
1952

May 19, 20 & 21

July 31

BETWEEN:

MR. W.....APPELLANT;

AND

MINISTER OF NATIONAL REVENUE RESPONDENT.

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, ss. 2(1)(n), 30, 31(1)—Application of partnership law to the provisions of the Income War Tax Act—The Partnership Act of Ontario, R.S.O. 1950, c. 270, ss. 2, 3, r. 3(3)—Deed of partnership does not necessarily of itself constitute partnership for income tax purposes but all circumstances to be considered to ascertain whether partnership exists in fact—Partners if they are shown partners in fact entitled to pay tax only on their individual shares in the partnership income—No distinction drawn under s. 30 of the Income War Tax Act between a trading partnership and one of professional men—Appeals from the Income Tax Appeal Board allowed.

The appellant is a barrister, solicitor, patent attorney and a member of a legal firm entered by him as a partner some few years ago. His admission raised the number of partners to three. The firm also controlled the business of a firm of patent attorneys. In 1943 the three partners agreed to carry on separately the two businesses, their respective interests being identical in each of the two firms. It was also provided that on the death of any partner in the firm of patent attorneys the surviving partners would admit his widow and adult daughters as partners in the said firm if they then survived and so desired. The shares in the said firm to which the widow and daughters were entitled while they continue to survive were set at . . . . a year subject to minor variations. One of the senior partners died on May 18, 1944, and the other senior member on September 4, 1948, and, in both cases, their widows and daughters declared their willingness to become partners in the firm of patent attorneys. In the meantime, on January 1, 1945, another lawyer and patent attorney became a member of the legal firm and also of the patent attorney firm. The situation on and after September 4, 1948, thus was that there were two active partners and six women who had been admitted as partners in the firm of patent attorneys. From January 1, 1946, to September 4, 1948, the net income of that firm was divided between the three active members and the widow and three daughters of

the senior member who died on May 18, 1944, and from September 5, 1948, to December 31, 1948, between those persons and the widow and daughter of the other senior member who died on September 4, 1948, and in the proportions agreed upon by them. The Minister contending that only three men were partners in the firm from January 1, 1946, to September 4, 1948, and only two from September 5, 1948, to December 31, 1948, disallowed the payments made to the wives and daughters and apportioned the whole of the income from January 1, 1946, to September 4, 1948, between the three partners, and from September 5, 1948, to December 31, 1948, between the two partners in the same proportion as they were respectively entitled to in each of the said years, and assessed the appellant accordingly. From these assessments the appellant appealed to the Income Tax Appeal Board which dismissed the appeal.

Held: That a deed of partnership does not necessarily of itself constitute a partnership for income tax purposes but regard may be had to what was done thereunder to ascertain whether there was a partnership in fact.

2. That in the absence of any provisions in the Income War Tax Act restricting the ordinary meaning of the words "partner" and "partnership" or conferring on the Minister the right to allocate the income of the partnership in any special way between the partners (as for example between "husband and wife" partnerships as in s. 31), the partners thereunder have the right to determine who will be their partners and the share to which each is entitled in the income therefrom; and if, under all the circumstances of the case, they are shown to be partners in fact, the members of the partnership are entitled to the benefit of s. 30 and to pay tax only on their individual shares in the partnership income.

3. That under s. 30 of the Income War Tax Act no distinction is drawn between a trading partnership and a partnership of professional men. The sole requirement is that "two or more persons are carrying on business in partnership" and if that requirement is met, then the respective shares in the income of the partnership shall be the taxable income of the partners.

4. That, although the wives and daughters were neither barristers, solicitors or patent attorneys and none of them participated in any way in the conduct of the business of the firm of patent attorneys, under all the circumstances of the case, they were in fact partners with the active partners in carrying on the business for the several periods in question and that the appellant in respect of his income derived from that firm was liable only to the extent of his share therein as agreed upon by all the partners.

APPEALS from the decision of the Income Tax Appeal Board dismissing the appellant's appeals against his 1946, 1947 and 1948 assessments.

The appeals were heard before the Honourable Mr. Justice Cameron at Ottawa.

