IN RE ESTATE JOHN ROSS ROBERTSON

1953

*Feb. 9, 10, 11, 12
*June 8

CHARTERED TRUST COMPANY, Trustee of John Sinclair Robertson Estate, and Executor of Jessie Elizabeth Cameron Estate, and BARBARA ANN ROBERTSON, surviving Executrix of the will of Irving Earle Robertson, deceased ..... APPELLANTS;

AND

TRUSTEES OF THE ESTATE OF THE LATE JOHN ROSS ROBERTSON *et al* ..... RESPONDENTS.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Will—Executors directed to carry on business—Annuities to be paid out of net profits, surplus accumulated—Reserve set up for depreciation—Whether on sale of business such reserve an accumulation of profits under the Accumulations Act, R.S.O. 1950, c. 4.

R., a newspaper owner, by his will authorized his trustees to carry on the business and hold all the real and personal property connected therewith until sold. Out of the net annual income properly divisible as profits, annuities were to be paid to his widow and his two sons and the Hospital for Sick Children, the remainder, if any, to be invested and accumulated. Upon the death of the survivor of the widow and the two sons the business was to be sold and the proceeds and all the remainder of the residue of the estate was to be paid to the Hospital. R. died in 1918, and his widow in 1947, predeceased by the two sons. In carrying on the business the trustees set up a reserve for depreciation with respect to the plant and the buildings and upon the sale of the property the next of kin claimed such write-offs were subject to the provisions of the Accumulation Act and that the amount realized by the sale showed them to have been excessive to such an extent that the whole amount so written off should be considered as income to which they were entitled.

*Held:* The reserve was not an accumulation within the meaning of the Accumulations Act. *Re Crabtree* 106 L.T. 49; *Re Gardiner* [1901] 1 Ch. 697, followed. *In re Bridgewater Navigation Co.* [1891] 2 Ch. 317, distinguished.

Decision of the Ontario Court of Appeal [1952] O.R. 283, affirmed.

APPEAL by the personal representatives of the next of kin of the late John Ross Robertson from the order of the Court of Appeal for Ontario (1), (Laidlaw and McKay JJ.

*Present: Kerwin, Rand, Kellock, Estey and Cartwright JJ.

(1) [1952] O.R. 283; 2 D.L.R. 594.

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dissenting), dismissing an appeal from an order of Gale J. (1), allowing an appeal by the Trustees for the Hospital for Sick Children, Toronto, and dismissing a cross-appeal by the representatives of the next of kin from an order of Macdonell J. of the Surrogate Court of the County of York made on the passing of accounts in the deceased's estate.

*G. W. Mason, Q.C., Terence Sheard, Q.C., G. E. Hill, Q.C.* and *A. B. Whitelaw* for appellants.

*C. F. H. Carson, Q.C., A. S. Pattillo, Q.C.,* and *A. J. Macintosh* for the Trustees appointed by Hospital for Sick Children, respondents.

*J. L. Stewart* for Trustees of the Estate of John Ross Robertson, respondent.

*G. T. Walsh, Jr.,* for The Queen Elizabeth Hospital for Incurables, respondent.

The judgment of Kerwin, Kellock, Estey and Cartwright, JJ. was delivered by:—

KELLOCK J.:—Under the will here in question the testator placed the residue of his estate in the hands of trustees upon trust "that my executors and trustees shall carry on the business of the Evening Telegram and for *that purpose* shall hold all the real and personal property connected therewith until the same shall be sold as hereinafter set out." It will be noticed that for the purpose of carrying on the business the testator makes no distinction between the real and personal property.

In paragraph 16 the testator directed that out of the "general income" of his estate, including "the net annual income properly divisible as profits" derived from the Telegram business, there should be paid certain annuities, including annuities in favour of his wife and his two sons and the Hospital for Sick Children. The testator further directed the remainder of such net annual income, if any, to be invested and the accumulated fund to be disposed of "as the remainder of my estate is disposed of."

By paragraph 22 he directed that upon the death of his widow and sons, the Telegram business, including the land and buildings, should be sold and that the proceeds and all the remainder of the residue of his estate should be paid

(1) [1951] O.R. 309; 3 D.L.R. 241.

to trustees for the Hospital for Sick Children, which institution, subject to any outstanding annuities, was to be entitled to the income, there being a gift over to other charities in certain contingent events.

