
1943
Apr. 12 & 13
Aug. 5.

BETWEEN:

WILLIAM M. O'CONNOR..... APPELLANT,

AND

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

AND

BETWEEN:

CLEMENT P. MOHER..... APPELLANT,

AND

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

AND

BETWEEN:

HELEN G. O'CONNOR..... APPELLANT,

AND

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

Revenue—Income—Income War Tax Act, R.S.C. 1927, c. 97, secs. 3 (a) and 3 (g)—"Annuities or other annual payments received under the provisions of any will or trust"—Payment of a legacy by instalments on specified dates—Distribution of the capital of an estate—Appeal from assessment for income tax allowed.

A testator by his will gave, devised and bequeathed the whole of his property to his trustee upon a number of trusts, one of which was to pay certain legacies out of the capital of his estate including legacies

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to the appellants. The legacy to the first named appellant was to be paid until the death of the survivor of said appellant and his widow or until the total sum of $40,000 should have been paid; the sum of $1,000 to be paid on each 24th day of March and 4th day of December, after the death of the testator, to the appellant or if he were dead to his widow if she were living on such date of payment. The legacies to the other two appellants were of a similar nature. The Commissioner of Income Tax assessed each appellant for income tax in respect of payments received by them on the ground that such payments were taxable income as being "annuities or other annual payments received under the provisions of a will" within the meaning of paragraph (*g*) of section 3 of the Income War Tax Act. Each appellant appealed to this Court. The three appeals were heard at the same time.

Held: That the will of the testator gave to each of the appellants several legacies out of the capital of the estate, payable on specific dates twice a year and aggregating a specified sum, subject to the contingency that the person entitled to each legacy payment should be alive when the legacy became payable; or, alternatively, it gave to each of the appellants a legacy of a maximum exclusively out of such capital payable by instalments and subject to the contingency that the person entitled to the instalment should be alive when it became payable; there was no bequest of an "annuity" or "annual payments" either for life or for an ascertained term of years but a distribution of the capital of the estate among the legatees.

2. That the term "annuities or other annual payments received under the provisions of any will or trust" as used in section 3 (*g*) of the Income War Tax Act, does not include or extend to legacies payable exclusively out of the capital of an estate even when such legacies are payable annually by instalments on specified dates, where the maximum amount which the legatee is to receive out of such capital is specified, such legacy being in each case the legatee's share in the distribution or division of such capital and constituting property acquired by him by gift, bequest, devise or descent within the meaning of section 3 (*a*) of the Act and as such not subject to tax.

APPEALS under the provisions of the Income War Tax Act from the decision of the Minister of National Revenue.

The appeals were heard before the Honourable Mr. Justice Thorson, President of the Court, at Ottawa.

C. F. H. Carson, K.C. for appellants.

R. Forsyth, K.C. and *E. S. MacLatchy* for respondent.

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

THE PRESIDENT now (August 5, 1943) delivered the following judgment:—

These three income tax appeals were heard together, the question in each apeal being whether certain amounts received by the appellant pursuant to the provisions of

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the last will and testament of the late Honourable Frank P. O'Connor are subject to income tax under the Income War Tax Act, R.S.C. 1927, Chap. 97, as amended.

By his will, Mr. O'Connor, who died on August 21, 1939, appointed the National Trust Company Limited as the executor and trustee of his will and left all his property to such Trustee upon certain trusts. The only provisions of the will relevant to these appeals are as follows:

3. I give, devise and bequeath the whole of my property of every nature and kind and wheresoever situate, including any property over which I may have any power of appointment, to my Trustee upon the following trusts, namely:

Then a number of trusts are set forth, one of them being,

(*d*) To pay the following legacies out of the capital of my estate·

Included among the many legacies thus directed to be paid out of the capital of his estate are those to the appellants in this case in the following order and terms:

To the appellant, Helen G. O'Connor:

To pay to Miss Helen Grace O'Connor, at present residing at 168 Inglewood Drive, Toronto, the sum of One Thousand Dollars on each 24th day of March and 4th day of December after my death until her death or until she shall have received the total sum of Forty Thousand Dollars, whichever event shall first occur.

To the appellant, Clement P. Moher:

Until the death of the last survivor of C. P. Moher, at present residing at 89 Rivercrest Road, Toronto, his widow and all his issue or until the total sum of Fifty Thousand Dollars shall have been paid, whichever event shall first occur, to pay on each 24th day of March and 4th day of December after my death the sum of Twelve Hundred and Fifty Dollars to the said C. P. Moher, or if he be dead to his widow, or if she also be dead to his issue alive on such date in equal shares per stirpes.

To the appellant, William M. O'Connor:

Until the death of the survivor of William Marcellus O'Connor, at present residing at 44 Heath Street West, Toronto, and his widow or until the total sum of Forty Thousand Dollars shall have been paid, whichever event shall first occur, to pay on each 24th day of March and 4th day of December after my death the sum of One Thousand Dollars to the said William Marcellus O'Connor, or if he be dead, to his widow, if she be living on such date.

Many other legacies, expressed in similar terms, are left to other persons. Only one other paragraph of the will need be referred to, namely:

16. By paragraph 3 (*d*) I have provided for the payment of certain legacies for a varying number of years after my death. It is my intention that the members of the group named in each sub-paragraph shall

in the order therein set out receive the payments provided so long as any of them are living but that only members of the group living when any payment is to be made shall share in such payment.

In due course payments were made to the present appellants pursuant to the provisions of this will exclusively out of the capital of the estate. They were not included in the income tax returns made by the appellants but in each case after notice the appellant was assessed for income tax in respect of them. In the case of the appellant, William M. O'Connor, by notice from the Inspector of Income Tax at Toronto, dated February 23/42, he was notified of the following change in respect of his income tax return for the year ending December 31/39: "Add—Annuity from Est. of Hon. Frank P. O'Connor $1,000." A similar notice of the same date was sent to the appellant, Clement P. Moher, that he was being assessed on $1,250 in addition to the income reported by him for the same year. In the case of the appellant, Helen G. O'Connor, a similar notice, dated March 2, 1942, was sent to her in connection with her income tax return for the year ending December 31/40 advising her, "Annuity from Hon. F. P. O'Connor—Est. is now taxable $2000.00". This appellant was also assessed in respect of the amount of $1,000 which she had received in 1939.

