BETWEEN:

GEORGE SMITH BUCHANAN ..... APPELLANT;

AND

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

Calgary 1966
April 1
Ottawa May 26

Income tax—Ex gratia payment to dismissed employee—Whether gift or income from employment—Intent of employer—Income Tax Act, s 5(1)(a).

Appellant was employed by a Calgary law firm at a salary of $750 a month. On August 25th 1961 he was informed that his salary would be reduced to $500 a month from September 1st and on September 11th he was summarily dismissed for cause and paid the amount due him to that date, $529. On September 12th he was informed that the firm would make him an *ex gratia* payment of $1,903.80, less deduction for tax on that sum and on the $529 paid previously, by semi-monthly instalments of $317.30 (less such deductions) but that on the request of appellant and his wife the full balance would be paid if they wished to return to Scotland (whence they had immigrated to Canada in 1957). Appellant stayed in Canada and received the $1,903.80 as promised. This sum was in fact equivalent to three months' salary at $750 a month less a deduction for income tax on three months' salary, $2,250, and on $529. In all its office procedures the law firm treated the payment of $1,903.80 as remuneration to appellant, describing it as salary, paying it semi-monthly, and reporting it as such.

Held, appellant's employer intended the payment of the $1,903.80 as remuneration rather than as a gift personal to appellant and the payment was therefore income to appellant from an office or employment under s. 5(1)(a) of the *Income Tax Act*. It was immaterial that the employment had been terminated when the payment was made.

Goldman v. M.N.R. [1953] 1 S.C.R. 211, applied; *Blakeston v. Cooper* [1909] A.C. 104, *Cowan v. Seymour* (1919) 7 T.C. 372, *Seymour v. Reed* [1927] A.C. 554, referred to.

APPEAL from a decision of the Tax Appeal Board.

W. D. Goodfellow for appellant.

D. G. H. Bowman for respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1] dated June 28, 1965 whereby an appeal from the appellant's assessment to income tax for his 1961 taxation year was dismissed. The Board held that an

[1] (1965) 38 Tax A.B.C. 449

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amount of $1,903.80 had been properly included by the Minister as part of the income received by the appellant in the taxation year in question.

The appellant, who had been a solicitor in Scotland, came to Canada in the fall of 1957 with a view to bettering his fortunes. He did not have any commitment of specific employment but he was armed with a letter of introduction to the then President of the Law Society of Alberta who was also, at that time, a member of the well known and established legal firm of Chambers, Might, Saucier, Peacock, Jones, Black and Gain of the City of Calgary, in the Province of Alberta. The appellant discussed with the then President of the Law Society the possibility of and requisite steps to qualifying as a barrister and solicitor in Alberta and also inquired concerning any oil companies which might have need for his services. He was offered employment in the above legal firm of a permanent nature as an articled law clerk, at the outset, at a salary of $600 per month which was a salary double his highest expectations. Naturally the appellant accepted that offer forthwith and began his duties in the mortgage department of that firm on September 12, 1957.

There was no written contract of employment, but only an oral agreement.

In October 1957 the appellant forwarded to his wife, who had remained in Scotland, sufficient funds from his own resources to enable his wife and son to travel to Calgary which they did, arriving in Calgary in November 1957. It was not a condition of the appellant's employment that the legal firm should assume any responsibility for the expense to be incurred in moving the appellant's family to Calgary but, if my recollection of the evidence serves me correctly, the firm did accommodate the appellant by assisting him in arranging a loan from a bank, which was a client, by way of endorsement of the appellant's promissory note in order that he might establish living accommodation for himself and family.

After some time the appellant qualified as a barrister and solicitor and continued his duties in the mortgage department of the legal firm with two other solicitors. His salary was raised to $700 per month and later to $750 per month. During the latter portion of the appellant's employment he

became the sole solicitor in the mortgage department. The appellant complained to the management committee of the legal firm that the volume of mortgage work was getting beyond him which might result in delays as well as complaining about the soul-killing monotony of that type of work. He was given other work of a similar nature which was not performed to the satisfaction of the client of the firm and accordingly to the firm's dissatisfaction.

On August 25, 1961 the management committee by memorandum of that date, advised the appellant that his usefulness to the firm was limited as he had not demonstrated qualities which would enable him to take charge of the mortgage department and that if he wished to remain with the firm it would be on the basis that his salary would be reduced to $500 per month as from September 1, 1961, that he would do such mortgage work as was allocated to him under the supervision of a member of the firm placed in charge of the mortgage department and that his employment was henceforth probationary.

