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THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

IAN G. WAHN ..... RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Business loss—Whether to be deducted first from other income in same year—Whether taxpayer has right to carry back as deduction in preceding year—Income Tax Act, R.S.C. 1952, c. 148, ss. 2, 3, 4, 5, 27(1)(e), 139(1)(x).

Taxation—Income tax—Partnership—Payment on withdrawal from partnership—Whether income or capital—If income, year in which taxable—Income Tax Act, R.S.C. 1952, c. 148, ss. 6(1)(c), 15(1).

At the end of the year 1961, the respondent resigned from a law firm of which he had been a partner and established his own firm. In the four months ending April 30, 1962, its first fiscal period, the respondent's new firm suffered a loss, of which the respondent's share was $6,902.89. He contended that he had the right under s. 27(1)(*e*) of the *Income Tax Act* to carry back this 1962 business loss as a deduction from his 1961 income. The Minister contended that the loss should be deducted first from the respondent's other income in 1962, which in fact exceeded the amount of the loss, and issued a revised assessment for the year 1961 in which he refused the deduction of the 1962 business loss. The respondent objected to his assessment for the year 1961. The Tax Appeal Board affirmed the assessment. The Exchequer Court reversed this decision and held that the respondent was entitled

*PRESENT: Cartwright C.J. and Judson, Hall, Spence and Pigeon JJ.

to carry back his loss to the year 1961. It was held by the Court that the respondent had the option of deducting the loss from his other income in the same year or of carrying it back to the preceding taxation year.

A second issue related to a payment received in 1963 by the respondent in respect of his interest in the former law firm. Pursuant to a clause in the partnership agreement, it was decided to pay the respondent, as a withdrawing partner, the sum of $39,589.20 over a four-year period in respect of his share of the 1962 profits in the old firm, and $9,897.30 of this amount was received by him in 1963. The Minister taxed the $9,897.30 as income received in 1963. The respondent contended that the amount should be treated as a capital receipt, and alternatively, if it was income, that it was taxable in 1962 rather than in 1963. The Tax Appeal Board upheld the Minister's assessment, but the Exchequer Court held that the payment of $9,897.30 was not income to the respondent. The Minister appealed to this Court on both issues.

Held: The Minister's appeal should be allowed on both issues.

Per Cartwright C.J. and Judson, Hall and Spence JJ.: It appears to be implicit in the wording of s. 139(1)(*x*) of the *Income Tax Act* that a business loss shall operate to reduce the taxpayer's income from other sources for the purpose of income tax for the year in which it was sustained. If the income from other sources in the current taxation year is less than the business loss, the amount by which the loss exceeds the income from other sources will be deductible in other years as provided by s. 27(1)(*e*) of the Act. It was extremely difficult if not impossible to make a perfectly logical and satisfactory reconciliation of all the provisions of the *Income Tax Act* which bear upon this question. However, the result arrived at by the Tax Appeal Board correctly expressed the intention of Parliament in enacting these provisions.

The sum of $39,589.20 allocated to the respondent pursuant to the partnership agreement was received by the respondent as income and not as capital. The respondent had at all relevant times computed his income on a cash receipt basis. When the decision was made in 1963 to pay him, he acquired a contractual right to receive payment in equal annual instalments in the years 1963 and following. Each instalment formed part of the respondent's income in the year in which it was received by him. This result was not altered by the terms of s. 6(1)(*c*) of the Act.

Per Pigeon J.: The construction placed on s. 139(1)(*x*) of the Act by the Exchequer Court that the appellant had an option of either deducting the business loss from his other income in the same year or of carrying it back to the preceding taxation year, is not supported by any argument and cannot be reconciled with the text. However, it was not necessary in this case to ascertain the extent to which a business loss operates to reduce income from other sources in the same year because there was no appeal from the respondent's assessment for the year 1962 in which the Minister had applied the business loss suffered in the year against other income in that same year. The appeal was from the 1961 revised assessment. The Courts could not revise the 1962 assessment. Under s. 46(7) of the Act, it was only by an objection made in proper time and an appeal, if necessary, that the respondent could prevent his 1962 business loss from operating to reduce his other income in that year by virtue of the assessment.

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Construing the partnership agreement as written, the intention of the parties was that the payment to a withdrawing partner should be an allocation of profits, in this case, the profits of the partnership in the year 1962. There is nothing to show that the true nature of the payment was of a capital nature. The wording of the provision for the allowance to a withdrawing partner showed that it was not intended to be a capital payment for goodwill but an allocation of profits, and this is conclusive evidence that it was income of the recipient. Furthermore, under s. 6(1)(*c*) of the Act and under the method followed by the respondent of reporting his income as received, he was properly assessed for the payment made by his former firm in the year in which he actually received it. Section 15(1) of the Act was not applicable since he was not a partner of his former firm in the year 1962.

Revenu—Impôt sur le revenu—Perte commerciale—Doit-elle être déduite en premier lieu des autres revenus de la même année—Le contribuable a-t-il droit de reporter la perte comme une déduction dans l'année qui précède—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, art. 2, 3, 4, 5, 27(1)(e), 139(1)(x).

Revenu—Impôt sur le revenu—Société—Paiement fait à un associé démissionnaire—S'agit-il d'un revenu ou d'un capital—S'il s'agit d'un revenu, en quelle année est-il imposable—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, art. 6(1)(c), 15(1).