In each case the appellant, on being assessed in respect of the amounts received under the will, gave notice of appeal on the ground that the payments were not income subject to tax. In each case the respondent took the ground that the payment received by the taxpayer from the estate of the late Honourable Frank P. O'Connor was taxable income under the provisions of section 3 (*g*) of the Income War Tax Act and affirmed the assessment. The appeals are now duly brought to this court for determination as to whether the amounts thus received by the appellants constitute taxable income to them.

Taxable income is defined by section 3 of the Income War Tax Act as follows:

For the purposes of this Act, "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be whether derived from sources within Canada or elsewhere; and shall include the

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interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not.

Thus far the definition does not directly affect the question involved in these appeals. The definition proceeds:

And also the annual profit or gain from any other source including;

Then follow paragraphs (*a*) to (*h*) of which paragraphs (*a*) and (*g*) are of particular importance in the appeals under review. Paragraph (*a*) reads:

(*a*) The income from but not the value of property acquired by gift, bequest, devise or descent.

Paragraph (*g*) is in the following terms:

(*g*) Annuities or other annual payments received under the provisions of any will or trust, irrespective of the date on which such will or trust became effective, and notwithstanding that the annuity or annual payments are in whole or in part paid out of capital funds of the estate or trust and whether the same is received in periods longer or shorter than one year.

It was contended on behalf of the respondent that the amounts severally received by the appellants pursuant to the provisions of Mr. O'Connor's will were "annuities or other annual payments received under the provisions of a will" and were, therefore, included in taxable income as defined by section 3 (*g*) of the Income War Tax Act. On the other hand, it was urged for the appellants that they were specifically exempted from taxation by the second part of section 3 (*a*) which carved out of taxable income "the value of property acquired by gift, bequest, devise or descent". It was also contended that the payments made to the appellants were not "annuities or other annual payments" within section 3 (*g*), but, on the contrary, were several legacies to each of the appellants, in each case aggregating the total sum that each was to receive, and payable exclusively out of the capital of the estate, that the essential test of an "annuity or other annual payment" under section 3 (*g*) was that it should constitute a charge upon the whole estate of the testator and that the payments to the appellants did not answer any such test, but were really a distribution or a division of the capital of the estate among the legatees entitled thereto. Finally it was argued that if the payments to the appellants were held to be "annuities or other annual payments" within section 3 (*g*), the appellants were taxable only in respect of the annual profit or gain from such "annuities or annual

payments" and not upon their full amount, since paragraph (*g*) is merely a statement of one of the sources of taxable income, and only the annual profit or gain from such source is taxable.

If it were not for the provisions of paragraph (*g*) of section 3, the case would present little, if any, difficulty. It would seem clear from the terms of paragraph (*a*) of section 3 that while the appellants would be taxable in respect of the income from their legacies they would not be taxable upon their value on the ground that the legacies were property acquired by bequest. It would not then matter whether they were paid in a lump sum or by instalments. In either event they would be expressly excluded from the definition of taxable income by the terms of the second part of paragraph (*a*) of section 3 which provides that taxable income shall not include "the value of property acquired by gift, bequest, devise or descent."

Paragraph (*g*) of section 3 was enacted as an amendment to the Income War Tax Act in 1938 by "An Act to amend the Income War Tax Act", Statutes of Canada, 1938, Chap. 48, sec. 3. The amendment followed the decision of this court in *Toronto General Trusts Corporation* v. *Minister of National Revenue* (1). In that case the testator by his will had provided:

> 12. I give and direct my Trustees to provide and pay to my wife, Sarah Whitney, an annuity of Twenty-five thousand dollars ($25,000) per annum during her life, payable quarterly in advance.

The only question in controversy was whether the so-called annuity of $25,000 given by the testator to his wife was income within the purview of the Income Tax Act. Angers J., allowed the appeal from the decision of the Minister and held that it was not. In support of his judgment he referred to and applied two decisions of the Supreme Court of the United States, namely: *Burnet* v. *Whitehouse* (2) and *Helvering* v. *Pardee* (3). He pointed out that paragraph (*a*) of section 3 of the Income War Tax Act was in substance the same as section 213 (*b*) (3) of the United States Revenue Acts of 1921 and 1924 upon which the judgments of the Supreme Court of the United States were based. He held that the annuity payable to Mrs. Whitney was a charge upon the whole estate, that it

(1) (1936) Ex. C.R. 172. (2) (1931) 283 U.S. 148.
(2) (1933) 290 U.S. 365.

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was not payable out of a settled fund, and, in effect, that it was excluded from liability for income tax by the terms of paragraph (*a*) of section 3, that "income" shall include "the income from" but that it shall not include "the value of property acquired by gift, bequest, devise or descent." If that were so in the case of an annuity charged upon the whole estate bequeathed by will, it would be beyond dispute that a legacy such as that given to the appellants in this case payable exclusively out of the capital of the estate would not be taxable income within section 3 of the Income War Tax Act but would, on the contrary, be expressly and clearly saved from liability for income tax by the latter part of section 3 (*a*). The provision that "income" shall not include "the value of property acquired by gift, bequest, devise or descent" may, perhaps, strictly speaking, not be a necessary provision in the Income War Tax Act but it is in any event declaratory of a fundamental principle that property acquired by gift, bequest, devise or descent does not constitute taxable income.

With the enactment of the amendment of 1938, whereby paragraph (*g*) was added to section 3 of the Income War Tax Act, it might well be considered that the kind of annuity bequeathed by will, which was held not to be taxable income by this court in *Toronto General Trusts Corporation* v. *Minister of National Revenue* (*supra*) would now be included within the definition of taxable income, although that is not entirely free from doubt if the "annuities or other annual payments" referred to in paragraph (*g*) are regarded merely as a source of income from which only the annual gain or profit is to be considered as taxable income. But even if it should be conceded that the whole amount of the annuity were taxable income it does not, by any means, follow that the amounts received by the appellants in this case under Mr. O'Connor's will come within the ambit of section 3 (*g*) of the Income War Tax Act or are caught as taxable income in the hands of the appellants by it.

