

BETWEEN :

ALEX W. MITCHELL ..... APPELLANT;

AND

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

1957  
Oct. 9  
Oct. 10

*Revenue—Income tax—Surtax—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 6(1), 32(1), 32(3), 32(4), 32(5), 67(1), 67(10), 67(11)—Surtax on investment income—Dividends from personal corporations investment income in hands of receiver.*

In his income tax return for 1955 the appellant included the sums of \$27,648.08 received from Ruth Realty Company Limited and \$5.77 received from Mitchell Consolidated Stores Limited as income received from personal corporations. The two corporations were personal corporations and the sums received by the appellant from them represented respectively their net rental income from real property. In reassessing the appellant for 1955 the Minister added surtax on the said sums. The appellant objected on the ground that the sums were not investment income and not subject to surtax but the Minister confirmed the assessment and the appellant brought the present appeal.

*Held:* That the income of the personal corporations was earned income in their hands because it came to them as rental from real property but the income of the appellant did not come to him as rental income from real property. Under section 67(1) of the Act it was deemed to have been distributed to, and received by, him as a dividend and was not "earned income" in his hands within the meaning of section 32(5) of the Act but "investment income" within the meaning of section 32(4) and subject to surtax under section 32(3).

2. That the appeal from the assessment must be dismissed.

APPEAL from income tax assessment.

The appeal was heard before the President of the Court at Winnipeg.

*D. C. McGavin* for appellant.

*F. J. Cross* for respondent.

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

THE PRESIDENT now (October 10, 1957) delivered the following judgment:

This is an appeal from the appellant's income tax assessment for 1955. The facts from which it arises are not in dispute. In the amount of taxable income reported by the

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appellant within the meaning of the *Income Tax Act* and included the sum of \$27,653.85 as income received by him from personal corporations, made up of \$27,648.08 from Ruth Realty Company Limited and \$5.77 from Mitchell Consolidated Stores Limited. When the Minister re-assessed him for 1955, as appears from the notice of re-assessment, dated November 16, 1955, he added surtax on the said sum. The appellant objected to the addition on the ground that the sum of \$27,653.85 was not investment income of the appellant within the meaning of the *Income Tax Act* and surtax on it should not have been assessed to him. The Minister confirmed the assessment on the ground that the dividends deemed to have been received by the taxpayer from the personal corporations of Ruth Realty Company Limited and Mitchell Consolidated Stores Limited under the provisions of subsection (1) of section 67 of the Act were investment income within the meaning of subsection (4) of section 32 of the Act. The appellant then brought his appeal from the assessment to this Court.

The issue in the appeal is a narrow one, namely, whether the amounts received by the appellant from the two corporations referred to are subject to the surtax which the Minister added. The determination of the issue depends on whether the amounts were investment income in the hands of the appellant or earned income. If they were the former the surtax was properly added; if they were the latter the addition of the surtax was erroneous. The determination turns on certain sections of the *Income Tax Act*, R.S.C. 1952, Chapter 148.

Section 32(1) of the Act sets out the rates of tax payable by an individual under Part I of the Act upon his taxable income or taxable income earned in Canada, as the case may be, for a taxation year. And section 32(3) provides for surtax as follows:

32(3) There shall be added to the tax of each individual computed under subsection (1) for each year an amount equal to 4% of the amount by which the taxpayer's investment income for the year exceeds the greater of

- (a) \$2,400 or
- (b) the aggregate of the deduction from income for the year to which he is entitled under section 26.

Section 26 sets out the deduction from his income for the year that may be made by an individual for the purpose of

computing his taxable income for a taxation year, such as for his status, children, and other dependents, etc.

Whether the surtax under section 32(3) may be added depends on whether the amount in respect of which it is to be added is investment income. Section 32(4) defines investment income. It reads:

32(4) For the purpose of this section, "investment income" means the income for the 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.

The said paragraphs set out the deductions from his income for the year that may be made by a taxpayer for the purpose of computing his taxable income for a taxation year for charitable donations, medical expenses and blind persons. And section 32(5) defines earned income. It reads:

32. (5) For the purpose of this section, "earned income" means

- (a) salary or wages, superannuation or pension benefits, retiring allowances, death benefits, royalties in respect of a work or invention of which the taxpayer was the author or inventor, and amounts allocated to the taxpayer by a trustee under an employees profit sharing plan,
- (b) income from the carrying on of a business either alone or as a partner actively engaged in the business, and
- (c) rental income for real property.

It is assumed that the two corporations referred to, namely, Ruth Realty Company Limited and Mitchell Consolidated Stores Limited were personal corporations within the meaning of the Act. They were so treated by the Minister, for what such treatment is worth. Consequently, section 67(1) of the Act must be considered. It provides:

67(1) The income of a personal corporation whether actually distributed or not shall be deemed to have been distributed to, and received by, the shareholders as a dividend on the last day of each taxation year of the corporation.

And consideration must also be given to section 6(i) of the Act which provides:

6. Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

- (i) amounts deemed to have been received in the year by the taxpayer under section 67 as a shareholder in a personal corporation;

The evidence before me established that the sum of \$27,648.08, the amount received by the appellant from

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Ruth Realty Company Limited, was the net income of Ruth Realty Company Limited coming to it as rental income from real property. It was also proved that the sum of \$5.77, the amount received by the appellant from Mitchell Consolidated Stores Limited, was the net income of Mitchell Consolidated Stores Limited coming to it as rental income from real property.

It was accordingly contended that the said amounts were earned income within the meaning of section 32(5) of the Act. In view of the evidence there is no doubt that the said amounts were "earned income" in the hands of the personal corporations referred to.

And it is clear that if an item of income is "earned income" within the meaning of section 32(5) of the Act it cannot be "investment income" within the meaning of section 32(4) and, consequently, is not subject to surtax under section 32(3).

But here I part company with counsel for the appellant. He submitted that the nature of the income continued to be rental income from real property in the hands of the appellant as it had been in the hands of the personal corporation and that, accordingly, the income received by him from the said personal corporations was earned income within the meaning of section 32(5) of the Act. I disagree. The income of the personal corporations was earned income in their hands because it came to them as rental income from real property but the income of the appellant did not come to him as rental income from real property. Under section 67(1) of the Act it was deemed to have been distributed to, and received by, him as a dividend. As such it was properly included in computing his income for 1955. It is, in my opinion, clear that while the amounts were earned income within the meaning of section 32(5) of the Act in the hands of the corporation, they were not earned income in the hands of the appellant. His income was not "rental income from real property", but income deemed to have been distributed to, and received by, him as a dividend. That being so, it was not "earned income" in his hands, within the meaning of section 32(5) but "investment income" within the meaning of section 32(4) and, consequently, subject to surtax under section 32(3).

I have considered the decisions in *Black v. The Minister of National Revenue*<sup>1</sup> and *Minister of National Revenue v. Trans-Canada Investments Corporation Ltd.*<sup>2</sup>, to which counsel for the appellant referred and on which he relied, and do not find in either of them anything inconsistent with the view that I have expressed. And sections 67(10) and 67(11) of the Act, to which counsel referred, have no bearing on the issue in this case.

In my opinion, the Minister was plainly right in adding surtax to the amount reported by the appellant on his return. His appeal from the assessment must, therefore, be dismissed with costs.

*Judgment accordingly.*

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