R. A. Bell, Q.C. for appellant.

W. R. Jackett, Q.C. and *E. S. MacLatchy* for respondent.

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

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

CAMERON J. now (July 31, 1952) delivered the following judgment:

By its decision dated February 5, 1952, the Income Tax Appeal Board disallowed the appellant's appeal from assessments to income tax for the years 1946, 1947 and 1948 (5 T.A.B.C. 375). From that decision an appeal is now taken to this Court. As both appeals were heard in camera, the name of all parties concerned will be omitted. No oral evidence was given on this appeal, it being agreed that that given before the Tax Appeal Board should be the evidence before me.

There is no dispute as to the facts, the sole matter in issue being the application of partnership law to the provisions of the Income War Tax Act, and the same principles apply to each of the taxation years in question. The appellant is a barrister, solicitor and a patent attorney and will hereinafter be referred to as "W"; for the three years he was a member of a legal firm, which I shall call "X and Y," and also of a firm of patent attorneys which I shall refer to as "Q and Co." The basic documents and agreements on which the appeal is founded are contained in Ex. A-2 and will be individually referred to by their tab numbers.

The legal firm of "X and Y" was founded in 1926 by Mr. "X" and Mr. "Y" (Tab. 4), and until January 1, 1940, when "W" became a partner (Tab. 6), they were the only members. For many years "X" had an interest in "Q and Co." which had branches in Canada and the United States, and by his agreement with "Y", the net income which "X" derived from "Q and Co." was added to the income of the legal firm of "X and Y" and divided in certain agreed proportions between "X" and "Y", and after "W" became a partner of "X and Y," between "X," "Y" and "W". As a result of certain proceedings, "X" became the sole member of the firm of "Q and Co." in September, 1940. Subsequently, the agreements between "X", "Y" and "W" were modified by an agreement dated November 18, 1943 (Tab. 7). Thereby, the three partners agreed to carry on separately the two businesses formerly carried on by "X" as "Q and Co.," and by "X", "Y" and "W" as "X and Y," the

respective interests of the three parties being identical in each of the two firms. It provided that all interest of a partner in the assets and goodwill of each firm should cease and determine upon his death; and that the provisions of all prior agreements relating to the interest of a deceased partner and to the benefits to be enjoyed by his widow and/or daughter, or daughters, were cancelled.

The following special provisions related solely to the firm of "Q and Co." and these are of particular importance inasmuch as the appeals herein relate entirely to the income derived from that firm.

3. Upon the death of any partner in the firm of "Q and Co." the surviving partners will admit the present wife of the deceased partner as a partner in the said firm if she so desires and then survives.

4. The share in the firm of "Q and Co." to which the widow of either "X" or "Y" shall be entitled while she continues to survive shall be the proportion which $8,000 bears to the total income of the firm in any year provided that the profits at least equal $12,000 and shall abate proportionately to the amount by which the said profits fall below that sum.

5. The interest of the widow of "W" shall be the proportion which $1,500 bears to the total income of the firm in any year provided that the profits at least equal $12,000 and shall abate proportionately to the amount by which the said profits fall below that sum.

6. In no circumstances shall the total interests of all the widows admitted to the partnership hereunder exceed 66 2/3 per cent of the total income of the firm in any year and if in any year 66 2/3 per cent of the income is insufficient to provide the amounts hereinbefore specified in full the interests of each of the several widows shall abate proportionately to the deficiency.

7. In addition, but only when and to the extent that the interests of any widow or widows who become partners in the firm by virtue of this agreement are together less than 66 2/3 per cent of the profits of the business in any year, the adult daughters of any of the parties hereto who desire to do so shall be admitted as partners in the firm of "Q and Co." and while they respectively survive their respective interests shall be the proportion which $1,200 bears to the total profits of the business in any year and shall abate proportionately to any deficiency below 66 2/3 per cent of the said profits after the interests of all widows have been satisfied.

8. Forthwith upon the death of any widow or daughter who becomes a partner in the firm of "Q and Co." pursuant to this agreement, her interest in the assets and goodwill of the firm shall cease and determine.

Then Clause 9 provided that the figures of $8,000, $1,500 and $1,200 should be varied from time to time by reference to the variations of the monthly index figure of wholesale prices published annually by the Bureau of

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

Statistics, the index figure of December, 1941, being taken as the base, certain other details thereof also being provided but which are not here of importance.