The testator died on the 31st of May, 1918, and his widow on July 11, 1947, she having been predeceased by the two sons. By a judgment of the Supreme Court of Ontario in 1939, it was held that any accumulation of income under paragraph 16 of the will subsequent to twenty-one years from the date of the testator's death was prevented by virtue of the Accumulations Act, the income so affected being payable to the next-of-kin of the testator.

On the passing of the trustees' accounts subsequent to the death of the widow, it appeared that the trustees, in carrying on the business, had set up a reserve for depreciation with respect to plant and buildings and that the amounts credited to this reserve subsequent to the twenty-one year period up to the date of the death of the widow, amounted to some $770,970. The next-of-kin, in their "surcharge" claimed that the

> said sum of $770,970.23 so held in reserve by the trustees, should be credited to income account accruing to the tenants *pur autre vie* (the next-of-kin) and cannot be credited to capital account except to the extent that the trustees can show that part or all thereof is required to make good impairment of capital on the realization of the Evening Telegram business and can show that any such transfer to capital account is not contrary to the provisions of the Accumulation Act.

The appellants say that the amount written off over the period in question for depreciation is subject to the provisions of the Accumulations Act and that such amount has been shown, by reason of the price realized on the sale of the business, to have been excessive to such an extent that the whole amount of the write-offs should now be considered income to which the appellants are entitled.

As stated in their factum, however, the appellants

> do not suggest that the executors acted improperly in setting up a reserve for depreciation.

Nor do they

> impugn in any way the general accounting practice of setting aside out of profits an annual amount as a reserve for depreciation.

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As pointed out by the learned judge of first instance,

> It is not suggested that the trustees acted improperly in setting up a reserve for depreciation *at the rates which they applied,* but it is claimed that in view of subsequent events and information now available, that we are now in a position to say what the real depreciation was, and that the amount deducted from income was unnecessary to preserve the capital assets.

The "subsequent events" to which the learned judge refers, and "the realization of the Evening Telegram business" referred to in the surcharge, are one and the same.

It may be observed at this point that the business was sold as a going concern, inclusive of the goodwill, and that there was no distribution of the purchase price with respect to any particular asset. The appellants rely on an appraisal of the physical assets obtained at the instance of the trustees for the purposes of sale indicating values of the physical assets considerably in excess of book values, less the depreciation reserve, as a basis for the contention that the price received reflects this excess.

On this assumption the appellants contend that, by a species of "relation back", the write-offs for depreciation were correspondingly excessive and, to that extent, constitute income of which they were deprived during the relevant period, which should now be recouped to them out of the proceeds of sale. The decision in *In re Bridgewater Navigation Company,* (1), is, in the first instance, relied upon.

In the *Bridgewater* case part of the profits had been carried to a "depreciation of steamers" reserve, which, on the sale of the undertaking of the company, was held to be income to which the ordinary shareholders were entitled as against the preference shareholders. In my opinion, the fund in question in the *Bridgewater* case was not at all, however, a true depreciation reserve such as is in question in the case at bar. The fund in the *Bridgewater* case may have had some elements of a depreciation reserve but it was much more than that. It is sufficient to refer to the judgment of Kay L.J., at p. 333, and particularly to his statement that the reserve was made

> not on account of any depreciation in fact, but to provide for the possibility of loss in case of the sale of the undertaking as a going concern, or the plant being brought under the hammer.

(1) [1891] 2 Ch. 317.

It seems clear from this, that far from being a depreciation reserve in the modern sense, the fund there in question was a contingent reserve set up against a fall in market value should the assets have to be sold either as a going concern or piecemeal by auction. Kay L.J., went on to point out that not only were

> the plant and works of the company being fully and efficiently maintained in good order and repair out of current revenue

but that "purchases of steamers" were charged against revenue.

At page 328 Lindley L.J., with whom Lopes L.J., agreed, said:

> As regards the depreciation fund, if the company chose, as in fact it did, to keep up the value of its plant, &c., and also to set apart some of its profits to meet unforeseen contingencies, such setting apart was not a *necessary proceeding in order to ascertain the divisible profits;*

I think these references are sufficient to make it clear that the "depreciation of steamers" fund was not a true depreciation reserve in the sense that that word is under consideration in the case at bar. The directors had used revenue for capital purposes, such as the purchase of steamers. The fund was not a reserve against the depreciation of the steamers but against the possibility of a fall in their market value.