It is axiomatic that in a taxing statute the intention to tax must be expressed in clear and unambiguous language. If the statute does not clearly and expressly impose the tax, the tax is not to be exacted. It is also well established that the words in a taxing statute are to be construed in their natural and ordinary meaning. Furthermore, it is erroneous to assume any intention to impose

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any tax other than such tax as the statute imposes clearly and expressly. The decisions laying down these and other general principles of construction in the case of taxing statutes have been conveniently gathered together in Quigg, Succession Duties in Canada, 2nd edition, Chap. 1.

The ruling English case on this subject is *Partington* v. *Attorney General* (1), where Lord Cairns used these words:

> I am not at all sure that, in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: 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.

The same judge also said in *Cox* v. *Rabbits* (2):

> A Taxing Act must be construed strictly; you must find words to impose the tax, and if words are not found which impose the tax, it is not to be imposed.

In *Attorney-General* v. *Earl of Selbourne* (3), Collins M.R. said:

> Therefore the Crown fails if the case is not brought within the words of the statute, interpreted according to their natural meaning; and if there is a case which is not covered by the statute so interpreted, that can only be cured by legislation, and not by any attempt to construe it benevolently in favour of the Crown.

And in *Tennant* v. *Smith* (4), Lord Halsbury said:

> In a taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act except to take such tax as the statute imposes. Cases, therefore, under the Taxing Acts always resolve themselves into the question whether or not the words of the Act have reached the alleged subject of taxation.

There are numerous Canadian cases in which the same principles are stated but only one need be mentioned. In *Versailles Sweets, Limited* v. *The Attorney-General of Canada* (5), Duff J. (as he then was) said:

> The rule for the construction of a taxing statute is most satisfactorily stated, I think, by Lord Cairns in *Partington* v. *Attorney General* (*supra*). Lord Cairns, of course, does not mean to say that in ascertaining "the letter of the law", you can ignore the context in which the words to be construed stand. What is meant is, that you are to give effect to the meaning of the language: you are not to assume: "any governing purpose in the Act except to take such tax as the statute imposes" as Lord Halsbury said in *Tennant* v. *Smith* (*supra*).

(1) (1869) L.R. 4 H.L. 100 at 122.
(2) 1878) 3 A.C. 473 at 478.
(3) (1902) 1 K.B. 388 at 396.
(4) (1892) A.C. 150.
(5) (1924) S.C.R. 466 at 468.

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If, therefore, the amounts received by the appellants under the provisions of Mr. O'Connor's will are not clearly and expressly made subject to income tax by the words of section 3 (*g*) of the Income War Tax Act, they are free from such tax. In the language of Lord Halsbury in *Tennant* v. *Smith* (*supra*) the question is, "whether or not the words of the Act have reached the alleged subject of taxation". Do the words, "annuities or other annual payments received under the provisions of any will", of section 3 (*g*) of the Income War Tax Act apply to the several legacies which the testator directed his Trustee to pay out of the capital of his estate to the appellants in this case? If it is not clear that they do, then the legacies are not subject to income tax.

The term "annuity" is not defined in the Income War Tax Act. While it is a word that is often loosely and, therefore, ambiguously used, its meaning has been clarified for income tax purposes by judicial decisions, where the "annuity" is payable under the terms of a contract. But where it is used in respect of a payment under the terms of a will its meaning is not nearly as clearly settled.

Ordinarily an annuity is thought of as a series of annual payments which a person has purchased or arranged for with a sum of money or other asset of a capital nature. As Best J. said in *Winter* v. *Mouseley* (1):

> I have, however, always understood the meaning of an annuitty to be where the principal is gone forever, and it is satisfied by periodical payments.

In Halsbury's Laws of England, Second Edition, Vol. 17, at page 181, this definition of an annuity is given:

> An annuity is an income purchased with a sum of money or an asset, which then ceases to exist, the principal having been converted into an annuity.

This accords with the ordinary acceptance of the term. The capital that went into the purchase of the annuity has been turned into a flow of income, so that the capital has disappeared altogether and only the flow of income continues. This definition by Halsbury owes its origin to Baron Watson in his remarks in the leading case of *Lady Foley* v. *Fletcher* (2). In that case the plaintiff sold her share in certain mines for £45,000, payable £3,385 down and the residue by half-yearly instalments during a period

(1) (1819) 2 B. & Ald. 802 at 806. (2) (1858) 3 H. & N. 769.

of thirty years. It was held that the instalments were not chargeable with income tax under the words "annuities or other annual profits and gains" in schedule (D) of the 16 & 17 Vict., c. 34; or under the words "annual payments, payable as a personal debt or obligation, by virtue of any contract", in the 5 & 6 Vict., c. 35, s. 102, such instalments being the payment of a debt, and not being profits and gains, and therefore not within the purview of the Acts.

Pollock C.B. said, at p. 779:

> If the annual payment is the repayment of principal, the return of a debt, and is not profit, it is not at all within the purview of the Act, the very title and all the provisions of which announce that it is for imposing a tax on profits. If there is the purchase of an annuity, that annuity is made chargeable in express terms. But this is not a contract to pay an annuity, but to pay a principal sum of money, and the court can only carry into effect the language of the act.

And, at page 780:

> If the plaintiff had sold her estate for an annuity, so calling it, the annuity would have been liable to income tax. But she has sold it for a sum which is payable by instalments, which is therefore not chargeable.

Watson B. said, at p. 784:

> But an annuity means where an income is purchased with a sum of money, and the capital has gone and has ceased to exist, the principal having been converted into an annuity. Annuities are made chargeable by express words. The words "other annual payments", in the same section, mean payments *ejusdem generis*, viz. as profits.

Then at page 785 he continued with this distinction:

> Take the case of a will giving to a legatee money payable by instalments; as, for instance £10,000, £5,000 payable at the end of the first, and £5,000 at the end of the second year after the testator's death. The sums so bequeathed would not be an annuity, and would be chargeable, not as income, but under the Legacy or Succession Duty Acts.

