
1959
Sept. 21, 22
1960
Apr. 6

BETWEEN:

AUDREY QUINN .....APPELLANT;

AND

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

AND BETWEEN:

JAMES C. SHORTT .....APPELLANT;

AND

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

Revenue—Income—Income tax—Business carried on by testamentary trustee for beneficiaries under a will—Whether net profits "investment income" or "earned income"—Income Tax Act, R.S.C. 1952, c. 148, ss. 32(1), (3), (4), 5(b).

For the purpose of the investment income surtax imposed by s. 32(3) of the *Income Tax Act,* R.S.C. 1952, c. 148, "investment income" is defined in s. 32(4) as "the income for the taxation year minus the aggregate of the earned income for the year . . ."; and, "earned income", for the purpose of s. 32, is defined by s. 32(5) as meaning "(*b*) income from the carrying on of a business either alone or as a partner actively engaged in the business".

Under the provisions of a will a trustee carried on a business the net profits of which belong under the terms of the will to a son and daughter of the testatrix. The Minister treated the whole of the income from the business as investment income and assessed investment surtax accordingly.

Held: (Allowing the appeals of the son and daughter) That the material words used in clause (*b*) of s. 32(5) are simply "Income from the carrying on of a business either alone or as a partner actively engaged in the business" without specifying that the carrying on must be by the taxpayer. Here, the income in question, was income which arose from the carrying on of a business by the trustee alone and fell within the meaning of clause (*b*) of s. 32(5) and therefore was deductible from income in computing "investment income" as defined in s. 32(4).

APPEALS from the judgments of the Income Tax Appeal Board[1] affirming in each case income tax assessments for the years 1953 and 1954. The appeals were heard together.

The appeals were heard before the Honourable Mr. Justice Thurlow at Toronto.

W. Z. Estey, Q.C. for appellants.

H. H. Guthrie, Q.C. and *J. D. C. Boland* for respondent.

THURLOW J. now (April 6, 1960) delivered the following judgment:

These are appeals from judgments of the Income Tax Appeal Board[1], affirming in each case income tax assessments for the years 1953 and 1954. The appeals were heard together. The appellant Audrey Quinn is the sister of the other appellant, James C. Shortt, and the issue on which each case turns is whether or not the appellant is liable to pay the four per cent investment income surtax on the profits to which he or she was entitled of a business carried on under the name and style of James McTamney & Co.

The appellants' mother, Olga Margaret Shortt, died on January 14, 1952, leaving this business as the principal asset of her estate. By her will, she gave the whole of her estate to her husband, Maurice J. Shortt, whom she named her executor and trustee, upon trust as to the residue after paying certain charges and providing for specific bequests, to pay certain sums each month to each of the appellants until they reached thirty years of age and thereafter to pay to each of them half of the net income from such residue until the "date of division". At the "date of division", the residue

[1] 19 Tax A.B.C. 144; 58 D.T.C. 243, 249.

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was to be divided into two equal shares, and Audrey Quinn was given the net income for her life from one of such shares, with remainder as to both income and capital to others. James C. Shortt was given the net income from the other share and would become entitled to the capital of such share, as well, in four payments maturing respectively on his attaining thirty, thirty-five, forty, and forty-five years, and there were provisions disposing otherwise of the remaining capital if he should die before attaining the specified ages. The "date of division" was defined as the date of the testator's death if her husband predeceased her, and if he survived her, the date during his lifetime which he should in writing fix and, in default of such fixing of the date by him, the date of his death. The trustee among other powers was given authority to carry on the James McTamney & Co. business for as long as he, in his absolute discretion, considered desirable and to use money or assets of the estate in the business for any purpose which he should in his absolute and uncontrolled discretion deem in the interest of the business. There was also a provision that "net income" from the McTamney business should for the purpose of distribution of net income to beneficiaries entitled thereto in any year mean such portion (not less than 40 per cent thereof) of the earnings after all taxes for such year as the trustee should in his absolute discretion determine. The will is a lengthy one, and in the foregoing I have but summarized what I consider to be the effect, in events which have occurred, of the provisions that appear to me to be material to the problem to be determined.

Maurice J. Shortt survived the testatrix, undertook the trust, carried on the business through the remainder of 1952 and the years in question in these appeals, and fixed December 31, 1952, as the date of division. In all three years, substantial profits were made in the business and were credited at the end of each year in the accounts of the business equally to the appellants.

With respect to the profits earned in 1952, I am unable to discover in the will any clause warranting such a division, but no question arises as to this. These profits were assessed as income of the trustee and the tax was paid by the trustee, but the remainder was not withdrawn by the appellants

and, save for payments therefrom of income tax, the profits earned in the business in 1953 and 1954, as well, remained in the business and thus in the hands of the trustee throughout the years in question and for some time thereafter.

