
1965

Winnipeg
Nov. 22, 23

Ottawa
Dec. 9

BETWEEN:

HARRY WALSH .....APPELLANT;

AND

MINISTER OF NATIONAL REVENUE ..RESPONDENT.

AND BETWEEN:

ARCHIE ROBERT MICAY .....APPELLANT;

AND

MINISTER OF NATIONAL REVENUE ..RESPONDENT.

Income tax—Rentals from apartment buildings and shopping centre—Whether income from property or business—Whether services provided tenants affected character of revenue—Capital cost allowances—Income Tax Regs. 1100(3), 1104(1)(a).

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On November 1, 1960, appellants (who were partners in a firm of solicitors) and two other persons purchased for $2,712,650 two large apartment buildings and a shopping centre in a Winnipeg suburb. The properties were managed for the owners by a management company. Tenants of one or both of the two apartment buildings were supplied with heat, electric stoves and refrigerators, carpets and drapes, parking space with block heaters, carpeted hallways, window washing, repair of electric and plumbing facilities, decorating as required, a self-operating elevator, coin-operated washers and dryers, and a telephone in the entrance lobby. Tenants of the shopping centre were supplied with heat and air conditioning and could for a consideration affix a sign to the free standing electrical neon sign.

Appellants claimed capital cost allowances on the properties for the whole of 1960, but the Minister would allow capital cost allowances for two months only, i.e. from the date of purchase of the properties, on the assumption that the income from the properties was income from a business and that capital cost allowances were limited to two months by virtue of secs. 1100(3) and 1104(1)(*a*) of the *Income Tax Regulations*.

Held, allowing the taxpayers' appeals, the income was income from property rather than from a business. The extent and nature of the services provided tenants did not affect the rentals received with a trading character. The rentals received represented payments for occupation of the premises, the additional services provided tenants being relatively insignificant. *Wertman v. M.N.R.* [1965] 1 Ex. C.R. 629, referred to.

APPEALS from decisions of the Tax Appeal Board.

J. F. O'Sullivan for appellants.

T. E. Jackson and *R. A. Wedge* for respondent.

CATTANACH J.:—These are appeals from decisions of the Tax Appeal Board[1], dated June 25, 1964, upholding assessments for income tax of the appellants for their respective 1960 taxation years. By order, upon consent, dated October 21, 1965 the appeals were tried together with common evidence.

The appellants carry on their profession in the City of Winnipeg as the senior members of a firm of barristers and solicitors. The appellants, as tenants in common and not in partnership, each acquired an undivided one-sixth interest, together with two other persons who each acquired a one-third interest, in three properties at a total purchase price of $2,712,650.

The three properties so purchased were (1) Park Towers Apartment, situated at 2300 Portage Avenue in the City of St. James, Manitoba, a part of greater Winnipeg, consisting

[1] (1964) 36 Tax A.B.C. 5, 16.

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of land and a building containing 121 suites and the chattels therein such as washers, dryers, refrigerators, stoves, carpeting, drapes and the furniture of one suite, (2) Silver Heights Apartment, situated at 2255 Portage Avenue, also in the City of St. James, consisting of land and a building thereon containing 136 suites and chattels therein being washers, dryers, refrigerators, stoves and like chattels, and (3) Silver Heights Shopping Centre, situate at 2281-2299 Portage Avenue, also in the City of St. James, consisting of land and a commercial building thereon and containing 18 stores and offices and chattels therein or thereabout being air conditioners, a neon electric advertising sign and other like chattels.

The vendor of all the aforesaid properties and chattels was Silver Heights Development Co., Ltd.

The agreement of purchase was entered into on September 22, 1960 with closing date of November 1, 1960. On the closing date, in accordance with an agreement among the parties, title to the properties was taken in the name of Burnell Investments Ltd., a corporation controlled by the appellants, for the purpose of avoiding the personal covenants under first mortgages to be assumed by the purchasers. On that day Burnell Investments Ltd., executed and registered transfers to each of the actual purchasers with respect to the real properties and executed bills of sale with respect to the chattels. Separate certificates of title were issued to each of the appellants in accordance with their respective interests in the land.

By an agreement dated October 12, 1960 between Silver Heights Development Co. Ltd., the vendor, and Burnell Investments Ltd., the vendor undertook to manage the properties for a period of five years commencing on November 1, 1960. This agreement was not assigned by Burnell Investments Ltd. to the appellants and the other two co-owners of the properties. However, Silver Heights Development Co., Ltd. did manage the properties, in all aspects, on behalf of the appellants and the other two co-owners thereof in accordance with the precise terms of its agreement with Burnell Investments Ltd. It secured the tenants, executed all the leases, collected all the rents, hired all necessary personnel, paid all maintenance expenses, made the payments under the mortgages from the rental proceeds received and remitted the balance directly to each

undivided owner proportionately to the interest of each of them. There were no occasions after November 1, 1960 when the monthly rental income collected by Silver Heights Development Co., Ltd. from the properties was insufficient to meet all expenses and mortgage payments. If there had been deficiencies the appellants and the other two owners would have been called upon to pay their proportionate share thereof.