Shortly thereafter, on September 11, 1961, Mr. J. J. Saucier, a senior member of the firm and chairman of the firm's management committee received a report of complaints respecting the appellant's personal conduct which was of such a nature as to cause him to convene an immediate and emergent meeting of the committee. The bases of the complaints so made were thoroughly investigated and in the opinions of the members of the committee were substantiated and warranted the appellant's summary dismissal without notice. The appellant was then summoned to Mr. Saucier's office, where, in the presence of Mr. Roberts, the office manager, Mr. Saucier informed the appellant of their findings of his misconduct which were the reasons for his dismissal and thereupon dismissed him effective as of five o'clock, the closing of office hours on that day. The appellant protested the truth of the allegations made against him. He was given a cheque in the amount of $529.53 being the amount of his salary accrued to that date plus two week's salary in lieu of holidays to which the appellant was entitled but had not taken. No deduction was made from this amount for income tax at that time. Mr. Saucier also informed the appellant that he would be written a letter confirming his dismissal.

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The next day, September 12, 1961, Mr. Saucier wrote such confirmatory letter to the appellant which was received by him on September 14, 1961 the text of which reads as follows:

> This will confirm my interview with you yesterday afternoon, at which our Mr. Roberts was present, when I dismissed you from the service of this firm, as of the close of business yesterday, upon grounds which I stated to you, and which our Management Committee considered sufficient to warrant your immediate dismissal without notice.
>
> You received at that time, a cheque for $529 53, being the amount of your salary accrued to that date, plus two weeks' salary in lieu of holidays you had been entitled to but had not taken, (no deduction being made for income tax).
>
> As I indicated to you, we do not consider that you are entitled to any further payment, but we do recognize that you moved your wife and children from Scotland to Calgary, in reliance upon what we had all hoped would be a permanent position with this firm. Notwithstanding the grounds which led to your dismissal, we wish to provide you with some financial assistance, to enable you to seek further employment, or to return to Scotland with your family. Therefore, as a matter of grace, we will pay to you the further sum of $1,903 80 (less deductions for income tax thereon and on the amount you received yesterday), by equal semi-monthly instalments of $317.30 each (less such deduction), on the 15th and last days of each month, commencing the 30th day of September, 1961, on the understanding that, if you wish to move your family in the meantime, we will consider a joint application of your wife and yourself, for prepayment of the balance then outstanding.

The amount of $1,903.80, the taxability of which is the issue in the present appeal, had not been demanded by the appellant, nor had the payment thereof been discussed with him at the time of his dismissal, his first intimation thereof being upon receipt of the above letter.

The matter of an *ex gratia* payment had been discussed by the management committee during its emergency meeting at which it decided to make such payment. Mr. Saucier testified that the appellant's wife was known to the members of the management committee, who held her in high esteem, that they were aware of the precarious cash position of the appellant from their knowledge of an outstanding bank loan they had assisted him to obtain and that the amount of $1,903.80 was a purely arbitrary figure suggested and determined upon by the committee as being an adequate amount to enable the appellant to return to Scotland with his family.

It so happens, however, that this amount of $1,903.80 is also the appellant's salary for three months at the rate of $750 per month less a deduction of $60 per month for

income tax and less a further deduction for income tax which had not been made from the cheque for $529.53 previously given to the appellant and representing accrued salary and holiday pay.

The appellant did not avail himself of the offer in the third paragraph of the letter dated September 12, 1961 quoted above whereby upon a joint application with his wife for prepayment of the entire amount or any balance thereof would be paid forthwith, but rather chose to remain in Calgary. He was unemployed from September 11, 1961 until mid November 1961 at which time, I observe from the appellant's Income Tax Return, he obtained employment. Meanwhile he received semi-monthly payments totalling $1,903.80 in accordance with the undertaking in Mr. Saucier's letter. These payments were recorded upon a form entitled "Employees' Earning Record" completed by the legal firm.

On the T4 form being a statement of remuneration paid, prepared by the appellant's employer, Chambers, Might & Co. and supplied to the appellant in duplicate, one copy of which was attached by him to his Income Tax Return for 1961, it was indicated that the appellant was employed for twelve months and that his salary or wages before deductions totalled $8,433.33. The appellant made corrections thereon in ink, changing the number of months employed from twelve to eight and one-half, substituting $6,529.53 as his total of salary or wages which he arrived at by deducting the sum of $1,903.80 from the sum of $8,433.33 and inserting the figure of $1,903.80 in a space on the form entitled "Lump Sum Payments". In a notation appended to his 1961 Income Tax Return the appellant described the deduction of $1,903.80 as a "Settlement for Relocation".

