Ottawa 1967
Jan. 12

BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

DORILA TROTTIER ..... RESPONDENT.

Income tax—Deductions—Husband and wife—Separation agreement—Mortgage of hotel to wife—Monthly payments—Whether periodic payments of alimony or maintenance—Income Tax Act, s. 11(1)(l).

T was owner of a hotel which he operated for a number of years with the active help of his wife until they separated in 1958. They then agreed that the wife was entitled to half the value of the hotel, estimated at about $90,000. In August 1958 they accordingly signed a document agreeing to sign a separation agreement when $12,000 was paid to the wife under a first mortgage of the hotel and stating that such agreement should include a second mortgage of the hotel for $45,000 to the wife who would sign a bar of dower. The second mortgage for $45,000 which *T* gave his wife provided for payment of $12,000 from the proceeds of a first mortgage and the balance by monthly instalments of $350 inclusive of interest at 5% on the outstanding balance, authorized prepayment without notice or bonus, and provided that the rights thereunder were assignable and should pass to the mortgagee's heirs, executors, administrators or successors. A separation agreement executed on October 23rd 1958 declared that the wife accepted the second mortgage in full settlement of all claims for an allowance for herself from her husband provided the mortgage covenants were observed.

Held, the monthly payments made by *T* to his wife were made pursuant to the second mortgage and not pursuant to the separation agreement

and accordingly were not deductible in computing *T*'s income under s. 11(1)(*l*) of the *Income Tax Act*. In order to qualify under s. 11(1)(*l*) a payment must fall precisely within its terms.

Unlike payments of alimony or maintenance the monthly payments by *T* to his wife were assignable, interest-bearing, and the obligation to pay them was absolute regardless of any change in the financial or marital status of the wife and whether she lived or died. Further, in case of default she was not restricted to proceeding under the mortgage but could elect to sue for maintenance.

APPEAL from Tax Appeal Board.

Bruce Verchere for appellant.

F. L. Gratton, Q.C. for respondent.

CATTANACH J.:—This is an appeal by the Minister from a decision of the Tax Appeal Board[1] dated October 21, 1964 in which it was held that certain monthly payments made by the respondent to his wife, Yvonne Trottier, in the total amount of $3,150 were properly deductible by the respondent in determining his taxable income for his 1961 taxation year as an amount paid by him in that year pursuant to a written agreement, as alimony or other allowance payable on a periodic basis for the maintenance of his wife from whom he was living apart pursuant to a written separation agreement in accordance with the provisions of section 11(1)(*l*) of the *Income Tax Act*[2].

Prior to trial the parties agreed upon a statement of issues, admitted facts and facts which were in dispute in the following terms:

I ISSUES

1. Were the payments in issue made by the Respondent to his wife pursuant to a charge by way of mortgage dated 7 August 1958 or pursuant to a written agreement dated 7 August 1958 as alimony or other allowance payable on a periodic basis for the maintenance of his wife, his child, or both of them?

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[1] (1964) 36 Tax A.B.C. 413.

[2] (1) an amount paid by the taxpayer in the year, pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written agreement, as alimony or other allowance payable on a periodic basis for the maintenance of the recipient thereof, children of the marriage, or both the recipient and children of the marriage, if he was living apart from, and was separated pursuant to a divorce, judicial separation or written separation agreement from, his spouse or former spouse to whom he was required to make the payment at the time the payment was made and throughout the remainder of the year;

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2. Were the payments in issue made by the Respondent to his wife as part of a property settlement or for the maintenance of his wife, his child, or both of them?

3. Were the payments in issue made by the Respondent as a partial or entire discharge of all obligations, present or future, to his wife whether of an alimentary nature or of any other nature?

II FACTS ADMITTED

1. During the period from 1947 to 1958 the Respondent owned a hotel known as the Algoma Hotel in Chelmsford, Ontario. The Respondent and his brother purchased the hotel in 1944 for $15,500 and operated it as a partnership until 1947 when the Respondent purchased his brother's interest for $7,000.

2. On 7 August 1958 the Respondent and his wife, in the presence of J. L. McMahon, the wife's solicitor, signed a memorandum of agreement, a copy of which is attached hereto as Schedule A.

3. On 7 August 1958 the Respondent mortgaged the Algoma Hotel to the Canada Permanent Mortgage Corporation for $21,000 repayable in five years.

