TAXATION RULINGS AND DECISIONS

Gilhooly v. *Minister of National Revenue*

On the 24th August last His Honour Judge J. C. A. Cameron sitting as a Deputy Judge in the Exchequer Court of Canada delivered judgment in the above appeal taken under the provisions of the Income War Tax Act.

The point involved was the disallowance by the taxing authorities of an amount for depletion in respect of income from mining received by the appellant as the life beneficiary of an estate. The facts are as follows.

The appellant, under the terms of her father's will, was entitled to receive during her life a portion of the income of the estate which consisted in part of dividends received from shares in a mining company. It would seem that the amount so received by the estate from this source was at all times segregated and was capable of determination and the proportion of the estate income received by the appellant from that source was determined as in the same relative proportion. In making the assessment a claim by the appellant for twenty per cent depletion against such income received from the estate was denied. The refusal to make such allowance was first commenced in 1938, it appearing from the evidence that prior to that time the appellant had received the allowance claimed. From this refusal the appellant appealed.

The right to such depletion was based on the provisions of section 5, ss. 1 (a) of the Income War Tax Act, the relevant part of which reads as follows:

> (1) "Income" as hereinbefore defined shall for the purpose of this Act be subject to the following exemptions and deductions:—
>
> (a) The Minister in determining the income derived from mining and from oil and gas wells and timber limits may make such an allowance for the exhaustion of the mines, wells and timber limits as he may deem just and fair, and in the case of leases of mines, oil and gas wells and timber limits the lessor and lessee shall each be entitled to deduct a part of the allowance for exhaustion as they agree and in case the lessor and lessee do not agree the Minister shall have full power to apportion the deduction between them and his determination shall be conclusive;"

The judgment indicates fully the practice which the Department followed in granting depletion on mining dividends which had always been allowed from the inception of the Act. In 1934

the Department established the rate of twenty per cent and permitted it to be deducted by the shareholders in determining their taxable income. This rate was lower than that which had previously been allowed.

It is pointed out that ordinarily an allowance for depletion would only go to the owner of the property. The practice of the Department, however, was that an allowance would be made to the mine itself as owner of the property and an additional allowance made to the shareholders upon the dividends received by them.

It was contended on behalf of the Minister that there was no legal justification in any event for a depletion allowance being given to the shareholders as it was only the owner of the property who was entitled to such relief. The learned judge, however, pointed out that the words of the statute referred to "income derived from mining" and that consequently he was not willing to assume that the interpretation which had been placed upon these words was wrong, particularly when it had been applied from the inception of the income tax law. He further says that had it been intended to limit the relief only to the actual owners of the mine, it would have been easy to have used express words to provide for such limitation. In dealing with this His Honour said:

> I find therefore that in the absence of any provision in the section limiting the allowance for exhaustion to the mine owner that one who receives dividends from a mining company does derive them from mining and is entitled to the allowance provided for. My opinion that this is the correct interpretation of the section is strengthened by the fact that the Department has so construed it since 1917.

A further contention was that the appellant being a life beneficiary only of the estate, the payments made to her were income from an estate and by passing through the estate lost its identity and that, therefore it could not be said to be income derived from mining. This argument was not accepted by the Court. He cites at some length the principles enunciated in several cases arising in other jurisdictions, notably Australia, and Africa, some of which were decided in the Privy Council. In the result His Honour held that the character of the income did not lose its identity on passing through the estate. Rather, the statute intended to give some relief in respect of income derived from mining and the fact that the monies came into the hands of the appellant through the medium of the estate did not deprive it of its character or of the relief to which it was thereby entitled. His Honour said in this connection:

> Nor do I think that the mere intervention of a trustee or executor (whose duty is merely to collect mining dividends and turn over that income in the proportions and to the persons mentioned in the testator's will as in this case) results in the ultimate beneficiary being deprived of the right of depletion.