Counsel for the appellant contended that the payment of $1,903.80 now in question, although prompted by the employer-employee relationship which had subsisted between the appellant and the legal firm until its abrupt termination on September 11, 1961, was a gift or benefaction of an exceptional kind, personal to the appellant and motivated by altruistic considerations of the former employer for the appellant's wife and family.

I assume, as an original premise, that gifts, as such, are not chargeable to income tax. The important question,

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however, is whether the employment of the appellant was the source of the benefit received by him. It does not necessarily follow, as was pointed out by counsel for the appellant, from the fact that an amount is received by an employee from a firm by whom he was employed that it is chargeable to tax (*vide Bridges v. Hewitt*)[1]. Whether a benefit received by a taxpayer was received by him "in respect of, in the course of, or by virtue of the office or employment" must be considered in relation to the particular circumstances in which it was received.

Counsel for the Minister contended that the sum formed part of the appellant's income from his office or employment by virtue of sections 5(1) and 25 of the *Income Tax Act* because,

(1) it constituted salary, wages or other remuneration or other benefit received or enjoyed by him in respect of, in the course of, or by virtue of the office or employment, or

(2) it was an amount received by him from the legal firm on account of, or in lieu of payment of, or in satisfaction of an obligation arising out of an agreement made by the legal firm with the appellant immediately prior to the period that the appellant was in the employment of the firm and accordingly is deemed, for the purposes of section 5, to be remuneration for the appellant's services.

Alternatively counsel for the Minister contended that the sum is to be included in computing the appellant's income by virtue of section 6(1)(*a*)(*j*) as a retiring allowance within the meaning of section 139(1)(*aj*) of the Act.

The provisions of the *Income Tax Act*[2], which I consider pertinent to the present appeal are reproduced hereunder:

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.

5. (1) Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year plus

[1] (1957) 37 T.C. 289. [2] 1948, c. 52.

(a) the value of board, lodging and other benefits of any kind whatsoever (except the benefit he derives from his employer's contributions to or under a registered pension fund or plan, group life, sickness or accident insurance plan, medical services plan, supplementary unemployment benefit plan or deferred profit sharing plan) received or enjoyed by him in the year in respect of, in the course of, or by virtue of the office or employment; . . .

I am convinced, on the evidence adduced, that the appellant was dismissed upon grounds which warranted his summary dismissal without notice. In the absence of exceptional circumstances such as prevailed in the present instance, a contract of general or indefinite hiring, such as the oral contract of hiring entered into between the appellant and the legal firm, might be terminated on reasonable notice. What constitutes reasonable notice depends upon the grade of employment. If it were incumbent upon me to do so, which it is not, I would decide that, in the circumstances of the appellant's employment, three months' notice would be reasonable.

While the legal firm paid the appellant an amount equivalent to three months' salary at $750 per month (less income tax thereon) it was under no legal obligation whatsoever to do so and the payment of that amount was purely voluntary. But a payment may be liable to income tax even though it was voluntary on the part of the person who made it.

In *Herbert v. McQuade*[1] Collins M.R. said at page 694:

...a payment may be liable to income tax although it is voluntary on the part of the persons who made it, and that the test is whether, from the standpoint of the person who receives it, it accrues to him in virtue of his office; if it does, it does not matter whether it was voluntary or whether it was compulsory on the part of the persons who paid it.

In *Goldman v. M.N.R.*[2] Rand J. in commenting upon the foregoing extract, had this to say at page 219:

In *Herbert v. McQuade,* it is said that the payment must be looked at from the standpoint of the person who receives it. While that aspect is no doubt relevant, the purpose of the donor or payer can be no less so. It is the latter's mind which determines that the payment be made at all and the object to which it is referred. That, at the same time, we should have, on the part of the receiver, an acceptance in the same understanding furnishes a complementary circumstance which would seem to me to put the matter beyond controversy.

[1] [1902] 2 K.B. 631.

[2] [1953] 1 S.C.R. 211.

