BETWEEN:

OLIVER MOWAT BIGGAR . APPELLANT,

AND

THE MINISTER OF NATIONAL REVENUE } RESPONDENT.

1947
Nov. 3 & 4
1948
Jan. 24

Revenue—Income—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 30—"Income of the partnership"—Partner not beneficially interested —Appeal allowed.

The appellant is a member of the legal firm of S. & B. and was assessed for income tax for the years 1939 to 1943 inclusive. S. was also a member of the firm of F. & Company and in charge of the Ottawa branch of that company for each of the years in question and divided the profits of that branch between F.B.F. and himself forwarding the former's share to him direct and by cheque on the bank account of F. & Company and paying his own share thereof, together with his share in the profits of all other branches of F. & Company into the bank account of S. & B. Thereafter, from that account S. paid to J.F. annual payments as consideration for the purchase of J.F.'s interest in F. & Company, and also to F.B.F. the latter's share in the profits from all branches of F. and Company other than the Ottawa branch. The respondent assessed appellant as though the full amount of the payments to F.B.F. had become the shares of the partners in the income of the partnership of S. & B. and on the basis of the appellant's interest in the firm of S. & B. Appellant was never a partner of F. & Company. He was entitled as a member of the firm of S. & B. to have the net profit of S. from time to time in the profits of F. & Company become part of the income of the firm of S. & B. He appealed from the assessment by respondent.

It was admitted by counsel at the hearing that appellant always accepted as correct the statement of S., verified by the auditor, setting out the profits of S. & B. and the money received from the firm of F. & Company in which appellant had never had any interest and from which he never received any money.

APPEAL under the provisions of the Income War Tax Act.

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

C. C. Robinson, K.C. for appellant.

J. R. Tolmie and *E. S. MacLatchy* for respondent.

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

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CAMERON J. now (January 24, 1948) delivered the following judgment:

This is an appeal from assessments to income tax dated February 15, 1946, for the taxation years 1939 to 1943, inclusive. The appellant is a member of the legal firm of Smart and Biggar, and for each of the years in question had made income tax returns and paid the full amount of tax calculated upon the income so returned. The assessments now in appeal include certain amounts which were not included by the appellant in making his annual returns.

This appeal was heard at the same time as another appeal by the executors of the will of the late Russell S. Smart, K.C., in regard to the latter's income for the same taxation years. The only oral evidence at the hearing was that of J. E. M. Fetherstonhaugh. A large number of documents were referred to, and for the sake of brevity, they will, after identification, be referred to by the numbers given them in the record filed.

By agreement dated November 1, 1926, (3) the appellant entered into a partnership agreement with the said Smart. That agreement contains the following clauses:

1. That Smart and Biggar agree to become partners in the practice of law, their relative interests as hereinafter defined extending to the earnings of Smart and Biggar in the practice of law after the date of the commencement of the partnership and to the then and prospective interest of Smart in the business of Fetherstonhaugh and Company.

3. The respective shares of Smart and Biggar shall be calculated by reference to the sum of the gross fees received by them severally or jointly from the practice of law, and Smart's net share from time to time in the profits of Fetherstonhaugh and Company, subject only to the deduction of such additional office expenses as, by reason of the association of Biggar with Smart in the practice of law, are not payable by Fetherstonhaugh and Company under the terms of the agreement dated the 1st of October, 1925, the net amount thus ascertained being hereafter referred to as the income of the partnership.

12. The benefit of any additional interest in Fetherstonhaugh and Company which may be acquired, or which may fall in to Smart under the agreement dated the 1st of October, 1925, shall accrue to the partnership hereby constituted.

Smart's then interest in Fetherstonhaugh and Company was derived under an agreement dated October 1, 1925, (2) by which he became a partner in that firm, the other partners being the founder, F. B. Fetherstonhaugh, and the latter's son, J. E. M. Fetherstonhaugh.