"X" died May 18, 1944, at the age of fifty-eight years. His widow declared her willingness to become a partner in "Q and Co." and by an agreement dated October 2, 1944 (Tab 8) executed by her and by "W" and "Y", it was agreed that the said business should thereafter be carried on by these three parties as partners. Thereby it was agreed that the net income—as therein defined—should be divided as follows: (*a*) To the widow of "X"—$8,475, such amount being subject to certain stated variations and to the condition that her share should not exceed two-thirds of such profits; (*b*) to "W" and "Y" one-half each of the balance.

It was further provided:

4. "Y" and "W" or the survivor of them shall be exclusively entitled to the management and control of the business of the firm and may admit such other partners in the said firm and business as they shall see fit or exclude any partners so admitted.

5. The share of the profits receivable by Mrs. "X" shall not be reduced by the admission of any additional partner other than the present wives of "Y" and "W" who may be severally admitted as partners after the death of their respective present husbands on the same footing as Mrs. "X", in which event the sums payable to Mrs. "X" and to the wife or wives so admitted shall not together exceed two-thirds of the profits.

6. "Y" and "W" or the survivor of them shall have the right to designate which of the persons who at the time of such designation are partners in the firm shall after the death of the survivor of "Y" and "W" be exclusively entitled to the management and control of the business of the firm, and the partner or partners so designated shall be entitled to such management and control accordingly shall have the same power as hereby given to "Y" and "W" to designate their successors to manage and control the firm.

8. Mrs. "X" may give three months' notice at any time to determine her interest in the partnership and shall not be responsible for the liabilities thereof incurred after the date upon which the notice takes effect.

10. All interest of any partner in the firm or its then assets shall determine forthwith upon his or her death, and the personal representative of any deceased partner shall not have any claim against the surviving partners in respect of the goodwill or any other asset of the firm existing at the date of the death of such partner.

The agreement was to have effect from May 19, 1944, the day following the death of "X".

By a further agreement also dated October 2, 1944 (Tab 9), the three daughters of "X" were taken into the firm of "Q and Co." and it was agreed that the business should thereafter be carried on by "W", "Y", Mrs. "X" and the said three daughters (who were called the parties of the second part). Then Clauses 2 and 3 provided:

2. Each of the parties of the second part shall be entitled to receive $1,271 yearly out of the profits of the said business ascertained as set out in the principal agreement subject to variation upwards or downwards as set out in the schedule hereto and subject to the conditions that there remains of the said profits for distribution under the principal agreement between the partners other than Mrs. "X" and the present wives of the said "Y" and "W" (if either or both the said wives is or are admitted to the partnership under the terms of the principal agreement) an amount at least equal to one-third of the profits ascertained as aforesaid, and that if such remainder is insufficient to pay the parties of the second part in full, the sums payable to them shall be reduced equally and proportionately.

3 The amounts payable to the parties of the second part shall be subject to further reduction if after the death of "Y" and/or "W" any daughter of either is admitted to the partnership on the same footing as the parties of the second part, in which event that part of the profits, if any, out of which the shares of the said parties of the second part are payable shall, if insufficient to provide for payment in full to each of the parties of the second part and to each of the daughters so admitted, be distributable equally among the said parties of the second part and the said daughters.

On January 1, 1945, Mr. "T", a lawyer and patent attorney, became a member of the legal firm of "X and Y" and also of "Q and Co.," the agreement in regard to the latter firm being reduced to writing on August 8, 1947 (Tab 10). By that agreement, certain provisions of the first agreement of October 2, 1944 (Tab 8) were incorporated therein, and it was provided that upon the death of "Y" and "W", "T", if then a partner, should be exclusively entitled to the management and control of "Q and Co." Similar provisions were made for the admission as partners of "T's" wife and daughters upon his death and the payment of specified shares of the income to them, that of the wife being limited to $4,200 and that of any daughter to $1,200, subject to certain variations.

"Y" died on September 4, 1948. Thereafter, and pursuant to the terms of the agreement of November 18, 1943, his widow and unmarried daughter declared their willingness to become partners in the firm of "Q and Co.," and

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

while no written agreement was filed, the evidence establishes that similar arrangements were entered into with them as had been made with Mrs. "X" and the three daughters of "X" respectively, such arrangements being effective September 5, 1948.

