BETWEEN:

THE TORONTO GENERAL TRUSTS CORPORATION, EXECUTOR OF THE LAST WILL AND TESTAMENT OF SARAH WHITNEY, DECEASED ..... } APPELLANT;

AND

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

1935
Dec. 12.
1936
May 28.

Revenue—Income—Annuity chargeable upon corpus of estate not taxable as income—Income War Tax Act.

Held: That an annuity chargeable upon the corpus of an estate rather than being payable out of a settled fund, and not dependent upon the production or use of any real or personal property in particular, is a gift and not taxable under the *Income War Tax Act*, R.S.C. 1927, c. 97.

APPEAL under the provisions of the Income War Tax Act from the decision of the Minister of National Revenue.

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

W. S. Montgomery, K.C., and *D. E. Gunn* for appellant.

W. S. Fisher and *J. R. Tolmie* for respondent.

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

ANGERS J., now (May 28, 1936) delivered the following judgment:

This is an appeal by the Toronto General Trusts Corporation as executor of the last will and testament of the late Sarah Whitney, widow of Edwin Canfield Whitney, under the provisions of sections 58 and following of the Income War Tax Act (R.S.C. 1927, chap. 97) and the amendments thereto, from the assessment of the said Sarah Whitney's income for the years 1931, 1932 and 1933.

By his last will and testament dated February 19, 1920, probated on March 25, 1924, Edwin Canfield Whitney

appointed The Toronto General Trusts Corporation as executor and trustee of his will and gave, devised and bequeathed all his real and personal estate unto his trustee upon certain trusts which it is not necessary to specify.

The said last will and testament contains (*inter alia*) the following stipulations:

4. I give to my wife, Sarah Whitney, the sum of Two hundred thousand dollars ($200,000) to be paid forthwith after granting of probate of this my will, also the sum of One hundred thousand dollars ($100,000) par value in Victory Bonds (Canada) of the year 1933 issue to be transferred and delivered to her at once on granting of probate of my said will.

12. I give and direct my Trustees to provide and pay to my wife, Sarah Whitney, an annuity of Twenty-five thousand dollars ($25,000) per annum during her life, payable quarterly in advance.

20. I declare that the provision hereinbefore made to my said wife, Sarah Whitney, shall be in lieu of all claims to dower in respect of real estate which I was at the time seized or to which I may be beneficially entitled and said legacy and annuity are only to become payable on my said wife consenting by proper instrument in writing to execute same in lieu of her dower rights.

Edwin Canfield Whitney died on or about February 6, 1924.

By an instrument in writing dated April 3, 1924, Sarah Whitney elected to take the bequests made to her under the will of her husband in lieu of dower.

I may note incidentally that it was admitted at the hearing that the testator had left no dowable lands and that consequently it could not be argued that Mrs. Whitney had taken the annuity of $25,000 by purchase: *Acey* v. *Simpson* (1). Mrs. Whitney was in the position of an ordinary legatee.

The only question in controversy is whether the so-called annuity of $25,000 given by the testator to his wife under clause 12 of the will is, in whole or in part, income within the purview of the Income War Tax Act. The Minister of National Revenue contends it is and has assessed it for the years 1931, 1932 and 1933, the only ones with which we are concerned. The appellant, claiming that it is not, asks that the assessment be set aside and seeks the refund of the tax paid thereon for the years 1931, 1932 and 1933.

It was urged on behalf of appellant that the payments of $25,000 a year to Mrs. Whitney constitute a gift or bequest and as such are not assessable. The respondent, on

(1) (1842) 5 Beav., 35.

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the other hand, submits that these payments, by the terms of the will as well as by their nature and intendment, are annual income in the hands of the annuitant and are accordingly liable to taxation.

The question at issue is governed by section 3 of the Act, the relevant provisions whereof read as follows:

3. For the purposes of this Act, "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be whether derived from sources within Canada or elsewhere; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source including

(a) the income from but not the value of property acquired by gift, bequest, devise or descent;

* * * * * * * * *

(f) rents, royalties, annuities or other like periodical receipts which depend upon the production or use of any real or personal property, notwithstanding that the same are payable on account of the use or sale of any such property.

It is hardly necessary to state that the annuity with which we are dealing does not come within the scope of the first paragraph or general clause of section 3; it is only fair to mention that counsel for respondent did not suggest that it does. Counsel relied on subsection (*a*) of section 3 and stressed the point that the annuity in question is the income of property acquired by gift, bequest or devise.

I must say that, after giving the matter careful consideration, I feel unable to adopt this view.

If the definition of "income" contained in the first paragraph of section 3 of the Income War Tax Act was apparently borrowed from The Assessment Act, R.S.O. 1914, chap. 195, s. 2 (*e*), reproduced in substance although not literally in R.S.O. 1927, chap. 238, s. 1 (*e*), subsection (*a*) of section 3 of the Income War Tax Act is derived from paragraph B of section II of chapter 16 of the Public Acts of the First Session of the Sixty-third Congress (1913) of the United States (see vol. 38 of the U.S. Statutes at Large, Part I); I think it is apposite to quote the relevant part of paragraph B:

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B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, *including the income from but not the value of property acquired by gift, bequest, devise, or descent:* * * *

A substantially similar provision exempting from taxation the value of, but not the income from, property acquired by gift, bequest, devise or descent was included in the various Revenue Acts which followed, particularly those of 1916, 1918, 1921 and 1924 (U.S. Statutes at Large, vol. 39, p. 758, s. 4; vol. 40, p. 1065, s. 213 (*b*) (3); vol. 42, p. 238, s. 213 (*b*) (3); vol. 43, p. 268, s. 213 (*b*) (3).

