1950
April 24
1952
Sept. 15

BETWEEN:

NATIONAL TRUST COMPANY LIMITED as Executor of the last Will and Testament of Robert Ray McLaughlin, deceased .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97 ss. 2(r) (i), 3, 6(f)—Presumption of validity of assessment—Onus of showing assessment erroneous on appellant—Meaning of "personal and living expenses" under s. 2(r) (i) not to be applied in cases not within its express words—Reasonable expectation of profit a question of fact.

Held: That an assessment under the Income War Tax Act carries with it a presumption of validity until the contrary is shown and the onus of showing that it is erroneous in fact or in law lies on the taxpayer who appeals against it.

2. That section 2(*r*) (i) of the Income War Tax Act extends the meaning of the term "personal and living expenses" far beyond its ordinary one and care must be taken to see that it is not applied in cases that do not fall within its express words.

3. That a taxpayer cannot be deprived of the right to deduct expenses to which he would ordinarily be entitled otherwise than by express words.

4. That where it is material to prove a person's intentions evidence may be given of what he said.

5. That whether Mr. McLaughlin maintained his farm with a reasonable expectation of profit is a question of fact.

6. That Mr. McLaughlin was engaged in the business of farming and cattle breeding bona fide for profit and with a reasonable expectation of profit.

APPEAL under the Income War Tax Act.

The appeal was heard before the President of the Court at Toronto.

W. Judson K.C. and *C. C. McGibbon* for appellant.

J. Singer K.C. and *P. H. McCann* for respondent.

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

The President now (September 15, 1952) delivered the following judgment:

These appeals are brought by National Trust Company Limited as executor of the last Will and Testament of Robert Ray McLaughlin, who died on September 23, 1947, against his income tax assessments for 1944 and 1945 levied after his death.

Mr. McLaughlin was a farmer and cattle breeder near Oshawa in Ontario. Up to and including the years under review he had carried on his farming operations at a loss, according to his accounting, and in his income tax returns had always deducted these losses from his income from other sources. His right to make these deductions was not challenged in any of the assessments for the years prior to 1944. But in the assessments for 1944 and 1945 the Minister allowed a deduction of only 50 per cent of the farm operating losses and also disallowed the claims for depreciation allowances, although in previous years similar claims had been allowed. From these assessments the appellant appealed to the Minister who served notice on the appellant of his intention to reassess the estate and disallow the deduction of the farm operation losses on the grounds that they were personal and living expenses within the meaning of section 2(*r*) (i) of the Income War Tax Act, R.S.C. 1927, chap. 97, and, therefore, prohibited from deduction by section 6(*f*) of the Act. After complying with the requirements of the Act the appellant now brings his appeals from the two assessments to this Court.

The sections of the Act particularly to be considered in this case are section 6(*f*) which provides:

6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

(*f*) personal and living expenses:

1952
R. R. McLaughlin Estate v. Minister of National Revenue
Thorson P.

and section 2(*r*) (i) which provides:

2. In this Act, and in any regulations made hereunder, unless the context otherwise requires,

(*r*) "personal and living expenses" shall include *inter alia*—

(i) the expenses of properties maintained by any person for the use or benefit of any taxpayer or any person connected with him by blood relationship, marriage or adoption and not maintained in connection with a business carried on *bona fide* for a profit and not maintained with a reasonable expectation of a profit;

The issue is whether Mr. McLaughlin's farm operating expenses were personal and living expenses within the meaning of section 2(*r*) (i) of the Act. If they were their deduction from his other income was prohibited by section 6(*f*). But if they were not, there was no reason why their deduction should not be allowed, in which case the appeals must be allowed.

It follows from what I have said that if the expenses were personal and living expenses within the meaning of the section the Minister had no right to allow 50 per cent of them as a deduction and his action in so doing was contrary to the Act. The Minister is bound by the Act and where it provides that in computing the amount of the profits or gains to be assessed a deduction shall not be allowed in respect of certain sums he has no authority to allow their deduction. He must make his assessment in accordance with the directions of the Act.

Moreover, the fact that the deduction of the farm operating expenses had been allowed in the assessments for the years prior to 1944, even after the enactment of section 2(*r*) (i), must not be taken as an admission by the Minister that the expenses were not personal and living expenses within the meaning of the section. If they were personal and living expenses their deduction ought not to have been allowed and the failure to disallow them cannot enure to the benefit of Mr. McLaughlin's estate. Indeed, no inference should be drawn from that fact.