From January 1, 1946, to September 4, 1948, the net income of "Q and Co." was divided in accordance with these arrangements between "Y", "W", "T", Mrs. "X" and the three daughters of "X". From September 5, 1948, to December 31, 1948, it was so divided between those persons (except "Y") and Mrs. "Y" and Miss "Y". The amounts received by all except "Y", "W" and "T" are shown in para. 28 of the Statement of Claim. Para. 10 shows the proportions thereof received respectively by "Y", "W" and "T" in each year, their shares being paid into the firm of "X and Y," and thereafter their shares in the two firms were payable to them individually, those of the appellant being shown in para. 17 of the Statement of Claim.

Income tax is not levied against the income of a partnership as such. In this case, the income of "Q and Co." was divided between the various persons who were considered to be partners, and in the proportions agreed upon by them. The full amount received by the appellant in each case was included in his annual returns and there is evidence that some, if not all, of the others (including Mrs. "X") completed their individual returns and were taxed accordingly. The Minister being of the opinion that only "Y", "W" and "T" were partners in the firm from January 1, 1946, to September 4, 1948, and only "W" and "T" from September 5, 1948, to December 31, 1948, declined to permit the deduction of any payments made to the wives and daughters of "X" and "Y" and apportioned the whole of the income from January 1, 1946, to September 4, 1948, between "Y", "W" and "T", and from September 5, 1948, to December 31, 1948, between "W" and "T", in the same proportion as they were respectively entitled to in each of the said years, and assessed the appellant accordingly. As I have stated, the Income Tax Appeal Board affirmed the assessments made upon the appellant.

The appellant relies upon s. 30 of the Income War Tax Act, which is as follows:

30. Where two or more persons are carrying on business in partnership, the partnership as such shall not be liable to taxation but the shares of the partners in the income of the partnership, whether withdrawn or not during the taxation year shall, in addition to all other income, be income of the partners and taxed accordingly.

The appellant submits that the wives and daughters of "X" and "Y" were, in fact, partners in "Q and Co." for the respective periods mentioned and that the payments received by them were received as partners and not otherwise. "Partnership" is not defined in the Act and I am therefore in agreement with the submission of appellant's counsel that the question as to whether the wives and daughters were or were not partners must be determined under the general law. As far as I am aware, the Income War Tax Act contains only two provisions relating to partnership, other than s. 30. By s. 2(1) (*m*), the income of a partner actively engaged in the conduct of the business of a partnership is declared to be "earned income," and it would follow from s. 2(1) (*n*) that the income of a partner not actively engaged in the conduct of such business would be "investment income." This, it seems to me, is a clear recognition that even under the Act a person can be a partner in a partnership although not actively engaged in the conduct thereof. Then by s. 31(1), the Minister is given a discretion in allocating the total income of a partnership to either husband or wife, where they are in partnership; but neither that subsection or the remaining portions of s. 31 have here any application.

It is common ground that the wives and daughters of "X" and "Y" were neither barristers, solicitors or patent attorneys; that none of them had any experience or training in any of these professions; that none of them participated to the slightest degree in the conduct of the business of "Q and Co." at any time or did anything whatever in relation thereto after they became "partners," except to receive their regular proportions of the income therefrom. Mrs. "X" has re-married and the three daughters of "X" have married, one or more of them now residing out of Canada. Further, I find that as each entered into the "partnership" agreement she brought nothing into the firm by way of capital or otherwise. Upon the death of

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

"X" and "Y", their respective interests in the assets and goodwill of the firm ceased forthwith. What the rights of the wives and daughters would have been had they been refused entry into the firm, or what they would have taken out in the event of a dissolution is here of no importance and need not be considered. The assets of the firm were not enhanced in any way when they respectively became members and there is no evidence that any of them at any later period brought in any capital. No change was made in the firm name which has always been known as "Q and Co.," and there was no change in the conduct of the business after the wives and daughters became "partners."

Partnership, though often referred to as a contract, is a relation resulting from a contract. By the Partnership Act of Ontario (in which province the head office of "Q and Co." was located) now found in R.S.O. 1950, c. 270, it is defined by s. 2:

2. Partnership is the relation which subsists between persons carrying on a business with a view of profit—.

Then by s. 3 thereof there shall be taken into consideration, in determining whether a partnership does or does not exist, certain rules, including 3(3).