4. On 7 August 1958 the Respondent entered into a mortgage agreement, a copy of which is attached hereto as Schedule B.

5. On 7 August 1958 the Respondent executed a direction to the Canada Permanent Mortgage Corporation and to Messrs. Hawkins & Gratton, Barristers and Solicitors, a copy of which direction is attached hereto as Schedule C.

6. On 7 August 1958 the Respondent and his wife, Yvonne Trottier, entered into a separation agreement, a copy of which is attached hereto as Schedule D.

7. In 1958 the Algoma Hotel was valued by the Respondent at approximately $100,000.

8 During the years 1944, 1945, 1946 and 1947:

(a) the Respondent and his brother attended to and operated the beverage rooms in the Algoma Hotel,

(b) the Respondent's wife, Yvonne Trottier, operated the kitchen and dining room in the Algoma Hotel and kept the books of account of the hotel business, and

(c) the Respondent's sister-in-law, that is, his partner's wife, attended to and was responsible for the rental of the bedrooms in the Algoma Hotel.

9. After 1947, and until 1957, the Respondent's wife continued to keep the books of account of the hotel business, to operate the kitchen and dining room and also attend to the rental of the bedrooms in the Algoma Hotel. The profit from operating the kitchen, dining room and bedrooms was kept in a separate bank account by the Respondent's wife.

10. During their married life, and until 1947, the Respondent and his wife maintained a joint bank account in Sudbury.

III FACTS WHICH ARE IN DISPUTE

1. Were the Respondent and his wife, in the period from 1947 to 1958, engaged, with regard to the Algoma Hotel business, in a joint enterprise to which each contributed work and money earned from other sources?

2. If the Respondent and his wife were engaged in such a joint enterprise, what approximately were their respective contributions to the business or enterprise?

3. Was the agreement entered into by the Respondent and his wife on or about 7 August, 1958 an agreement providing for alimony or other allowance payable on a periodic basis to the Respondent's wife for her maintenance or was it an agreement which provided for a property settlement?

Attached to such document are Schedules A, B, C, and D.

Schedule A referred to in paragraph (2) under the heading II Facts Admitted, is a photostatic copy of a memorandum of agreement dated August 7, 1958 between the respondent and his wife stating that the parties agree to sign a separation agreement when payment of $12,000 on a first mortgage is made to the wife, that the separation agreement should include a second mortgage given by the respondent to his wife securing an amount of $45,000, and that the wife would sign a permanent bar of dower.

Schedule B, referred to in paragraph (3) of the aforesaid heading is a copy of a mortgage dated August 7, 1958 between the respondent as mortgagor and his wife as mortgagee charging the Algoma Hotel, which is therein described by its legal description, as security for payment of the principal sum of $45,000.

Schedule C, referred to in paragraph (5), is a copy of a direction by the respondent dated August 7, 1958 to the first mortgagee to pay the sum of $12,165 from the proceeds of the mortgage loan to his wife and is stated to be in consideration of her barring her dower and other considerations.

Schedule D, referred to in paragraph (6), is a copy of the separation agreement between the respondent and his wife, which is dated August 9, 1958, and was executed by the parties thereto on October 23, 1958.

Mr. and Mrs. Trottier were married in 1929 and separated some 29 years later in 1958. The respondent, prior to his marriage and during the initial years thereof, had been engaged in a variety of jobs, but his principal occupation had been that of a bartender. He earned about $100 a month. His wife had been a school teacher earning a like monthly amount.

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In 1944 the respondent purchased the Algoma Hotel in the circumstances outlined in the Statement of Facts admitted and the hotel was operated, as is also therein outlined, during the period indicated.