In accordance with the management agreement all matters of policy governing the operation of the premises were subject to the approval of the owners and the management agent was not to incur any unusual expense in respect of repairs, renovations or improvements to the premises without the approval of the owners first being obtained.

The management agent undertook to and did furnish at the end of each month statements and vouchers showing the income and expenditures incurred. A firm of chartered accountants was employed to audit and verify the monthly statements of the rental agent on behalf of the appellants and the other two owners. The remuneration of Silver Heights Development Co., Ltd. for its management services was computed at 2½ per cent of all rental monies received by it. This remuneration worked out to a sum less than that paid for salaries of the janitors, who were employees of a firm providing janitorial services, and which janitors were supplied with living accommodation in the premises.

With respect to Park Towers Apartments the tenants therein were supplied with heating, electric stoves and refrigerators, carpeting in the living rooms and hallways in all suites and drapes upon the windows. The common hallways were carpeted and were maintained by the janitorial service employed. There was inside parking space provided for the tenants' automobiles as well as outside parking space with electrical plug-ins for block heaters with additional charges for such facilities. In winter the outside parking area was kept clear of snow at the expense of the landlords. The landlords also paid for window washing services, normally every six months, as contracted for by the management agent. The electrical appliances, plumbing and like facilities were repaired and maintained by the landlords. Decorating was done as required. The building contained a self-operated elevator and coin-operated washers and dryers were located strategically on each floor for

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the convenience of the tenants. A telephone was located in the entrance lobby for the convenience of the tenants. The Park Towers apartment was described as a high rise apartment commanding a high rental. I would assume that drapes were supplied by the landlords to ensure a uniform and thereby attractive external appearance to the building.

Similar services were supplied to the tenants of Silver Heights apartment, except that the living rooms and hallways of the suites were not carpeted, there was no elevator nor telephone in the entrance lobbies, nor was there an indoor parking area and the coin-operated washers and dryers were in one central location rather than on every floor. The rentals commanded for suites were more moderate than those in the Park Towers apartment.

The tenants of the shopping centre were supplied with heat and air conditioning. They were entitled to affix a sign to the free standing electrical neon sign for which an additional charge was exacted.

The appellants still own their respective one-sixth interests in the three aforesaid properties and have subsequently purchased the interest of one of the other two original co-owners.

In completing their respective income tax returns for their 1960 taxation years the appellants claimed an allowance in respect of the capital cost on the two apartment buildings and shopping centre for the entire twelve months of the taxation year.

By notice of re-assessments mailed June 19, 1960 the Minister allowed only 61 days out of 366 days of the capital costs allowance so claimed against the rental income.

The appellants filed a Notice of Objection. After considering the facts and reasons set out in the Notice of Objection the Minister confirmed the assessment as having been made in accordance with the provisions of the *Income Tax Act* and in particular on the ground that

> the allowance in respect of the capital cost of the depreciable property *of the business* known as Park Towers, Silver Heights Apartments and Silver Heights Shopping Centre has been determined in accordance with the provisions of subsection (3) of section 1100 of the Income Tax Regulations as the 1960 taxation year of the said business was less than 12 months in duration as defined by paragraph (*a*) of subsection (1) of section 1104 of the said Regulations.

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The provisions of sections 1100 (1)(*a*), 1100 (3) and 1104 (1) upon which the Minister based his contentions read as follows:

1100. (1) Under paragraph (*a*) of subsection (1) of section 11 of the Act, there is hereby allowed to a taxpayer, in computing his income from a business or property, as the case may be, deductions for each taxation year equal to

(*a*) such amounts as he may claim in respect of property of each of the following classes in Schedule B not exceeding in respect of property

(iii) of class 3, 5%

of the underpreciated capital cost to him as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class;

. . .

(3) Where a taxation year is less than 12 months in duration, the amount allowed as a deduction under paragraphs (*a*), (*d*) and (*h*) of subsection (1) shall not exceed that proportion of the maximum amount allowable that the number of days in the taxation year is of 365.

. . .

1104. (1) Where the taxpayer is an individual and his income for the taxation year includes income from a business the fiscal period of which does not coincide with the calendar year, in respect of the depreciable properties acquired for the purpose of gaining or producing income from the business, a reference in this Part to

(*a*) "the taxation year" shall be deemed to be a reference to the fiscal period of the business, and

(*b*) "the end of the taxation year" shall be deemed to be a reference to the end of the fiscal period of the business.

. . .

Under section 1100 (3) it is provided that, if a taxation year is less than 12 months in duration, the amount allowed as a deduction under section 1100 (1) (*a*) should not exceed that proportion of the maximum amount allowable that the number of days in the taxation year is of 366 which in the present case would be 61 days.