The appellant in this case had a life interest only in the estate. His Honour, however, stated that notwithstanding the limited interest she was concerned with the capital depletion and the fact that such life interest did not vest any right in the capital for which the depletion was being given did not operate to deprive her of the relief sought. He emphasized that the Act did not state that the depletion was to go to the owner but that it was rather to go to the person who received income derived from mining and that in this case such income was actually derived from mining in the form of dividends received from a mining company. Accordingly the appeal was allowed.

In view of the basis on which the conclusions were reached there does not appear to be any conflict between this judgment and that given by the President of the Exchequer Court, Mr. Justice Thorson, in the case of the *King* v. *Davidson*, a note of which is given hereafter and wherein it was held that a life tenant was not entitled to claim depreciation in respect of certain real estate held by an estate and from which the income he received was derived.

Davidson v. *The King*

This was an action heard before the Honourable Mr. Justice Thorson in the Exchequer Court of Canada instituted by way of Petition of Right. The suppliant had filed no appeals against certain assessments within the prescribed time limit and consequently had to proceed by way of an action for recovery of amounts claimed to have been overpaid. The facts are as follows.

The suppliant was an executor and beneficiary under the will of his father who died in 1901. Under the will the widow of the testator was entitled to an annuity of $3,000 a year from the income of the estate, the balance going to the suppliant. Upon the death of the widow a half share of the assets of the estate vested in the suppliant and he took a life interest in one-half the income of the remainder of the estate, subject to an annuity to his brother, corpus of which was to go to his children, grandchildren of the testator.

As executor of the estate the suppliant filed income tax returns on Form T. 3 showing the income received, and proper allowances were made for depreciation on the assets of the estate which consisted largely of apartments, houses and other buildings. The suppliant then personally filed a T. 1 return showing receipt of the income apportioned to him from the estate and which included amounts which had been set aside by the estate as being depreciation. After a division of the estate in later years when the suppliant took over his share of the corpus, he reported the income from his property as having been received by him direct and claimed and was allowed depreciation thereon. For three years, certain assets, the property of the suppliant, remained in the estate and were treated for Income Tax purposes as part of the corpus.

With respect to the income received as his life interest in the balance of the estate he did not claim any amount for depreciation but included in his returns the total amount received and which included the amounts which had been allowed to the estate in its accounting records as being depreciation. It was the amount paid to him out of the depreciation reserve of the estate which the suppliant claimed was improperly assessed and taxed in his hands. On behalf of the Crown it was contended that the failure of the suppliant to file an appeal against the assessments taxing him upon the depreciation allowance received and in particular in view of the very wide language used in sections 67 and 69 of this Act that the assessments were binding. In this connection the wording of section 69 is of interest. It reads as follows:

> 69. If a notice of appeal is not served or a notice of dissatisfaction is not mailed within the time limited therefor, the right of the person assessed to appeal shall cease and the assessment shall be valid and binding notwithstanding any error, defect or omission therein or in any proceedings required by this Act.

In dealing with this His Lordship said:

> The assessments are therefore now binding upon the appellant and his case must fail unless he can bring himself outside the implications of Section 69 and show his entitlement to relief apart from the procedure prescribed by the Act.

This remark is of interest as indicating that notwithstanding the very strong and explicit language of the Act there might be circumstances arise under which a claimant could receive relief although no indication is made as to the nature of what

such circumstances would be whereby such relief could be granted.

On behalf of the suppliant it was argued that under section 5, ss. 1 (a) of the Act, which in the years under consideration read as follows:

> 5. (1) "Income" as hereinbefore defined shall for the purpose of this Act be subject to the following exemptions and deductions:—
>
> (a) Such reasonable amount as the Minister in his discretion may allow for depreciation. . . . .

he had a statutory right to depreciation and that the Minister had erred in not making provision therefor. It was admitted that no claim had been made by the appellant in his income tax return for such depreciation. In rejecting this contention His Lordship said:

> It is I think clear from section 5 (a) that it presupposes that a claim for depreciation has been made and that it is in respect of such a claim that the Minister is to exercise his discretion and allow a reasonable amount. The use of the word 'allow' in the section connotes that there is a claim before the Minister for his consideration. It follows that if no claim for depreciation was made by a taxpayer there was no duty on the part of the Minister under section 5 (a) to make any allowance of depreciation to him for there was nothing before him in respect of which he could exercise his discretion. To suggest that the Minister must make an allowance for depreciation to a taxpayer even when he has not claimed any and that his failure to do so will render an assessment invalid and of no effect is in my opinion an utterly untenable position. If there was no duty on the part of the Minister to make an allowance for depreciation for the suppliant he would have no statutory right to it.