A la fin de l'année 1961, l'intimé a démissionné d'une étude d'avocats dont il était un des associés et a établi sa propre étude. Durant sa première période fiscale, c'est-à-dire les quatre mois finissant le 30 avril 1962, la nouvelle étude de l'intimé a subi une perte dont la part de l'intimé revenait à $6,902.89. Ce dernier a prétendu qu'il avait droit en vertu de l'art. 27(1(*e*) de la *Loi de l'impôt sur le revenu* de reporter cette perte commerciale de 1962 comme déduction de son revenu de 1961. Le Ministre a soutenu que la perte devait être déduite en premier lieu des autres revenus de l'intimé pour l'année 1962, qui en fait excédaient le montant de la perte, et il a émis une cotisation amendée pour l'année 1961 dans laquelle il refusa la déduction de la perte de 1962. L'intimé a produit une opposition à sa cotisation pour l'année 1961. La Commission d'appel de l'impôt a confirmé la cotisation. La Cour de l'Échiquier a infirmé cette décision et a jugé que l'intimé avait droit de reporter la perte à l'année 1961. La Cour statua que l'intimé avait le choix de déduire la perte de ses autres revenus de la même année ou de la reporter à l'année d'imposition qui précédait.

Un second point concernait un paiement reçu en 1963 par l'intimé en considération de son intérêt dans l'ancienne étude d'avocats. Selon une clause du contrat de société, il a été décidé de payer à l'intimé, comme associé démissionnaire, la somme de $39,589.20 à être versée sur une période de quatre années en considération de sa part des profits de l'année 1962 de son ancienne étude. En 1963, l'intimé a reçu $9,897.30 de ce montant. Le Ministre a cotisé cette somme comme un revenu reçu en 1963. L'intimé a soutenu que ce montant devait être traité comme un capital, et alternativement, s'il était un revenu, qu'il devait être cotisé en 1962 plutôt qu'en 1963. La Commission d'appel de l'impôt a maintenu la cotisation du Ministre, mais la Cour

de l'Échiquier a statué que le paiement de $9,897.30 n'était pas un revenu pour l'intimé. Le Ministre en appela à cette Cour sur les deux points.

Arrêt: L'appel du Ministre doit être accueilli sur les deux points.

Le Juge en Chef Cartwright et les Juges Judson, Hall et Spence: Il semble clair du texte de l'art. 139(1)(*x*) de la *Loi de l'impôt sur le revenu* qu'une perte commerciale a pour effet de réduire le revenu du contribuable retiré d'autres sources aux fins de l'impôt sur le revenu pour l'année dans laquelle elle a été subie. Si le revenu retiré des autres sources dans l'année d'imposition courante est moins que la perte commerciale, l'excédent de la perte sur le revenu provenant des autres sources pourra être déduit dans les autres années tel que prévu à l'art. 27(1(*e*) de la Loi. Il est extrêmement difficile sinon impossible de réconcilier d'une façon logique et satisfaisante toutes les dispositions de la *Loi de l'impôt sur le revenu* qui traitent de cette question. Cependant, le résultat atteint par la Commission d'appel de l'impôt exprime correctement l'intention que le Parlement avait en décrétant ces dispositions.

La somme de $39,589.20 attribuée à l'intimé en vertu du contrat de société a été reçue par lui comme revenu et non pas comme capital. Durant toute la période critique l'intimé a calculé son revenu d'après l'encaissement. Lorsqu'il fut décidé en 1963 de lui payer ce montant, il a acquis le droit contractuel de recevoir paiement en quatre versements annuels égaux dans les années 1963 et suivantes. Chaque versement a fait partie du revenu de l'intimé dans l'année dans laquelle il a été reçu par lui. Les termes de l'art. 6(1)(*c*) de la Loi ne changent pas ce résultat.

Le Juge Pigeon: La Cour de l'Échiquier a interprété l'art. 139(1)(*x*) de la Loi comme donnant à l'appelant le choix soit de déduire la perte commerciale de ses autres revenus de la même année ou de la reporter à l'année d'imposition précédente. Cette interprétation n'est supportée par aucun argument et ne peut pas être conciliée avec le texte. Cependant, dans le cas présent, il n'est pas nécessaire de décider jusqu'à quel point une perte commerciale a pour effet de réduire le revenu retiré d'autres sources dans la même année parce qu'il n'y a pas eu appel de la cotisation de l'intimé pour l'année 1962 dans laquelle le Ministre a déduit la perte commerciale subie durant l'année des autres revenus de la même année. L'appel est de la cotisation amendée de 1961. Les tribunaux ne peuvent pas amender la cotisation de 1962. En vertu de l'art. 46(7) de la Loi, c'est seulement en produisant une opposition dans les délais et un appel, si nécessaire, que l'intimé pouvait empêcher sa perte commerciale de 1962 d'avoir pour effet de réduire ses autres revenus de cette année en vertu de la cotisation.

Interprétant le contrat de société tel que rédigé, c'était l'intention des parties que le paiement à un associé démissionnaire soit une répartition des profits, dans le cas présent, ceux de la société pour l'année 1962. Il n'y a rien qui démontre que de sa vraie nature le paiement était un capital. Le texte de la disposition concernant l'allocation à un associé démissionnaire montre qu'elle n'était pas censée être un paiement en capital pour l'achalandage mais une répartition des profits. Cela est une preuve concluante qu'il s'agit d'un revenu pour le bénéficiaire. De plus, en vertu de l'art. 6(1)(*c*) de la Loi et en vertu de la méthode adoptée par l'intimé de déclarer son revenu d'après l'encaisse-

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ment, il a été correctement cotisé pour le paiement versé par son ancienne étude dans l'année durant laquelle il l'a effectivement reçu. L'article 15(1) de la Loi n'a pas d'application puisque l'intimé n'était pas un associé de son ancienne étude durant l'année 1962.

APPEL d'un jugement du Juge Gibson de la Cour de l'Échiquier du Canada[1], en matière d'impôt sur le revenu. Appel accueilli.

APPEAL from a judgment of Gibson J. of the Exchequer Court of Canada[1], in an income tax matter. Appeal allowed.

G. W. Ainslie and *F. P. Dioguardi,* for the appellant.

W. Z. Estey, Q.C., and *A. Englander,* for the respondent.

The judgment of Cartwright C.J. and of Judson, Hall and Spence JJ. was delivered by

THE CHIEF JUSTICE:—The relevant facts are set out in the reasons of my brother Pigeon which I have had the advantage of reading.