It is well established that an assessment under the Income War Tax Act carries with it a presumption of validity until the contrary is shown and that the onus of showing that it is erroneous in fact or in law lies on the taxpayer who appeals against it: *vide Dezura* v. *Minister of National*

Revenue (1); *Johnston* v. *Minister of National Revenue* (2); *Bower* v. *Minister of National Revenue* (3): *vide* also the discussion of the nature and extent of the onus in *Goldman* v. *Minister of National Revenue* (4). Consequently, if the appellant is to succeed it must show that the facts of Mr. McLaughlin's case are such as to put his farm operating expenses outside the ambit of section 2(*r*) (i) of the Act.

The section was enacted in 1939 by section 2 of An Act to Amend the Income War Tax Act, Statutes of Canada, 1939, chap. 46, to offset the effects for the future of the decisions of this Court in *Malkin* v. *Minister of National Revenue* (5) and *Hatch* v. *Minister of National Revenue* (6). In each of these cases the taxpayer had received the benefit of the deduction of certain expenses which the taxing authority considered were substantially personal and living expenses. In the *Malkin* case the appellant had entered into a trust agreement with his four children and a trustee whereby he and they transferred their respective interests in a certain residence property to the trustee. Certain investments had also been transferred to him from which he received an income. It was one of the terms of the agreement that the trustee should maintain the residence property but the appellant was permitted to occupy it rent free. It was unsuccessfully sought to assess him on the trustee's income from the investments on the ground that it was required to be applied in payment of what were essentially his personal and living expenses. This case accounts for the first part of section 2(*r*) (i), but the *Hatch* case and one of the cases referred to in it seem to have been the sources of the rest of the section. In the *Hatch* case the appellant was the owner of a personal corporation which, for a time, merely held investments for him. But in 1927 the corporation began to operate a horse breeding farm and racing stable. The appellant included in his income tax return money received from the personal corporation after it had deducted the farm and stable expenses. It was unsuccessfully contended that these

(1) (1948) Ex. C.R. 10 at 15.
(2) (1947) Ex. C.R. 483; (1948) S.C.R. 486.
(3) (1949) Ex. C.R. 61 at 63.
(4) (1951) Ex. C.R. 274.
(5) (1938) Ex. C.R. 225.
(6) (1938) Ex. C.R. 208.

1952
R. R. McLaughlin Estate v. Minister of National Revenue
Thorson P.

expenses were personal and living expenses of the appellant and, therefore, not deductible. It was after these decisions that Parliament enacted the section.

The section extends the meaning of the term "personal and living expenses" far beyond its ordinary one so that, while full effect must be given to it in the circumstances specified, no matter how unusual it is, since Parliament has so enacted, care must be taken to see that it is not applied in cases that do not fall within its express words. Just as tax liability cannot be fastened on a person unless his case clearly comes within the express words of the taxing enactment so a taxpayer cannot be deprived of the right to deduct expenses to which he would ordinarily be entitled otherwise than by express words. It is the letter of the law that governs: *Partington* v. *Attorney General* (1).

It is, therefore, necessary to examine the component elements of section 2(*r*) (i) to see whether they existed in Mr. McLaughlin's case. I think that it must be admitted that his farm operating expenses were expenses of properties maintained by him for the use or benefit of himself and his wife and family and that the first condition of the section was in existence.

The next enquiry is whether the expenses were expenses of properties that were not maintained in connection with a business carried on bona fide for a profit. To take Mr. McLaughlin out of this requirement of the section the appellant must show that his farm operating expenses were those of a business that was carried on bona fide for a profit. It was contended for the respondent that Mr. McLaughlin was not in a business at all, and that his farm operations in 1944 and 1945 were not "a trade or commercial or financial or other business or calling" or "office or employment" or "profession or calling" or "trade, manufacture or business" within the meaning of section 3 of the Income War Tax Act. The facts are against this contention and I reject it. The evidence is conclusive that Mr. McLaughlin was a farmer. That was his calling or business and he had no other. He was not what is commonly called a gentleman or hobby farmer. He had always been interested in farming and wanted to become a farmer.

(1) (1869) L.R. 4 H.L. 100 at 122.