3. (3) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him a partner in the business, and in particular,

The interpretation to be placed on the latter provision is stated in Lindley on Partnership, 11th Ed., at p. 44 as follows:

The effect of sharing profits as prima facie evidence of partnership was considered by the Court of Appeal in the case of *Badeley* v *Consolidated Bank*, 38 Ch. D. 238, pp. 250-258, and was there explained to be that if all that is known is that two persons are participating in the profits of a business, this, unless explained, leads to the conclusion that the business is the joint business of the two and that they are partners. But if the participation in profits is only one among other circumstances to be considered, it is wrong then to say that the participation in profits raises a presumption of partnership which has to be rebutted by something else; in such a case all the circumstances must be considered in order to ascertain the real intention of the parties before any conclusion is drawn.

In this case there are circumstances other than the mere participation in profits and therefore it is necessary to consider all the circumstances in order to ascertain the real

intention of the parties before reaching my conclusion. One of such circumstances, and I think a very important one (although not by itself conclusive), is the fact that in the agreement of November 18, 1943, and in all the subsequent agreements, the word "partners" is used not only in regard to "X", "Y" "W" and "T", but also in regard to their respective wives and daughters. The agreements were prepared by counsel of very great experience and it must be assumed that in using that term they understood the full legal effect of designating their wives and daughters as "partners," and the liabilities which, as partners, they would incur for partnership debts under R.S.O. 1937, c. 187, s. 10. In the agreement of October 2, 1944, by which Mrs. "X" entered the firm, there is a recital in which she stated her willingness to become a partner "and render herself responsible for the liabilities (of the firm) in consideration of a share in the profits thereof." Then, by s. 8 thereof, she could determine her interest in the partnership by three months' notice, "and shall not be responsible for the liabilities thereof incurred after the date upon which the notice takes effect." Similar provisions are found in the other agreement of October 2, 1944, by which the daughters of "X" entered the firm, and while in neither agreement is there any express covenant by Mrs. "X" or the daughters of "X" to be liable for such liability, I have no doubt that if losses did occur they would be liable therefor as partners and in view of the recitals I have mentioned. It follows, therefore, that not only are the wives and daughters of "X" and "Y" entitled to share in the profits, but they are also liable for the losses incurred in the operation of the business. It is of no consequence to suggest that in this type of business losses are not likely to occur; they might occur and if they did, the wives and daughters would be liable therefor.

One of the points urged on me for the respondent is that you do not as a rule constitute or create or prove a partnership by saying that there is one, or merely by production of a document called a partnership agreement and in which the parties are referred to as partners, and with that submission I am in general agreement (*C.I.R.* v. *Williamson* (1); *Dickinson* v. *Gross* (2)).

(1) (1928) 14 T.C. 335 at 340. (2) (1927) 11 T.C. 614.

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

Then it is said that the wives and daughters *were not persons carrying on the business of* "Q and Co." and were therefore not partners. Counsel for the respondent stresses the fact that they contributed nothing in the way of services or capital and that by the agreements, the management and control of the business of the firm and the sole right to admit or to exclude other partners in the firm is reserved to the active partners, "X", "Y", "W" and "T". It must be conceded, I think, that one who contributes services but no capital, and one who contributes capital but renders no services, may be partners in a firm. In general, a partner does contribute something, either skill or property, but that is not necessarily so, and on the authorities which I shall mention, it appears that one may be a partner in fact without contributing anything.

In Halsbury's Laws of England, 2nd Ed., Vol. 24, p. 396, it is stated:

> 774. The above definition (i.e., the definition of partnership which is the same as found in the Partnership Act of Ontario, (*supra*) involves a contract between the partners to engage in a commercial business with a view to profit. As a rule each partner contributes either property, skill or labour, but this is not essential. A person who contributes property without labour, and has the rights of a partner, is usually termed a sleeping or dormant partner. A sleeping partner may, however, contribute nothing.