By an agreement dated December 3, 1928, (4) J. E. M. Fetherstonhaugh assigned all his interest in Fetherstonhaugh and Company to Smart, F. B. Fetherstonhaugh joining therein to approve of the same. In part, that agreement is as follows:

AND WHEREAS it has been agreed between the parties that the Assignor should assign to the Assignee all his interest in the partnership under the terms hereinafter set out.

NOW THIS AGREEMENT WITNESSETH that:

1. The Assignor, as of October 1st, 1928, hereby assigns to the Assignee all his interest in the business carried on by FETHERSTONHAUGH & CO., and after that date all his rights in relation to the said firm and the business carried on by it except as hereinafter provided.

The Assignor, as of October 1, 1928, with the consent of the Assignee and the Party of the Third Part, assumes all the assets and liabilities of the New York Office of Fetherstonhaugh & Co., and after such date the profits and assets of New York Office shall belong solely to him.

2. The ASSIGNEE, in consideration of the assignment to him of the interest provided in clause 1, covenants and agrees out of his receipts from the business of said firm to pay to the Assignor during the latter's life the sum of . . . . . annually, by quarterly installments on the first days of January, April, July and October in each and every year, commencing January 1, 1928, said annual sum to be the first charge on any receipts from the business of the firm which the Assignee may receive during each and every year. If any annual payment balance is outstanding at the end of any year it shall be carried forward to the succeeding year or years.

3. In the event of the Assignee's share of receipts from the business for any one year not equalling . . . . . and consequently the Assignor receiving less than the agreed upon annual sum, then, the Assignor shall have the privilege and right, upon his election, to come back into the partnership on the same terms as existed prior to this assignment without affecting the assets and profits of the Assignor as to his New York Office as hereinbefore provided in clause 1, upon such Assignor paying back to the Assignee any difference between the total sum paid to such Assignor and the total amount he would have received as his share of the profits from the partnership had this assignment not been made, such repayment to include simple interest at the rate of five per cent (5%) per annum. The repayment shall only apply when the total amount paid by the Assignee to the Assignor shall be greater than the total amount such Assignor would have received as his share of the profits of the firm had he continued in the partnership.

Pursuant to the terms of this agreement, Smart became entitled to the share of profits to which J. E. M. Fetherstonhaugh had been previously entitled, as well as his own; and during his lifetime the said Smart paid to J. E. M. Fetherstonhaugh the said annual sum of $. , save for two or three years when there was a dispute which resulted in a compromise settlement. All of Smart's profits in Fetherstonhaugh and Company (save as hereinafter

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mentioned) were paid into the bank account of Smart and Biggar, and all payments to J. E. M. Fetherstonhaugh were paid by cheque on that account.

On June 19, 1940, Smart learned of breaches by F. B. Fetherstonhaugh of the partnership agreement of October 1, 1925. On June 25, 1940, he instituted an action in the Supreme Court of Ontario, asking for a declaration in accordance with clause 19 of the partnership agreement of 1925 (2) that F. B. Fetherstonhaugh had forfeited all his rights in and to the assets and goodwill and firm name of Fetherstonhaugh and Company, and that the share thereof formerly held by F. B. Fetherstonhaugh had become vested in Smart and was his property. After some weeks of negotiation, the litigation was finally settled in September, 1940, on the terms that F. B. Fetherstonhaugh should not defend but should allow judgment to go as prayed, and that *Smart* should pay him during his lifetime the same share of profits of Fetherstonhaugh and Company after judgment, as before. The judgment of September 16, 1940, (7) was given accordingly in default of defence, as prayed.

Paragraphs 18 and 19 of the Statement of Claim in this appeal are:

18. In accordance with this settlement the profits of Fetherstonhaugh & Co. continued to be divided as between Smart and F. B. Fetherstonhaugh in the same proportions as before; and from the date of the said judgment until Smart's death Smart made the appropriate payments to F. B. Fetherstonhaugh whenever such profits were divided. When profits of the Ottawa office were so divided, Smart, as before, paid F. B. Fetherstonhaugh's share by a cheque of Fetherstonhaugh & Co. on that firm's local Ottawa account, and deposited his own share, paid by a similar cheque, in the account of Smart & Biggar. The other offices of Fetherstonhaugh & Co. all now remitted their profits to Smart instead of to F. B. Fetherstonhaugh, and Smart continued to deposit all that he so received in the bank account of Smart & Biggar, paying F. B. Fetherstonhaugh his share by a cheque on that account, and leaving the remainder in that account as his own net share of these profits.