He never wanted to be anything else. Farming was his life work and he had no interest in any other occupation. He lived on his Elmcroft farm and had no other place of residence. He directed all the farm operations himself and worked along with his men in every kind of farm work. He worked hard and for long hours. He supervised the program of crop rotation, bought all necessary seed and fertilizer and looked after the harvesting. He attended to all the necessary repairs of fences, buildings and machinery. He was regarded by the community as a hard-working, thorough and competent farmer who ran his farm well. Mr. McLaughlin also personally supervised the building-up of his Holstein herd. He made all the breeding decisions himself, took steps to keep up the milk production of his cows and kept their production records carefully. He was recognized as an outstanding cattle breeder and an authority on Holsteins. He received the award of Master Breeder from the Holstein Friesian Association of Canada of which he was a director and vice-president. On the evidence, I find as a fact that Mr. McLaughlin was engaged in the business of farming and cattle breeding.

I am also satisfied from the evidence that he carried on his business as a farmer and cattle breeder bona fide for a profit. He was not merely indulging himself in an activity for pleasure. He was anxious to make a success of his work. Mr. F. Batty, a neighbouring farmer, who knew him well, stated that when he started farming he knew that his ambition was to make money on the farm. He had heard him say that he was going to make it pay. His widow, Marjorie O. McLaughlin, also said that he intended to carry on his farming for a profit. She had had many conversations with him on the subject. He realized that more money was going into the farm than was coming out but he expected that it would reach the place where it would break even and begin to make a profit. Although he suffered several set-backs in his program he never had the slightest intention of giving the farm up. He always hoped that he would get it on a paying basis so that it would be an attractive proposition to his sons. He had a conviction that he could make a go of it on a paying proposition and hoped that he would have it paying by the

time his son George, who was going to the Agriculture College at Guelph, would be ready to start. Counsel for the respondent objected to the admissibility of the evidence I have just referred to on the ground that it was hearsay but I am of the view that it was admissible as an exception to the hearsay rule. There is abundant authority to support this view. In *Sugden* v. *Lord St. Leonards* (1) Mellish L.J. put the rule thus:

> wherever it is material to prove the state of a person's mind, or what was passing in it, and what were his intentions, there you may prove what was said, because that is the only means by which you can find out what his intentions were.

Vide also 4 C.E.D. (Ont.) p. 584 and Wigmore on Evidence, 3rd Edition, para. 1714, where it is said that statements of a person's own mental or physical condition have long been the subject of an exception to the hearsay rule. But it is not necessary to rely on what Mr. McLaughlin said for there is plenty of other evidence from which it may be inferred that he intended to make a profit. He had first thought of specializing in the breeding of Shorthorn cattle but decided at an early date that they did not seem to be paying their way and he switched to Holsteins so that while he was building up his herd he could obtain a revenue from the sale of milk. He became the Oshawa Dairy's biggest and best milk producer. He had also intended to breed horses but gave this up as a non-paying proposition. Similarly, he switched from Southdown to Suffolk sheep because the former were a losing venture. Mr. Hagerty, who had been Mr. McLaughlin's foreman, said that he was always trying to do something that would make labour a little easier and cut down expense. This led him to gradual mechanization to save labour expense. He was regarded as a good farm manager. He was interested in the best seeds and fertilizers and established improved grazing clover pastures to increase the carrying capacity of his farms per acre. He was thorough in all his work and careful in his expenditures. In my opinion, there is no doubt at all that Mr. McLaughlin was engaged in the business of a farmer and cattle breeder bona fide for profit. This finding takes him out of one of the requirements of section 2(*r*) (i).

(1) (1876) L.R. 1 P.D. 154 at 251.

But it is not enough to establish that Mr. McLaughlin was engaged in the business or calling of a farmer and cattle breeder bona fide for profit. The appellant must also show that he did so with a reasonable expectation of profit. This is the most difficult portion of the onus resting on it. Whether Mr. McLaughlin maintained his farm with a reasonable expectation of profit is a question of fact to be determined in the light of all the circumstances. It was shown that he, according to his own income tax returns, had suffered farm losses in every year since 1920, that the total of these losses exclusive of depreciation came to $289,578.09 and that his claims for depreciation totalled $123,322.87. On these facts, counsel for the respondent argued that it could not be said that in 1944 and 1945 he was maintaining his farm with a reasonable expectation of profit. While there is force in this contention there are other facts to be considered.