These remarks seem to be to be very opposite to the facts of the present case. I cannot see any basic difference between the payment of a legacy in two instalments and the payment of it in a greater number. It is not the annuality of a payment by itself that makes it an annuity. Something more than mere annuality of payment is required, as will be seen later.

In my view, *Lady Foley* v. *Fletcher* (*supra*) established that it is of the essence of a contractual annuity for income tax purposes that the capital that went into its purchase has ceased to exist as such, and that where a taxing statute purports to tax "annuities or other annual payments", the term "annual payments" must be read *ejusdem*

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generis with "annuities" and does not include annual payments which are in reality instalment repayments of a capital sum or debt even although the feature of annuity is present in such payments.

Halsbury proceeds with the following statement, Second Edition, Vol. 17, at p. 181:

> In order therefore to constitute an annuity properly so called, the purchaser must have handed over the money or other asset altogether and converted it into a certain or uncertain number of yearly payments. Where on an examination of the facts it is found that he has so parted with the money or asset, such yearly payments as he may receive will be taxable. If, however, it appears from the facts on the true construction of the contract that he has not parted with the money or other asset, but is to receive his capital back in the form of yearly payments, then such payments are not income payments and are not taxable.

The mere fact that a payment is described in the contract itself as "an annuity" does not necessarily make it such. It is necessary to examine each case in order to discover the real nature of the transaction. In *Secretary of State in Council of India* v. *Scoble* (1), the Secretary of State for India had power to purchase a railway, paying for the purchase the full value of all the shares or capital stock of the railway company, with the option of paying instead of a gross sum "an annuity" for a term of years, the rate of interest to be used in calculating the annuity being determined in a specified way. The Secretary of State purchased the railway and exercised the option to pay an annuity instead of a gross sum. The annuity was paid half yearly, each payment representing, as to part, an instalment of the purchase money, and as to the rest, interest on the amount of the purchase money unpaid. The House of Lords unanimously held that the Income Tax Acts do not tax capital as income, and that income tax was not payable upon that part of the annuity which represented capital.

In that case it was argued by the Attorney-General and Solicitor-General that the annual payment came within the words of the Income Tax Act, 1842, s. 102, which imposed the tax upon all "annuities, yearly interest of money, or other annual payments"; and within the words of the Income Tax Act, 1853, s. 2, "all profits arising from interest, annuities, dividends, and shares of annuities payable out of any public revenue" (Sched. C); and "all interest of money, annuities, and other annual profits and

(1) (1903) A.C. 299.

gains, not charged by virtue of any of the other schedules contained in this Act" (Sched. D) but this contention was rejected. Earl of Halsbury, L.C., said, at p. 302:

> Inasmuch as it is the duty of those who assert and not of those who deny to establish the proposition sought to be established, I think the Crown must fail in the contention that this is "an annuity" within the meaning of the Act.

And on the same page:

> The loose use of the word "annuity" undoubtedly renders a great many of the observations that have been made by the Attorney-General and Solicitor-General very relevant to the question under debate. Still, looking at the whole nature and substance of the transaction (and it is agreed on all sides that we must look at the nature of the transaction and not be bound by the mere use of the words), this is not the case of a purchase of an annuity, it is a case in which, under powers reserved by a contract, one of the parties agrees to buy from the other party what is their property, and what is called an "annuity" in the contract and in the statute is a mode of making the payment for that which had become a debt to be paid by the Government.

The ambiguity of the word "annuity" was also stressed by Lord Lindley who said, at p. 305:

> The difficulty which exists is attributable entirely to the ambiguity of the word "annuity". The annuity in this case is to my mind proved to demonstration to be nothing more than the payment by equal instalments of the purchase money for the railway with interest at the rate of £2 17s. per cent The annual instalments are not at all profits or gains, but are in fact partly payments of principal moneys and partly only profits in the shape of interest. I cannot with any satisfaction to myself accept the view that this is in substance the purchase of an annuity; it is nothing of the sort.

In both of these cases the purchase of property was involved and it was comparatively easy to determine that the annual payments were not annuities in the ordinary sense but were instalment payments of the purchase price of the property. The same general principles have also been laid down in cases where the contract did not involve any question as to the repayment of the purchase price of property. In *Perrin* v. *Dickson* (1) the Court considered the tests that should be applied to determine whether annual payments under a contract are subject to income tax. In that case by a policy of assurance affected by a parent with an Assurance Society to provide for his son's education, the Society, in consideration of six premiums of £90 each, paid annually between 1912 and 1917, agreed to pay to the son's guardian an annuity of £100 each year for seven years as from September 29, 1920. If the son

(1) (1929) 2 K.B. 85; (1930) 1 K.B. 107.

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should die before the expiry of the seven years the premiums were to be repaid to the parent or his representative less any annual payments already made, but without interest. The parent also effected a similar policy to provide for his daughter's education by which the Society agreed to pay him £50 a year during a period of five years. There was evidence that the sums payable were calculated so as to return in the event of the son and daughter living the whole period, the amounts paid to the Society with compound interest. The parent duly received the annual payments, and assessments were made upon him for income tax under Sch. D, Case III, of the Income Tax Act, 1918, on these sums as on an annuity for these years. The matter came before Rowlatt J., on a case stated by the special commissioners. He held that, as the principal money remained intact, the annual payments by the Society did not constitute an annuity under the Income Tax Acts, and that income tax was only payable upon such part of them as consisted of interest. An appeal from this judgment to the Court of Appeal was unanimously dismissed.

In the course of his judgment (1) Rowlatt J., said:

> In these cases the argument always goes back to Watson B's statement in *Foley* v. *Fletcher* (*supra*) that an annuity means "where an income is purchased with a sum of money, and the capital has gone and has ceased to exist, the principal having been converted into an annuity". That definition has never been seriously questioned, and is, I think, still accurate.

Later, on the same page, after referring to the remarks of Walton J., in *Chadwick* v. *Pearl Life Insurance Co.* (2) "that it may be very difficult to distinguish between an agreement to pay a debt by instalments, and an agreement for good consideration to make certain annual payments for a fixed number of years" he laid down the following test:

> The mere circumstance of a pre-existing debt is not the test, but whether or not the principal sum is liquidated or not. If it is liquidated, the annual payments made in consideration of the debt constitute an annuity. If the principal sum is not liquidated, but continues to exist and is repaid in annual instalments, the repayment does not constitute an annuity.

