
Montreal 1967 / June 13-14 / Sept. 15

BETWEEN:

LOUIS REITMAN .....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .....RESPONDENT.

Income tax—Capital cost allowances—Assignment of lease containing building erected by lessee—Lessee's covenant to deliver up building at end of term—Whether rate for buildings or leasehold interest—Income Tax Regs., s. 1102(4) and (5) Sch. B, Classes 3, 13.

The lessee of a 99 year lease of land in Ontario assigned the lease to appellant and his associates in 1960. The lease contained a covenant by the lessee to erect a building and to yield up the building at the end of the term, and the lessee did erect a building before assigning the lease. Appellant claimed capital cost allowances in respect of the building at the 5% rate allowed for buildings under class 3 of Schedule B to the *Income Tax Regulations*.

Held, appellant was only entitled to the 2½% rate for the leasehold interest allowed under class 13 since the requirements of s. 1102(4) and (5) of the *Income Tax Regulations* were not performed by appellant.

Cohen et al v. M.N.R. ante p. 110, distinguished.

INCOME TAX APPEAL.

P. F. Vineberg, Q.C. for appellant.

L. R. Olsson and *P. F. Cumyn* for respondent.

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DUMOULIN J.:—This is an appeal from a decision rendered on June 18, 1965, by the Tax Appeal Board[1] affirming an assessment of $12,404.35 levied in respect of one Louis Reitman's income for taxation year 1960.

A most tangled skein of documentary transactions, some of which do not even properly relate in names or dates to preceding deeds allegedly referred to, painfully depicts the throes of financial agony that a speculative enterprise, Principal Investments Limited, vainly sought to overcome. After the usual convulsions of mortgages, leases, lease-backs, borrowings, this company was finally laid to its rest in the melancholy ledgers of receivership. Somewhat belatedly the Court is entrusted with the *post-mortem* task of analyzing the legal nature of such pecuniary antidotes as were fruitlessly administered to Principal Investments by, amongst others, the actual appellant.

Any attempt to recite at length the involved sequence of indentures and covenants that plague the case would be a waste of time and paper; I must for clarity's sake (if this be not too presumptuous an expectation), have recourse to the summarization of facts appearing in the Minister's Reply to the Notice of Appeal.

Before so doing, it should be said that Louis Reitman the appellant, in a "Declaration of Trust", dated at Montreal, December 22, 1960, agrees that "Carlingwood Properties Limited, a body corporate and politic, duly incorporated under the Corporation Act of the Province of Ontario..." acts as his nominee and for certain other persons; his own share in the alleged leasehold interest "in the said land and premises" being one-quarter of 45 percent ($\frac{1}{4}$ of 45%), (cf. Ex. A-12). Both parties admit this statement.

And now, the long but indispensable recital given under paragraph 5 of the previously mentioned Reply:

> 5. In assessing the Appellant for his 1960 taxation year he (the respondent) assumed *inter alia* that:
>
> (*a*) Carling Shopping Ltd., the owner of a certain parcel of land and premises in the City of Ottawa, leased it to Principal Investments Ltd. for a term of 99 years from the 1st day of July, A D. 1954 to the 30th day of June A.D. 2053, at a yearly rental of $16,500.00.

[1] 38 Tax A.B.C. 346.

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(*b*) there was a covenant in the said lease that Principal Investments Ltd. would erect a shopping centre on the said land and premises and the said lease also provided *inter alia* that

(i) the lessee would not demolish or remove any buildings or appurtenances in or upon the premises which would not increase the value thereof without the consent of the lessor;

(ii) the lessee would repair, maintain and keep in good and tenantable repair the buildings, structures and appurtenances from time to time on the demised premises;

(iii) at the end of the term the lessee would yield up to the lessor the demised premises together with all buildings erected thereon, and fixtures affixed thereto during the term of the lease. (*vide* ex. A-1, vol. 1, pp. 12-13, clauses 1-3-4)

(*c*) By about the end of 1956, Principal Investments Ltd. had erected a shopping centre known as Carlingwood Plaza Shopping Centre on the said land and premises.

(*d*) Principal Investments Ltd. granted and assigned to Carlingwood Properties Ltd. its interest in the lease referred to in subparagraph (*a*) hereof and Carlingwood Properties Ltd. (in which the appellant holds a ¼ of 45% share) agreed *inter alia* to pay the rent ($16,500 per annum) and perform the covenants of Principal Investments Ltd. under the head lease referred to in subparagraphs (*a*) and (*b*) hereof. (Ex. A-5, vol. 1, pp. 29 & ff.)