As authority he cites *Pooley* v. *Driver* (1). The following extracts are taken from the judgment of Jessel, M.R.:

> p. 472—". . . . There could not be a partnership without there was a commercial business, to be carried on with a view to profit and for division of profits; and as a general rule, I take it, if it fulfils that definition, it is a partnership. I say, as a general rule, that simple definition appears, so far as it goes, to be an accurate definition.
>
> Then whether or not the association requires that one or more of the partners shall contribute labour or skill, or what they shall contribute, is a question which may be considered as subsidiary; but I take it that the ordinary meaning of the word "partnership" is that, no doubt as a rule, each partner does contribute something either in the shape of property or skill. But it is not a universal rule, and therefore the definition of Chancellor KENT, which is given in the same page, is not quite correct. He says "Partnership is a contract of two or more competent persons to place their money, effects, labour, and skill, or some or all of them, in lawful commerce or business . . ."
>
> P. 473. You can have, undoubtedly, according to English law, a dormant partner who puts nothing in—neither capital, nor skill, nor anything else. In fact, those who are familiar with partnerships know it is by no means uncommon to give a share to the widow or relative of some former partner who contributes nothing at all, neither name, nor

(1) (1877) 5 Ch. D. 458.

skill, nor anything else. Therefore it is not quite accurate, as Chancellor KENT puts it, that they must contribute labour, skill, or money, or some or all of them . . . .

Then Pothier says they must have "something in common (en commun quelque chose)," but, as I said before, that is not necessary according to the English notion of partnership. The dormant partner may put in nothing whatever, as in the case of the widow or child of a deceased partner; therefore that shows again the enormous difficulty of giving a definition which shall be applicable to all cases . . . .

p. 475-6—(After quoting passage on pp. 306-7 from Lord Cranworth in *Cox* v. *Hickman*) "Now what Lord CRANWORTH means there is quite plain. He says in fact that the participating in the profits is sufficient proof of partnership if there is nothing to get rid of it. If you find an association, and a contract made by the members of the association that the trade is to be carried on, and that they are to share the profits in certain proportions, then that makes a partnership, unless you can show from the surrounding circumstances some other relation. It is not impossible to show some other relation, but, as he says, it is very difficult to do so. It is often conclusive by itself,—not always."

p. 476-7—"The question of course is whether a man is liable as a dormant partner. Now a dormant partner means a person who does not take an active part in the conduct of the business, and who may be, and often is, prohibited from taking such active part. Therefore, when the inquiry is whether a man is a dormant partner, it does not appear to me to aid that inquiry by saying that there are provisions preventing his taking an active part in the conduct of the business, or that there are provisions which make it optional for him to take an active part in the business or not. It only shows he is not an active partner. Upon that there is an observation of Lord CRANWORTH'S (8 H.L.C. 309): "I can find no case in which a person has been made liable as a dormant or sleeping partner, where the trade might not fairly be said to have been carried on for him, together with those ostensibly conducting it, and when, therefore, he would stand in the position of principal towards the ostensible members of the firm as his agents."

It is perfectly competent for parties to agree that the management of the partnership affairs shall be confided to one or more of their members exclusively of the others. (See Lindley, 11th Ed., p. 387; R.S.O. 1950, c. 270, s. 24(5)). Similarly, it is competent for partners to agree that the right to admit or exclude partners may be vested in one or more of their members (ss. 24, 25 of the Partnership Act of Ontario; Lindley on Partnership; p. 450; *Lovegrove* v. *Nelson & Cox* (1); *Byrne* v. *Reid* (2).

It is further submitted for the respondent that while there was an agreement which might be called a partnership agreement, so far as the wives and daughters were concerned it had never governed the relations of the parties, that it

(1) (1834) 3 M. & K. 1. (2) (1902) 2 Ch. 735.

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

was put aside and disregarded, and that the business continued exactly as it had previously been. I was referred to *Dickinson* v. *Gross* (*Inspector of Taxes*) (1), the headnote to which is as follows:

> The appellant, a farmer, had entered into a Deed of Partnership with his three sons with the admitted intention of reducing the Income Tax liability in respect of the profits. The deed provided inter alia that two farms owned by the appellant should be let to the appellant and his sons at stated rentals, that accounts should be made up annually, that the net profits should be divided equally between the partners, and that each of the partners should have the right to sign and endorse cheques on behalf of the firm. It was shown in fact that no rent had been paid, that no accounts or books had been kept, or any distribution of profits made, that cheques had been signed only by the appellant, and that business receipts had been paid indiscriminately into the appellant's private bank account and into the firm's account. The General Commissioners decided that there had been no partnership in fact, and accordingly that there was no partnership for Income Tax purposes.
>
> Held, that as a partnership did not exist in fact, there was no partnership for the special purposes of the Income Tax Act.