Then Rowlatt J., went on to say:

> In *Chadwick* v. *Pearl Life Insurance Co.* (*supra*) the annual payments were not a principal sum at all, but were paid and received as income. Here, on the contrary the position is not so much that the

(1) (1929) K.B. 85 at 89. (2) (1905) 2 K.B. 507, 514.

principal was repaid by means of the annuities as that it was never parted with. In the case of a life annuity the principal sum is of necessity parted with and disappears. But here the principal is never lost sight of. It is always there and is repaid, in certain events without interest, in other events with interest.

The Court of Appeal (1) agreed with the reasoning and judgment of Rowlatt J., in the court below and the appeal from his judgment was accordingly dismissed.

Counsel for the respondent relied upon a later decision of the English Court of Appeal in *Sothern-Smith* v. *Clancy* (2) in which some criticism of the decision in *Perrin* v. *Dickson* (*supra*) was made. In that case the facts were that in consideration of the respondent's brother paying to a life assurance society a single premium of $65,243.22, the society undertook to pay him a life annuity of $6,510 with a guarantee that, if at his death the annual sums paid did not equal the capital invested, the society would continue payments of the annuity to the respondent until the amount of the capital investment had been repaid. Thus, the aggregate amount payable by the society might exceed the capital invested, if the respondent's brother lived long enough, but could not in any event be less than the capital invested. The brother died after $26,040 had been paid, and the society continued to pay the respondent annual sums of $6,510. On these the respondent was charged with income tax. It was held by the Court of Appeal reversing the judgment of Lawrence J. (3), that the contract was one to pay an annual sum for an ascertainable period of years or for the life of the respondent's brother, whichever might prove the longer, and the payments received by the respondent were income, and were properly chargeable with income tax.

As I read the judgment in *Sothern-Smith* v. *Clancy* (*supra*), the Court of Appeal while finding it difficult to follow the reasoning of the Court of Appeal in *Perrin* v. *Dickson* (*supra*) in its application of the law to the facts of that case did not take issue with the test laid down by Rowlatt J., in *Perrin* v. *Dickson* (*supra*) to which I have referred or the proposition that it is an essential test of an annuity that the capital that went into its purchase has been extinguished as such. Indeed this proposition is the basis upon which the judgment of the Court of Appeal is founded. Sir Wilfrid Greene, M.R., at page 17, said:

(1) (1930) 1 K.B. 107. (2) (1941) 1 All E.R. 111.
(3) (1940) 3 All E.R. 416.

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The contract is to pay an annual sum for an ascertainable period of years or for the period of Sothern's life, whichever may prove to be the longer There is no debt, nor is there anything which can properly be described as analogous to a debt. The sum paid by Sothern has gone once and for all.

Then, at page 118, he said:

Lawrence, J., from whom I am respectfully differing, thought that the capital sum paid by Sothern never ceased to exist and that the contract in express terms guaranteed that the capital invested should be refunded or returned. I do not take this view. It seems to me that the capital sum did cease to exist, once it was paid, and that the so-called guarantee was an undertaking not to refund a capital sum or any part of a capital sum, but to continue annual payments for an ascertainable period.

The essence of a true "annuity or other annual payment received under the provisions of a contract", in order to make it subject to income tax, is that the annuitant has so used his capital, whether it be a sum of money or other property, as to entitle him only to the receipt of annual payments whether for life or a term of years, and so that the annual payments to which he is entitled cannot be considered as instalment payments of the purchase price of his property and that he retains no right to the return of his capital, either in whole or by instalments. The annuitant must have completely parted with his capital to the person or company that has assumed the obligation to pay him the annuity so that the capital has disappeared and ceased to exist as such. This is the ordinary conception of the term "annuity" as applicable to annuities under a contract where the recipient of the annuity is the very person who originally put up the capital that procured the annuity. But this test is not applicable to the case of an "annuity or other annual payment received under the provisions of a will" for one does not ordinarily think of the term "annuity" in connection with a legacy except perhaps in the cases where there is a bequest of an annuity by a will and the bequest has been termed an "annuity" by the testator. It is not, however, the term that matters but rather the true nature of the payment and its receipt.

In the English Income Tax Act, 1918, annuities or other annual payments, whether payable by virtue of a deed or will or a contract are dealt with in the same charging section. Rule 1 applicable to Case III of Schedule D reads:

The tax shall extend to—(*a*) any interest of money, whether yearly or otherwise, or any annuity, or other annual payment, whether such payment is payable within or out of the United Kingdom, either as a charge on any property of the person paying the same, by virtue of any deed or will or otherwise, or as a reservation thereout, or as a personal debt or obligation by virtue of any contract.

This rule reproduces s. 102 of the Income Tax Act, 1842.

In the Canadian Income War Tax Act, "annuities" are not made subject to income tax by the charging sections of the Act, as one might normally expect, particularly when it is sought to tax amounts which are not ordinarily thought of as exclusively annual profits or gains but are referred to in section 3, which is the definition section of the Act, and are dealt with in two separate paragraphs. Paragraph (*g*), dealing with annuities or other annual payments received under the provisions of a will, has been already cited. Paragraph (*b*), dealing with contractual annuities, reads:

(*b*) annuities or other annual payments received under the provisions of any contract, except as in this Act otherwise provided;

The ambiguous nature of the term "annuity" even in cases of contractual annuities and the necessity of examining the true nature of each transaction was stressed by the House of Lords in *Scoble's Case* (*supra*) but there are, as we have seen, certain tests that may be applied in order to determine whether annual payments received under contracts are taxable as annuities or not. The term "annuity" is perhaps even more ambiguous when it is sought to apply it to a legacy or bequest by will. In a contractual annuity the person who put up the capital and transferred it to the person or company that is charged with the obligation to pay the annuity is ordinarily himself the recipient of the annuity when it becomes payable. His capital has gone but his right to receive the annual payments takes its place. The annuity under a contract is in a sense the result of an inseparable blending of capital and interest. If it is truly an annuity, it is all taxable within the meaning of section 3 (*b*) notwithstanding the fact that it was made possible by the expenditure of capital and in that sense includes a return of it. If the capital is not clearly distinguishable by reason of the fact that it has disappeared and ceased to exist as such, the whole annuity is dealt with as subject to tax under section 3 (*b*), whatever its original source may have been.

