1953
Oct. 13
Nov. 20

BETWEEN:

JOSEPH HAROLD WILSON ..... APPELLANT;

AND

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

Revenue—Income—Income tax—The Income War Tax Act R.S.C. 1927, c. 97, s. 6—The Income Tax Act 11-12 Geo. VI, c. 52, s. 12(1)(a)—Income or capital—"Disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income"—No deduction in respect of "an outlay or expense except 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".

A testator by his will bequeathed to appellant the business and lands and premises on which that business was carried on in the City of Victoria under the name of "W. & J. Wilson" subject to appellant entering into and carrying out certain covenants namely, to pay testator's widow a fixed sum each month, to pay all taxes and charges and expenses of repairs on testator's two houses. By the will testator charged the business premises with the performance of such covenants. Appellant accepted the bequest and upon entering into the covenants provided by the will became owner of the business which was carried on under its original name, the legal title to the business premises being retained by the executors of the will.

Appellant fulfilled the obligations upon him by the covenants entered into, all such payments being made by cheque of W. & J. Wilson and posted in the books of the business as "Account of Mrs. A. A. Wilson" such payments being charged to rent account in the auditor's statements of the business of W. &. J. Wilson.

Appellant deducted such amounts from his income for taxation purposes. The deduction was disallowed by respondent and appellant now appeals to this Court.

Held: That the payments were not disbursements or expenses wholly, exclusively and necessarily laid out or expended for the purpose of earning the income of appellant, nor were they payments made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the appellant.

2. That the payments were made on account of capital, since money paid for acquiring the business or for property in which a business is to be carried on is a capital expenditure and none the less so if it is paid in part or in whole by a series of payments.

3. That the proprietor of a business which is carried on in his own premises and under his own name may not deduct the annual value of the property or rent in computing his income and that rule applies when the owner is the sole proprietor of the business which is conducted under a somewhat different name.

4. That payments made by appellant were not rent.

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APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Cameron at Victoria.

L. J. Ladner, Q.C., W. H. M. Haldane, Q.C. and *W. M. Carlyle* for appellant.

J. G. Ruttan and *T. E. Jackson* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CAMERON J. now (November 20, 1953) delivered the following judgment:

This is an appeal from the decision of the Income Tax Appeal Board dated February 4, 1953, whereby the appellant's appeals in respect of income tax assessments made upon him for the taxation years 1946, 1947, 1948 and 1949, were dismissed.

There is no dispute as to the facts. During each of the years in question the appellant carried on business at Victoria, B.C., and elsewhere, as "W. & J. Wilson," of which business he was the sole proprietor. To his T-1 General returns, he attached in each year an auditor's statement of the business of "W. & J. Wilson," such statements showing annually a deduction for "rent" as follows:

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

In assessing the appellant, the respondent totally disallowed these items as deductions, added them to the income of the appellant and assessed him accordingly. From such assessments, appeals were taken to the Income Tax Appeal Board and subsequently to this Court.

Prior to January 2, 1945, the business of "W. & J. Wilson" was owned and operated by J. E. Wilson, father of the appellant. For many years he carried on that business at the premises known as 1221 Government Street in the City of Victoria and more particularly known as Lot 166, Block 13, which premises he also owned. J. E. Wilson died on that date and by his will, duly admitted to probate

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(Ex. 1), he appointed the Canada Trust Company and the appellant to be his executors and trustees, and disposed of the said business and premises as follows:

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

And then, omitting subclause (*a*), (*b*) and (*c*) not here relevant, the said will continued:

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

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

(*f*) The said Lot 166 shall be and is hereby charged with the performance by my said son's covenants required above by paragraphs (*d*) and (*e*) to be entered into by him and accordingly, during the lifetime of my wife the title to the said Lot 166 shall be in the names of my said Trustees with the right to my said son, should he desire that the same be sold, to require my Trustees to sell the same provided the sale price thereof and the terms of sale meet with their approval and the moneys to be realized from any such sale shall, if my said son so desires, be used in the purchase of other business premises for my said son, and unless so used shall be invested and the income to be derived therefrom shall be paid to my said son, subject to the performance by him of his covenants as above mentioned, and on the death of my said wife the capital thereof shall be paid to my said son:

(*g*) Upon my son complying with the terms of this bequest and devise to him within three months from the date of my death my Trustees are authorized to turn over the said business to my said son as a going concern as of the date of my death, but should my son fail to carry out the above terms within the said period of three months or thereafter within a period of one month from the giving of written notice to my said son requiring him to elect as to whether he will take the said business over or not, then my Trustees are to sell and convert the said business and land into money, and pay the moneys required to be paid under paragraphs (*a*), (*b*) and (*c*) hereof and to set aside a sufficient amount which when

invested will in the opinion of my Trustees produce a sufficient income to pay to my wife the said sum of $500 as provided by paragraph (*d*) hereof, and the other outgoings provided by paragraph (*e*) hereof, and apply such income for such purpose and to pay the balance of said proceeds to my said son, and on the death of my said wife to pay to my said son the capital retained and invested as above required to be invested. I AUTHORIZE AND EMPOWER my Trustees until the said business be turned over to my son or sold and converted as above provided, to manage and carry on the said business and for such purpose in their discretion to appoint my said son to act in the full management thereof:"

The appellant, having chosen to accept the bequest and devise subject to all the conditions imposed by the said will, duly entered into the agreements as required by subsections (*d*) and (*e*). Thereupon, the said trustees turned over to the appellant the business of "W. & J. Wilson" of which he then became the sole proprietor. Pursuant to the provisions of subsection (*f*), the title to the said Lot 166 was retained by the said executors, and, as shown by the Certificate of Encumbrance dated Nov. 30, 1951 (Ex. 2), it was on that date still held in their names.

By his will, J. E. Wilson gave to his widow a life interest in his Victoria residence and in his summer home at Finnerty's Beach. The disbursement which the appellant now seeks to deduct consisted of the monthly payment of $500 which he had agreed to pay to his mother during her lifetime, and of the taxes and other outgoings on the Victoria residence and on the summer residence, which, by his agreement with the trustees, he had undertaken to pay. It is shown that all such payments for the years in question were paid by the cheque of "W. & J. Wilson" direct to the widow. In the books of that business they were posted to "Account of Mrs. A. A. Wilson," and at the end of each year the total sums paid were charged to "Rent Account" in the annual auditor's statements of the business of "W. & J. Wilson."

The Income War Tax Act is, of course, applicable to the taxation years 1946, 1947 and 1948. Its relevant provisions are as follows:

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;

(*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;

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

For the taxation year 1949 the Income Tax Act is applicable, its relevant provisions being as follows:

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,

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

It is not contended that in this case there is any substantial difference between these provisions of the Income War Tax and the Income Tax Act.

The onus is, of course, on the appellant (*Johnston* v. *M.N.R.* (1)). The first submission is that the sums so paid were "rent" or analogous to rent. It is said that the position here is the same as if the lands and buildings had been left to the trustees for the lifetime of the widow and that the trustees had then entered into a lease with the appellant, or with "W. & J. Wilson"; or, alternatively, as if the property were left to the widow for life and that she had then leased it to the appellant, or to "W. & J. Wilson." In either of such cases, I may assume that the actual rent so paid (to the extent that it was not unreasonable) would have been a deductible expense. In support of this contention, it is pointed out that the title to the property did remain in the name of the trustees and that the evidence establishes that the actual sums so paid were in amount roughly equivalent to what might have been a fair rental for the property.

In my view, however, the facts of the case do not support this contention. The property was, in fact, devised to the appellant, subject to his complying with the conditions named, and with which he did comply. The widow was not given a life interest in the property, and that which she was entitled to receive was not the rent of the property but the fulfilment of the contracts entered into personally by the appellant with her and with the trustees. The

(1) [1948] S.C.R. 486.

charge created on the property and the direction that the paper title should remain in the trustees during the life of the widow, were steps taken to collaterally secure that the appellant's personal covenants should be carried out. She was entitled to the benefits of his covenants whether or not he carried on business on the premises.

No lease for the property was entered into at any time. The fact is that the appellant, whether considered as an individual or as the sole owner of "W. & J. Wilson," was never a tenant of the property. I have considered the terms of the will carefully and have reached the conclusion that the appellant became the beneficial owner of the property immediately upon complying with the conditions laid down in his father's will, namely, payment of the succession duties and the small legacies which he was required to pay, and the completion of the contracts which I have mentioned. That he considered himself as such owner there can be no doubt. In each year his tax returns showed that he included the premises as an asset of "W. & J. Wilson," that he paid the taxes thereon, that depreciation thereon was claimed and allowed, and that some small part of the premises was rented as a barbershop, the rent therefrom being duly accounted for. I am quite unable to reach the conclusion that the payments made by or on behalf of the appellant, who was the beneficial owner and not the tenant of the property, to his mother, who was not the owner of the property, can in any way be regarded as rent or as in the nature of rent.