(*e*) Subsequently (Sept. 1, 1960) Carlingwood Properties Ltd. subleased the said lands and premises back to Principal Investments Ltd. for a term of 25 years from September 1st, 1960 to August 31st, 1985. (This is the lease-back already mentioned, and is Ex. A-2, vol. 1, pages 35 to 82.)

. . .

Despite this transfusion of financial blood, Principal Investments Ltd. failed to survive, so I was told, and, henceforth, disappears from the scene, leaving merely two antagonists confronting one another, the appellant and the respondent. The former's contention is accurately stated in the opening paragraph (para. 1) of "The Minister's Written Argument in Reply to the Appelant's Notes"; I quote:

1. It was the Appellant's contention at the hearing of this appeal, *inter alia,*

(*a*) that its interest in the building, material to this appeal, was that of an owner;

(*b*) that consequently it was entitled to treat that building as property included in Class 3 of Schedule B of the *Income Tax Regulations*;

(*c*) subsidiarily, that by virtue of sections 1102(4) and 1102(5) of the *Income Tax Regulations,* the aforementioned building was deemed to be property included in Class 3 of Schedule B.

Denying the appellant's interpretation of the facts and law, the respondent, in paragraph 2 of the same written argument, retorts as follows:

> 2. It was the Respondent's submission at the hearing of this appeal,
>
> (*a*) that the interest of the Appellant in the building was a leasehold interest;
>
> (*b*) that in common law whatever is affixed to land becomes part thereof for purposes of determining ownership, and that consequently the Appellant could not claim to be lessee of the land and owner of the building;
>
> (*c*) that the aforesaid interest was not property included in Class 3 of Schedule B of the *Income Tax Regulations* for the purpose of capital cost allowance;
>
> (*d*) that the Appellant's interest was property included in Class 13 of Schedule B, and that the Appellant was entitled to capital cost allowance thereon pursuant to section 11(1)(*a*) of the *Income Tax Act* and section 1100(1)(*b*) of the *Income Tax Regulations*.

If, as I hope, the essential factors of the debate now appear with sufficient clearness, the questions to be answered relate to, firstly, the nature of appellant's interest, ownership or leasehold, and, secondly, the class of amortization applicable. A subsidiary matter could be added to the two main points: the feasibility of granting an ownership classification on sublessees of a 99-year lease.

Easier cases, fortunately, are not lacking in our judicial annals, nor would it seem unbecoming flattery to claim for the legislator more than a few instances in which his paramount will was enshrouded in thinner mists.

Be that as it may, the law must be resorted to as it appears in the statute, the pertinent texts of which are hereunder reproduced, in accordance with the enabling section 11(1)(*a*), that allows the taxpayer to deduct from his income tax such part of the capital cost of property, "or such amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation".

Conformably to section 11(1)(*a*), regulation 1100(1)(*a*) contains a list of XV classes of capital cost deductions with their respective percentages.

Thereafter, instead of describing in simple terms and consecutive sections the deductions extended to ownership and leasehold interests, the *Income Tax Act* devises something in the nature of a criss-cross exercise, leaping from

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regulations to classifications and from the latter back again to the former, all the while avoiding to plainly express its intent.

Subparagraph (*b*) of Regulation 1100(1) provides the permissible deduction where:

> (*b*) . . . a taxpayer has property of class 13 in Schedule B which was acquired by him for the purpose of gaining or producing income, such amount as he may claim not exceeding, in respect of each item of the capital cost thereof to him, the lesser of
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> (i) one-fifth of the capital cost thereof to him, or
>
> (ii) the amount of the year obtained by apportioning the capital cost thereof to him equally over the period of the lease unexpired at the time the cost was incurred, . . .

The remainder is irrelevant, but subparagraph (7) of 1100 specifies that:

> (7) Where under the terms of a lease the period of the lease unexpired at the time the costs were incurred is greater than 40 years, for the purpose of subparagraph (ii) of paragraph (*b*) of subsection (1), the period of the lease unexpired at the time the costs were incurred shall be deemed to be 40 years.

