BETWEEN:

ROGER L. VINCENT .....APPELLANT;

AND

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

1965
Sept. 19-21
1965
Feb 18

Revenue—Income—Income tax—Computation of tax on income derived from several sources—Farming losses—Source of income other than farming—What expenses deductible from income from a particular source—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 11(1)(c), 12(1)(b), 13 and 139(1)(aa)—Income Tax Regulation 1700.

These are appeals from the assessments of the appellant for income tax for the taxation years 1957-1960 inclusive.

The appellant was, at all material times, the president and director of a legal publishing company and he also owned and operated a 300 acre farm near Georgetown, Ontario. He had owned a farm near Streetsville, Ontario, but sold it for $50,000 cash and a mortgage of $100,000 immediately before purchasing the Georgetown farm. To effect repairs on and purchase machinery for his farm the appellant borrowed money from the bank on which he paid interest in his 1959 and 1960 taxation years In all four taxation years under review the appellant suffered farming losses exceeding $5,000 in each year, and he claimed part of such losses in each year as deductions in computing his taxable income.

The respondent added to the appellant's income the interest payments he had received in each of the taxation years under review on the mortgage he held on the Streetsville farm, and in computing the appellant's farming losses for these years he added thereto the amounts of interest paid by the appellant on the mortgage on his Georgetown farm and refused to allow these amounts as deductions in computing the appellant's incomes from sources other than farming. The respondent also added the interest paid by the appellant on his bank loan when computing appellant's farming losses for 1959 and 1960.

After the trial and before judgment the appellant in effect conceded that his chief source of income during the relevant taxation years was neither

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farming nor a combination of farming and some other source of income.

Held: That in the the application of s. 13 of the *Income Tax Act* the appellant must ascertain, firstly his income from all sources other than farming, secondly, the farming loss, and thirdly, the amount of the farming loss, which the appellant is permitted thereby to deduct from his income from all other sources. Section 13 of the Act provides that the taxpayer's income for a year shall not be deemed to be less than his income for the year from all sources other than farming minus his farming loss for the year or an amount determined in accordance with the formula in the section, which cannot exceed $5,000.

2 That the interest the appellant received on the mortgage he held on the Streetsville farm should be included in his income from sources other than farming. The source of this income was not farming but property, viz. the mortgage under which the appellant was entitled to interest. The mortgage was not property used for the purpose of producing income from the farming business but was itself a separate source of income, and is therefore a source of income other than farming.

3. That s. 3 of the *Income Tax Act* contemplates as sources of income such things as businesses, of which the taxpayer may have more than one, property and offices of which he may also have more than one. Each business, property and office may be a source of income, and income from a source is to be computed by following the provisions of the Act applicable to the computation of income from each source on the assumption that the taxpayer had no income except from that particular source. In so computing income from a source the taxpayer is entitled to no deductions except those relating to that source.

4. That the capital cost allowances in respect of property used to earn income from the farming business bear no relationship to the earning of income from the appellant's office or employment, or partnership or the acquisition of the interest from the mortgage on the Streetsville farm. The interest paid on the mortgage on the Georgetown farm and on the appellant's bank loan bears no relationship to the earning of income from his office or employment or partnership or the acquisition of the interest from the mortgage on the Streetsville farm and that both such items are directly and exclusively related to his Georgetown farming activities. The foregoing items are not properly deductible in computing the income from the appellant's sources of income other than farming from which it follows that the respondent was right in assessing the appellant as he did.

5. That the appeal is allowed.

APPEAL under the *Income Tax Act*.

The appeal was heard by the Honourable Mr. Justice Cattanach at Hamilton.

F. E. LaBrie for appellant

G. W. Ainslie and *D. G. H. Bowman* for respondent.

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

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CATTANACH J. now (February 18, 1965) delivered the following judgment:

These are appeals from the assessments of the appellant under the *Income Tax Act*, R.S.C. 1952, chapter 148 for the taxation years 1957, 1958, 1959 and 1960.