Counsel for the appellant, however, emphasized the fact that the payments here were made by the business of "W. & J. Wilson." He submits that that business must be considered as a separate entity and that in computing its profits, it was necessary to take into account the disbursements so made. He points out that for the year 1946 and 1947 the business was assessed to excess profits tax. Exhibits 3 and 4 are such assessments and I note therefrom that in each year the Minister disallowed the deductions claimed in respect of the payments to Mrs. A. A. Wilson.

Mr. P. S. Watt, the chartered accountant whose firm had been auditing the accounts of "W. & J. Wilson" for many years, stated that while he had not personally audited the accounts for the years in question, he had examined the

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annual returns and the books of the company and had been informed of the terms of the will of the appellant's father. He said that he considered that the disbursements in question were properly classified as "rents" and that from an accounting point of view they should be taken into account in determining the net profits of the business. At another point he said: "As an accountant I considered 'W. & J. Wilson,' or the appellant, as the owner of the property, which property was burdened with an obligation to pay the annual amounts which I classify as 'rent'." I am unable to follow his conclusion that the monies paid out by an owner of property could be considered as rent for that property.

The remaining submission by the appellant is that the payments were necessarily made for the purpose of ensuring that the business of "W. & J. Wilson" should remain in occupation of the premises. The evidence shows that the business has been carried on in that particular location for a great many years, that it would be difficult to secure an equally valuable site in Victoria, and that if it were moved to another location, some of the goodwill might be lost. It is submitted that if the payments were not made, the appellant's mother, in order to secure the payments to which she was entitled, might institute proceedings to bring the property to sale and that "W. & J. Wilson" might in that case lose possession thereof.

Now "W. & J. Wilson" were under no legal obligation whatever to pay any amounts to Mrs. A. A. Wilson. It was not necessary for them to pay anything of that nature to any one. The obligation to pay her the amounts in question was an obligation personal to the appellant. The disbursements were made in satisfaction of his personal obligations and were not made for the purpose of earning the profits. In *Minister of National Revenue* v. *Dominion Natural Gas Co. Ltd.* (1), Crocket, J. referred to and applied the principle laid down by Lord Davey in *Strong & Company Ltd.* v. *Woodifield* (2), that "it is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits."

(1) [1941] S.C.R. 19. (2) [1906] A.C. 448.

There is no evidence before me as to the reason for the payments being made by "W. & J. Wilson" rather than by the appellant personally. But even if it were found that the purpose was to prevent the possible extinction of the business in that property—and I do not think that was the real purpose—that would not be an expense incurred for the production of income. That point was referred to in *The Dominion Natural Gas* case (*supra*), in which Duff, C.J. cited the case of *Ward & Co.* v. *Commissioner of Taxes* (1), in which the Judicial Committee of the Privy Council approved a statement in the Court of Appeal of New Zealand as follows:

'We find it quite impossible to hold that the expenditure was incurred exclusively, or at all, in the production of the assessable income. It was incurred not for the production of income, but for the purpose of preventing the extinction of the business from which the income was derived, which is quite a different thing. It was contended by the Company that it was illogical that while legitimate expenses incurred in the production of the income are deductible, similar expenses incurred for the much more important purpose of keeping the profit-making business alive are not deductible, and, further, that it was inequitable that the Legislature should, on the one hand, force a certain class of traders into a struggle for their very existence, and, on the other hand, treat the reasonable expenses incurred in connection with such struggle as part of the profits assessable to income tax. These aspects of the matter are clearly and forcibly set out in the contentions of the Company as embodied in the correspondence with the Commissioner contained in the case, but they raise questions which can only be dealt with appropriately by the Legislature. This Court, however, cannot be influenced by such considerations, being concerned only with the interpretation and application of the law as it stands.'

Their Lordships agree with this reasoning . . . The expense may have been wisely undertaken, and may properly find a place, either in the balance sheet or in the profit-and-loss account of the appellants; but this is not enough to take it out of the prohibition in s. 6, subs. 1(*a*), of the Act.