In making the assessments under appeal, the Minister treated the whole of the income from the business credited to the appellants at the end of each of the years 1953 and 1954 as investment income and assessed four per cent investment income surtax accordingly, pursuant to s. 32(3) of *The Income Tax Act*, R.S.C. 1952, c. 148, and the question to be determined is whether this income is properly treated as investment income for that purpose.

By s. 32(1) of *The Income Tax Act*, "the tax payable by an individual under (Part I) upon his taxable income" is declared to be at certain specified rates. Section 32(3) then provides that "there shall be added to the tax of each individual computed under s-s. (1) for each year an amount equal to four per cent of the amount by which the taxpayer's investment income for the year" exceeds the greater of two amounts. Investment income, however, is not necessarily what that expression might connote but is defined as follows by s. 32(4):

> (4) For the purpose of this section, "investment income" means the income for the taxation year minus the aggregate of the earned income for the year and the amounts deductible from income under paragraphs (*a*), (*c*) and (*d*) of subsection (1) of section 27.

Earned income, as well, is not necessarily what the expression might connote but is defined thus by s. 32(5):

> (5) For the purpose of this section, "earned income" means
> (*a*) salary or wages . . .
> (*b*) income from the carrying on of a business either alone or as a partner actively engaged in the business.

It is, I think, important to observe that, while the James McTamney & Co. business was, by the will, vested in Maurice J. Shortt as trustee, with wide authority reposing in him alone to employ in the business assets of the estate the net income of the estate which accrued after the date of division fixed by him pursuant to the will belonged to the appellants. This income included the profits of the business earned after December 31, 1952, which the trustee

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had determined to be net income for the purpose of distribution. It has already been mentioned that, in the books of the business which were under the control of the trustee, the whole of the profits of the business was credited to the appellants in equal shares, and this, I think, may be taken as indicating that a determination of the net income as contemplated by the will had been made in each year. There is also evidence given by the trustee, Maurice J. Shortt, that income or profit from the business was divided equally between the children, from which I would infer that a determination had been made. Such a determination having been made, however, the right of the appellants to the profits of the business earned by the estate, in my opinion, arose under the will itself, and from the moment of such determination the power of the trustee, derived from the will, to employ such profits in the business, except by the consent of the appellants, was at an end. Moreover, while within the limits prescribed by the will the determination of the amount of business earnings available for distribution as income was left to the trustee, the making of such a determination could not change the nature of the amount as income from the carrying on of a business. *Vide Syme v. Commissioner of Taxes*[1], *Baker v. Archer-Shee*[2], and *Minister of National Revenue v. Trans-Canada Investment Corporation Ltd.*[3] And the immediate right of the appellants to the sum when determined was not dependent upon any further act or determination by the trustee to pay it. Accordingly, the factual situation, as I view it, is one wherein the income in question was income from the carrying on by the trustee of a business which was vested in him as trustee for the appellants and others, but wherein the net income from such business, as determined by the trustee, belonged entirely to the appellants.

Is this income then "income from the carrying on of a business" within the meaning of clause (*b*) of s. 32(5)? business either alone or as a partner actively engaged in the That the question so posed is a close one is, I think, brought out by two cases which were cited in the course of the argument. On the one side, there is the judgment of the

[1] [1914] A.C. 1013. [2] [1927] A.C. 844.
[3] [1956] S.C.R. 49.

Privy Council in *Syme v. Commissioner of Taxes* (*supra*), where the words "income arising or accruing from any trade carried on in Victoria" were qualified by "although the income has not arisen or accrued or been . . . derived from the taxpayer's own personal exertion or trade" and were held to include income of a *cestui que trust* arising from a business vested in and carried on by trustees. On the other side may be placed the judgment of the Court of Session (Scotland) in *Fry v. Shiels' trustees*[1], where the statute defining "earned income" required that it should be "immediately derived by the individual *from the carrying on* or exercise *by him of his* profession, *trade* or vocation either as an individual or in the case of a partnership as a partner personally acting therein", and the Court held that income which was earned by trustees in carrying on a business and which in the exercise of a discretion the trustees paid over to the guardians of children not otherwise absolutely entitled thereto was not "earned income" of the children within the meaning of the statutory definition. On the same side is the judgment of the Court of Session (Scotland) in *M'Dougall v. Smith*[2], where income earned by the curator of an incompetent person in carrying on the latter's business was held not to be income of the incompetent person "earned by him in the carrying on of his trade" within the meaning of the same statutory provision. It will be observed that this case was in some respects stronger on its facts in favour of the taxpayer than the present case, in that the business belonged outright to the incompetent person and was carried on entirely on his behalf, but the judgment turned on the terms of the applicable statute, which, in my opinion, were as materially different from those now under consideration as were those interpreted in *Syme v. Commissioner of Taxes* (*supra*).

