vocisano had converted to his own use a very large amount of the funds of the company. At first Vocisano undertook to settle the tax liability of the company and to arrange all outstanding matters, but he subsequently took the position that he owed nothing to the company or to Bannerman. He did pay a substantial sum as taxes owing by the company.

1959

BANNERMAN v. MINISTER OF NATIONAL REVENUE

Kerwin C.J.

The appellant was advised to have the company placed in voluntary liquidation but his efforts in that direction were defeated by Vocisano's casting vote. The appellant then took proceedings to have the company wound up on the ground that it was just and equitable so to do and after a trial lasting about thirteen days Mr. Justice Batshaw ordered the company wound up and appointed Harold J. Inns as liquidator.

Subsequent thereto Vocisano and the appellant agreed to submit to arbitration an accounting between the company and Vocisano and between the company and Bannerman. The award of the arbitrators was filed as an exhibit in this case in the Exchequer Court. At pp. 165 and 168 of the record are found references by the arbitrators to "padded expenses" recorded in the books of the company. At p. 165 it is stated "both Mr. Vocisano and Mr. Bannerman have admitted that it was their practice over a number of years to 'pad' the gratuities account in the company's records and to split between themselves the excess of the amount paid by the company to Mr. Vocisano over the amount said to have been actually disbursed by him" and at p. 168, that the appellant received from Vocisano, other than in repayment of loans, sums totalling $103,554.50, included in which were:

Bonds received by Mr. Bannerman shortly after he had made a cash subscription of $25,000.00 for capital stock	$25,000.00
Bonds and cash received by Mr. Bannerman in 1951 and said to represent the division between himself and Mr. Vocisano of the excess of the proceeds of three cheques over gratuities alleged to have been paid by Mr. Vocisano	6,000.00

The arbitrators found that these two payments were made by Vocisano to Bannerman out of revenues of the company diverted by the former and they accordingly held the appellant accountable to the liquidator for the total of these two sums, $31,000, and gave Vocisano credit for a corresponding sum in his accounting with the liquidator. The arbitrators also found that the liquidator owed Bannerman $15,065.67 for rent of a certain property in Toronto owned by Bannerman and occupied by the company.

The question of damages alleged to have been suffered by the company as a result of Vocisano's actions was removed from those matters to be considered by the

arbitrators. During the pendency of the arbitration proceedings an action was instituted by the liquidator against Vocisano to recover $2,000,000 as such damages. The judgment of Mr. Justice Montpetit in that action is filed in these proceedings. We were advised that each party appealed to the Court of Appeal for Quebec and that the judgments rendered by that Court have been appealed to this Court.

Reference has been made to the arbitration and to the winding-up proceedings because they indicate that the expenses claimed by the appellant as a deduction from his income tax for the year 1952 were not made for the purpose of earning income from his property, *i.e.*, his shares in the company. As to the claim that part of the $13,357.06 was incurred for the purpose of Bannerman securing the rent, it is significant that in his letter of April 27, 1953, quoted above, the only suggestion advanced is that he paid the money "to protect my interests in the income of another Canadian Company". I agree with the learned Judge of the Exchequer Court that there was nothing to prevent the appellant bringing an action to recover the rent. It is quite true that if some other proceedings were taken that had the same result that would suffice so long as the purpose of earning income could be deduced. Furthermore, as to all the items, a careful perusal of the record satisfies me that the appellant's action in taking the winding-up proceedings was to remove Vocisano from the position he occupied in the company's affairs by reason of his casting vote. The extracts quoted above from the exhibits filed in this case indicate that the appellant definitely had in mind throughout a long period the question of income tax. Section 81(1) of the *Income Tax Act* provides:

> 81. (1) Where funds or property of a corporation have, at a time when the corporation had undistributed income on hand, been distributed or otherwise appropriated in any manner whatsoever to or for the benefit of one or more of its shareholders on the winding-up, discontinuance or reorganization of its business, a dividend shall be deemed to have been received at that time by each shareholder equal to the lesser of
>
> (*a*) the amount or value of the funds or property so distributed or appropriated to him, or
>
> (*b*) his portion of the undistributed income then on hand.

1959

BANNERMAN v. MINISTER OF NATIONAL REVENUE

Kerwin C.J.

I also agree with the learned trial judge that a distribution under that section will not inevitably take place and that the receipt by the appellant of monies "deemed to be a dividend" is very unlikely. Under all the circumstances the money paid out by the appellant totalling $13,357.06 and which includes a payment on account of $10,000 for legal fees, the balance being travelling and telephoning expenses, is really an outlay of capital under s. 12(1)(*b*) of the *Income Tax Act*.

For these reasons the appeal should be dismissed with costs.

Appeal dismissed with costs.

Attorneys for the appellant: Brais, Campbell, Mercier & Leduc, Montreal.

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