Here it would be desirable to give a brief historical review of Mr. McLaughlin's farm operations. He began farming in 1917 when he was only 20 years of age. This was on the Elmcroft farm of 214 acres. By 1945 his holdings had expanded to 1034 acres. In 1918 and 1919 he was in the Canadian Army. When he came back he started to raise Shorthorn cattle but the price of beef cattle began to fall and in 1923 he changed from Shorthorns to Holsteins. This was because he considered that dairy cattle could do better and he could obtain milk revenue while he was building up his herd. Unfortunately, he ran into a serious infection of Bang's Disease which caused a great set-back in his efforts to build up a pure bred herd. There was great expense in treating the infected cattle, loss in selling animals at butcher prices and failure to get the natural offspring. By about 1935 his herd was free of Bang's Disease and he was able to make progress with his breeding program. He used the best sires he could obtain, kept strict account of the production records of his cows for pedigree purposes, and culled his herd rigorously, keeping only the best heifers and selling those that did not seem to fit in with his herd blood lines. In 1942 he made an important change in his breeding program. In that year he bought several outstanding Holstein cows from the Victoria Farms. This brought the standard of his Holstein

1952
R. R. McLaughlin Estate v. Minister of National Revenue
Thorson P.

herd up so that it was one of the ten best Holstein herds in Canada. His sires were used for artificial insemination and there were more bulls of his breeding used for that purpose in Ontario than of any other breeding. By 1944 the price of bull calves was going up, the average being $500 in that year, $800 in 1946 and $1,400 in 1948. In 1948 his son sold a five months old bull for $9,400 and in 1949 he sold one bull for $6,800 and another for $2,500.

I have some doubt whether evidence of what happened subsequently to 1945 is admissible in the determination of whether Mr. McLaughlin was in 1944 and 1945 operating with a reasonable expectation of profit but I have come to the conclusion that I can determine the question without regard to events subsequent to the years for which the assessments appealed against were made. The evidence is clear that it was Mr. McLaughlin's intention to build up as fine a herd of pure bred Holstein cattle as he could. The accomplishment of such a purpose takes a long time but it was established that he had made rapid progress towards his goal. Mr. G. M. Clemens, the secretary-manager of the Holstein Friesian Association of Canada, said that when he first knew Mr. McLaughlin's herd of Holsteins it was a good herd without being an outstanding one, but that it had become one of the top ten for the breed in Canada. Mr. Clemens' view was that if Mr. McLaughlin had relied only on good bulls it would have taken him 25 years to build up his herd, at which time he would have a profitable herd, but he had bought outstanding females in 1942 and this made for more rapid progress in the development of a top grade herd. The evidence of Mr. E. A. Innes, who was the agricultural representative for Ontario County, was more specific. He said that when he first knew Mr. McLaughlin in 1936 he had a better than average herd and that in the next 5 or 6 years it had become one of the best herds in Canada. It was his opinion that at any time during the last few years, Mr. McLaughlin could, if he had seen fit, have sold his animals and shown a profit. He thought that he could expect a profit from his herd in 1945 or 1946 or thereabouts.

I have given as careful consideration as I can to this question which is not free from difficulty and have come to the conclusion that it would not be fair to decide that Mr.

McLaughlin was not maintaining his farms with a reasonable expectation of a profit. On the contrary, I think that the better inference to draw from all the facts, notwithstanding the long list of reported losses, is that in 1944 and 1945 he did have a reasonable expectation of a profit and I so find. This finding takes his farm operating expenses out of the ambit of personal and living expenses within the meaning of section 2(*r*) (i). They were, therefore, properly deductible from his income from other sources. The result is that the appeals from the assessments herein must be allowed.

The Court cannot, of course, make any decision on the subject of Mr. McLaughlin's claims for depreciation allowances for this matter is exclusively within the jurisdiction of the Minister. All that the Court can do is to refer the assessments back to the Minister for the exercise of his discretion in respect of such claims.

The appellant should have its costs of these appeals including those of the hearing before O'Connor J. prior to his decease.

There will, therefore, be judgment allowing the appeals from the assessments, referring them back to the Minister for the purpose indicated and for costs as directed.

Judgment accordingly.