The basic arrangement between the respondent and his wife appears to have been that she would assume the responsibility of operating the kitchen and dining room facilities of the hotel and later assumed the responsibility for the rental of rooms. The respondent, on his part, assumed the responsibility of operating the beverage room or tavern. Mrs. Trottier kept the books of account for the entire combined enterprise. These two areas of responsibility appear to have been somewhat segregated. When acquired, the hotel was in a run-down condition, the kitchen and dining room equipment was inadequate and the bedrooms were in constant need of refurbishing. Mrs. Trottier purchased new equipment and effected repairs, the cost of which was paid from the income received by her from the operation of that portion of the hotel enterprise and when there was not sufficient income from that source, she returned to teaching to supplement her resources. The proceeds from her part of the hotel operation and teaching were kept by Mrs. Trottier in a separate bank account maintained in her name. Counsel for the respondent introduced in evidence the statements from Mrs. Trottier's savings account ledger from 1950 to 1966 but I did not have the benefit of any explanation thereof or any particular item therein. The account shows a modest credit balance over the years varying between $2,000 and $500 with equally modest withdrawals and deposits. She testified that on occasion she paid accounts incurred in the operation of the tavern, although no cash was turned over to the respondent, her husband. The respondent, in giving evidence, sought to emphasize the complete independence of the operation of the beverage room by himself and the remainder of the hotel by his wife. He testified that he paid the taxes, lighting and heating costs, and like expenses from the revenue received from the beverage room. However, he acknowledged that his wife worked very hard, that she expended monies for improvements and repairs, that she engaged and paid staff, but he did state that any revenue received by her was her own. The respondent did not deny that some accounts incurred in

the beverage room were paid by his wife and admitted that when he left he owed his wife $1,000 which he subsequently paid.

I am convinced, from the evidence, that while there was a considerable degree of separation in those portions of the hotel business conducted by the respondent and his wife respectively, nevertheless, I am also convinced that there was a considerable mingling of funds. From the very nature of the operation and the relationship of husband and wife, it could not have been otherwise. The hotel was originally purchased for $15,500 and in 1958 it had appreciated in value to $100,000. I am equally convinced that Mrs. Trottier by her industry over the years contributed substantially to that appreciation in value, but I am unable to assess with any exactitude the respective contributions in effort and monies from sources other than from the operation of the combined business to that enterprise because of the imprecise nature of the evidence with respect thereto.

The couple occupied space in the hotel which served as the matrimonial home. In 1957 the respondent left to live elsewhere under circumstances which were understandably intolerable to his wife. He continued to operate the beverage room. On being approached by his wife to ascertain if he intended to resume his domestic relationship with her, the respondent informed her that he did not. Mrs. Trottier thereupon told the respondent she could no longer continue to live in the hotel or to operate her part of the hotel business and that financial arrangements must be made to facilitate their separation.

In her view, her contribution of effort and money to the development of the hotel business morally entitled her to one-half the value thereof at that time. She neither pressed for nor claimed any interest in the respondent's other assets which included an apartment building of unestablished, but likely negligible, value.

The respondent readily and amicably agreed to his wife's demands. It was also agreed between them that the reasonable value of the hotel was $90,000 after taking into account the expenses and possible diminution in price consequent upon a precipitate sale.

The respondent did not have $45,000 readily available in cash to pay to his wife. He, therefore, undertook to raise

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funds by placing a first mortgage on the hotel premises from the proceeds of which $12,000 would be forthwith paid to his wife, as he stated in evidence, in order that she might build or purchase an adequate home for herself and their daughter. For the balance of $33,000 he undertook to give his wife a second mortgage repayable in monthly instalments inclusive of interest at five percent to be payable upon a maximum sum of $21,000. While the respondent was quite willing to pay his wife the sum of $45,000, there was some negotiation between them on the question of whether interest should be paid and if so at what rate. The wife felt that she was entitled to interest on any unpaid balance, but the respondent did not and accordingly the compromise above outlined was agreed upon. As the respondent explained the matter, it was his hope that the foregoing arrangement would enable his wife to live out the remainder of her life in comfort and without working and that he gave her the second mortgage on the hotel premises to ensure her "protection". The respondent also agreed to give his wife the sum of $50 monthly for the maintenance and education of their daughter for a period of two years or until her education was completed.

The matter of the total of the $50 monthly payments paid in the taxation year for the maintenance and education of the respondent's daughter and the initial lump sum payment of $12,000 is not in dispute. The dispute is restricted to the deductibility of the total amount of $3,150 paid by the respondent in computing his income for his 1961 taxation year.

The respondent contends that the amount is deductible as payments made pursuant to a separation agreement on a periodic basis in strict accordance with the provisions of section 11(1)(*l*) of the *Income Tax Act*.