The opening line of subparagraph (*b*) of section 1100(1) alludes to class 13 in Schedule B, reading as follows:

> CLASS 13
>
> Property that is a leasehold interest except
>
> (*a*) . . .
>
> (*b*) that part of the leasehold interest that is included in another class by reason of subsection (5) of section 1102 . . .

wherein we see that:

> 1102. . . .
>
> (5) Where the taxpayer has a leasehold interest in a property, a reference in Schedule B to a property that is a building or other structure shall be deemed to include a reference to that part of the leasehold interest acquired by reason of the fact that the taxpayer has
>
> (*a*) erected a building or structure on leased land,
>
> (*b*) made an addition to a leased building or structure, or
>
> (*c*) made alterations to a leased property which substantially change the nature or character of the property.

Going backwards, we find at subsection 4 that the capital cost of a property being a leasehold interest also includes amounts expended on an "improvement or alteration" to the leased property other than those specifically mentioned in subparagraphs (*a*), (*b*) and (*c*) of subsection (5) just cited.

We have now singled out the requirements, four (4) in number, which by a fiction of the fiscal law extend to a purely leasehold title advantages similar to ownership status, namely an annual capital cost deduction of 5% foreseen by Class 3, over a possible maximum period of twenty years (5% × 20) as against forty in subsection (7) (1/40 per annum during 40 years).

Those conditions are prescribed, if I may be pardoned this repetition, in subparagraphs (*a*), (*b*) and (*c*) of subsection (5) of section 1102 and its preceding subparagraph (4), none of which, it should be stated right now, were accomplished by the appellant, Louis Reitman, who only participated in a monetary loan to the builders of Carlingwood Plaza Shopping Centre, the erstwhile Principal Investments Ltd.

Moreover, all of the several deeds and agreements of record entered into by Carlingwood Properties Limited, duly constituted nominees of Louis Reitman, are covenants of lease and declare nothing else than a leasehold interest. It could not be otherwise as the building itself was erected by Principal Investments Ltd. and terminated around the end of 1956. The first appearance of appellant's agents, Carlingwood Properties Ltd., occurred approximately four years later, on September 1, 1960 (cf. Ex. A-2).

So much then for the facts of the case vesting in the appellant an irrefutable leasehold interest.

There now remains to be determined whether a leasehold title, in the language of the *Income Tax Regulations* can, nevertheless, be treated as straight ownership for purposes of capital cost deductions under class 3.

The appellant's learned counsel filed exhaustive notes in which he takes the view that:

> . . . Determination of the (capital cost) allowance is stated (in the regulations) to be based upon the objective nature of the "property" and not on the subjective characteristics of the taxpayer seeking the deduction. In Schedule B of the regulations, detailing the different classes, the opening word of *every* single class of capital cost allowance is: *"Property"*. The usual phrase is: "Property that is . . . ". It's the property, the thing or the building, that falls into one class or another.

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On page 2, it is stated that:

> Section 1102(2) of the regulations makes it clear that the classes of property described in Schedule B "shall be deemed not to include the land upon which a property described therein was constructed or is situated". In effect, you look at the building without the land.

At page 2, third paragraph:

> In buying the rights of Principal Investments Ltd. for $3,000,000 Louis Reitman et al. did not expend this amount "on an improvement or alteration to a leased property" any more than they expended it on "the construction of a building or other structure".

From the above "starting point" appellant's Notes reach the following conclusion:

> It is common ground between both parties that the shopping centre properties erected by Principal Investments Ltd. on the leased land constituted Class 3 properties. Where we part company is in the allegation by the Respondent that the Class 3 properties in the hands of Principal Investments Ltd. when it transfers its right to Louis Reitman, et al, become in the hands of the acquirers Class 13 property.

I cannot adopt such assumptions for the obvious reasons that throughout the entire affair each and every legal obligation (even those of the builders, Principal Investments Ltd.), assumed by Louis Reitman and associates, were of a leasehold kind, as the exhibits produced convincingly prove. Also because, the key or general rule giving access to Class 3 consists in the ownership title, and leasehold interest may claim the same benefit as an exception solely if and when it complies with specific conditions stipulated in paragraphs (*a*), (*b*), (*c*) of subsection (4) and (*a*), (*b*), (*c*) of subsection (5) of section 1102. And we have read, a few lines past, appellant's admission of not being within the purview of these enabling exceptions. A builder, shouldering the burden and manifold risks of a construction, deserves, not unreasonably, a certain degree of fiscal abatement; one might conjecture that Class 3 was meant for such a purpose. Conversely, a lessee or tenant cannot lay claim, outside of the exception, to anything of this kind.