19. The only exception to the practice described in paragraph 18 arose from an advance made by Smart to Fetherstonhaugh, on the conclusion of the settlement, of $ . . . . . on account of Fetherstonhaugh's share of future profits, which Smart paid by a cheque on the account of Smart & Biggar. Smart recouped himself, and repaid Smart & Biggar, at first by depositing in Smart & Biggar's account the whole of any profits from the Ottawa office of Fetherstonhaugh & Co., and paying no part to F. B. Fetherstonhaugh of any profits from the other offices, and later, at Fetherstonhaugh's request, by paying Fetherstonhaugh, out of the appropriate account, at each division of profits, only half Fetherstonhaugh's

share of such profits. In this way the advance was finally wiped out, and Smart & Biggar were fully repaid in March, 1942. A list (No. 10) of the cheques to F. B. Fetherstonhaugh from September, 1940 to May 1, 1944, shows by which firm each was drawn.

The Statement of Defence admits the facts set out in these two paragraphs.

It is in respect of these payments by Smart to J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh that the assessments now in question charge the appellant in proportion to his share in the partnership profits of Smart and Biggar. Each of the other partners in Smart and Biggar has been similarly charged in proportion to his share in those profits.

The assessments as to the matters in question are made under section 30 of the Income War Tax Act, as follows:

Sec. 30. *Partnerships*—Where two or more persons are carrying on business in partnership the partnership as such shall not be liable to taxation but the share of the partners in the income of the partnership, whether withdrawn or not during the taxation year shall, in addition to all other income, be income of the partners and taxed accordingly.

I have today given judgment dismissing the appeal of the executors of the will of the late R. S. Smart, K.C. In that judgment I considered in detail all the evidence in regard to the payments made to both J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh. The evidence is the same in that case as in the present appeal. I do not consider it necessary to here repeat all that I said in that judgment. In the present case I have reached the same conclusions as to the facts and the law (other than the assessability of the appellant) as I did in the Smart Estate Appeal, and reference may be made to my judgment in that case as forming part of my reasons for judgment in the present case. I shall, however, briefly summarize those findings in reference to the special features of the present appeal.

Smart, who was in charge of the Ottawa branch of Fetherstonhaugh and Company for each of the years in question, divided the profits of that branch between F. B. Fetherstonhaugh and himself, forwarding the former's share to him direct, and by cheque on the bank account of Fetherstonhaugh and Company, and paying his own share thereof, together with his share in the profits of all

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the other branches of Fetherstonhaugh and Company, into the bank account of Smart and Biggar. Thereafter, from that account, he (Smart) paid to J. E. M. Fetherstonhaugh the annual payment of $, and to F. B. Fetherstonhaugh the latter's share in the profits from all branches of Fetherstonhaugh and Company other than the Ottawa branch. Approximately two-thirds of the amounts paid to F. B. Fetherstonhaugh were made direct from Fetherstonhaugh and Company and never reached the bank account of Smart and Biggar. The respondent, however, has assessed the appellant as though the full amount of the payments to F. B. Fetherstonhaugh had become the shares of the partners in the income of the partnership of Smart and Biggar, and on the basis of the appellant's interest in the firm of Smart and Biggar.