In *Bishop v. Smyrna,* (1), to which the appellants also refer, where the decision in *Bridgewater* was followed, an investment made by the defendant company having fallen in value in the market, the amount of the depreciation was debited to revenue. In the liquidation of the company, when the value of the investment had again risen, it was held that the amount of the appreciation must be treated as revenue. The reserve, like the reserve in the *Bridgewater* case, was simply a reserve against a fall in *market value* and has no relation to a true depreciation reserve. This decision illustrates just what was involved in *Bridgewater's* case.

In my opinion the true nature of a depreciation reserve such as is involved in the case at bar, is illustrated in the decision of the Court of Appeal in *In re Crabtree,* (2). In that case the testator authorized his trustees to carry on

(1) [1895] 2 Ch. 596. (2) (1912) 106 L.T. 49.

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his business during the lifetime and widowhood of his wife and to pay her "the profits arising from my business". The question arose as between the tenant for life and remainderman as to whether, in addition to the cost of repairs to the machinery, the trustees were entitled to deduct from the profits otherwise payable to the wife, an annual sum for depreciation of the machinery at a specified rate on its original value. It was held that this was a proper deduction. The trial judge, Swinfen Eady J., as he then was, said at page 50:

> But in the ordinary course of ascertaining the profits of a business where there is power machinery and trade machinery which is necessary in order to perform the work of the business, it is, in my opinion, essential that, in addition to all sums actually expended in repairing the machinery, or in renewing parts, that there should be also written off a proper sum for depreciation, and that sum ought to be written off before you can arrive at the net profits of the business, or at the profits of the business; and it is not profit until a proper sum, varying with the class of machinery, with the nature of the business, and with the life of the machinery, has been written off for depreciation.

This decision was affirmed by the Court of Appeal, the passage quoted above from the judgment of Swinfen Eady J., being expressly approved by Cozens-Hardy M.R., and Fletcher Moulton L.J. At page 51 the latter said:

> All the plant in a business has a lifetime which is longer or shorter in various cases. If a man starts some new mills he keeps them in working order, but if he acted on the supposition that there was consequently no loss of value, or that the machines were not wearing out, he would be deluding himself, and in time find himself much poorer than he expected.

Buckley L.J., said on the same page:

> The profits of this business are not ascertained until a sufficient sum has been deducted to meet the depreciation of the machinery.
>
> One of the witnesses in his affidavit referred to the saleable value of this machinery. That is not the right standard. Here it is the value of the machinery for the purpose of this business, not the saleable value.

It is of interest to observe that the witness McDonald, who testified on behalf of the respondents, gave the following answer in cross-examination:

> Q. Is it a fact that the purpose of the depreciation allowance is to make up the loss of capital in that sense?
>
> A. To make up the loss in value, not exchange value but loss in value *to a business* of the capital assets.

Apart from the question as to the proper rate or rates at which write-offs for depreciation in any particular case should be made, and in the case at bar there is no question

of that sort, such write-offs are, in my opinion, necessary and proper, and profits or income cannot be ascertained until such write-offs have been made. The theory of such write-offs is maintenance of capital. If there are no profits until after proper write-offs for depreciation have been made, the fact that ultimate realization produces a surplus over book values, a result dependent on market conditions at the time of sale, does not establish that, after all, there were additional profits.

I think, therefore, that the Accumulations Act has no application. There is, in my opinion, no accumulation in connection with a true depreciation reserve within the meaning of the statute. The reserve, as already pointed out, is, in theory, made to maintain value and not to add to it. In *In re Gardiner* (1), the will there in question directed a yearly sum out of the rents of leaseholds held for a term of more than twenty-one years from the testator's death to be applied in effecting and keeping on foot a policy of insurance to secure the replacement at the end of the term of the capital that would be lost through not selling the leaseholds. It was held that the Accumulations Act had no application. Buckley J., as he then was, said at page 699:

> What the testator has here directed is not, in my opinion, an accumulation within the Act. All that he has done is to direct that the property shall not be diminished.