Another conjecture could account for the exclusion of the cost of the land upon which a property, described in Schedule B, "was constructed or is situated" as decreed in subsection (2) of regulation 1102. In urban centres, or their vicinity, land becomes the object of intense speculation and, in any case, vacant or "unbuilt" land usually is of little interest to assessors of all vintages.

Finally, a time-honoured maxim of fiscal law interpretation was laid down as long ago as 1869 by Lord Cairns in *re: Partington v. The Attorney-General*[2]; it is formulated thus:

> If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.

Directives of so stringent a nature, and of persisting application, leave small room indeed for the admissibility of the subtle but specious dissertation attempted in his Notes by appellant's learned counsel.

A last and significant aspect of this case must now be disposed of. On June 2 of the current year, Mr. Justice Noël of this Court handed down, in the matter of *Nathan Cohen et al. v. The Minister of National Revenue*[3], a decision with which the undersigned is in complete accord, taking into account the all-important fact that the latter suit was adjudged according to the Civil Code of the Province of Quebec, the pertinent *lex loci contractus,* whilst the actual one comes under the common law.

The circumstances of the Quebec case were, in brief, that in June, 1910, the Ecclesiastics of the Montreal St-Sulpice Seminary "entered into a deed of lease and agreement with respect (to certain property) with The Transportation Building Company Ltd." for a period of 99 years, the ultimate duration allowed by law to emphyteutic leases. The original lessees had obligated themselves to construct a large office building on the demised land and by 1912 this had been done. On the 4th of July, 1952, The Transportation Building Company "sold, conveyed, transferred and made over to Hyman Zalkind and to Nathan Cohen all its right, title and interest in and to the aforesaid Lease and Agreement and in and to the building..." erected, at a time when the 1910 emphyteutic covenant still had some 58 years to run.

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[2] [1869] L.R. IV H.L., 100 at 122.

[3] *ante* p. 110.

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The distinction between those two systems of law was earmarked by my learned brother Judge as giving rise to essential consequences, and a review of the relevant Civil Code provisions will readily prove it is so; for instance:

Art. 567 enacts that:

> Emphyteusis or emphyteutic lease is a contract by which the proprietor of an immoveable conveys it for a time to another, the lessee subjecting himself to make improvements, to pay the lessor an annual rent, and to such other charges as may be agreed upon.

Art. 568:

> The duration of emphyteusis cannot exceed ninety-nine years and must be for more than nine.

Art. 569:

> Emphyteusis carries with it alienation; so long as it lasts, the lessee enjoys all the rights attached to the quality of a proprietor. He alone can constitute it who has the free disposal of his property.

Art. 570:

> The lessee who is in the exercise of his rights, may alienate, transfer and hypothecate the immoveable so leased without prejudice to the rights of the lessor; . . .

Art. 571:

> Immoveables held under emphyteusis may be seized as real property, under execution against the lessee by his creditors who may bring them to sale with the formalities of a sheriff's sale.

Emphyteusis "carries with it" ownership full and complete of land and buildings in contradistinction to the common law, which the respondent's learned counsel, unchallenged on that score, repeatedly expounded at the hearing as "automatically vesting the landlord with the ownership of all buildings a lessee may have erected on the land during the life of the lease". In support of this averment reference was made to several passages of Anger and Hornberger's treatise *"The Law of Real Property"*,[4] from which I quote the undergoing one:

> The law of fixtures is based upon the old maxim *quidquid plantatur solo, solo cedit,* planted being used in the broad sense of attached, and soil including anything attached in turn to the soil so as to become part of it in the eyes of the law. The maxim has been freely translated as "whatever is fixed to the freehold of land becomes part of the freehold or inheritance" (per Lord Cairns L.C. in Bain v. Brand, 1876, 1 App. Cas. 762 at p. 767, H.L.)

[4] 1959 edition, at p. 454.

All this goes to show that Cohen and Zalkind, or their assigns, in their capacity of emphyteutic lessees, enjoyed during the life of their lease, i.e., 58 years, ownership of land and constructions conveyed by the deed of 1952, and were, therefore, eligible to claim capital cost allowance under Class 3 of our Act, when, on the other hand, Louis Reitman never was invested, either at common law or in virtue of the pertinent provisions, oft alluded to herein, of the *Income Tax Act*, with anything else than a simple leasehold title.

For the reasons aforesaid, the appeal is dismissed, the respondent being entitled to all taxable costs.