The appellant was, throughout the taxation years in question, the president and member of the board of directors of a corporation carrying on a legal publishing business in Canada, from which he received income by way of salary, bonuses and director's fees and he was simultaneously engaged in the business of farming on a 300 acre farm owned and operated by him in the vicinity of the Town of Georgetown, in the County of Halton, Province of Ontario (hereinafter referred to as the "Georgetown farm"). Immediately prior to the appellant's purchase of the Georgetown farm, he had owned and operated a farm near Streetsville, Ontario (hereinafter referred to as the "Streetsville farm"), which he sold for $150,000 receiving $50,000 in cash and a first mortgage back for the balance with interest.

The appellant, in the course of operating the Georgetown farm, was obliged to make extensive repairs and additions to farm buildings and to purchase farm machinery. At the trial Counsel for the Minister conceded that these expenditures were capital outlays. However to effect such repairs and to purchase the required farm machinery, the appellant borrowed money from his bank on which loan he paid interest in the amounts of $487.86 and $768.65 in his 1959 and 1960 taxation years respectively.

As shown by his income tax returns, the appellant suffered farming losses as follows, in the 1957 taxation year, $14,040.06, in the 1958 taxation year, $5,806.67, in the 1959 taxation year $14,229.08 and in the 1960 taxation year, $8,408.57, and in those respective taxation years the appellant claimed, in respect of such losses, as deductions in computing his income, the following amounts, $4,585.27; $4,153.33; $5,000; and $5,000.

In assessing the appellant the Minister added to his income the following amounts, for 1957, $142.11; for 1958, $588.90; for 1959, $499.56 and for 1960, $840.75; being income from two partnerships in which the appellant participated and with respect to which there is no dispute, either

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as to the amounts or the taxability thereof, except as incidental to submissions on behalf of the appellant which will be outlined later.

The Minister also added to the appellant's income the following amounts, for 1957, $5,000; for 1958, $4,500; for 1959, $3,213.69 and for 1960, $3,000. These four amounts are payments of interest which the appellant received on the first mortgage which he held on the Streetsville farm as security for payment of the balance of the purchase price therefor and which farm had been sold almost simultaneously with his purchase of the Georgetown farm. The accuracy of these amounts is not in dispute and they come into question by reason of an alternative submission on behalf of the appellant that if it should be held that the payments of mortgage interest made by the appellant on the purchase of the Georgetown farm are properly included in computing the farming losses, then the mortgage interest payments received by him should be considered as income from the appellant's farming business.

The Minister, in computing the appellant's farming losses for 1957, 1958, 1959 and 1960 added thereto the respective amounts of $5,580; $3,600; $3,213.69 and $2,850, being the mortgage interest paid by the appellant on his purchase of the Georgetown farm and he refused to allow those amounts as deductions in computing the appellant's incomes from sources other than farming for those years. In addition the Minister also added, in his computation of the appellant's farming losses for the years 1959 and 1960, the respective amounts of $487.86 and $768.65 being interest paid by the appellant to his bank on the loan he had obtained to effect repairs to the farm buildings and to purchase farm machinery. The effect of such additions by the Minister to the appellant's farming losses is to increase the farm losses as computed by the appellant.

In 1957 the appellant had claimed a farming loss of $4,585.27 which the Minister increased to $5,000. In 1958 the farming loss of $4,153.33 claimed by the appellant was increased by the Minister to $5,000. In 1959 and 1960 the appellant had claimed farming losses of $5,000 in each such year which the Minister did not alter.

By Notices of Objection dated May 7, 1962, the appellant objected to the assessments for each taxation year and

claimed, *inter alia,* that he should be allowed to deduct his full farming loss for each year, but the Minister confirmed the assessments as having been made in accordance with the provisions of the *Income Tax Act.*

The Minister did not make a determination that the appellant's chief source of income for the taxation years under review was neither farming nor a combination of farming and some other source of income, as he might have done, in his discretion, under subsection (2) of section 13 of the *Income Tax Act.*

The appellant objected to the Minister's denial of his contention that he should be allowed to deduct his total farming losses for the 1957, 1958, 1959 and 1960 taxation years in computing his income from all sources for each of those taxation years.

He contended, first, that section 13(1) of the *Income Tax Act,* upon which the Minister relied in assessing the appellant as he did, does not apply.