Rowlatt, J., in holding that the partnership was non-existent, stated at p. 620:

> The partnership deed here, of course, was a deed perfectly good according to its tenor; and if it had been what really governed the relations of the parties it would have effected the object of those who entered into it or purported to enter into it, because it would have produced another legal position to which a tax attached differently from the legal position which existed before. As I pointed out in the case Mr. Bremner cited to me—and as has been often pointed out before—people can arrange their affairs, if they do really arrange them, so as to produce a state of facts in which the taxation is different, and it is no answer—it is perfectly immaterial—to say that they have done it for that purpose. But in this case the facts show that in very many ways the deed was simply set on one side and disregarded, and when you find the deed is disregarded, and also that it was entered into for the purpose of obtaining relief from taxation one is apt, perhaps naturally and quite properly upon the question of fact, to pay a little more attention to those circumstances and those points in which it was disregarded. Now Mr. Bremner, I think, has very truly said that if these young men had come forward and pointed to this deed and said: "Here, Father, you have signed this deed; kindly carry it out", he would have been in a very great difficulty, as King Lear was, in getting out of it, and they probably would have held him to it; and if they had held him to it the Commissioners would have had no justification for finding as they have. But they did not. On the contrary they let the deed slide and proceeded in the ordinary patriarchal way which everybody who is the least familiar with the habits of the countryside, as I have no doubt these three Commissioners were, knows very well.

(1) (1927) 11 T C 614.

Now what the Commissioners have done is that they have found that there was no partnership in fact. Mr. Bremner says that looks as if they were splitting some hair and saying there was no partnership in fact, although there was a partnership in law. I do not think that is the way to look at the finding at all. A partnership, of course, is a legal position and a legal result, but like every other legal position it depends on facts, and what the Commissioners are saying here is: "The facts are not those from which a legal partnership results, because although there was the deed they are not acting on it; it is not governing their transactions; they are not paying the slightest attention to it. They are going on just as before." They have not used the word "fictitious," and they have not used the word "sham," but I think they have put it even more clearly. They say: "The facts here were not a partnership although there was a bit of paper in the drawer, which if the facts had been according to it, would have shown there was a "partnership."

The only general principle which can be deduced from that decision is that a deed of partnership does not necessarily of itself constitute a partnership for income tax purposes but that regard may be had to what was done thereunder to ascertain whether there was a partnership, in fact. In that case it was found that the terms of the partnership were never carried out but were completely disregarded even to the extent that no distribution of profits was made. The facts in the instant case are quite different; it is not shown that any parts of the several agreements were disregarded and it is apparent that the books of the firm were set up on the basis that the inactive as well as the active partners were "partners" and regular monthly distribution of the profits was made to all in accordance with the agreements. The partnership agreements governed the relations of the parties thereto throughout the three years in question.

Further, it is submitted that as the wives and daughters of "X" and "Y" were paid fixed amounts (subject to minor variations), such amounts did not represent a share in the profits in the sense that "share" usually means a proportion or percentage of the profits. The point was considered in *Re Young ex. Parte Jones* (1), where Vaughan, Williams, J. stated at p. 490:

It was suggested that a person did not receive a share of the profits unless he obtained a right to a certain rate of profits out of the whole of the profits earned. I do not see why I should so hold. The fund is distinctly fixed out of which the weekly payments were to come. It seems to me, therefore, that an agreement for the receipt of a sum out of the profits is an agreement for the receipt of a share of the profits.

(1) (1896) 2 Q.B. 484.

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

Reference may also be made to Lindley on Partnership, 11th Ed., p. 65.

It is also submitted that the provisions made by the agreements for the wives and daughters, notwithstanding the fact that they are called "partners," amounted to nothing more than the provision of fixed annuities for them, and again stress is laid on the fact that they were not required to and did not perform any duties, but merely had the right to receive payment of their fixed shares in the income. That submission was upheld by the Income Tax Appeal Board. It was pointed out that by the agreement of November 18, 1943 (Tab 7), the widows of "X" and "Y" were entitled to benefit while they lived, and not merely while they remained partners. That provision, however, does not appear in the actual partnership agreements of October 2, 1944.

