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Sept. 4

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BETWEEN:

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

AND

J. W. ALLEN NEILSON ..... RESPONDENT.

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97 as amended, ss. 2(m), 2(n), 3(1), 5(1) (c), 9(1) (a), Paras. A and AA of the First Schedule—Definitions of "income", "earned income" and "investment income"—Whether there is statutory authority for allowing a claim for personal exemption as a deduction in computing tax payable under Para. AA of the First Schedule of the Act—Appeal allowed.

Respondent had appealed to the Income Tax Appeal Board from an assessment dated June 1, 1949, in respect of one item of his income for the taxation year 1947. The appeal was dismissed and no further appeal was taken from that part of the Board's decision. The Board, however, *ex proprio motu,* being of the opinion that a taxpayer in the computation of "investment income" was entitled to deduct not only the then statutory exemption of $1,800, but also the amount of his personal exemption under s. 5(1) (in this case $750), reduced the assessment by the sum of $30, being 4 per cent of $750. From that part of the Board's decision the appellant appealed.

Held: That "earned income" as defined in s. 2(*m*) of the Income War Tax Act was solely defined for the purpose of then defining "investment income", and, for the purpose of this case, in general terms investment income means any income not defined in the Act as "earned income".

2. That in supplying these definitions Parliament was dividing up into two classes that which it had defined as "income" in s. 3(1) of the Income War Tax Act—namely, the annual profit or gain—a distinction being drawn between that part of the income which was earned and that which was unearned.

3. That after reviewing the history of the legislation it seems reasonable to assume that in setting a fixed exemption from investment income as has been done throughout, Parliament fixed upon an amount which might fairly represent for the time being an average and reasonable exemption available for all taxpayers; and that on those occasions when personal exemptions were available as an alternative deduction (as has been the case throughout except for the period of 1942-1948), the alternative was provided merely to meet the particular needs of a taxpayer who might have more than the average number of dependents. If that be so, the deductions of both fixed and personal exemptions would result in double exemptions for the same purpose. That was never intended and nothing can be found in the Income War Tax Act as it was in 1947, or at any time prior thereto, which warrants such a conclusion.

APPEAL from the decision of the Income Tax Appeal Board varying the assessment made by the appellant.

The appeal was heard before the Honourable Mr. Justice Cameron at Ottawa.

W. R. Jackett, K.C. and *A. L. DeWolf* for appellant.

No one for respondent.

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

CAMERON J. now (September 22, 1951) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board dated July 3, 1950. The respondent herein had appealed from an assessment dated June 1, 1949, in respect of one item of his income for the taxation year 1947, but the Board disallowed his appeal insofar as that matter was concerned and no further appeal has been taken from that part of the Board's decision.

The Board, however, *ex proprio motu,* being of the opinion that a taxpayer in the computation of "investment income" was entitled to deduct not only the then statutory

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exemption of $1,800, but also the amount of his personal exemptions under section 5(1) (in this case $750), reduced the assessment by the sum of $30, being 4 per cent of $750. From that part of the Board's decision the Minister of National Revenue now appeals. The amount involved is small, but I understand that the decision of the Board reverses the practice of the Department over many years. By virtue of the changes made in the Income Tax Act, the decision affects assessments for the taxation years 1947 and 1948 only.

The applicable sections of the Income War Tax Act, R.S.C. 1927, c. 97 as amended, were in 1947 as follows:

Sec. 9(1) There shall be assessed, levied and paid *upon the income* during the preceding year of every person, other than a corporation or joint stock company,

(*a*) residing or ordinarily resident in Canada at any time in such year; . . . a tax computed at the rates set forth in paragraph A and paragraph AA of the First Schedule to this Act.

Paragraph A of the First Schedule:

Rates of tax applicable to *income* of persons, other than corporations or joint stock companies under subsection one of section nine.

On the first $250 of *the income* or any portion thereof, 22 per centum per annum; or . . .

Paragraph AA of the First Schedule:

Rate of tax applicable to *investment income* of persons other than corporations and joint stock companies, under subsection one of section nine of this Act,

On investment income in excess of $1,800—four per centum.

Sec. 2(*m*)—defines earned income.

Sec. 2(*n*)—"Investment income" includes any income not defined herein as "earned income" and also any amount deemed by this Act to be a dividend.

"Income" was defined by section 3(1) of the Act and section 5(1) provided:

5(1) "Income" *as hereinbefore defined* shall for the purpose of this Act be subject to the following exemptions and deductions:

(*c*) . . . Seven hundred and fifty dollars in the case of each person not entitled to the aforesaid deduction of fifteen hundred dollars.

The Board's decision was, in part, as follows:

Obviously, the word "income" as used in the opening words of subsection (1) of section 9 refers only to the income arrived at after all the deductions and exemptions provided by subsection (1) of section 5 have been deducted. Subsection (1) of section 9 is the only section which provides for the imposition of the tax in question in this appeal, and the closing words of the subsection which refer to paragraphs A and AA of the First Schedule, refer only to the rates therein mentioned.