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Indeed, the ordinary conception of a contractual annuity is a series of annual payments in which principal and interest have been blended so that they are not distinguishable; in other words, that the annuitant has caused his capital to disappear in a return flow of income to him. On the other hand, no such state of affairs exists in the case of an annuity received under the provisions of a will and the tests that are applicable to contractual annuities are not applicable to testamentary ones. The recipient of the annuity is not the contributor of the capital that made the annuity possible. As a matter of fact, "annuity" in its ordinary meaning, as we have seen it applied to contractual annuities, is not an apt term to apply to legacies under a will, except, perhaps, in so for as it is loosely used in a will to signify annual payments of a fixed amount, either payable out of income or chargeable upon the whole estate. The term "annuity" cannot, therefore, have precisely the same meaning in section 3 (*g*) of the Income War Tax Act as it has in section 3 (*b*), since the term is not as referable to the payments that come to a beneficiary under a will as it is to those that come to a person under a contract, where such person has himself contributed the capital that went into the purchase of the annuity.

Some meaning must, however, be found for the words "annuities or other annual payments received under the provisions of any will". In the first place, I think it clear, as in the case of *Lady Foley* v. *Fletcher* (*supra*), that the term "other annual payments" in section 3 (*g*) must be read *ejusden generis* with the term "annuities", whatever that term itself may mean. I can think of no better rule to apply in order to ascertain the meaning of that term than the well-known rule in *Heydon's Case* (1), and I repeat what Lindley M.R., said in *In re Mayfair Property Co.* (2) at page 35:

> In order properly to interpret any statute it is as necessary now as it was when Lord Coke reported *Heydon's Case* to consider how the law stood when the statute to be construed was passed, what the mischief was for which the old law did not provide, and the remedy provided by the statute to cure the mischief.

It has already been observed that paragraph (*g*) of section 3 of the Income War Tax Act was brought into the Act following the judgment of this court in *Toronto General Trusts Corporation* v. *Minister of National Revenue*

(1) (1584) 3 Co. Rep. 7b. (2) (1898) 2 Ch. 28 at 35.

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(*supra*) where Angers J. held that the annuity left to Sarah Whitney by the will of her late husband of $25,000 per annum during her life was a charge upon the whole estate, and not payable out of any fund, and was not taxable income in her hands under the Income War Tax Act. It is therefore reasonable to assume that paragraph (*g*) was introduced to bring into charge for income tax purposes the kind of annuity received under the provisions of a will that had been held by Angers J., to be not subject to income tax. I may, therefore, I think, quite properly hold that the term "annuity" as used in section 3 (*g*) of the Income War Tax Act includes annuities received under the provisions of a will, where such annuities constitute a charge against the whole estate of the testator and it is the intention of the testator that the beneficiary shall receive the fixed annual amount regardless of whether it comes from the income of the estate or its capital or both.

Indeed, counsel for the appellants in this case strongly contended that the test as to whether an annuity received under the provisions of a will came within section 3 (*g*) was whether it was chargeable upon the whole estate of the testator so that the recipient had the assurance of receiving the income annually regardless of whether it came out of the income or the capital of the estate. His argument was that the bequest of the income of a particular fund was not truly an annuity but that an annual payment directed to be made to a beneficiary chargeable upon the whole estate, so that the beneficiary had the assurance of receiving it no matter from what source it came, whether from the income or the corpus of the estate, would be an annuity. This argument was by way of analogy to a contractual annuity, that is chargeable to the person or company that has assumed the obligation to pay the annuity since such person or company is the source of the flow of income. Just as the contractual annuity is not payable out of any particular fund but by the person or company itself so in the case of a testamentary annuity it must be the whole estate of the testator that is chargeable with its payment. It was also his argument that where the payment was pursuant to a bequest of the aliquot parts of a particular fund or a bequest of the income from the estate or from a particular fund the payment would not be a true annuity even although it had the feature of annuality. He urged that the essential feature of an annuity was its

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chargeability to a person or company in the case of a contractual annuity, and to the whole estate of the testator in the case of a testamentary one.

While there is much to be said for this contention, I am inclined to the opinion that it sets too narrow a limitation upon the meaning of the term and, in any event, it is not necessary for me in this case to set the limits as to what might be included within the term "annuity" as used in section 3 (*g*). I think it sufficient to say that, applying the rule in *Heydon's Case* (*supra*) to the interpretation of section 3 (*g*) the term "annuities or other payments received under a will" does include annuities that are chargeable against the whole estate of the testator.

Counsel for the respondent cited a number of cases in which annuities under wills had been held subject to income tax, such as *Brodie* v. *Commissioners of Inland Revenue* (1); *Lindus & Horton* v. *Commissioners of Inland Revenue* (2); *Michelham* v. *Commissioners of Inland Revenue* (3); *In re Cooper* (4); *Drummond* v. *Collins* (5); *Scholefield* v. *Redfern* (6); *In re Janes' Settlement* (7), but in my opinion none of them is applicable to the facts in these appeals. I shall deal only with some of them.

In *Brodie* v. *Commissioners of Inland Revenue* (*supra*) the trustees of a will were directed, on the testator's death, which occurred in 1920, to hold on trust certain shares together with three-fourths of the residue of his estate and to pay the income thereof to his widow for her life, with the proviso that if, in any year, the income from these sources did not amount to £4,000, they were to raise and pay to her out of the capital of the estate such a sum as added to the income would make a total of £4,000, it being the testator's expressed intention that the income payable to her should not be less than £4,000 a year. For a number of years the income of the shares and of the specified part of the residuary estate together fell short of £4,000, and the trustees made payments to the widow of varying amounts out of the capital of the estate to make up that sum each year. These sums were assessed

(1) (1933) 17 Tax. Cases 432.
(2) (1933) 17 Tax. Cases 442.
(3) (1930) 15 Tax. Cases 737.
(4) (1917) W.N. 385.
(5) (1915) 6 Tax Cases 525.
(6) (1863) 62 E.R. 587.
(7) (1918) 2 Ch. 54.

for income tax. It was held that income tax was payable in respect of the whole of the payment of £4,000, to the widow, including the payments made out of capital.