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Mr. Saucier testified that the amount of $1,903.80 was a figure arbitrarily arrived at by the members of the management committee as being adequate to permit the appellant to return, with his family, to Scotland, or in the alternative, as put in the letter of dismissal dated September 12, 1961, to enable him to seek further employment. I have great difficulty in following how the amount was merely arbitrary other than in the sense that it need not have been given at all. I should have thought that an arbitrary amount would have been expressed in round figures, for example $2,250, being three months' salary at $750. Further there appears to be an inaccuracy in Mr. Saucier's letter when he states "Therefore, as a matter of grace, we will pay to you the further sum of $1,903.80 (less deductions for income tax thereon and on the amount you received yesterday) . . .". The resultant figure was in fact $1,903.80 from which no deductions were made, but rather the deductions were taken from the figure of $2,250 as well as from the accrued salary and holiday leave of $529.53 paid to the appellant on the day of his dismissal, but from which tax had not been deducted at that time so as to arrive at the figure of $1,903.80. There is no question in my mind that what the appellant was paid, and what the firm intended to pay to him, in addition to his accrued salary, was three months' salary less tax deductions thereon. The firm was also generous in not restricting the amount to the appellant's salary of $500 per month which became effective on September 1, 1961.

Mr. Saucier also testified that income deductions were made as a matter of caution to avoid any penalties under the *Income Tax Act* upon an employer who failed to deduct and remit the tax on employees' salaries. In response to a question from myself Mr. Saucier intimated that the amount paid to the appellant had been included as an expense in arriving at the profits of the legal firm for the year in question.

There is no question that the legal firm in all its office procedures treated the payment as remuneration for the services of the appellant. It was described as salary, it was paid semi-monthly, income tax deductions were made therefrom and it was reported as such.

The English authorities to which I was referred have decided that if the sum in question is received by a taxpayer by reason of his office, even if the payment is made voluntarily, it is taxable, but if it is a gift personal to the taxpayer and not by virtue of his office, then it is not taxable as a profit or gain of the office because it is not income received from the office. Where a gift of money is made by an employer to an employee under circumstances which lead to the conclusion that it was nothing more than extra remuneration to the taxpayer for his work, then that gratuitous payment is taxable.

In *Blakeston v. Cooper*[1] a special Easter offering to augment a clergyman's income was held to be taxable. It was argued that the offerings were personal non-official free will gifts given to the vicar as marks of esteem and respect. While such reasons may have played their part in increasing the offerings, nevertheless, Lord Ashbourne had no doubt that they were given to the vicar as vicar and accordingly formed part of the profits accruing by reason of his office.

In *Cowan v. Seymour*[2] a sum paid to the secretary of a company who had acted as liquidator without remuneration was held not to be taxable, the amount having been paid to him by the shareholders after the winding up as a tribute or testimonial personal to him and not as payment for services.

Later in *Seymour v. Reed*[3] Viscount Cave stated the principle to be that Schedule E of the English Act rendered taxable,

> all payments made to the holder of an office or employment as such, that is to say, by way of remuneration for his services, even though such payments may be voluntary, but they do not include a mere gift or a present (such as a testimonial) which is made to him on personal grounds and not by way of payment for his services.

He held that an award of the proceeds of a benefit match to a cricket player was not a profit accruing to him in respect to his office or employment, but was a personal gift to him. Benefit matches were arranged by a committee of the club which had an absolute discretion as to how the proceeds were to be applied and the player had no right to have them paid to him.

[1] [1909] A C. 104.
[2] (1919) 7 T.C 372
[3] [1927] A C. 554.

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I take the question to be whether a payment is in the nature of a personal gift or is it in the nature of remuneration. In this sense the words "personal gift" are used in contradistinction to remuneration. Therefore, to say that a payment was intended as a personal gift is merely to say that it was not intended to be remuneration. An employer, for the purpose of assisting an employee whom he did, in fact, remunerate for his services, cannot relieve the employee from his obligation to pay income tax by saying that it was intended as a personal gift and not remuneration. This I believe to be the effect of Mr. Saucier's evidence that the amount paid to the appellant was determined upon an arbitrary basis as being adequate to enable the appellant to return to Scotland. The payment was a gift in the sense that the legal firm was under no obligation to pay the appellant anything. But they did. The amount paid was identical to three months' pay in lieu of notice. It was treated by the firm as remuneration and I cannot escape the conclusion that it was intended as such rather than as a gift personal to the appellant.

In my view it, therefore, follows that the payment was income in the hands of the appellant from an office or employment being a benefit received by the appellant in respect of, in the course of, or by virtue of the office or employment within the meaning of section 5(1)(*a*) of the *Income Tax Act*.

Neither do I think, the fact that the appellant's employment had been terminated when the payment was made, prevents the payment being taxable income (see *Cowan v. Seymour* (*supra*)).

Because of the conclusion I have reached it is not necessary for me to consider the remaining arguments advanced on behalf of the Minister.

The appeal is dismissed with costs.