## TAXATION DECISIONS AND RULINGS

### Excess Profits Tax Act

### Capital Employed in the Business

The first schedule to the Excess Profits Tax Act deals with capital employed in the business, and more particularly in section 4 thereof, with the treatment of reductions in the assets during the taxation period. This question arose in a recent English case—*Inland Revenue Commissioners* vs. *Terence Byron Ltd.* [1]

In this case the taxpayer was the owner of a theatre which was totally destroyed in 1941 by enemy action. The taxing authorities apparently sought to reduce the standard profits by determining that the value of the theatre was no longer "capital employed in a trade or business." It was admitted that a valid claim had arisen under the War Damage Act in respect of the building and that in due course it would be allowed and paid in the amount of £12,280.

In his judgment Macnaghten J. made particular reference to the section of the English Act, which is similar to paragraph (b) of section 2 of the first schedule of the Canadian Act. He refers to "debts due to the person carrying on the trade or business" being capital employed and states,

> A debt due to a person carrying on a trade or business is no doubt an 'asset' of the trade or business but it cannot in ordinary parlance be described as 'employed' in the trade or business before it has been paid. It seems, therefore, that the word 'employed' as used in the Finance (No. 2) Act 1939, s. 13(3) in connection with the word 'capital' is not used in a very strict sense, and that the expression 'capital employed in a trade or business' has much the same meaning as 'capital of a trade or business' and must be so construed.

It is possible that the learned judge was seeking an equitable solution to the question involved since he states:

> if the standard profits suffer no reduction by reason of the fact that the person carrying on the trade or business does not chance to use a particular asset, it would seem unreasonable to reduce the standard profits because the asset has become unusable owing to enemy action.

Provision is made in section 3 (e) of the first schedule of the Canadian Act for the exclusion of "unproductive assets not required for the purpose of the business." This however may not be applicable in the light of the following words in the judgment:

> Moreover, in the present case, the respondents remain liable for all expenses in connection with their ownership of the destroyed theatre, such as fencing and watching, and such expense would, of course,

[1] [1943] 2 All E.R. 415.

> in the assessment of the profits for income tax purposes, be allowed as expenses of the business, and if any income were received from letting the site as a parking place or as a place for static water, the receipts from such source would be included in the income of the business. In these circumstances I think it may be fairly be said that the respondents do in fact 'employ' this asset in their business, notwithstanding the destruction of the theatre.

It was further held that there was evidence to support the decision that the value of the property should be the amount of the anticipated claim of £12,280 under the War Damage Act.

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## EXCESS PROFITS TAX ACT
## FILING OF CONSOLIDATED RETURNS

The following regulation issued pursuant to section 14 of the Excess Profits Tax Act has been issued and was published in the Canada Gazette of December 25th, 1943.

### DEPARTMENT OF NATIONAL REVENUE
### THE EXCESS PROFITS TAX ACT 1940

### Regulations re Consolidated Returns

The Excess Profits Tax Act provides by Section 10:

> "Where a taxpayer has elected under subsection three of section thirty-five of the Income War Tax Act to file a consolidated return for the taxation year, such election shall apply to the returns required under this Act."

The Excess Profits Tax Act however is silent on the question of how the standard profits of the parent and the several subsidiary companies forming the consolidation shall be determined.

It is therefore required of the Minister, by section 75, subsection 2 of the Income War Tax Act, which is incorporated by section 14 thereof as part of the Excess Profits Tax Act, to

> "make any regulations deemed necessary for carrying this Act into effect. . . . ."

The following Regulation is therefore made, namely,—

> "1. Companies that elect or have elected since 1st January, 1940, to file consolidation returns shall have as their standard profits for consolidated purposes the standard profits, whether factual or ascribed, of that bona fide, continuing, operating company which of all forming the

consolidation has the highest standard, plus $5,000 added thereto for each subsidiary company forming part of the consolidation, whether such other companies have or have not standard profits greater than $5,000.

2. If subsidiary companies are added to and become part of an existing consolidation on or after the 1st of January, 1940, the standard profits of the consolidation shall be increased by $5,000, for each such subsidiary company.