In *Lindus & Horton* v. *Commissioners of Inland Revenue* (*supra*) the facts were only slightly different. The trustees under a will were directed, on the death of the testator's widow, which occurred in 1909, to hold in trust one-half of the residuary estate and to pay the income thereof to his daughter for her life without power of anticipation and, on her death, for her children in equal shares. The income from the daughter's moiety proved insufficient for the maintenance of herself and her home and by a deed of family arrangement executed in 1925, in which the daughter and all her children joined, the trustees were authorized to supplement the income of the daughter arising from the trust funds by payment to her out of the capital of the fund of such sums as the trustees in their absolute discretion thought necessary and proper for the maintenance of herself and her home. During a number of years the trustees paid the daughter sums out of the corpus of the trust fund in addition to the income of the fund. It was held that the payments were not voluntary allowances but were taxable income of the recipient.

In *In re Cooper* (*supra*) the question was a simple one. In that case the trustees of the testator were directed to pay his widow £50 per month for life, and that if there was not enough income out of which to pay it, it should be paid out of the capital. The position was taken that, since the money was payable every month, it was not an annuity or annual payment and therefore not subject to tax. This contention was rejected by the court. The principal of this case was applied in *In re Janes' Settlement* (*supra*), where a fixed weekly payment under a separation agreement made payable on a fixed day every week for a period possibly exceeding a year was an "annual sum" within the Income Tax Acts so that the person liable to make the payment was entitled to deduct income tax.

It may, I think, fairly be assumed that the draughtsman who put into paragraph (*g*) of section 3 of the Income War Tax Act the words "notwithstanding that the annuity or annual payments are in whole or in part paid out of capital funds of the estate or trust" intended to make the paragraph apply to such cases as came before the court in *Brodie* v *Commissioners of Inland Revenue* (*supra*) and

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Lindus & Horton v. *Commissioners of Inland Revenue* (*supra*) and that, when he used the words "whether the same is received in periods longer or shorter than one year", he had in mind such cases as *In re Cooper* (*supra*) and *In re Janes' Settlement* (*supra*). The paragraph seems to have been drafted in the light of such decisions.

I would, therefore, think it reasonable to hold that section 3 (*g*) brought into charge for income tax purposes, not only annuities bequeathed by will that are chargeable upon the whole estate of the testator but also the kind of annual payments received under the provisions of a will or trust that were held to be taxable in the *Brodie Case* (*supra*) and the *Lindus & Horton Case* (*supra*) and such payments under a will or trust as were referred to *In re Cooper* (*supra*) and *In re Janes' Settlement* (*supra*), all of which kind of payments would not have been subject to income tax prior to the introduction of paragraph (*g*) into section 3 of the Income War Tax Act in 1938.

The class of cases thus brought into charge for income tax purposes does not, in my view, include such bequests as the legacies to the appellants in this case. These legacies were not annuities in the ordinary sense of the term. If one were to take the term "annuity" in such ordinary sense it would certainly not be used to describe what each of the appellants received under Mr. O'Connor's will. An "annuity" is not ordinarily thought of as applicable to a legacy payable out of the capital of an estate or in connection with the distribution of such capital among legatees. In reality, the testator's will gave to each of the appellants several legacies out of the capital of the estate, payable on specific dates twice a year and aggregating a specified sum, subject to the contingency that the person entitled to each legacy payment should be alive when it became payable. Alternatively, the will gave to each of the appellants a legacy of a maximum amount exclusively out of such capital payable by instalments and subject to the contingency that the person entitled to the instalment should be alive when it became payable. There was no bequest of an "annuity" or "annual payments" either for life or for an ascertained term of years but rather a distribution of the capital of the estate among the legatees. Since the tests that are available to determine whether annual payments received under contracts are taxable as "annuities" are not applicable to payments received under a will, and although a

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special meaning must, therefore, be found for the term "annuities or other annual payments received under a will", as used in section 3 (*g*) of the Income War Tax Act, there is no justification for extending the meaning of the term beyond the purposes which it was intended to achieve. If it be conceded that paragraph (*g*) of section 3 brought into charge for income tax purposes for the first time the kind of annuities or annual payments received under a will that have been referred to, then the purpose of the amendment has been accomplished. As Lord Halsbury said in *Tennant* v. *Smith* (*supra*);

> It is impossible . . . to assume any intention, any governing purpose in the Act except to take such tax as the statute imposes.

By the application of the rule in *Heydon's Case* (*supra*), the term "annuity" which has no ordinary meaning as applicable to a bequest by will except such as has been indicated, has been given a particular meaning in order "to cure the mischief for which the old law did not provide". It should not receive any wider meaning than is necessary for the purpose sought to be accomplished, nor be made to apply to cases that are quite different from those which it was designed to cover. In *Toronto General Trusts Corporation* v. *Minister of National Revenue* (*supra*) there was a bequest of an annuity of $25,000 per annum for life, chargeable upon the whole estate. There the testator called it an annuity. He could easily have called it "income". It was certainly not a distribution of the estate. In *Brodie* v. *Commissioners of Inland Revenue* (*supra*) there was a specific direction that the income from a part of the estate should go to the widow, but that if in any year the income should be less than £4,000, enough should be paid out of the capital of the estate to make up such an amount, the expressed intention of the testator being that the widow should receive not less than £4,000 a year. The clear intention of the testator that his widow should receive such an income was stressed in the reasons for judgment in that case. In that case there was a bequest of income, chargeable in a sense, against the whole estate, if the income from the specific sources fell below £4,000 in any one year. In *Lindus & Horton* v. *Commissioners of Inland Revenue* (*supra*), there was a direction that the daughter should have the income from a specific part of the estate and by a family deed of arrangement the trustees were empowered to pay amounts out of the capital of the

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fund in their discretion and as they thought necessary for the maintenance of the daughter. In this case there was an intention shown by the deed of arrangement that the daughter should have sufficient income for her annual maintenance.