I am of the opinion that the word "income" and the words "investment income" as used in paragraphs A and AA above mentioned, mean in each case the income arrived at after deducting all of the exemptions and deductions mentioned in 5(1) of the Act.

Therefore, in determining the amount of his investment income on which a tax of 4 per cent is imposed, the appellant benefits of the statutory exemption provided for in 5(1) (*c*) as he does when he determines his net taxable income for the graduated tax.

It will be seen, therefore, that the Board was of the opinion that in computing the amount of taxable "investment income," a taxpayer was entitled to deduct all the deductions and exemptions mentioned in section 5(1) of the Act to the same extent as he undoubtedly was in computing the amount of his "income" which was taxed at the rate set out in paragraph A of the First Schedule. It is of some interest to note that in the calculation of tax under the T.1-General 1947 tax return form, the calculation of surtax on investment income is set up in a manner which does permit certain deductions provided for in section 5(1)—namely, charitable donations, gifts to the Crown and certain medical expenses; but the form excludes from deduction, in such calculation, "personal exemptions" (marital and dependents) which are also provided for in section 5(1). However, I am not here concerned with the fact that the Minister did in that tax form allow exemptions for medical expenses and charitable gifts, but only with the question as to there being any statutory authority for allowing a claim for personal exemptions as a deduction in computing the tax payable under paragraph AA of the First Schedule. That was the precise matter which was before the Board and I shall confine my attention to that phase of the matter.

With great respect I am unable to agree with the decision of the Board. My opinion is arrived at partly by the definition of "investment income," but in the main by a somewhat lengthy consideration of the history of the legislation in regard thereto since the surtax thereon was first levied.

Paragraph AA of the First Schedule not only fixes the rate of tax to be levied, but directs that the tax shall be on "investment income" and that must mean investment income as defined in the Act.

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In my view, "earned income" was defined solely for the purpose of then defining "investment income," and, for the purpose of this case, it is sufficient to say that in general terms investment income is any income not defined in the Act as "earned income." It seems to me that in supplying these definitions Parliament was dividing up into two classes that which it had defined as "income" in section 3(1)—namely, the annual net profit or gain, a distinction being drawn between that part of the income which was earned and that which was unearned. In neither definition is anything said about personal exemptions. That particular matter is left to be dealt with in other parts of the Act or the Schedules. As will be noted later, Parliament in its investment income legislation has been careful to indicate that personal exemptions could not be deducted from investment income except as an alternative to the deduction of the fixed statutory exemption, or could not be deducted at all.

Before turning to the history of the legislation, it may be noted that in 1947 the subsection providing for personal exemptions formed part of section 5(1), the opening words of which were "income *as hereinbefore defined.*" Clearly, therefore, the personal exemptions could be deducted from the general tax on income as defined in section 3(1), but it is equally clear that on a strict interpretation of the section the deduction was applicable only to "income" and not to "investment income."

By c. 40, Statutes of 1935, there was first levied a tax on investment income. Earned income and investment income were defined by subsections (2) (*m*) and (*n*). A new subsection (4) was added to section 5 as follows:

> 5(4) The following income shall not be liable to the additional rates of tax on investment income, namely,
>
> (*a*) all income up to five thousand dollars; or
>
> (*b*) "earned income" up to but not exceeding fourteen thousand dollars; or
>
> (*c*) income equal in amount to the sum of the exemption and allowances for dependents to which the individual is actually entitled under the provisions of paragraphs (*c*), (*d*), (*e*) and (*i*) of subsection one and of subsection two of this section; whichever affords the greatest exemption to which the taxpayer is entitled.

That subsection seems to establish beyond question that Parliament did not consider that investment income meant "investment income" less the personal exemptions provided

in section 5(1). It did give a right to deduct personal exemptions, but only as an alternative to deducting the fixed exemption in (*a*) or the other exemption in (*b*). If a taxpayer chose the exemption of $5,000 he could not also deduct his personal exemptions.

It may be noted, also, that following the amendments in 1935 there was a marked distinction between paragraph A and paragraph AA of the First Schedule. In paragraph A the first rate is stated to be "on the first one thousand dollars of net income or any portion thereof *in excess of exemptions,* 3 per centum or . . ." In paragraph AA nothing is said about exemptions, the first rate being levied "on investment income included in any income exceeding $5,000 . . ."

By the amending Act of 1935 subsection (3) was added to section 9 as follows:

(3) The total income of each taxpayer other than a corporation or a joint stock company shall be compiled by having the earned income form the base, above which shall be placed the investment income, and according thereto the appropriate additional rates of tax on investment income as provided by paragraph AA of the First Schedule of this Act shall be applied.

The purpose of that subsection is explained in Dominion of Canada Tax Service, vol. 1, at 9-451, and need not here be considered. But it is important to note that the *total* income (not the income less exemptions) is comprised of "earned income" and "investment income." That subsection was still in the Act in 1947.