3. Nothing herein shall be deemed to affect the operation of Section 15 or Section 15A of the Excess Profits Tax Act."

Dated at Ottawa this 11th day of November, 1943.

COLIN GIBSON,
*Minister of National Revenue.*
C. FRASER ELLIOTT,
*Deputy Minister (Taxation).*

## THE TAXATION OF INCOME OF HUSBAND AND WIFE

The incomes arising to a husband and wife are given special consideration in the Income War Tax Act. It is the evident intention to assure that income or profits cannot be diverted within a household by methods which would reduce the tax thereon. While therefore each is treated as a separate entity, they are taxable as individuals only upon the income which arises to each of the spouses in their own right.

Individuals are determined as being in one of two categories for income tax purposes. Their tax liability therefore falls to be decided on whether their status is that of

(a) a married person;

(b) an unmarried person.

Certain unmarried persons are taxed on the same basis as that of a married person. These are

(a) those who maintain a self-contained domestic establishment as defined in the Act;

(b) unmarried ministers or clergymen in charge of a diocese or parish, who maintain a self-contained domestic establishment.

A married person is taxed on the same basis as an unmarried person if both spouses are in receipt of an income in excess of $660.00 in the taxation year.

Where a person's status is that of an unmarried person, the tax liability is determined on all income over $660.00 and in addition the rate of normal tax is based on the net income received, with the proviso that the tax shall not in any event reduce the income below $660.00. A married person pays normal tax at the lowest rate, irrespective of the amount of income, and while tax is payable on all income over $660.00, there is allowed a credit of $150 against such tax and in any event it shall not be such as will reduce the income below $1,200.00.[1]

If the spouses have each an income of $660.00 or more in the year, any relief is lost and a tax is payable on the excess over $660.00 although the tax may not reduce the income in each case below $660.00. In addition the credit against the tax of $150.00 is lost. The effect of this rate structure is substantially to increase the tax burden, if the income of one of the spouses is slightly in excess of the minimum exemption of $660.00.

The income on which the marital status is based is the *net income* and not the *net taxable income*. Thus a wife may have a net income of $700.00 and disburse $50.00 of this in donations to charitable organizations in Canada. In the result these donations being deductible under section 5(1)(j), there is a net taxable income of $650.00 on which no tax is payable. It is true that this sum is liable for the normal tax, but as it would reduce the income below $660.00, it is not payable. This has apparently been the practice of the Income Tax Department. The question arose in an appeal in the Exchequer Court, *Kennedy* vs. *Minister of National Revenue*.[2] Unfortunately, while the report of the case clearly indicated the position taken by the Department, the appeal was decided upon other grounds, and without consideration of the particular question upon which the appeal arose. There would appear to be support for the contention of the tax authorities, in as much as the income was actually received and then disbursed. Income is defined in section 3 of the Act, and if it comes within the definition, is taxable, although the amount of tax payable is relieved by the deductions allowed in section 5. As was said in the *Kennedy* case (*supra*) at p. 40.

> There is no such thing as presumption of exemption, if anything, the presumption would be in favour of the taxing power. Immunity from taxation by statute will not be recognized unless granted in terms too plain to be mistaken.

[1] Income War Tax Act, Schedule 1A, Sec. 3, Rule 1.
[2] [1929] Ex. C.R. 36.

The exemption to a married person is granted on the actual status, and subject only to the amount of income received by each spouse. It is not based on dependency. A married man is entitled to the appropriate relief although he may not support his wife. If the parties are separated, the husband receives the major relief, unless his wife actually receives income in excess of the minimum exemption. Should she receive such income, then both are treated on the status of an unmarried person. It would seem further that the onus is upon the taxpayer to satisfy the authorities as to the amount of income of the other party.

A divorce obtained in a foreign jurisdiction not recognized by the laws of Canada or of the provinces would not deprive the parties of their marital status. This might be contingent upon the claimant for relief not having submitted his rights to such foreign jurisdiction. If such person sought the divorce, then it is doubtful if he could successfully repudiate the judgment of the tribunal to which he submitted himself and say that it was not binding upon him. Actually, it would seem that circumstances would arise which would create some inconsistencies. For example, a wife might seek a divorce in a foreign jurisdiction whose judgment would not be recognized here. She might then remarry and return to Canada and it would appear that the married status could be granted only to the first husband, although his factual status would be exactly similar to that of a single person.