On the first question, that is whether the respondent was entitled to carry back the business loss of $6,902.29 which he sustained in his 1962 taxation year as a deduction to be made in computing his taxable income for his 1961 taxation year, I agree with the conclusion of the learned member of the Tax Appeal Board, Mr. J. O. Weldon, Q.C.

It is true, as my brother Pigeon points out, that the decision of Mr. Weldon is based mainly upon the wording of s. 139(1)(*x*) of the *Income Tax Act* which is an interpretation section. Just over a hundred years ago Cockburn C.J. in *Wakefield Board of Health v. West Riding and Grimsby Railway Company*[2] said at p. 801:

> I hope the time will come when we shall see no more of interpretation clauses, for they generally lead to confusion.

That hope has not been fulfilled and how profoundly the substantive law can be affected by the wording of an interpretation clause is shown by such cases as *Klippert v. The Queen*[3].

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[1] [1968] C.T.C. 5, 68 D.T.C. 5023.

[2] (1865), 6 B. & S. 794 at 801, 122 E.R. 1386.

[3] [1967] S.C.R. 822, 61 W.W.R. 727, [1968] 2 C.C.C. 129, 2 C.R.N.S. 319.

It appears to me to be implicit in the wording of s. 139(1)(*x*) that a business loss shall operate to reduce the taxpayer's income from other sources for the purpose of income tax for the year in which it was sustained and that the reason that the provisions of s. 27(1)(*e*) do not refer to business losses sustained in the current taxation year is that if the income from other sources during that year exceeded the business losses the whole of those losses will have been deducted by virtue of s. 139(1)(*x*). If, on the other hand, the income from other sources in the current taxation year was less than the business loss, the amount by which the loss exceeded the income from other sources would be deductible in other years as provided by s. 27(1)(*e*). I agree with my brother Pigeon that it is extremely difficult if not impossible to make a perfectly logical and satisfactory reconciliation of all the provisions of the *Income Tax Act* which bear upon this question, but it appears to me to be our duty to endeavour to ascertain the intention of Parliament in enacting these provisions and, in my opinion, the result arrived at by Mr. Weldon correctly expresses that intention. Should we be wrong in so deciding Parliament can deal with the matter by amendment. Having reached this conclusion, it becomes unnecessary for me to consider the effect of the business loss of $6,902.29 having in fact been deducted from the respondent's income from other sources for purpose of income tax for his 1962 taxation year which is dealt with in the reasons of my brother Pigeon and I express no opinion upon it.

It is next necessary to consider (a) whether the sum of $39,589.20 allocated to the respondent pursuant to clause 14(*b*) of the partnership agreement, quoted in the reasons of my brother Pigeon, was a capital payment or forms part of the income of the respondent and (b) if it is held to be income, in what taxation year or years it should be included in the calculation of the respondent's income.

As to (a) I agree with the conclusion of my brother Pigeon and that of Mr. Weldon that the sum in question is received by the respondent as income and not as capital. I do not find it necessary to add anything to the reasons which they have given for reaching this conclusion.

As to (b), the respondent had at all relevant times computed his income on a cash received basis. He was not

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entitled to receive any part of the sum of $39,589.20 until the decision of the Management Committee to allot that amount to him was made early in 1963. He did not, upon that decision being made, become the owner of that sum or entitled to withdraw it but had a contractual right to receive payment of it in equal annual instalments of $9,897.30 in the years 1963, 1964, 1965 and 1966. Each instalment forms part of the respondent's income in the year in which it was received by him. For the reasons given by my brother Pigeon I agree with his conclusion that this result is not altered by the terms of s. 6(1)(*c*) of the *Income Tax Act*. It was therefore correct for the appellant to include the sum of $9,897.30 received by the respondent in 1963 in the computation of his income for that year.

For these reasons, I would allow the appeal with costs in this Court and in the Exchequer Court, set aside the judgment of the Exchequer Court and restore the decision of the Income Tax Appeal Board.

PIGEON J.:—The respondent is a barrister practising in Toronto. At the end of the year 1961 he resigned his partnership in the law firm Borden, Elliott, Kelley & Palmer and established a new firm under the name of Wahn, McAlpine, Mayer, Smith, Creber, Lyons, Torrance & Stevenson. This new firm elected to end its fiscal year on April 30 and consequently its 1962 fiscal year was a four-month period. The audited financial statement for that period showed a deficit of which respondent's share was $6,516.39. After adding to this loss $386.50 for expenses incurred during the year 1962 in connection with the practice of his profession, he sought to have the total of $6,902.89 carried back to the year 1961 against his substantial professional income for that year.

The Minister took the view that the 1962 loss had to be deducted first from other income in the same year and, as there was in that year other income (mostly from an office or employment) to an amount exceeding the aforementioned loss and all other allowable deductions, he assessed respondent for 1962 on that basis. For the year 1961 he issued a revised assessment in which it is expressly stated that the deduction of the 1962 business loss is refused for the reason that it "has previously been allowed as a deduction from other income in 1962".

Seeing that respondent had a substantial professional income in 1961 while his other income in 1962 exceeded his allowable deductions and the aforementioned loss by a very small sum only, the progressive character of our income tax results in the respondent obtaining for the 1962 loss by such assessment an income tax credit that is only a small fraction of that which he would obtain if allowed to carry it back to the year 1961.

Respondent objected to his assessment for the year 1961 and the Minister refused to modify it.

On appeal to the Tax Appeal Board, the assessment was affirmed (J. O. Weldon, February 15, 1967). This decision was based essentially on the statutory definition of loss in para. (*x*) of s. 139(1) of the *Income Tax Act* (hereinafter referred to as the Act):

> (*x*) "loss" means a loss computed by applying the provisions of this Act respecting computation of income from a business *mutatis mutandis* (but not including in the computation a dividend or part of a dividend the amount whereof would be deductible under section 28 in computing taxable income) minus any amount by which a loss operated to reduce the taxpayer's income from other sources for purpose of income tax for the year in which it was sustained.