Reference may also be made to the case of *Calvert* v. *Commissioner of Taxes* (2). That was a decision of the High Court of Australia in which the Court unanimously affirmed the judgment of the Supreme Court of Victoria (3). In that case the taxpayer carried on the business of a grazier on lands which had been conveyed to him by his father. By the agreement between them, the taxpayer agreed to pay a certain annuity to his father, and in the event that his mother survived his father, to pay her a

(1) [1923] A.C. 145. (2) (1927-8) 40 Commonwealth L.R. 142.
(3) 49 A L.T. 42.

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certain annuity for her life, such annuities to be secured by a registered charge upon the said lands. Following the death of the father, other lands were substituted for the original lands so purchased and charged (but that fact was held to be of no importance), and the taxpayer made the required annual payments to his mother. In his income tax return for the year 1925, he reported the income received from his business as a grazier, as well as his income from property, and claimed the right to deduct from the former the amount paid to his mother during that year. The Commissioner of Taxes disallowed the said deduction on the ground that it was barred by the provisions of s. 19(2) of the Income Tax Act 1915 Vict., which provided that "in estimating the balance of the income liable to tax no sum shall be deducted therefrom for . . . (*g*) any disbursements or expenses whatever not being money wholly and exclusively laid out or expended for the purpose of such trade."

In the Supreme Court of Victoria, Cussen, J., speaking for the full Court, said at p. 44:

> The position then would be that on condition of paying this annuity . . . certain land had been transferred to him by his father and he had personally covenanted to pay this annuity the charge being given as security for the payment. On the land so charged he is now and has for some time been carrying on the business of a grazier. But he entered into no undertaking to retain the land so charged or to carry on the business of a grazier upon it. . . .
>
> Here the payment of this annuity is in no way legally connected with the taxpayer's carrying on his business of a grazier. It would have to be paid by the taxpayer and would remain a charge on the land whether he remained the owner of the land or not and whether he carried on the business of a grazier or not. It is therefore not a disbursement wholly expended for the purpose of his trade as a grazier.

The taxpayer's appeal was dismissed, the Court being of the opinion that it was unnecessary to consider the further question as to whether the payment was a capital payment or not. An appeal to the High Court of Australia was dismissed, the Court merely stating that the decision below was correct in that s. 19(2)(*g*) excluded the item as a deduction. In that Court, counsel for the appellant made practically the same submissions as have been made to me in this case.

For these reasons I am of the opinion that the disbursements so made in the years 1946, 1947 and 1948 were barred by the provisions of s. 6(1)(*a*) of the Income War

Tax Act; and that those made for the year 1949 were barred by the provisions of s. 12(1)(*a*) of the Income Tax Act.

I am also of the opinion that the deductions were barred by the provisions of s. 6(1)(*b*) of the Income War Tax Act and by s. 12(1)(*d*) of the Income Tax Act as being payments on account of capital.

As I read the will of the appellant's father, its intention was clearly to confer on the appellant an option to acquire —and, in effect to purchase—the business and the property. He could exercise that option only by accepting the conditions laid down, namely, to pay the succession duties and small legacies and to enter into the contracts with his mother and the trustees. Part of the consideration, therefore, was the monthly sums to be paid his mother and the taxes and other charges on the two residences. Money paid for acquiring the business or for property in which a business is to be carried on is a capital expenditure and none the less so if it is paid in part or in whole by a series of annual payments. (See Konstam on the Law of Income Tax, 10th Ed., 115.)

Were I to give effect to the arguments advanced by counsel for the appellant, the result would be that an individual who is the sole proprietor of a business which is carried on on his own property, but under a name somewhat different from his own, in computing the income derived from that business could deduct the annual value of property. S. 6(1)(*c*) of the Income War Tax Act and s. 12(1)(*d*) of the Income Tax Act (*supra*) are applicable to all taxpayers, including partnerships, and by their terms the annual value of property—except *rent* actually paid for the use of such property or *rent* for property leased by the taxpayer for use in his business—may not be deducted. The proprietor of a business which is carried on in his own premises and under his own name may not deduct the annual value of the property or rent in computing his taxable income. In my view, the same rule applies where—as in this case—the owner is the sole proprietor of the business which is conducted under a somewhat different name.

For these reasons the appeal will be dismissed with costs, and the assessment made upon the appellant will be affirmed.

Judgment accordingly.