As regards the payments made to J. E. M. Fetherstonhaugh, I found in the Smart Estate Appeal that they were paid by Smart in consideration of the sale by J. E. M. Fetherstonhaugh to Smart of the former's share in the business of Fetherstonhaugh and Company—a capital asset; that, as profits of Fetherstonhaugh and Company accruing to Smart out of that business, they attracted tax in the hands of Smart at that point, and that the mere fact that they were paid into, and later out of, the bank account of Smart and Biggar, did not affect the situation in any way, the procedure followed being only a convenient way for Smart to handle the matter. I reached the same conclusion in regard to the payments made to F. B. Fetherstonhaugh. I found also that all the members of the firm of Smart and Biggar had accepted Smart's computation as to what he was required to bring into the firm of Smart and Biggar from his profits in Fetherstonhaugh and Company, pursuant to agreement (3); that they concurred in his deduction therefrom of the payments made to both J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh, and that the appellant and the third partner in Smart and Biggar at no time considered that they were beneficially entitled to any part of the said sums, and in fact did not withdraw any part of them for their own use.

It is important to state that at no time was the appellant a member of the firm of Fetherstonhaugh and Company,

and that the payments to both J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh were made out of profits accruing to Smart from Fetherstonhaugh and Company, and paid by Smart in pursuance of agreements made by Smart, and not by the appellant.

The appellant is assessed as a member of Smart and Biggar under section 30 of The Income War Tax Act *supra*. The respondent, therefore, must show that these amounts, said to be assessable in the hands of the appellant, are part of his share as a partner in the "income of the partnership" of Smart and Biggar. Did the payments at any time become "income of the partnership" of Smart and Biggar? The only suggestions that can be made to establish that they were "income of that partnership" are (*a*) that by agreement (3) Smart's net share from time to time in the profits of Fetherstonhaugh and Company was to become part of the income of the firm of Smart and Biggar; and (*b*) that all the payments made to J. E. M. Fetherstonhaugh, and approximately one-third of the payments made to F. B. Fetherstonhaugh for the years in question, were paid out of the bank account of Smart and Biggar from monies paid into that account by Smart out of the profits of Fetherstonhaugh and Company.

Not all money in the bank account of a partnership is "income of the partnership." Many deductions may be made before the income of the partnership is ascertained. In the case of a firm of solicitors, substantial amounts of trust monies may pass through the firm's accounts, but such trust funds could not be considered as "income of the partnership." The mere fact that all of the monies paid to J. E. M. Fetherstonhaugh, and part of the monies paid to F. B. Fetherstonhaugh, passed through the bank account of Smart and Biggar does not by itself establish that the sums represented by these payments were "income of the partnership." It would be necessary, I think, to establish that under the agreement (3) they were sums which represented Smart's "net share from time to time" in the partnership of Fetherstonhaugh and Company, and to which the firm of Smart and Biggar was entitled, and which had been received by that firm.

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If Smart had been a partner in Fetherstonhaugh and Company, and in no other partnership, there could be no question, I think, that all the payments to J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh would have been taxable income in his hands as having been profits derived from that business. But there is nothing in agreement (3) which in clear terms required Smart to bring into Smart and Biggar all the profits he was entitled to in Fetherstonhaugh and Company. The relevant part of the agreement between the partners of Smart and Biggar was: "The respective shares of Smart and Biggar shall be calculated by reference to the sum of the gross fees received by them severally or jointly from the practice of law, and Smart's *net share* from time to time in the profits of Fetherstonhaugh and Company . . . . ."

It was open to the parties of agreement (3) to agree as to what was meant by "net share." It was their own agreement and, provided they all concurred in the interpretation to be placed on any part of it, no one else could raise any objection. And, so far as the evidence before me is concerned, there is no doubt whatever that they all agreed that what should be brought into the firm of Smart and Biggar for distribution amongst the partners thereof by Smart, was the net amount that Smart got after paying out all his obligations in respect of his former partners in Fetherstonhaugh and Company. In the minds of the partners of Smart and Biggar that constituted Smart's "net share from time to time in the profits of Fetherstonhaugh and Company." It is alleged by the appellant and admitted by the respondent, that the appellant, in computing his share in the income of Smart and Biggar for the purpose of his income tax returns, accepted Smart's computation of Smart's "net share from time to time in the profits of Fetherstonhaugh and Company," and made his own return accordingly. The auditor's reports to Smart and Biggar indicate very clearly that, in arriving at the amount they were entitled to receive from Smart's share in the profits of Fetherstonhaugh and Company, the net profits earned at the various branch offices of Fetherstonhaugh and Company had been first divided between F. B. Fetherstonhaugh and R. S. Smart, as provided in the