The provision in each of the above Revenue Acts exempts from taxation the "value of property acquired by gift, bequest, devise, or descent" but enacts that the income from such property shall be included in gross income.

The meaning and import of this provision formed the subject of two decisions of the Supreme Court of the United States, namely, *Burnet* v. *Whitehouse* (1); *Helvering* v. *Pardee* (2).

In the case of *Burnet* v. *Whitehouse,* the testator, James Gordon Bennett, had by his will provided for the payment of certain annuities, among which was one of $5,000 to Sybil Douglas, wife of William Whitehouse. The will contained, among others, the following stipulations:

I authorize and empower said executors or executor to retain and hold any personal property which may belong to me at the time of my death and to set aside and hold any part thereof to provide for the payment and satisfaction of any annuity given by me.

It appears from the notes of Mr. Justice McReynolds, who delivered the opinion of the Court, that the annuity given to Mrs. Whitehouse was satisfied from the corpus of the estate prior to November 14, 1920, and that after that date it was paid out of income derived therefrom. It further appears that the Commissioner of Internal Revenue demanded of Mrs. Whitehouse income tax for 1921 on the payments received during that year. She appealed to the

(1) (1931) 283 U.S., 148. (2) (1933) 290 U.S., 370.

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Board of Tax Appeals and the Board held that the bequest to her was within paragraph (*b*), item (3), of section 213 and therefore exempt; the decision of the Board was approved by the Circuit Court of Appeals, First Circuit (1). The Supreme Court affirmed the judgment of the Circuit Court of Appeals.

At page 150 of the report, McReynolds, J. says:

The most plausible argument submitted for the Commissioner is this: An annuity given by will is payable primarily out of the income from the estate. The residuary estate of Bennett produced enough during 1921 to meet all bequeathed annuities. The payments received by Mrs. Whitehouse during that year were, in fact, made from such income. Consequently, it cannot be said that the bequest was one of corpus; and the payments were taxable under *Irwin* v. *Gavit*, 268 U.S. 161.

As held below, the bequest to Mrs. Whitehouse was not one to be paid from income but of a sum certain, payable at all events during each year so long as she should live. It would be an anomaly to tax the receipts for one year and exempt them for another simply because executors paid the first from income received and the second out of the corpus. The will directed payment without reference to the existence or absence of income.

Irwin v. *Gavit* is not applicable. The bequest to Gavit was to be paid out of income from a definite fund. If that yielded nothing, he got nothing. This Court concluded that the gift was of money to be derived from income and to be paid and received as income by the donee. Here the gift did not depend upon income but was a charge upon the whole estate during the life of the legatee to be satisfied like any ordinary bequest.

In the case of *Helvering* v. *Pardee* the testator, Calvin Pardee, gave to his wife an annuity of $50,000 to be computed from the date of his decease and to be paid in advance in quarterly payments.

Mr. Justice McReynolds, delivering the judgment of the Court, said (p. 370):

The total amount paid by the trustees to the widow under the will during the tax years 1924 and 1925 and prior thereto did not aggregate the value of the interest to which she would have been entitled had she declined to take under the will. When computing the taxable income of the estate the trustees deducted the amounts paid to the widow, claiming credit therefor under § 219. The Commissioner's refusal to allow this was sustained by the Board of Tax Appeals. The court below ruled otherwise.

The annuity provided by the will for Mrs. Pardee was payable at all events. It did not depend upon income from the trust estate. She elected to accept this in lieu of her statutory rights. She chose to assume the position of an ordinary legatee. Section 213 (*b*) (3), Revenue Act of 1924, c. 234, 43 Stat. 253, 267, 268, exempts bequests from the income tax there laid. Payments to Mrs. Pardee by the fiduciary were not necessarily made from income. The charge was upon the estate as a whole; her claim was payable without regard to income received by the fiduciary. Payments to her were not distribution of income; but in dis-

(1) (1930) 38 Fed. (2nd), 162.

charge of a gift or legacy. The principle applied in *Burnet* v. *Whitehouse*, 283 U.S. 148, is applicable.

Subsection (*a*) of section 3 of the Income War Tax Act, as we have seen, is in substance the same as section 213 (*b*) (3) of the United States Revenue Acts of 1921 and 1924, upon which are based the judgments of the Supreme Court in *Burnet* v. *Whitehouse* and *Helvering* v. *Pardee;* these two cases are in point and I agree with the decisions rendered therein.

The annuity payable to Mrs. Whitney was a charge upon the whole estate; it was not payable out of a settled fund. The fact that the trustees thought advisable to buy Dominion of Canada tax-free bonds with which to pay in whole or in part the annuity in question seems to me absolutely immaterial; this was a mere matter of administration on the part of the trustees which could not affect the rights of the beneficiary.

There remains subsection (*f*) of section 3, enacted by 24-25 Geo. V, chap. 55, s. 1 (assented to July 3, 1934) and made applicable to the 1933 taxation period by section 18 of said Act. I do not think that subsection (*f*) applies to the present case: the annuity bequeathed to Mrs. Whitney by her husband does not depend upon the production or use of any real or personal property in particular; it is a charge against the corpus of the estate.

For the above reasons I have reached the conclusion that the appeal must be allowed and that the decision of the Minister affirming the assessments must be set aside.

The respondent is ordered to refund to the appellant the sums which have been overpaid for the years 1931, 1932 and 1933. If the parties cannot agree on the amount to be refunded, they will be at liberty to refer the matter to me for adjudication.

At the opening of the trial, counsel for respondent made a motion orally for leave to file an amended assessment for the year 1931; by consent the decision on this motion was left in abeyance until after the case was heard. Seeing the conclusion at which I have arrived, the motion is of no avail and it is accordingly dismissed.

The appellant will be entitled to its costs against the respondent.

Judgment accordingly.