This was apparently taken to mean that a business loss *always* so operates to reduce the income from *all* other sources in the same year.

On a further appeal to the Exchequer Court[4] Gibson J. took a different view. He held that the taxpayer was entitled to carry back his loss to the year 1961, saying:

> By reason of section 139(1)(*x*) of the *Income Tax Act* the appellant had the option to deduct this 1962 business loss from his 1962 non-business other income but it was not mandatory for him to do so and he did not do so.

I must say at the outset that I cannot agree with this construction of the Act. It is not supported by any argument and I cannot reconcile it with the text. A reading of the whole Act shows that where it is intended that a taxpayer shall have an option, this is clearly indicated. In my view, the last part of the definition of loss is not intended to define the extent to which a loss operates to reduce income from other sources in the year in which it is sustained. That part of the definition clearly means one thing only and that is that the word "loss" applies only to what

[4] [1968] C.T.C. 5, 68 D.T.C. 5023.

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remains of the loss after deducting therefrom whatever part has operated to reduce the income from other sources in the year in which it was sustained. It is equally clear that one must look to the substantive provisions of the Act in order to ascertain the extent to which a loss so operates: the definition does not purport to indicate such extent. Of course it does imply that it may so operate but it does not specify in which circumstances or to what extent. One cannot read into this definition any intention to enact a substantive rule such as that a business loss does not operate to reduce the income from other sources in the current year except at the option of the taxpayer or that it always does so operate. It may happen that substantive provisions creep into statutory definitions but this is not to be presumed.

It is therefore necessary to examine the whole Act in order to ascertain the extent to which a business loss operates to reduce income from other sources in the same year. This is by no means an easy task.

In the first place, it is apparent that the definition was drawn up essentially for the purposes of para. (*e*) of s. 27(1) respecting the deduction of business losses. This provision deals with such deduction only in the immediately preceding and the five immediately following taxation years and not in the year in which they are sustained. It is in Division C dealing with deductions in the "Computation of Taxable Income", not in Division B: "Computation of Income".

When the Act was originally adopted in 1948 with the definition in its present form, there was in Division B a provision (repealed in 1952) that might be considered as defining the extent to which a loss could be deducted in the year in which it was sustained. This was s. 13 of which subs. 1 read:

> (1) The income of a person for a taxation year shall be deemed to be not less than his income for the year from his chief source of income.

The effect of that provision was that whenever a loss was incurred in a business that was not the taxpayer's chief source of income, it could not be deducted from income from that source. This might be said to imply that it

could be deducted from other income, because, if as a general rule, a loss from one source could not be deducted from income from any other source in the same year, there would never have been any reason for enacting any rule to limit such deductions in respect of the taxpayer's chief source of income.

Section 13(1) as enacted in 1948, was substantially to the same effect as s. 10 of the *Income War Tax Act* when replaced by the new Act. This may be of some importance when comparing the wording of the "general rules" of the present Act in Division B "Computation of Income" with the corresponding provisions of the former Act. In the latter, "income" was defined as meaning "the annual net profit or gain or gratuity, . . .". The word "net" was there from the outset and was obviously considered as implying the right to deduct any expenses or losses incurred in the year because Parliament in 1919, besides making other changes, added to the definition of "income" the following paragraphs (9-10 George V, c. 55, s. 2):

> (*e*) in determining the income no deduction shall be allowed in respect of personal and living expenses, and in cases in which personal and living expenses form part of the profit, gain or remuneration of the taxpayer, the same shall be assessed as income for the purposes of this Act;
>
> (*f*) deficits or losses sustained in transactions entered into for profit but not connected with the chief business, trade, profession or occupation of the taxpayer shall not be deducted from income derived from the chief business, trade, profession or occupation of the taxpayer in determining his taxable income.

The above para. (*f*) was amended the following year to provide for conclusive determination by the Minister and, in 1923, was replaced by a new provision stating that "the income of a taxpayer shall be deemed to be not less than the income derived from his chief position, occupation, trade, business or calling". In the 1927 revision this became s. 10. Despite the change of wording no doubt effected for the purpose of plugging loopholes, the purpose of the provision clearly remained to prohibit the deduction of business losses from income derived from the taxpayer's chief occupation while leaving intact the right to deduct them from income from any other sources by virtue of the general rule that net income only was taxed.

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However, and this might be said to be the main basis of respondent's argument, the present Act no longer defines "income" as "net income". The basic provisions are now the following:

2. (3) The taxable income of a taxpayer for a taxation year is his income for the year minus the deductions permitted by Division C.

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

5. (1) Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year plus . . .

* * *

minus the deductions permitted by paragraphs (*i*), (*ib*), (*q*) and (*qa*) of subsection (1) of section 11 and by subsections (5) to (11), inclusive, of section 11 but without any other deductions whatsoever.

Concerning business losses the difficulty is that, as we have seen, the only provision for their deduction is para. (*e*) of s. 27(1) in Division C. This, as already noted, does not provide for such deduction in the year in which they are suffered. Section 4 defining income from a business or property as "the profit therefrom" would appear to negate the consideration of losses. Also the definition of "loss" requiring the application of the provisions "respecting computation of income from a business *mutatis mutandis*" implies that "income" in the "general rules" does not include a loss.

On the other hand, the result of such literal reading of ss. 2, 3, 4 and 5 would be that what is contemplated in the last part of the definition of "loss" would never arise. A loss would never operate to reduce the taxpayer's income from other sources for purposes of income tax for the year in which it is sustained if s. 3 contemplates only the addition of income from every source this being taken in the case of a "business" as meaning a profit not a loss. The difficulty is that such a construction deprives the last part of the definition of "loss" of any meaning.