Where a husband and wife are either separated or divorced, and the wife receives a separation allowance or alimony, it is deemed to be income to her. This is in accordance with section 3(1)(h) of the Act which was enacted in 1942, and made applicable to the 1942 taxation period. Formerly, such payments were not deductible by the payor but some relief was given in 1942 by the enactment of section 8A. This provides that such person is entitled to a credit against the tax, otherwise payable, of an amount equal to the tax which is paid by the recipient of the separation allowance or alimony determined as if such were the sole income of the recipient, and computed on the basis of an unmarried person. In effect, this means that there is no relief unless the payments are in excess of $660.00 a year.

Where a husband and wife have each a taxable income, the exemption for dependent children may be taken by either parent as may be agreed upon between them. In the case of any dispute the exemption will be given to the father "unless the Minister otherwise determines."[3]

[3] Income War Tax Act 1A, section 2, rule 7.

Due to conditions arising from the war and in order to encourage women to seek employment a special provision was made in 1942 as follows:

> .... a husband shall not lose his right to the deduction provided in rule three of this section by reason of his wife being employed and receiving any earned income, but his wife shall for the purposes of this section be treated as an unmarried person.[4]

If therefore a wife is employed, the husband will not thereby lose the tax relief to which he is entitled by reason of his actual marital status. It is limited, however, to those husbands whose wives accept employment, and would not be applicable if the wife were to engage in trade or business by herself. Further, the fact that the wife was employed prior to the war would not deprive the husband of the benefits given herein.

Where a husband and wife are carrying on business as a partnership the income therefrom, in the discretion of the Minister, may be taxed in the hands of either one, as the Minister may determine. The only exception would probably be in those cases where the husband or wife actually contributed to the partnership capital which they owned in their own right. Where the husband or wife is employed by a partnership in which one of them is a partner, then the salary or wages paid to the spouse employed is added back to the profits of the partner in proportion to the interest held in the partnership. Also, if a husband or wife is an employee of the other, the amount of salary or wages paid is added back and is not allowed as an expense of the business.[5] But the receipt of such salary or wage in excess of $660.00 would not deprive the other of the relief appropriate to the married status.

While the legislation states that the wife so employed shall "be treated as an unmarried person" this would not operate if in fact her husband was not in receipt of an income of more than $660.00. In this connection it should be noted that any member of the armed forces is deemed to be in receipt of an income in excess of the minimum exception, notwithstanding the actual rate of pay. Such pay, and the uniform and maintenance supplied, which, being personal and living expenses are income to the recipient, are deemed to be equivalent to more than $660.00 a year.

One other point is important in the treatment of husband and wife under the Income War Tax Act. Under section 32(2), if a

[5] Income War Tax Act 1A, section 2, rule 6.
[6] Income War Tax Act, section 31, s.s.1, 2 & 3.

husband transfers property to his wife, or vice versa, the income from the property so transferred is taxed in the hands of the transferor as if such transfer had not been made. In applying this section full significance has not been given to the connotations in the word "transfer". The section is applied only when the transfer has been made by way of donation and without adequate consideration, except that a transfer under the terms of a marriage contract and subsequent to the marriage is not recognized.

One difficult situation may arise in connection with the application of this section. If a husband were to transfer a bond or other security to his wife, he is taxable on the income therefrom. Then if after receiving such a gift from the husband the parties were divorced and the former wife continued to receive the income, the husband would be required for tax purposes to treat it as though he had received it himself.

The husband is liable for the income derived from property substituted for that originally transferred. It may be contended that the liability would extend to income derived from the investment, by the wife, of the returns from such property but this would seem to be debatable. It seems clear, however, that if a wife should invest savings from a household allowance, this would be the property of the husband, and the income taxed accordingly.

Any transfer between husband and wife is subject to gift tax. This applies since the introduction of the Dominion Succession Duty Act and the repeal in the same year of para. (e) of s.s. 8 of sec. 88 of the Income War Tax Act, and is applicable to all gifts made after April 30th, 1941.

J. S. FORSYTH.

Ottawa.