The main submission put forward on behalf of the Minister was that clause (*b*) of s. 32(5) contemplates only a business carried on by the taxpayer himself whether alone

[1] (1914) 6 T.C. 583. [2] (1918) 7 T.C. 134.

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or as an active partner. In support of this submission, counsel referred to the earlier subsections of s. 32 where, in s-s. (1), are found the expressions "individual" and "his taxable income", and he contended that the subsequent subsections referred to the same individual when speaking of "income" and the sources from which it arose. The difficulty with this, as I see it, is that, even if one inserted the words "of the taxpayer" after the word "income" in clause (*b*) of s. 32(5), it would still be necessary to add further wording which is not therein expressed in order to exclude income of the kind here in question.

While the words of s. 32(5)(*b*) are not the same as those interpreted in *Syme v. Commissioner of Taxes* (*supra*), some of the considerations referred to in the judgment appear to me to apply in the present case with much the same force. Lord Sumner says at p. 1018:

> In saying "any trade carried on in Victoria" the definition does not say by whom such trade is carried on. The amending section enlarges "personal exertion" and extends it to trade carried on by vicarious exertion without stating the legal relationship between the real and the vicarious trader, or defining the capacity in which the business must be carried on by the latter. Their Lordships were informed that the provision in the Act of 1896 was inserted to settle a doubt whether a person could claim the lower, or personal exertion, rate, when all the work in his business was done for him by his agents. Be this as it may in fact, the enactment is general in form: it does not make the definition of 1895 affirmatively include business carried on by agents, but it provides negatively that a business may be carried on by personal exertion for the purposes of this Act, even when there is no personal exertion on the part of the person who benefits by the business, but everything is done for him. Again the Act does not say for whom the trade is carried on. When a trade is carried on by trustees there is no doubt that they carry it on for the beneficiaries and not for themselves, save in so far as their remuneration is provided for by law or by the trust deed. Unless the definition clause, as amended, is interpreted as though it ran "any trade carried on by the taxpayer or his agents", for which the language of this taxing Act affords no sufficient warrant as against the subject, the definition of "income derived from personal exertion" is wide enough to cover the present case. What the appellant gets is "income arising . . . from a trade carried on in Victoria" by trustees, for the benefit of himself and others, entitled equally with him, "although the same has not accrued . . . from his own personal exertion" in his capacity as such a beneficiary.

The material words used in s. 32(5)(*b*) of the *Income Tax Act* are simply "income from the carrying on of a business either alone or as a partner actively engaged in the

business". Nowhere does the subsection say by whom the carrying on must be done, or for whom it must be done, or whose the business must be. The word "alone", in my opinion, is not equal to "by the taxpayer alone". In its position and context, it qualifies the words "carrying on", and its purpose appears to me to be to distinguish a business carried on by a single party from one carried on by several persons in partnership. It serves also to emphasize, in the words which follow and which deal with partners, a distinction between actively engaged and other partners, but it is noteworthy that the word "actively" is not made applicable in the case of a business carried on by one "alone". To give effect to the Minister's submission, it would be necessary to make the subsection read "income *of the taxpayer* from the carrying on *by the taxpayer* of the *taxpayer's* business either alone or as a partner actively engaged in the business". Undoubtedly, the subsection refers to the taxpayer's income, for that is the subject with which the statute is concerned, but as I read it, s-s. (5) of s. 32 is concerned with classification of the taxpayer's income for a statutory purpose, and the subject being dealt with is not the taxpayer or what he does, but the nature of the several sources of his income. It is, I think, clear that a business may be a source of income to a taxpayer whether or not it is carried on by him either alone or as a partner actively engaged in it, and when, therefore, the subsection simply refers to "income from the carrying on of a business" without specifying that the carrying on must be by him, I can see no warrant for limiting the application of the natural meaning of the words which Parliament has used by, in effect, reading in words that are not there. Given the fact that the income arose from the carrying on of a business either by a person alone or, in the case of a partnership, by a person who actively engages in the carrying on of the business, the income appears to me to be of the kind which falls within the meaning of s. 32(5)(*b*), whether or not the taxpayer is the person or one of the persons who carry it on.

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I am, accordingly, of the opinion that the income in question of both appellants for the years in question being income which belonged directly to them and which arose from the carrying on of the James McTamney & Co. business by the trustee alone falls within the meaning of clause (*b*) of s. 32(5) and, accordingly, is deductible from income in computing investment income as defined in s. 32(4).

The appeals will be allowed with costs and the assessments referred back to the Minister to be revised accordingly.

Judgment accordingly.