It must also be considered that when ss. 2, 3 and 4 were enacted in 1948, the Act included besides the definition of

"loss" a s. 13 which would have had no effect unless, as a general rule, business losses were deductible from other income in the same year. This provision was repealed in 1952 (1 Eliz. II, c. 29, s. 4). However, according to Maxwell (On Interpretation of Statutes, 11th ed., p. 37):

> Where a part of an Act has been repealed, it may, although not of operative force, still be taken into consideration in construing the rest, for it is part of the history of the new Act.

But, how do we know that the provision was not repealed because it was considered useless?

One must also consider that under s. 27(1)(*e*) as amended in 1958 (c. 32, s. 12), business losses sustained in the five preceding years or in the immediately following year are now deductible not only from the income from the same business but from the income from any other business as well. It would be an extreme anomaly if they were not deductible from the income from another business in the same year, but such is the result if ss. 3 and 4 are read literally as requiring an addition of income from every source without deducting any loss.

On this literal construction, another equally anomalous result would follow from the definition of "earned income" (s. 32(5)) as it now stands. Despite its length, I find it necessary to quote it in full.

> (5) For the purpose of this section, "earned income" means the aggregate of
>
> (*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, amounts included in computing the income of the taxpayer by virtue of paragraph (*d*), (*da*) or (*db*) of subsection (1) of section 6, amounts allocated to the taxpayer by a trustee under an employees profit sharing plan, amounts received by the taxpayer from a trustee under a supplementary unemployment benefit plan, amounts included in computing the income of the taxpayer by virtue of section 79B and amounts included in computing the income of the taxpayer by virtue of subsections (9) and (14) of section 79C,
>
> (*b*) income from the carrying on of a business either alone or as a partner actively engaged in the business, and
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> (*c*) rental income from real property,
>
> minus
>
> (*d*) business losses sustained in the taxation year in the course of the carrying on of a business either alone or as a partner actively engaged in the business,

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(*da*) losses sustained in the taxation year from the rental of real property, and

(*e*) amounts deductible under paragraph (*u*) or (*v*) of subsection (1) of section 11 or under section 79B in computing income for the taxation year.

The above provision clearly indicates that for the purpose of the definition of "earned income" business losses are deductible from what might be described as all income other than investment income in the year in which they are suffered, but not in subsequent or preceding years although they may be deductible from business income in such years. While it is very hard to see how Parliament can possibly have intended that business losses should be deducted in the same year for ascertaining what is "earned income" and not for ascertaining what is "income", one must bear in mind that the paramount duty of the Courts is to construe the legislation as written and not to depart from the clear wording because the result of the literal construction appears illogical or unfair. Here, if we compare, as we must, the provisions of s. 32(5) with those of ss. 3, 4 and 5, we find not only an explicit provision for an algebraic addition, plusses and minusses being specified, but also a reference not to income only but to losses as well. A comparison of the language thus appears to indicate a deliberate different intention. It must be noted that this difference arises essentially from an amendment enacted in 1957 (5-6 Eliz. II, c. 29, s. 9). In the Act as adopted in 1948, subs. (5) of s. 31 read:

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

(*a*) salary or wages, superannuation or pension benefits, retiring allowances and royalties in respect of a work or invention of which the taxpayer was the author or inventor, and

(*b*) income from the carrying on of a business either alone or as a partner actively engaged in the business.

One must now turn to the last part of subs. (1) of s. 5, being the definition of "income from an office or employment". While s. 4 does not specify the deductions that may be made in ascertaining the income from a business or property, s. 5, after enumerating all the items to be included in income from an office or employment, expressly limits the allowable deductions to those contemplated in a few specifically enumerated provisions of the Act. Can this mean that the other deductions, although they are thus disallowed from income from an office or employment, are

nevertheless allowable from total income even if there is no other income, or if all other income amounts to less than those deductions? Would this not deprive the restriction of any practical effect due to the repeal of s. 13(1)? It does not seem that this repeal was intended to have that result because not only was the limitation of the deductions allowable against employment income left intact at that time, but it was reenacted in amended form in 1957 (5-6 Eliz. II, c. 29, s. 1). Parliament having decreed that income from an office or employment shall include all the items specified minus the permitted deductions "but without any other deductions whatsoever", it is not easy to see on what basis some other deductions, namely business losses incurred in the same year, should be allowed to reduce the income of a taxpayer below the amount of his income from an office or employment.

On the other hand, the limitation of deductions from "income from an office or employment" is only in the definition of such income (s. 5) and does not affect the definition of "income" (s. 3). Can it be held to exclude the deduction of business losses incurred in the same year unless it is also held that the latter definition does not implicitly provide for that particular deduction being made? If it is so, then there is no basis anywhere in the Act as it now reads for allowing the deduction of a business loss from income from any other source in the same year as is expressly contemplated in the definition of "loss" (s. 139(1)(*x*)). Should it be said that this merely means that this part of the definition was made useless by the repeal of the former s. 13(1) in 1952? Nothing indicates that this amendment was intended to prohibit the deduction of any business loss in the same year.

Both parties seek to avoid the difficulty by calling this a "netting out" instead of a deduction.

Respondent contends that the plural "businesses" in s. 3 implies a "netting out" of the income from all businesses in the same year. This argument is self-defeating because, if the plural does of itself carry such an implication, then this must be applied to "sources" as well, resulting in an overall "netting out" that is the very basis of the Minister's contention.

On the other hand, some very serious objections to any "netting out" theory are not only that the word "net" was

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eliminated from the Act in the 1948 revision but also that, in the Act generally, "deduction" appears to cover anything that may be subtracted. Moreover, the word "loss" is found in s. 12 dealing with deductions that are not to be made.