agreement of December 3, 1928; and that from that share of Smart was also deducted the annual payment of $ .. .. to J. E. M. Fetherstonhaugh. The appellant, no doubt, approved of this computation as correct. It would have been more to his financial advantage had he insisted that all the profits be paid into Smart and Biggar, the shares of the partners then ascertained, and Smart required to meet his personal obligation to J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh out of his own share in the profits of Smart and Biggar. I have no hesitation, therefore, in finding that the appellant's interpretation of agreement (3) was made in good faith.

As I have stated above, there is no evidence to indicate that the appellant benefited in any way by the payments to J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh. At no time did he consider that he was entitled personally to any part of such payments. So far as the evidence goes, the only person who benefited by the payment was Smart, who thereby acquired the ownership of the shares of his former partners in Fetherstonhaugh and Company.

My conclusion, therefore, is that the amounts paid into the bank account of Smart and Biggar, and later disbursed by Smart to J. E. M. Fetherstonhaugh and F. B. Fetherstonhaugh, were at no time part of the "income of the partnership" of Smart and Biggar in which the appellant had any beneficial interest. The bank account of Smart and Biggar was no more than a conduit pipe through which the monies passed. The beneficial ownership thereof remained in Smart until the sums were paid out in satisfaction of his own personal obligations. No part of these sums was taxable income of the appellant.

Approximately two-thirds of the total payments made to F. B. Fetherstonhaugh over the years in question were paid to him by Smart on the bank account of Fetherstonhaugh and Company, Ottawa Branch. These sums were never in the bank account of Smart and Biggar and did not appear in their books in any way. To be "income of the partnership" of Smart and Biggar under section 30, they would have to be part of the annual net profit or gain received directly or indirectly by Smart and Biggar. They were never so received and the firm of Smart and Biggar

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never had any control over them. Even had the partners in Smart and Biggar interpreted their agreement (3) to mean that Smart was required to bring into Smart and Biggar all his profits and receipts from Fetherstonhaugh and Company, without any deduction of the amounts paid to F. B. Fetherstonhaugh, the mere fact that these sums were "receivable" by Smart and Biggar would not, under the circumstances here discussed, make them income of the partnership of Smart and Biggar until they were directly or indirectly received.

In *Dewar* v. *Commissioners of Inland Revenue* (1), Lord Hanworth, M.R., in delivering judgment in the Court of Appeal, said at p. 576:

> In the *St. Lucia* case, (1924) A.C. 508, Lord Wrenbury applied a test, and says this at page 512: "The words 'Income arising or accruing'"—words which we have not got in the present case—"are not equivalent to the words 'debts arising or accruing.'" To give them that meaning is to ignore the word "income". The words mean "money arising or accruing by way of income". There must be a coming in to satisfy the word "income". Again those words must be taken in their true sense, because that is not an exhaustive definition of what is taxable under an Income Tax Act. Profits and gains are taxable although they do not in the true sense come in . . . . . But all those observations tend in this direction, that you must find something which is in the enjoyment of the subject. He could make use of the money which lies abroad to his use. It is in that sense in his enjoyment. At the present time, upon the present facts, there is no enjoyment by Mr. Dewar, there is no gain by him, he has derived no profit and there is nothing in his hands which will answer the test of what you mean by "income".
>
> Then I come to (1928) 1 K.B. 73, the case of *Leigh* v. *Commissioners of Inland Revenue,* in which Mr. Justice Rowlatt, whose experience and knowledge of the Income Tax Acts is quite unrivalled, says this at page 77: "It is to be remembered that for Income Tax purposes 'receivability' without receipt is nothing. Before a good debt is paid there is no such thing as 'Income Tax upon it'." I agree with those words . . . . . I think Mr. Justice Rowlatt was right in saying that for Income Tax purposes receivability without receipt is nothing.