His Lordship then refers to what he considers an aspect of the case which he thinks is an important one, but which was not argued before him. This is as to whether depreciation is an amount which represents the capital being used in the earning of the income and is granted only to the owner of such capital in order to enable the income producing unit to remain intact. He states:

> A taxpayer whose income comes to him otherwise than from the use of his assets is not entitled to any depreciation in respect of such income. It follows that a beneficiary of an estate insofar as he is entitled only to income from it is not entitled to deduct any amount of depreciation in respect of such income since it is not his assets but those of the estate that have been used in the production of such income. Any amount that may be allowed for depreciation, being an item of capital, enures to the benefit of the estate and those entitled to its corpus.

His Lordship then states:

> In respect of the income from this half of the estate the claim of the suppliant that he made a mistake in failing to deduct depreciation from it fails completely for he had no right to any such deduction.

It is to be noted that His Lordship here is dealing with depreciation only. While the view expressed may appear contrary to that held in the case of *Gilhooly* v. *The Minister of National Revenue*, in that case the subject matter was depletion and it was there held that it was not a question of renewal of capital but rather a benefit given in respect of income derived from mining. There is, therefore, no conflict in the two decisions.

Notwithstanding the definite finding noted above his Lordship goes on to discuss the other arguments advanced. The suppliant argued that the assessments were invalid inasmuch as the Minister had assessed that which was not income. That in doing so the Minister had exceeded his statutory authority which was to check and examine the returns and if an overpayment has been made to refund the amount of such overpayment. In dealing with this his Lordship said:

> The taxpayer's own return of his income while not binding upon the Minister, may be the basis of the assessment made by him. It is reasonable that this should be so since the taxpayer knows better than anyone else what his income is. How, then, can it possibly be said that an assessment based upon the taxpayer's own return of his taxable income is an assessment made without jurisdiction to assess? The question carries its own answer. . . . The taxpayer may make an error in his return by including as income that which may really be capital or by failing to claim a deduction to which he may be entitled, and he may be able on appeal in the manner prescribed by the Act, to show such error and have the assessment set aside, but there is a vast difference between an assessment that is invalid as being erroneous and one that is invalid as being made without jurisdiction to make it.

It is apparent, however, that there was a period following the death of the widow of the testator and the distribution of his share of the corpus to the suppliant, when the whole income was treated as belonging to the estate. This includes the taxation years 1923 to 1926 inclusive. His Lordship indicates that the suppliant was entitled to depreciation, in those years, upon those assets of the estate to which he was entitled and from which he received income. But by his failure to claim such allowance, and by not seeking relief through the procedure

provided by statute for appealing from any assessment, he had lost his right to recover any overpayment.

During the first three years the Income War Tax Act was in force, that is 1917, 1918, and 1919, it was the duty of the Minister to assess the returns upon the basis of information supplied in the return. After the return had been examined the assessment was made and the taxpayer notified. Commencing for the taxation year 1920 and thereafter the system known as self-assessing was introduced. Under this the taxpayer was required to complete a return and determine the tax payable by him on the basis of such return. The Minister was not bound by the return or the determination of the tax, but rather "notwithstanding such return or information, or if no return has been made, the Minister may determine the amount of tax to be paid by any person". The judgment in this case indicates that notwithstanding the statutory right of the Minister to reassess, in doing so he may disregard any relief to which the taxpayer is entitled if no claim for such relief has been made.

The judgment lends emphasis to the necessity of every taxpayer being informed of the law and procedure in income tax matters. The duties of the assessing authorities extend only to seeing that all income of which they have knowledge, and which is furnished to them through various sources, is assessed and that the actual mathematical computations are correct.

J. S. FORSYTH.

Ottawa.