> 12.(1) In computing income, no deduction shall be made in respect of
>
> * * *
>
> (*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part,

This might be said to imply that a loss that is not a loss of capital is, as a rule, deductible. But, if this is a "deduction", how can it escape the effect of the limitation of deductions against "income from an office or employment"?

Having thus stated at length the problem presented in argument by the parties, I find however that it does not require to be solved in the instant case because there is no appeal from respondent's assessment for the year 1962. It is for that year that the question really arose whether, for income tax purposes, the business loss suffered in that year was to be applied first against other income in that same year. Although the assessment notice for the year 1962 is not in the record, the transcript shows that while respondent was testifying in the Exchequer Court, his counsel said:

> MR. ESTEY:
>
> Then, I believe, My Lord, part of the record already before Your Lordship includes the three assessment notices which followed that sequence of correspondence. There are three in all which perhaps would be helpful to the Court to mention for a moment now. The first one is 1961 on which is endorsed, after the arithmetic is sorted out—and there is no contest on the arithmetic—"As per amended return filed with the exception of 1962 business loss, 1962 business loan has previously been allowed as a deduction from other income in 1962". So the issue for 1961 is narrowed down to whether or not the loss which the taxpayer seeks to apply against that year has already been used up in 1962. And then on the '62 assessment, notice of assessment, is endorsed: "Your loss from business in 1962 must first be applied against any other income of the year in which the loss occurs, and accordingly it has been deducted in 1962 and your amended 1961 return will have no effect." And the third one is for 1963 which again, after dealing with the other matters of arithmetic, it adds in the $9,897.30 with this note: "Taxable income as previously assessed as payments received from Borden, Elliott deemed income $9,897.30." I take it it is not necessary to file those as exhibits, My Lord?

to which His Lordship replied: "No."

Thus it appears that in making up respondent's assessment for the year 1962, the Minister applied the business loss suffered in that year against other income in that same year. Respondent's return, which is in the record, shows how this was done and also reveals that there was other income in that year in an amount exceeding the business loss and all other allowable deductions. As there is no appeal from that assessment, the courts cannot revise it. It follows that they cannot consider whether the Minister was correct in applying the business loss, as he did, against other income in that year. That is a question that arose on respondent's assessment for the year 1962 and was properly determined on that assessment. That determination is binding on the parties. Section 46(7) reads:

> (7) An assessment shall, subject to being varied or vacated on an objection or appeal under this Part and subject to a re-assessment, be deemed to be valid and binding notwithstanding any error, defect or omission therein or in any proceeding under this Act relating thereto.

It is only by an objection made in proper time and an appeal, if necessary, that the respondent could prevent his 1962 business loss from operating to reduce his other income in that year by virtue of the assessment. As this was not done, the result is that, having to consider only the assessment for the year 1961, the statutory definition of loss is to be applied to the facts as they are. These are that the whole amount of the 1962 business loss has operated to reduce the taxpayer's income from other sources for purposes of income tax for the year in which it was sustained and, therefore, it is not available as a deduction in the previous year.

I must add that s. 46(7) was not referred to in argument written or oral and I would consider a rehearing necessary on that point before such could properly be the basis of the majority decision on this branch of the case.

For the year 1963 the facts are the following. The partnership known as Borden, Elliott, Kelley & Palmer was, at the material time, governed by an agreement made as of January 1, 1961. Clause 1 of this contract states that the partnership is a continuation of the partnership heretofore carried under the same firm name and shall continue until determined by the affirmative vote of 75 per cent of the total votes exercisable. There are elaborate provisions for establishing yearly the percentage of the profits to which

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each partner is to be entitled. It must be noted that two of them are entitled to fix their own share without any restriction and also to exercise this right upon a dissolution with respect to all assets remaining after discharging any liabilities. In respect of withdrawals from partnership, clause 14 provides:

14. In the event of the withdrawal from partnership or death of any partner, the withdrawing partner or the estate of a deceased partner, as the case may be, shall be entitled to receive, not later than six (6) months following the date of such withdrawal or death, the amount of undrawn profits from years preceding the year of withdrawal or death then standing to the credit of such partner.

The withdrawing partner or the estate of a deceased partner shall also be paid the following additional amounts,—

(*a*) In respect of the financial year (hereinafter in this sub-paragraph (*a*) called the "current financial year") in which death or withdrawal occurred, such portion of the profits for that year as shall be voted to the withdrawing partner or to the estate of the deceased partner at the ballot conducted pursuant to sub-paragraph (*c*) of paragraph 12 by the partners then entitled to vote. The withdrawing partner or the personal representatives of the deceased partner shall not be entitled to vote on such ballot but the name of the withdrawing or deceased partner shall appear on the ballot; provided that the withdrawing partner or the estate of the deceased partner shall be entitled to receive from the profits for the current financial year not less than an amount which shall be the average of his percentage rates of profit participation for the three (3) preceding financial years applied to the profits in which the withdrawing or deceased partner would have been entitled to share but for his withdrawal or death of the current financial year and prorated to the period from the commencement of such current financial year to the date of withdrawal or death. The amount so voted to such partner or the aforesaid minimum whichever may be the greater, after deduction of sums paid on account as monthly drawings to the withdrawing partner, or to the deceased partner and his estate, as the case may be, shall be paid in full at once; and pending the determination of the actual amount so payable there shall be paid on account thereof each month during the balance of the current year an amount equal to his last effective monthly drawing rate, and any necessary adjustment shall be made when the actual amount so payable is determined; and