However, the present case is one where individuals acquired income producing properties during the course of the year. Since section 139 (2)(*b*) of the *Income Tax Act* provides that the taxation year of an individual is the calendar year, section 1100 (3) of the Regulations would not apply. Accordingly, an individual acquiring income producing property during the year is entitled to claim capital cost allowance for the entire year. But under section 1104 of the Regulations where income from a business is included in an individual's income and the fiscal period of the business does not coincide with the calendar year then the words, "taxation year" in the Regulations are deemed

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to be a reference to the fiscal period of the business. Therefore if an individual begins to carry on a business the fiscal year of which is not a calendar year then capital cost allowance on the depreciable assets acquired to carry on that business would be pro-rated according to section 1100 (3) of the Regulations.

Thus the question for determination resolves itself into the very narrow one as to whether the income received by the appellants was income from a business, as contended by the Minister, in which event the appellants would only be entitled to 61/366ths of the capital cost allowance or whether it was income from property, as contended by the appellants in which event they would be entitled to deduct a capital cost allowance for the entire year.

In *Henry Wertman v. M.N.R.*[1], Thurlow J. had occasion to consider the question of whether receipts from the letting of real property are to be considered to be receipts from a business or receipts from property. He carefully reviewed and analyzed the leading United Kingdom and Canadian cases on the subject. He was particularly conscious of the fact that in Great Britain, income from real property is computed for taxation purposes on a special basis prescribed under Schedule A and that because of this, cases in which the revenue authorities have sought to bring the rentals of real property into the computation of profits under Schedule D as profits of a trade are not strictly parallel and thus not applicable in considering a case arising under the provisions of the *Canadian Income Tax Act*. He did conclude, however, that they offer light on the subject of what is income from property as distinguished from income from trading.

He concluded that when the question arises it is one that must be resolved on the facts of the particular case. I am in complete agreement with this conclusion and the reasoning by which it was arrived at.

In my view, *prima facie* the perception of rent as land owner is not the conduct of a business, but cases can arise where the extent of the various services provided by the landlord under the terms of a leasing contract and the time and labour devoted by him are such that the rental paid by the tenant can be regarded as in a substantial measure

[1] [1965] 1 Ex. C. R. 629.

payment for such services as well as for the use of the property and the interrelation of the use of the premises with the use of such services may be so extensive that the whole sum could readily be regarded not as mere rental of property, but as true receipts of a business of providing apartment suites and services to tenants. It is a question of fact as to what point mere ownership of real property and the letting thereof has passed into commercial enterprise and administration.

In the present case I do not consider it necessary to decide whether the appellants engaged Silver Heights Development Co., Ltd. as their management agent with respect to the properties in question in the capacity as agent or independent contractor. It is obvious that if the management agent had not been engaged then the services undertaken by it would have to have been performed by the appellants personally or in such proportions as might be agreed upon among themselves and the other two co-owners.

In my opinion the question remaining to be determined is whether the extent and nature of the services provided to tenants as above outlined can affect the rentals received with a trading character as distinct from mere income receipts from property.

On the evidence I think that the rentals received by the appellants should be regarded as having accrued to them as owners of the properties rather than as traders and that the rentals accrued from use by the tenants of the property in that the rentals represent payments for their occupation thereof rather than from a combination of such use and the other services from which the tenants benefitted. I regard the additional services which were provided to tenants as being relatively insignificant and insufficient to convert the appellants from land owners into the conductors of a business. The services such as the provision of heat, electric stoves and refrigerators, janitorial services to the common hallways, snow removal, carpeting in some rooms of the suites and drapes for windows are those which tenants have come to expect and are those which landlords normally provide in living accommodation of this kind. These are refinements offered to the tenants in connection with the occupation of suites and, in most instances, are also

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property for the use of which, along with the suites themselves, rent is paid. The heating of the building and snow removal are ancillary to the property itself and are exercised in the landlords capacity as owner of the property rather than as a service to tenants although the tenants incidentally enjoy the benefits thereof. While the nature of services provided has a bearing on the question, the services above described are not such as would characterize the rental received therefor as income from a business rather than income from property, as services such as the provisions of breakfast, maid, linen, laundry and such like services might do.

The additional charges imposed upon tenants for the use of either indoor or outdoor parking space is also income which accrues from the occupation of property.

Accordingly, I am of the opinion that the income received by the appellants from the operation of Park Towers Apartment, Silver Heights Apartment and Silver Heights Shopping Centre was not income from a business, but was income from property.

In my view, the appelants were, therefore, entitled to a capital cost allowance with respect to the three buildings owned by them from November 1, in the 1960 calendar year, for the entire twelve months of that year.

The appeals are, therefore, allowed with costs and the assessments are referred back to the Minister for reconsideration and re-assessment in accordance with these reasons.