On behalf of the Minister it is contended that the payments were not made pursuant to a separation agreement but rather were made pursuant to the second mortgage which had been accepted by her in full settlement of all her claims against the respondent. The argument on behalf of the Minister was extended to submit that on the true interpretation of the arrangement between the respondent and his wife it was, in effect, a division or distribution of their property and that it was, in effect, an agreement

whereby the respondent was discharged from his liabilities present or future to his wife whether of an alimentary nature or of any other nature, e.g. her forebearance to claim for a division of the hotel property whether the claim was meritorious or not.

The arrangement as outlined above was discussed and finally agreed upon between the respondent and his wife without prior legal advice. It was their own independent solution of the predicament in which they found themselves.

Having so decided they attended, during July 1958, at the office of a solicitor acting on behalf of Mrs. Trottier for the purpose of having him prepare the necessary documentation to implement the foregoing plan agreed upon by the respondent and his wife. This the solicitor did by preparing the documents annexed to the agreed statement of issues, admitted and disputed facts as Schedules A to D inclusive.

As recited in Schedule A, the parties agreed to separate, and that a separation agreement would be entered into by them when an initial payment of $12,000 was paid to Mrs. Trottier. Because of the respondent's financial position this payment could be made by him only when he had received the proceeds of a first mortgage on the hotel premises. To facilitate the placing of the first mortgage Mrs. Trottier undertook to sign a permanent bar of dower.

Schedule B is the second mortgage given by the respondent to his wife. It recites that "In consideration of the sum of $45,000 paid to me" he charges the land therein after described. The principal sum of $45,000 is made repayable as follows:

> The sum of Twelve Thousand Dollars ($12,000.00) shall be paid when the proceeds of a first mortgage loan to Canada Permanent Mortgage Corporation dated July 29, 1958, are available, or within one month from the date of execution of the Charge, which ever is the sooner. The balance of Thirty-Three Thousand ($33,000 00) Dollars shall be paid in equal consecutive monthly instalments of Three Hundred and Fifty ($350 00) Dollars, including interest, commencing on the 1st day of October, 1958, and on the 1st day of each and every month thereafter until all arrears of principal and interest monies hereby secured are fully paid and satisfied. The interest at the rate of Five per cent (5%) per annum shall be calculated half yearly, not in advance, on the unpaid balance of principal outstanding. Not withstanding, anything written above the interest shall not be calculated at any time on a principal sum greater than Twenty-One Thousand ($21,000.00) Dollars. Such monthly instalments when received by the mortgagee shall be applied firstly on

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account of interest and interest in arrears, if any, and secondly upon the unpaid balance of the Principal The interest payable shall be calculated from the 1st day of September, 1958

In addition to the usual covenants there was also inserted a clause permitting the respondent as mortgagor to pay the whole or any part of the mortgage money without notice or bonus. It is also stated that the rights thereunder are assignable and shall pass to the mortgagee's heirs, executors, administrators or successors as the case may be.

The separation agreement, Schedule D, which is stated to have been made on August 7, 1958 but which was not executed until October 23, 1958 when Mrs. Trottier was assured of the receipt of the initial payment of $12,000, in addition to the usual mutual covenants in an agreement of this nature, provides in paragraph 2 as follows:

> 2. The wife accepts in full settlement a second mortgage upon the property known as Lot Number (2) TWO, in the Fourth concession in the Township of Balfour, for the sum of Forty-Five Thousand ($45,000 00) Dollars in full settlement of all claims for an allowance for herself from her husband. This is provided the covenants in the mortgage are observed.

There is no question whatsoever in my mind that the respondent recognized his legal obligation and duty to maintain and provide for his wife and that he was quite prepared to discharge that obligation and duty which he did in the manner above described. I am also certain that in agreeing to pay his wife the total sum of $45,000, (which I have roughly estimated as being payable over a period of eleven years pursuant to the instruments executed to effect the arrangement between them, and ending when the wife would have attained her 63rd year,) the respondent was guided, in reaching that quantum, by the yardstick of one half of the then mutually accepted value of the combined hotel business operated by his wife and himself. I am equally certain that Mrs. Trottier did not regard the sum of $45,000 to be paid to her as being payment for her maintenance but rather that she regarded it as being her share of the hotel business to which she had contributed her efforts and some of her monies to establish.