(*b*) The Management Committee shall examine into and, in the exercise of its best judgment, evaluate the profits accruing or to accrue or likely to accrue to the partnership from work in process or in contemplation on which the withdrawing or deceased partner was engaged or in respect of which he had general supervision or which he had introduced to the partnership and shall allocate to the withdrawing or deceased partner such portion of those profits as they, in their sole and unrestricted discretion shall consider to be just and equitable; provided, however, that unless the Management Committee shall, by the affirmative vote of 90% of the total votes exercisable in accordance with clauses (*d*) and (*f*) of paragraph 11 of this agreement (excluding for the purpose of such

vote the votes of the withdrawing partner), have determined that the withdrawing partner or the deceased partner has by his misconduct or dishonesty caused actual loss or damage to the partnership or prejudiced its reputation with the public or clients or the profession, the amount so allocated shall not be less than an amount calculated as follows:—

The average of the percentage rates of profit-participation awarded to the withdrawing or deceased partner during the three (3) financial years of the partnership last completed on or before the date of his withdrawal or death shall be calculated. The average percentage rate so obtained shall be applied to the amount of the profits of the partnership, in which the withdrawing or deceased partner would have been entitled to share but for his withdrawal or death, for the financial year of the partnership next following that in which the withdrawal or death occurred and the amount so obtained shall be the minimum entitlement of such partner under this sub-paragraph (*b*).

Such allocation shall be final and binding on all persons in interest and shall not be subject to review in any court. The profits so allocated under this sub-paragraph (*b*) to a withdrawing or deceased partner shall be paid in full at once or in equal annual instalments over such period of time not exceeding five years from the date on which such withdrawal or death occurred as the Management Committee shall, in its discretion, consider appropriate. There shall, however, be paid to the estate of a deceased partner, on account of the profits to be so allocated, a sum equal to the income tax payable by the estate in respect of the said profits, and such sum shall be paid forthwith upon the ascertainment of the amount of such tax. In no event shall interest be payable on any deferred balance.

Some time after respondent's withdrawal from the firm, the Management Committee made a decision under para. (*b*) of the above clause. The decision allocated to the respondent an amount calculated on the minimum basis specified and decided that this would be payable in four yearly equal instalments starting in 1963. On April 23, 1963, the auditors of the firm certified in writing "that the sum of $39,589.20 was credited to the account of Mr. I. G. Wahn as his share of the net profit of the firm for the year ended December 31, 1962", and on April 26 this was mailed to the respondent with a cheque for $9,897.30 being one quarter of the total credit.

In his income tax return for the year 1962, respondent, after setting forth the details of his business loss of $6,902.89 previously referred to and claiming the right to carry it back against his 1961 professional income, added the following note:

I also received from Borden, Elliott, Kelley & Palmer a cheque for $9,897.30 being one quarter of the amount (which is subject to dispute and adjustment) payable to me under my old partnership agreement with that

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firm. The proper amount payable is determined by reference to 1962 profits of Borden, Elliott, Kelley & Palmer. I left that firm effective December 31, 1961. Accordingly all such payments are capital not income.

Although, as previously mentioned, the notice of assessment for the year 1962 is not in the record, it is clear that the respondent was not assessed for income tax on his income for the year 1962 in respect of either the whole amount allocated to him by his former firm or the part of this amount that was paid to him in April 1963. What happened was that on August 16, 1965, a notice of reassessment was issued for the taxation year 1963 bearing the following mention:

> ADD: payments received from Borden, Elliott, Kelley & Palmer—deemed income.....$9,897.30

In his notice of objection, respondent again raised the contention that this was "a capital payment". He also urged in alternative that if the payment is considered as income, it should be treated as income for the taxation year 1962 rather than 1963. The objection was overruled by the Minister who said in a notification dated May 31, 1966:

> The amount of $9,897.30 received by the taxpayer in the 1963 taxation year from Messrs. Borden, Elliott, Kelley and Palmer pursuant to clause 14 of the Agreement dated 1st January, 1961 has been properly taken into account in computing the taxpayer's income for the 1963 taxation year in accordance with the provisions of sections 3 and 4 and paragraph (*c*) of subsection (1) of section 6 of the Act.

The parties took substantially the same position in the notice of appeal to the Income Tax Appeal Board and the reply thereto.

On February 15, 1967, the Tax Appeal Board upheld the assessment. Weldon said, after quoting from clause 14(*b*) of the partnership agreement:

> My interpretation of sub-paragraph (*b*) is that it was included in the Partnership Agreement to provide a convenient formula for compensating a withdrawing partner in respect of legal fees which he had earned, in whole or in part, but which were destined to be received by his former firm after his withdrawal therefrom. In that light, the amount of $39,589.20, allocated to the Appellant as aforesaid, was clearly income.

Concerning respondent's alternative contention, all that was said is the following:

> Since the above payment of $9,897.30 was properly made to the Appellant by his former partners strictly in accordance with the relevant provision contained in the Partnership Agreement, there is no question,

in my view, that the payment does not fall directly within the taxpayer's 1963 taxation year. That point has been clarified because Mr. Wahn has submitted, in the alternative, that, if the payment of $9,897.30 was found to be income instead of capital, as maintained by him, it should be taxed in his 1962 rather than in his 1963 taxation year.

This is found in the reasons for judgment of the Board before the other quoted passage in which reference is made not to the amount paid in 1963 but to the whole amount allocated out of the 1962 profits. This makes it rather difficult to understand the precise basis on which respondent's alternative contention was rejected by the conclusion confirming the assessment for the year 1963.

In the Exchequer Court, Gibson J. said:

> The payment in 1963 of $9,897.30 (together with the payments of a similar amount in the four years following) was for the release, transfer or surrender of the interest of the appellant in goodwill in the law practice of Borden, Elliott, Kelley and Palmer to the remaining partners, the corollary of purchased goodwill, a capital asset, and also to a small degree for the surrender of all the right, title and interest of the appellant in the other capital assets less his responsibility for the liabilities of this firm, and therefore the receipt of this sum for such by the appellant was not income to him within the meaning of the *Income Tax Act*.