After referring to the judgment of Lindley L.J., as he then was, in *Vine v. Raleigh* (2), he added:

> I understand him to mean because they simply keep up the property and do not add to it.

Apart from the fact that it may be resorted to at any time for the purposes for which it was set up, a depreciation reserve of the nature of that here in question is intended merely to keep up the initial value of the property and not to add to it. In my opinion, therefore, such a reserve is not within the statute.

I would dismiss the appeal with all costs to be paid out of the estate, the costs of the Trustees for Estate of John Ross Robertson to be taxed as between solicitor and client.

(1) [1901] 1 Ch. 697. (2) [1891] 2 Ch. 13 at 26.

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RAND J.:—It is agreed that the direction to carry on the newspaper business, under the conditions laid down, was valid and that the setting aside of the depreciation reserve in the manner and to the extent done was authorized and unobjectionable. These premises furnish the background to the interpretation of art. 16 of the will which reads:—

> 16. And upon the further trust out of the General income of my estate *including the net annual income properly divisible as profits derived from the Evening Telegram business* and the income derived from the purchase money thereof if and when the same shall be sold to pay the following sum, namely, . . .

I take that to mean that once each year when the "net annual income properly divisible as profits" derived from the business has been transferred to the general income account of the trustees, the latter, under the article, have no further interest in the income of the business for that year; and that it is only the residue of that general income remaining after payment of the specific bequests that is directed to be accumulated for the beneficiary mentioned in the last paragraph of the article. That this is what the language used means is, I think, unquestionable. If the accumulation of that residue of income had ended at twenty years and the business had then vested in another person, can there be any doubt that the beneficiary of the latter would have been entitled to every asset of the business including the reserve? How, then, can it make any difference that the statute intercepts the accumulation beyond twenty-one years or that the proceeds from the sale of the business rather than the business itself vest in the beneficiary? or that there is the same beneficiary in both cases?

Mr. Sheard's argument based on *In re Bridgewater Navigation Company* (1), is vitiated by the assumption contrary to the fact that the profits to be accumulated mean all profits of the business including those placed in the reserve which may ultimately be found to be in excess of the requirements for which they were set aside. In Bridgewater admittedly the common shareholders were entitled to all the divisible profits, and the decision was that that right extended to accumulated earnings undisposed of in the reserves on the winding up.

(1) [1891] 2 Ch. 317.

The remaining question is whether the Statute of Accumulations applies to the reserve. The latter is not an accumulation directed by the testator; it is authorized and is voluntary, not directed: it is subject at any time to be resorted to for appropriate application. An accumulation means not only a process in time but a process of maintenance from a beginning, that is, that money placed aside shall be kept intact until the end of a period. The reserve possesses no such character; it does not irrevocably bind any appropriation to it for any period at all; the funds are at all times free and available for the purposes of the business; and its character is quite outside the mischief aimed at by the statute. This conclusion is confirmed by the fact that it has not been shown that one dollar of the existing sum represents an actual retention in the fund beyond twenty-one years. Any other view would in reality declare that a direction to carry on a business in the full sense of the term could not extend beyond twenty-one years.

I would, therefore, dismiss the appeal with all costs to be paid out of the estate, including, in the case of the trustees of the Robertson estate, costs as between solicitor and client.

*Appeal dismissed with costs.*

Solicitors for the trustee of the Estate of John Sinclair Robertson, appellant: *Macdonald & Macintosh.*

Solicitors for the executors of the Estate of Jessie Elizabeth Cameron, appellants: *Bicknell, Cameron & Chisholm.*

Solicitors for the executrix of the will of Irving Earle Robertson, appellant: *Holmstead, Sutton, Hill & Kemp.*

Solicitors for the appointed trustees, respondents: *Blake, Anglin, Osler & Cassels.*

Solicitors for the Trustees, respondents: *Fraser, Beatty, Tucker, McIntosh & Stewart.*

Solicitors for Grand Lodge, A.F. & A.M., respondents: *Kilmer, Rumball, Gordon & Beatty.*

Solicitors for The Children's Aid and Infants' Homes of Toronto, respondents: *Borden, Elliott, Kelley, Palmer & Sankey.*

Solicitors for the Queen Elizabeth Hospital, respondents: *Clark, Gray, Baird & Cawthorne.*