1949
Dec. 5
1950
Jan. 7

BETWEEN:

HELEN COOPER .....APPELLANT;

AND

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

Revenue—Income—Income tax—Income War Tax Act, R.S.C. 1927, c. 97—Appellant life beneficiary of estate—Depreciation claimed by executors paid to appellant is income of appellant—Payment out of corpus may properly be assessable income in hands of recipient—Taxpayer not to be assessed for amount of depreciation claimed by executors and withheld by them.

Executors in filing the Income Tax Return for 1938 of an estate claimed depreciation on various assets of the estate in the sum of $11,468.37. Appellant, the life tenant of the estate, in her Income Tax Return included as revenue from the estate the sum of $7,189.69. The respondent amended this return by adding thereto the sum of $11,468.37, claimed as depreciation and assessed appellant accordingly. From this assessment an appeal was taken to this Court. It was shown at the hearing of the appeal that the executors had received in the taxation year the sum of $18,658.06 and had paid to appellant a total sum of $14,850 which was $7,660.31 in excess of the net amount payable to her after deducting depreciation.

Held: That depreciation claimed by executors in filing an income tax return for an estate but in reality paid to the life beneficiary of that estate is taxable income in the hands of the recipient.

2. That the life beneficiary is not liable for income tax on the amount claimed by executors as depreciation but not paid to the beneficiary.

APPEAL under the Income War Tax Act.

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

N. C. MacPhee, K.C. for appellant.

G. L. Fraser, K.C. and *J. D. C. Boland* for respondent.

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

CAMERON J. now (January 7, 1950) delivered the following judgment:

This is an appeal from an assessment to income tax dated February 2, 1940, for the taxation year 1938. The appellant is the widow of James Cooper who died in 1931. By his will he appointed Maurice Pougnet and E. F. Ladore to be his executors, and after providing for payment of his debts, funeral and testamentary expenses, he made provision for his widow, the appellant herein, as follows:

3. To my dear wife, Helen Cooper, for the term of her natural life, I will, devise and bequeath all my real and personal estate, wherever situate, of which I died possessed or to which I may die entitled.

Subject to the life interest of his wife, he devised and bequeathed all his estate in equal shares to his three daughters. The concluding paragraph of his will was as follows:

I authorize the trustees of this my Will to invest the moneys of my estate in any investments which they shall deem reasonably secure, and likely to return a fair income, not being limited to investments expressly authorized by law, and with power to retain investments made by me in my lifetime as long as they shall think proper and to re-invest the proceeds of the same or any part thereof in similar securities. And in order to carry out my intention I exonerate the trustees hereof from any responsibility for loss or damage which may be occasioned by retaining investments in the form in which the same shall be at the time of my death or by reason of investments made by them in good faith in securities other than those authorized by law.

The evidence indicates that the executors managed the entire estate, which in 1938, consisted of certain original assets and a number of businesses, some of which were also original assets and others which, by foreclosure or other means, had been taken over by the executors to protect the interest of the estate therein. Mr. Pougnet, one of the executors stated that the gross income for the year 1938, after payment of expenses, was $18,658.06. He said that in filing the estate T.3 Income Tax Return the executors had claimed depreciation on the various assets in the sum of $11,468.37 and had shown a net amount of $7,189.69 as income payable to the appellant for the year 1938. The appellant in her T.1 Income Tax Return included as revenue from her husband's estate the sum of $7,189.69 only. The respondent, however, acting

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apparently on the ground that the depreciation so claimed by the executors was merely a book entry and had not actually been retained by the executors as a depreciation reserve, and believing that the full sum of $18,658.06 had, in fact, been paid to the appellant, amended her return by adding thereto the sum of $11,468.37, and assessed her accordingly. It is from that assessment that the appeal has been taken.

The evidence on the appeal shows that out of the gross income of $18,658.06, the executors in 1938 actually paid the appellant $14,850, expended the sum of $2,398.01 in replacement of machinery and equipment; and, following an audit of the estate accounts in 1939, may have paid the appellant the balance of $1,410.05 in some later year.

The disagreement between the parties is solely as to the right of the appellant to any allowance for depreciation on the income received by her from the estate. It is admitted that had she been paid the gross income of $18,658.06, and had she been entitled to claim depreciation in respect thereof, the total claim for depreciation of $11,468.37 would have been allowed, that sum being made up in accordance with the depreciation allowances normally granted in 1938 for the various assets under administration by the executors. It appears, also, from the evidence that for many years prior to 1938 the executors, in filing the T.3 Estate Income Tax Returns, had deducted depreciation from the gross income of the estate and had shown as income payable to the appellant only the net amount after deducting such depreciation; and, also, that the appellant in her own income tax returns had shown only such net income as received from the Cooper Estate.