Further changes were made by c. 18, Statutes of 1941. Thereby "earned income" and "investment income" were re-defined, the latter being in the same form as it was in 1947 (supra). The new subsection (4) of section 5 was as follows:

(4) The following income shall not be liable to the additional rate of tax on investment income, namely:

(*a*) investment income up to fifteen hundred dollars; or

(*b*) investment income equal in amount to the sum of the exemptions to which the individual is entitled under the provisions of paragraphs (*c*), (*d*), (*e*) and (*i*) of subsection one and of subsection two of this section;

whichever amount is the greater.

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A new paragraph AA was provided as follows:

AA. Rate of tax applicable to all persons other than corporations and joint stock companies, in respect of "investment income" as provided for in this Act.

On investment income in excess of the exemption provided therefor in subsection four of section five of this Act . . . 4 per centum.

By these amendments of 1941, therefore, there was dropped the former provision that all income over $14,000 was deemed to be investment income; and the surtax was levied on that which was, in fact, investment income. The exemption in this section was limited to the fixed sum of $1,500, *or* the total of the taxpayer's personal exemptions, whichever was greater. A taxpayer could not deduct both.

Further important amendments were made by c. 28, Statutes of 1942. Those parts of section 5(1) which had provided the personal exemptions were repealed and also section 5(4). Paragraphs A and AA of the First Schedule were repealed and new paragraphs substituted. Paragraph A was entitled "Rules for Computation of Income Tax under Subsection One of Section Nine." For the first time the general income tax was divided into normal tax and graduated tax and the rules set up under paragraph A contained the only provisions in regard to personal exemptions. They were therefore inapplicable to paragraph AA and from 1942 to 1946 personal exemptions were entirely excluded from the computation of investment income. For the first time the taxpayer was deprived of the alternative to deduct his personal exemptions and could deduct only the fixed amount provided by the new paragraph AA, which was as follows:

AA. Rate of tax applicable to all persons other than corporations and joint stock companies, in respect of "investment income" as provided for in this Act.

On investment income in excess of $1,500—four per centum.

The next amendments bearing on this problem were made by c. 55, Statutes of 1946, and were in effect from January 1, 1947. It seems to me that up to that date the legislation made it quite clear that investment income meant that part of the net annual profit or gain which was other than earned income, and not that, less the personal exemption. From 1935 to 1942 the right to

deduct personal exemptions existed only as an alternative to the other fixed exemptions and from 1942 to 1946 that right no longer existed.

By the 1946 amendments, substantial changes were made. The whole of the First Schedule, including the rules for computation of income tax in determining the normal and graduated tax, were dropped. The personal exemption sections were re-instated as subsections (*c*), (*d*) and (*e*) of section 5(1), thereby making them applicable to the general tax on income as they had been throughout. The opening words of paragraph AA as then re-enacted were as I have set out above and although the wording is somewhat different from what it was prior to the amendment, I do not think the change is here of any importance. The operational part of paragraph AA, however, remained precisely as it had been except that the fixed exemption was increased from $1,500 to $1,800. No provision was made for the alternative deduction of personal exemptions.

It seems to me, therefore, that by the 1946 amendment, Parliament intended to make no change in the computation of investment income except by slightly increasing the exemption. The replacement in section 5(1) of the subsections providing for personal exemptions was occasioned by the elimination of the rules formerly in paragraph A where the personal exemptions from the general income tax had previously been. Personal exemptions involve very substantial amounts and had it been the intention to go beyond anything that had previously been in effect and allow both the fixed exemptions and personal exemptions, that intention, I think, would have been clearly expressed.

It seems reasonable to assume that in setting a fixed exemption from investment income as has been done throughout, Parliament fixed upon an amount which might fairly represent for the time being an average and reasonable exemption available for all taxpayers; and that on those occasions when personal exemptions were available as an alternative deduction (as has been the case throughout except for the period of 1942-1948), the alternative was provided merely to meet the particular needs of a taxpayer who might have more than the average

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number of dependents. If that be so, the deductions of both fixed and personal exemptions would result in double exemptions for the same purpose. I do not think that was ever intended and I can find nothing in the Income War Tax Act as it was in 1947, or at any time prior thereto, which warrants such a conclusion.

To complete the history of the legislation on this matter, it may be noted that for the taxation year 1949 and subsequent years, the Income Tax Act makes provision by section 31(3) whereby the taxpayer in computing the surtax on an investment income may deduct the greater of $2,400, *or* the aggregate of the deductions from income to which he is entitled under s. 25 (i.e. personal exemptions).

For these reasons the appeal of the Minister of National Revenue will be allowed, the decision of the Tax Appeal Board insofar as it varied the assessment of June 1, 1949, will be set aside, and that assessment affirmed.

At the time the motion was made to set down the appeal for hearing, the respondent herein indicated that he was not further interested. The order then made did not require service to be made upon him and consequently he was not represented at the hearing of the appeal. Under these circumstances, counsel for the appellant does not ask for costs and therefore no order will be made in regard thereto.

Judgment accordingly.