Section 13(1), as applicable to the years 1958 to 1960, reads as follows:

> 13 (1) Where a taxpayer's chief source of income for a taxation year is neither farming nor a combination of farming and some other source of income, his income for the year shall be deemed to be not less than his income from all sources other than farming minus the lesser of
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> (*a*) his farming loss for the year, or
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> (*b*) $2,500 plus the lesser of
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> (i) one-half of the amount by which his farming loss for the year exceeds $2,500, or
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> (ii) $2,500.

As applicable to the year 1957, section 13(1) was somewhat different, but the differences are of no significance to the points involved in these appeals.

The appellant's contention at the trial was that section 13(1) does not apply because the appellant's chief source of income in each of the taxation years was, in fact, a combination of farming and his employment. However, subsequent to the conclusion of the trial the appellant withdrew this contention, which withdrawal is tantamount to an admission that the appellant's chief source of income during the relevant taxation years was neither farming, nor a combination of farming and some other source of income.

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However, the appellant objects to the Minister having deducted, in computing his income from farming, the payments of mortgage interest on the purchase of the Georgetown farm in all taxation years in question as well as the interest paid on his bank loan in the years 1959 and 1960 because such payments were expenditures on capital account and as such are expressly disallowed by section 12(1)(*b*) of the *Income Tax Act*. Such deductions of mortgage and bank interest were made by virtue of section 11(1)(*c*) reading as follows:

> 11. (1) Notwithstanding paragraphs (*a*), (*b*) and (*h*) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:
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> . . .
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> (*c*) an amount paid in the year or payable in respect of the year (depending upon the method regularly followed by the taxpayer in computing his income), pursuant to a legal obligation to pay interest on
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> (i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt), or
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> (ii) an amount payable for property acquired for the purpose of gaining or producing income therefrom or for the purpose of gaining or producing income from a business (other than property the income from which would be exempt),
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> or a reasonable amount in respect thereof, whichever is the lesser;

The appellant, therefore, contends that such interest payments were not properly deductible in computing the appellant's farming income, but rather that they are proper statutory deductions in computing the appellant's income from all other sources for each appropriate taxation year.

As I mentioned before, the appellant contends alternatively, that if such interest payments are properly included in determining his farming loss, then the interest payments received by him on the sale of his Streetsville farm should be included in computing his income from the business of farming.

For reasons similar to those advanced in objecting to the Minister's deduction of mortgage and bank loan interest in computing the appellant's farming income and not in computing his income from sources other than farming the appellant contends that capital cost allowances should not be deducted in computing the appellant's income from farming for the 1958, 1959 and 1960 taxation years and that such

allowances should be deducted in computing his income from sources other than farming for those years.

In Part B, paragraph 4(*a*)(*b*)(*c*) and (*d*) of the Notice of Appeal it was objected that the computation of the appellant's income for the four taxation years were subject to the adjustments therein outlined which had not been made by the Minister. At the trial Counsel for the Minister agreed that the items therein set forth should be deducted, as alleged, subject to Counsel agreeing to the accuracy of the amounts. An exception was made by Counsel for the Minister with respect to subparagraph (v) of paragraph 4(*d*) wherein a claim was made by the appellant for deduction of a capital cost allowance for the year 1960, (which had not been previously claimed by him), from sources other than farming.

Accordingly three issues remain for determination.

First, whether the interest paid by the appellant on the mortgage given by him back to the vendor on the purchase of the Georgetown farm and on the money borrowed from the bank for capital outlays on the farm was properly deducted by the Minister in computing the appellant's income from the business of farming, as contended by the Minister, or whether those payments should be deducted in the computation of the appellant's income from sources other than farming, as contended by the appellant.

Second, whether the interest received by the appellant on the mortgage held by him on the Streetsville farm which he had sold, should be brought into the computation of his income from the business of farming and not into the computation of his income from other sources, as contended by the appellant should the first issue be resolved against him.

Third, whether capital cost allowance, for the years 1958, 1959 and 1960 should be deducted in the computation of the appellant's incomes from the business of farming, as the Minister contends, or in the computation of the appellant's incomes from other sources, as contended by the appellant.

The appellant, by his abandonment of his contention that his chief source of income was farming or a combination of farming and some other source of income has relieved me from the necessity of making a finding in this respect.

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Section 13 of the Act is, therefore, applicable.