That was a case in which the appellant was entitled under his uncle's will, of which he was an executor and trustee, to a pecuniary legacy and also to a share of the residuary estate. As from 11th April, 1931 (one year from the date of the testator's death), the pecuniary legacy in law carried interest at 4 per cent per annum on such part of it as was for the time being unpaid. The first of several payments on account of that legacy was made to the appellant on 14th April, 1932, at or about which date he decided

(1) (1935) 19 Tax Cases 561.

to allow the question of interest to stand over. At the date of the hearing of the appeal he had received no interest and had made no election as to whether or not he would claim the interest from the estate, which was at all material times sufficient to enable the interest to be paid.

The appellant appealed against the inclusion in an assessment to Sur-tax made on him for the year 1932-33 of a sum representing interest at 4 per cent on the legacy. The Special Commissioners decided that the voluntary forgoing by the appellant of the interest which he had a right to receive ought to be regarded simply as being an application of the interest, which had accordingly been correctly included in the assessment.

On appeal, it was held that, as the respondent had not received any interest in respect of the legacy, no amount could be included for such interest in computing his total income for the purposes of the assessments in question.

In the same case, Romer, L.J., said at p. 579, after expressing approval of the decision in the *St. Lucia* case (*supra*):

> Now it is said, and said truly, that it has not been received by Mr. Dewar or placed at his disposal owing to his voluntary act or omission; that is to say the interest has not been paid, not because the debtor cannot pay it, but because Mr. Dewar has not thought fit to ask for payment, and further has intimated the possibility of his releasing the debtor altogether from payment of that interest. But for the purposes of Income Tax, one does not take an account of an impossible income on the footing of wilful default. The question is what income the man has received, and not what income he has received or but for his wilful default might have received. The truth of the matter here is that no one owes a duty to the State to maintain his assessment for Sur-tax at the highest possible figure. If a subject thinks proper so to do he assuredly may get rid of an income-bearing security for the purposes of avoiding the addition of the income from that security to his assessment for Sur-tax purposes. That is admitted. A tenant for life, if he thinks fit, may surrender his life interest. If he does so, most assuredly he does not remain liable to be assessed to Income Tax in respect of the income which he has surrendered, and I for myself can see no reason why a man should not, if he thinks fit, retain the corpus of an income-bearing fund and release his right to receive the income, either for one year or two years or altogether. If he does so in my opinion he does not receive the interest. For that reason that interest cannot be assessed for Sur-tax.

Maughan, L.J., after considering the *St. Lucia* case, *Lambe* v. *Commissioners of Inland Revenue* (1), and *Leigh* v. *Commissioners of Inland Revenue* (2), said, at p. 580:

> For the reasons given, in particular by the Master of the Rolls, who has dealt with those cases in some detail, I am of opinion that the cases

(1) (1934) 1 K.B. 178. (2) (1928) 1 K.B. 73.

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were correctly decided and that they do not depend or relate solely to cases where there has been a default in payment by a debtor. I think they have a wider range than that and include cases where the debtor (if there is a debtor) for some reason other than default, and without any act on behalf of the creditor which might be alleged to amount to an exercise of dominion over the debt, has not in fact paid the sum of interest in question during the year of assessment.

Reference may also be made to *Woodhouse* v. *Commissioners of Inland Revenue* (1), in which it was held, following the decision in *Dewar* v. *Commissioners of Inland Revenue* (*supra*), that only the amounts received should have been included in the assessments.

As to the payments made to F. B. Fetherstonhaugh by Smart out of the account of Fetherstonhaugh and Company, my conclusion is that they were not part of the income of the partners of Smart and Biggar, and therefore formed no part of the taxable income of the appellant herein, for the years in question.

The appeals will therefore be allowed, with costs to be taxed.

Judgment accordingly.