Here again I find myself unable to agree with the view taken in the Court below. In order to ascertain the nature of the amount allocated to the respondent out of the profits of the firm from which he had withdrawn, the partnership agreement must be construed as written. It was obviously drawn up with great care and special consideration was given to the fiscal consequences of the provisions for payments to a withdrawing partner or to the estate of a deceased partner. In the latter case it is provided that payment will be made by the firm of "a sum equal to the income tax payable by the estate in respect of the said profits" (viz. the profits so allocated). This shows clearly that it was not the intention that the remaining partners should bear the income tax on the part of the 1962 profits allocated to the respondent. However, such would be the result of treating the amount as a capital payment. Respondent would be getting it free from income tax but the amount allocated to him out of the 1962 profits would be added to the share of the remaining partners because, on the assumption that the sum allocated is a capital payment, the whole amount of the 1962 profits would have to be apportioned among the partners instead

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of the portion remaining after deducting the amount allocated to the respondent. This is clearly what was never intended and I fail to see on what basis the agreement should be given an effect other than that which was undoubtedly intended.

It is contended that what is said in the agreement respecting income tax cannot override the provisions of the Act. This is quite true but does not mean that what is said is not to be taken as expressing the intention of the parties. I find it obvious that the intention was that the payment to a withdrawing partner should be an allocation of profits. It is true that the fact that a payment is measured by reference to profits may not prevent it from being of a capital nature but there must be something to show that such is the true nature of a payment. In the present case, I can find nothing tending to indicate that it is so. On the contrary, clause 18 provides clearly that a withdrawing partner has no interest in the capital assets of the firm.

> 18. The amounts hereinbefore provided to be paid to a withdrawing, retiring or expelled partner or to the estate of a deceased partner shall be accepted by the withdrawing, retiring or expelled partner or by the estate of the deceased partner in full satisfaction of all claims or demands which he or it may have against the partnership.

It must also be noted that when respondent was admitted to the partnership, he was not required to make and did not make, at that time or at any other time, any contribution to capital account. Under such circumstances it is only natural that the agreement was not intended to compel the other partners to pay a substantial capital sum for the privilege of retaining assets to which respondent had not contributed. Concerning goodwill, it is significant that the agreement contains no provision intended to secure it to the remaining partners as against a withdrawing partner although such provision is made for the case when a partner retires because of age or ill health. In such case, clause 17 of the agreement provides for a retiring allowance subject to the condition that he shall not "in any way compete with the continuing partnership". It is thus clear that the matter of goodwill was considered in the drafting of the partnership agreement. The wording of the provision for the allowance to a withdrawing partner shows that it was not intended to be a capital payment for goodwill but an

allocation of profits and this is conclusive evidence that it is income of the recipient as was held by this Court in *Minister of National Revenue v. Sedgwick*[5].

Much was said of the *Partnerships Act*, R.S.O. 1960, c. 288, but I can find nothing in it which would compel us to hold that the amount allocated to the respondent is anything else than what the agreement intends it to be, namely a share of the 1962 profits. Sections 32 and 33 clearly show that it may be lawfully stipulated that a partnership will continue after the withdrawal of a partner and s. 43 implies that payments to a withdrawing partner may be governed by the stipulations of the partnership agreement.

Having come to the conclusion that the amount allocated to the respondent by his former firm is not a capital payment but a part of the profits of that partnership in the year 1962, being the year following his withdrawal, it is necessary to consider s. 6 of the Act and especially para. (*c*). This section down to that paragraph reads as follows:

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

(*a*) amounts received in the year as, on account or in lieu of payment of, or in satisfaction of
  (i) dividends,
  (ii) director's or other fees,
  (iii) Repealed. 1963, c. 21, s. 2(1).
  (iv) superannuation or pension benefits,
  (v) retiring allowances, or
  (vi) death benefit;

(*aa*) amounts received in the year as annuity payments;

(*b*) amounts received in the year or receivable in the year (depending upon the method regularly followed by the taxpayer in computing his profit) as interest or on account or in lieu of payment of, or in satisfaction of interest;

(*c*) the taxpayer's income from a partnership or syndicate for the year whether or not he has withdrawn it during the year;

These provisions must be considered in the light of s. 15 of which subs. (1) reads as follows:

15. (1) Where a person is a partner or an individual is a proprietor of a business, his income from the partnership or business for a taxation year shall be deemed to be his income from the partnership or business for the fiscal period or periods that ended in the year.

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[5] [1964] S.C.R. 177, [1963] C.T.C. 571, 63 D.T.C. 1378, 42 D.L.R. (2d) 492.

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It is clear that the last quoted provision cannot be applied to the respondent. He was not a partner of his former firm in the year 1962. In my view, this provision should also be taken as defining what is meant as the taxpayer's income from a partnership in para. (*c*) of s. 6(1). The Shorter Oxford Dictionary gives the following as the first two meanings of the word "partnership":

> 1. The fact or condition of being a partner.
>
> 2. *Comm.* An association of two or more persons for the carrying on of a business, of which they share the expenses, profit, and loss.

In the first and stricter sense the payment made to the respondent in 1963 was not income from a partnership because he was not a partner, although in the second and wider sense it might be said to be income from the partnership because it came from the association of which he had formerly been a member. Bearing in mind 1° that fiscal statutes must be construed strictly, 2° that the respondent having regularly followed the method of reporting his income as received, para. (*c*) is an exception to the more general rule, 3° that the narrow sense is the only one consistent with s. 15(1), I have reached the conclusion that the respondent was properly assessed for the payment made by his former firm in the year in which he actually received it.

For the above reasons I am of the opinion that the appeal should be allowed with costs, that the judgment of the Exchequer Court should be reversed, that respondent's appeal to that Court from the decision of the Income Tax Appeal Board should be dismissed with costs and that the said decision should be re-established and confirmed.

Appeal allowed with costs.

Solicitor for the appellant: D. S. Maxwell, Ottawa.

Solicitors for the respondent: Robertson, Lane, Perrett, Frankish & Estey, Toronto.