It follows from the provisions of section 13 that, for each taxation year, it is obligatory to ascertain, first, the appellant's income from all sources other than farming, second, the farming loss and third, the amount of the farming loss which the appellant is permitted thereby to deduct from his income from all other sources. When such amounts have been ascertained and the computation contemplated made, the resultant figure is to be deemed to be the income of the taxpayer. Section 13 provides that the taxpayer's income for a year shall not de deemed to be less than his income for the year from all sources other than farming minus his farming loss for the year or an amount determined in accordance with the formula in the section, which incidentally cannot exceed $5,000.

The first problem, therefore, is to ascertain the appellant's income from sources other than farming. It is clear from the evidence that these sources are his office and employment in the publishing company, two partnerships in which he was a partner and the mortgage on the Streetsville farm.

It is clear, in my opinion, that there should be included in the appellant's income from other sources, the interest which he received from the mortgage on the Streetsville farm. Such income has no relationship to the farming activities of the appellant at the Georgetown farm. The source of this income was not farming but "property" (compare section 3 of the *Income Tax Act*) namely, the mortgage under which the appellant was entitled to interest. This mortgage was not property used for the purpose of producing income from the farming business but was itself a separate source of income. Such property is, therefore, a source of income other than farming.

The next problem is what deductions should be made in the computation of income from the sources other than farming and whether there should be deducted the capital cost allowances in respect of the property used in the farming business and the interest paid by the appellant on the mortgage for the unpaid purchase price of the Georgetown farm and on the bank loan used for capital expenditures on that farm.

Section 139(1)(*az*), (which is applicable to all taxation years in question except 1960) provides:

a taxpayer's income from a business, employment, property or other source of income or from sources in a particular place means the taxpayer's income computed in accordance with this Act on the assumption that he had during the taxation year no income except from that source or those sources of income and was entitled to no deductions except those related to that source or those sources; and.[1]

Section 3 of the Act declares that a taxpayer's income for the purposes of Part I is his income from all (*a*) businesses, (*b*) property, (*c*) offices and employments. From this it is clear that what is contemplated as sources of income are things such as businesses, of which the taxpayer may have more than one, property, and offices of which he may also have more than one. Each business may be a source and each property and office may be a source. The word "source" has the same meaning in section 139(1)(*az*). The section directs that income from a source is to be computed in accordance with the Act, that is to say, by following the provisions of the Act applicable to the computation of income from each source on the assumption that the taxpayer had no income except from that particular source. In so computing income from a source, the taxpayer is entitled to no deductions except those relating to that source.

It is obvious that the capital cost allowances in respect of property used to earn income from the farming business, bear no relationship whatsoever to the earning of income from the appellant's office or employment, or partnerships or the acquisition of the interest from the mortgage on the Streetsville farm. It is equally obvious that the interest paid on the mortgage on the Georgetown farm and on the appellant's bank loan bears no relationship to the earning of income from his office or employment or partnership or the acquisition of the interest from the mortgage on the Streetsville farm and that both such items are directly and exclusively related to his Georgetown farming activities.

Therefore, in my view, the foregoing items are not properly deductible in computing the income from the appellant's sources of income other than farming from which it follows that the Minister was right in assessing the appellant as he did in these respects.

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[1] Section 139(1)(az) was repealed by section 33(3) chapter 43, 1960 S.C. and by section 33(5) of the same statute section 139(1a)(a) was added. The difference in language is not material to the points involved in the appeal for the year 1960.

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The appellant made a further submission that Regulation 1700 of the *Income Tax Regulations* is *ultra vires* in so far as it purports to restrict the deduction of capital cost allowances in respect of property used in a farming business to the computation of income from that business. In view of the conclusion that I have reached as to the computation of income from different sources under the provisions of the Statute itself, I do not need to deal with that argument.

In view of the agreement of the parties that the assessments should be referred back to the Minister for the allowance of certain items which were not in controversy between the parties at the trial, the appeal is allowed and the assessments are referred back accordingly.

As the Minister has been successful on all matters that were in controversy between the parties at the hearing of the appeal the Minister shall be entitled to his costs, except any costs related exclusively to the items with respect to which the assessments are being referred back and the appellant shall be entitled to a set-off in respect of any costs incurred by him relating to such items.