In the case of *Davidson* v. *The King* (1), the President of this Court came to the conclusion that the beneficiary of an estate, insofar as he is entitled to income from it, is not entitled to deduct any amount for depreciation in respect of such income, inasmuch as it is not his assets but those of the estate that are used in the production of such income. He found that any amount that might be allowed for depreciation—being an item of capital—enured to the benefit of the estate and those entitled to its corpus.

Counsel for the appellant endeavoured, however, to draw a distinction between the Davidson case and the case at

(1) (1945) Ex. C.R 160.

bar. He says that while in the Davidson case the appellant was entitled merely to the income for life in one-half of the estate, Mrs. Cooper, by the terms of her husband's will, is entitled specifically to the use and enjoyment in specie of the assets of her husband's estate without interference by the executors; and that such being the case she is bound to maintain the corpus of the estate intact for the remaindermen and cannot do so unless she is allowed depreciation at the proper rates. He suggests that in the absence of any evidence to prove the contrary, the executors throughout may have been acting merely as her agents in the management of the estate and not *qua* executors of her husband's estate.

I do not consider that it is necessary for me to determine whether under her husband's will the appellant had or had not the right to the use and enjoyment of the assets of his estate in specie. I am not concerned in this case with any possible dispute between the life tenants and the remaindermen. The only question is whether that which the appellant received from the executors in 1938 was taxable income in her hand.

The appellant is not one of the remaindermen in the estate. Her only interest in the estate is that of a life beneficiary and as such she would be entitled to receive the income arising from the assets of the estate whether as profits resulting from the operation of the businesses which formed part of the estate, or as revenue from investments, and equally so whether operated by herself—as she asserts she was entitled to do—or as managed and operated by the executors as para. 7 of the Statement of Claim states was the fact. Under no circumstances would she be entitled to any of the corpus for her own personal use and benefit. The executors would have no right to pay her any moneys whatever except such moneys as constituted income from the estate.

As I have said above, the executors in 1938 received and reported a gross income of $18,658.06. Apart from the provisions of the Act relating to depreciation, the whole of that amount would have been income accruing to the appellant and under the provisions of section 11(1) would have formed part of her income whether received by her or not in 1938. It is not disputed, however, that the

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executors were entitled to deduct therefrom depreciation in the amount now claimed by the appellant. Had they retained the amount of such depreciation and not paid it or a large portion thereof to the appellant, no difficulty would have arisen. They did, however, pay over to her in that year a total of $14,850 which was $7,660.31 in excess of the net amount payable to her after deducting depreciation.

What then is the nature of that payment of $7,660.31? It was paid out of income received by the executors, it was applied by them in the direction that income should be applied—namely, to the appellant who was the life beneficiary—and received by her as such and applied by her to her own use and benefit. None of it has been repaid by her to the executors and there is no evidence that she was ever asked to repay it.

In my opinion, therefore, that amount constituted taxable income in the hands of the appellant.

A further argument advanced by the appellant was that if she was not entitled to receive this sum of $7,660.31 as income, it must have been paid to her—possibly in error—as a payment out of capital; and that as it was paid out of depreciation which is an item of capital, it should not be considered as income in her hands. In view of the decision in *H. K. Brodie* v. *The Commissioners of Inland Revenue* (1), that contention cannot be supported. In that case Findlay, J. said at p. 439:

> If the capital belonged to the person receiving the sums—if he or she was beneficially entitled not only to the income but to the capital—then I should think that, when the payments were made, they ought to be regarded, and would be regarded, as payments out of capital, but where there is a right to the income, but the capital belongs to somebody else, then, if payments out of capital are made and made in such a form that they come into the hands of the beneficiaries as income, it seems to me that they are income and not the less income, because the source from which they came was—in the hands, not of the person receiving them, but in the hands of somebody else—capital.

Reference may also be made to *Williamson* v. *Ough* (*Inspector of Taxes*) (2), where at p. 392 Lord Russell of Killowen said,

> It is well settled that a payment out of corpus may properly be assessable income in the hands of the recipient.

For the reasons which I have given, I am of the opinion that the respondent was entitled to amend the 1938 return

(1) 17 Tax Cases 432 (2) (1936) A C 384

of the appellant by including as an item thereof the amount which she actually received in that year from the Cooper Estate. He had assumed in error that she had received $18,658.06, whereas, in fact, she received only the sum of $14,850. I do not think that to that sum there should be added the further sum of $1,410.05 which the executor, at the trial, thought she might have received in a subsequent year. That amount in 1938 was, in my opinion, not accruing to her and it was not received by her. Until paid over to her, the executors were entitled to treat it as part of a depreciation reserve and she could not have successfully made claim thereto.

I therefore refer the matter back to the respondent to amend the assessment by substituting the sum of $14,850 as income from the James Cooper Estate for the sum of $18,584.37 as found by the respondent, and to adjust the assessment accordingly.

Success being divided, under all the circumstances I will make no order as to costs.

Judgment accordingly.