Because of the conclusion which I have reached upon the first contention on behalf of the Minister that the payments here in issue were made by the respondent to his wife pursuant to the second mortgage and not pursuant to

a written agreement as an allowance payable on a periodic basis for her maintenance, it is not necessary for me to decide the two alternative contentions raised by the Minister, i.e. that the agreement between the respondent and his wife was, in effect, a division of property between them or that it was a general obligation whereby the respondent would be relieved of all liabilities to his wife whether of an alimentary nature or otherwise.

Prior to the enactment of section 11(1)(*l*) and its analogous predecessor sections, payments made on account of alimony or pursuant to separation agreements were not deductible by a taxpayer in determining his taxable income on the basic principle that personal or domestic expenses are not deductible or the principle that when income was received it is chargeable at that moment no matter what subsequent disposition was made of it. Alimony or maintenance whether or not paid out of the husband's income was considered as something to which the wife was entitled.

Section 11(1)(*l*) permits deduction in the computation of taxable income of:

> an amount paid by the taxpayer in the year...pursuant to a written agreement, as alimony or other allowance payable on a periodic basis for the maintenance of the recipient thereof. . . .

In order to qualify as a deduction from his income the payments made by the respondent to his wife must fall precisely within those express terms.

With such considerations in mind a reference to paragraph 2 of the separation agreement, Schedule D, discloses that Mrs. Trottier accepted a second mortgage on the hotel property for the sum of $45,000 "in full settlement of all claims for an allowance for herself from her husband". While the value of the second mortgage might not be $45,000, nevertheless in my view, the language of the paragraph indicates that what Mrs. Trottier got from her husband in exchange for her right to maintenance was an incorporeal property of value.

It was submitted on behalf of the respondent that the separation agreement, Schedule D, and the second mortgage, Schedule B, must be read together and that payment of $33,000 in equal consecutive monthly instalments of $350 inclusive of interest were periodic payments for the maintenance of the recipient pursuant to a written agree-

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ment which is contained in the two documents. I do not accept that submission. In my view the second mortgage stands in exactly the same position as a promissory note or a parcel of real property which the respondent might have given to his wife in satisfaction of his obligation to provide for her. The real property, if such had been given, rather than the second mortgage, could have been disposed of by the wife, or if a promissory note had been given the note could have been discounted by her. So too could the second mortgage have been negotiated by Mrs. Trottier, either at a discount or a bonus dependent on the state of the second mortgage market if any such market existed. In short I construe paragraph 2 of the separation agreement as being an executory provision.

Alimony or maintenance continues through the joint lives of the husband and wife but terminates upon the death of either. If Mrs. Trottier had died during the currency of the second mortgage the payments under the second mortgage would continue to be payable to her assignee, if she had assigned it, and otherwise to her heirs, executors or administrators in accordance with a covenant in the indenture to that effect. It follows that the periodic payments cannot be classified as payments for maintenance.

Further maintenance is payable for the support of the wife and as such is not assignable by her and neither do such payments, from their very nature, bear interest. The payments here under consideration are both assignable and interest bearing under the terms of the second mortgage.

The result might be different if paragraph 2 of the separation agreement, Schedule D, were a specific covenant by the respondent to pay to his wife a sum certain by way of periodic instalments during her lifetime and the second mortgage had been given to Mrs. Trottier as collateral security for those payments. But such is not the case. The second mortgage was not given by way of collateral security but rather in discharge of the respondent's obligation to support his wife.

Further paragraph 2 of the separation agreement provides that the acceptance by the wife of the second mortgage in full settlement of her claim for an allowance is dependent on the covenants in the mortgage being observed. If there had been default under the second mort-

gage Mrs. Trottier's remedy would not be restricted to taking proceedings to foreclose the mortgage. If she did not elect to proceed under the mortgage she would be free to institute an action for maintenance.

Furthermore, there was an absolute obligation upon the respondent to pay the sum of $45,000 pursuant to the terms of the second mortgage regardless of any changes in the financial or marital status of his wife and whether she lived or died. This is quite inconsistent with the payments being for maintenance.

Therefore, in my opinion, it cannot be properly said that the payments here in question were made, in the words of section 11(1)(*l*), as an amount paid by the taxpayer in the year pursuant to a written agreement, as alimony or other allowance payable upon a periodic basis for the maintenance of the recipient thereof.

Therefore, there will be judgment allowing the appeal with costs against the respondent in favour of the Minister to be taxed in the usual manner.