It is bequests of this character that are sought to be charged by section 3 (*g*), and, without any attempt being made necessarily to fix the limits of what the term "annuities or other annual payments", as used in section 3 (*g*), includes, it might well be considered that the term does include bequests of income and annual payments made out of the capital of the estate or out of a fund of the kind dealt with in the *Brodie Case* (*supra*) and the *Lindus & Horton Case* (*supra*), where the payments were made out of the capital in order to supplement, up to a certain requirement, specific bequests of income. In the case now before the Court there is a totally different situation, clearly distinguishable from that of the cases referred to. There is no bequest of an annuity or income chargeable against the whole estate as in *Toronto General Trusts Corporation* v. *Minister of National Revenue* (*supra*), nor any specific bequest of income to be supplemented by annual payments out of the capital of the estate or out of a fund, either to insure a minimum annual income as in the *Brodie Case* (*supra*) or a sufficient amount for annual maintenance as in the *Lindus & Horton Case* (*supra*). In the case now under review, there was a direction to the trustee to pay legacies exclusively out of capital and the evidence shows that the payments received by the appellants, which are sought to be assessed for income tax in this case, all came out of the capital of the estate. A maximum amount was fixed by the will for each legatee. He was not to receive it all in one lump sum but at stated periods twice a year provided that the person entitled was still alive when the payment fell due. There was no bequest of income from the estate or any part of it and no charge against either the whole estate or any particular fund. It was a distribution of the capital. The term "annuity", even when loosely used, is not ordinarily regarded as an apt term to describe a person's share in the distribution of the capital of an estate, even although such share is payable by instalments, and the term "annual payments" must be read *ejusdem generis* with the term "annuity".

There is a further comment that may well be made with regard to *Brodie* v. *Commissioners of Inland Revenue* (*supra*). In that case Finlay J. sought to lay down a test as to whether an annual payment received under a will was taxable or not, the test being "was the sum received as income". He said, at page 439:

> But, I think, the governing consideration is this; the question being, was the sum received as income, one has to consider what was the source from which it was received and what were the circumstances in which it was received. If the capital belonged to the person receiving the sums—if he or she was beneficially entitled not only to the income but to the capital—then I should think that, when the payments were made, they ought to be regarded, and would be regarded, as payments out of capital, but where there is a right to the income, but the capital belongs to some one else, then, if payments out of capital are made and made in such a form that they come into the hands of the beneficiaries as income, it seems to me that they are income and not the less income, because the source from which they come was—in the hands, not of the person receiving them, but in the hands of somebody else—capital.

It must be remembered that the payments out of capital to which Finlay J. is referring are those which the trustees were empowered to make in order to raise the widow's annual income up to at least £4,000. Then later, on the same page, after referring to the remarks of Rowlatt J., *Michelham* v. *Commissioners Inland Revenue* (*supra*), he said:

> It seems to me that there Mr. Justice Rowlatt is laying down a principle which exactly covers the case which is before me. He is there, I think, deciding that, though the payer may pay out of capital which is his capital—he may, of course, hold it for other people, but that is immaterial—but which is not the capital of the beneficiary to whom he is paying it, where he is paying out of capital in that way, but the beneficiary is receiving the sum as income, then it is income and is liable to tax.

I must confess that I find difficulty in understanding exactly what is meant by the test "was the sum received as income" for the recipient of an amount under a will cannot be said to receive it otherwise than as it was intended to be paid by the testator, in which case the test would be "was the sum paid as income to the recipient" a test more easy of application, with an answer more definitely ascertainable from the will itself. In any event the payments received by the appellants in this case do not answer the test thus laid down by Finlay J. in the *Brodie Case* (*supra*). The appellants did not receive their payments as income but as part of the capital of the estate. They are the beneficiaries of the estate with whom we are

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concerned, and are the very persons entitled to the capital of the estate to the extent of their legacies. It is their capital which is in question. It was capital in the hands of the trustees of the estate and paid by them to the appellants as such, they being entitled to receive it as such. The legacies to the appellants, exclusively payable out of the capital, constitute a distribution or division of the capital of the estate among the legatees entitled to share in it, among whom the appellants are included, to the extent of each legatee's entitlement. The payments to the appellants were not out of the income of the estate but out of its capital, nor were they paid by the trustees or received by the appellants as income, but as shares of the distribution or division of the capital, coming to them by instalments. If the legacies in this case are a distribution or division of the capital of the estate, as I think they are, I do not see how payment of them by instalments changes their character, and it would take much clearer language than that used in section 3 (*g*) to bring such instalments of the distribution or division of the capital of an estate into charge for income tax purposes.

In my view, the term "annuities or other annual payments received under the provisions of any will or trust", as used in section 3 (*g*) of the Income War Tax Act, does not include or extend to legacies payable exclusively out of the capital of an estate, even when such legacies are payable by instalments on specified dates annually, where the maximum amount which the legatee is to receive out of such capital is specified, such legacies being in each case the legatee's share in the distribution or division of such capital and constituting property acquired by him by gift, bequest, devise or descent within the meaning of section 3 (*a*) of the Act and as such not subject to income tax.

In my judgment, the respondent has failed to discharge the onus that rests upon him to shew that the words of section 3 (*g*) of the Income War Tax Act "have reached the alleged subject of taxation" and clearly and expressly brought into charge for income tax purposes the amounts received by the appellants under the provisions of the late Honourable F. P. O'Connor's will, and I must, therefore, hold that such payments are not subject to income tax.

In view of the conclusion which I have reached it is not necessary to deal with the contention of counsel for the appellants that, if the payments in question are held to

come within section 3 (*g*) of the Income War Tax Act, the appellants are taxable only in respect of the annual profit or gain from such payments on the ground that paragraph (*g*) is merely a statement of one of the sources from which only the annual profit or gain is taxable income, nor with the very interesting argument of counsel for the respondent in reply thereto, with his historical exposition of the section and the French version of it, or his contention that the subject matter of the paragraph is all included as taxable income within the meaning of section 3 of the Act.

It follows from what I have said that the three appeals herein must be allowed with costs with the result that the assessments appealed from will be set aside.

Judgment accordingly.