It is in evidence that prior to the agreement of November 18, 1943, between "X", "Y" and "W", provision had been made by which the ascertained interest of a deceased partner in the firm of "X and Y" would be discharged by the payment to his widow and, in certain events also, to his daughters, of life annuities payable by the surviving partner or partners, out of and to be a charge upon the profits of the firm of "X and Y." Insofar as "X" and "Y" were concerned, somewhat similar provisions had existed since their original agreement of November 11, 1926 (Tab 4). In the meantime, however, "X" had become the sole proprietor of "Q and Co.," and as stated in the agreement of November 18, 1943, "It is now possible to modify the principal agreement and the "W" agreement so as to simplify their operations and more effectively to carry out the intentions of the party." By Clause 2 thereof, the provisions of the said agreements in regard to the interest of a deceased partner and in regard to the benefits to be enjoyed by his widow and/or daughter or daughters were cancelled "and all interest in the assets and goodwill of each of the firms of any deceased partner shall cease and determine forthwith upon his death." Then followed the provisions regarding the admission of the wives and daughters of a deceased partner as "partners" in "Q and Co." and the payment of fixed sums to them out of the profits, as I have mentioned above.

It is manifest that had the wives and daughters of "X" and "Y" been the recipients of the payments under the agreements existing prior to November 28, 1943, such payments would have been annuities and the then partners in "X" and "Y" would not have been entitled to deduct any portion thereof, before ascertaining their own shares of the income liable to taxation. But it is not under those agreements that the appellant is now claiming, but rather under the agreements of October 2, 1944, and upon similar arrangements entered into with Mrs. "Y" and Miss "Y" in 1948. It was perfectly open to the active partners to arrange their affairs in such a manner as to escape tax burdens, provided they did it legally. I have already cited the opinion of Rowlatt, J. in *Dickinson* v. *Gross* (*supra*) on that point and reference may also be made to *Hawker* v. *Compton* (1), where at p. 313 Sankey, J. said:

> I quite agree with what the learned Attorney General said, which is this—I have said it already twice this morning—that it is perfectly open for persons to evade this particular tax if they can do so legally. I again say I do not use the word "evade" with any dishonourable suggestion about it. If certain documents are drawn up, and the result of those documents is that persons are not liable to a particular duty, so much the better for them.

Reference may also be made to *Ayrshire Pullman Motor Services* v. *The Commissioners of Inland Revenue* (2), and to *Commissioners of Inland Revenue* v. *Fishers Executors* (3).

Now there is no direct evidence as to why the previous arrangements for valuing the interest of a deceased partner and the discharge thereof by the payment of annuities to his wife and daughters were changed to new provisions under which all the interest of such deceased partner in the assets and goodwill of the firm should terminate upon his death, and the widow and daughters should then have the right to become partners. One of the reasons recited is "to more effectively carry out the intention of the parties." The active partners probably had in mind the benefits to be gained by making the wives and daughters "partners" rather than annuitants and the possible saving in succession duty and the undoubted saving in income tax under the provisions of s. 30. I can see nothing illegal in their attempting to do so. Supposing for the moment that on the death of

(1) (1922) 8 T.C. 306. (2) (1929) 14 T.C. 754 at 763.
(3) (1926) A.C. 395 at 412.

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

"X" he had left his wife destitute and there was no agreement by which she had the right to become a partner; but that the surviving partners out of a sense of moral obligation had agreed to take in Mrs. "X" as a partner; that she was brought in on terms which required her to render purely nominal services or provide a very small amount of capital, or even perform no services and bring in no capital. In any such case, and under the existing law, I do not think it could be said that she was not a partner in the firm or that the active partner would have to pay income tax on that part of the firm's income to which under their agreement she was entitled. If that is so, I see no reason why the situation should be different in this case, merely because she came in as a partner under the terms of the pre-existing agreement which entitled her to do so, or because under prior agreements which had been cancelled, she was to be provided with an annuity.

It is my opinion that in the absence of any provisions in the Income War Tax Act restricting the ordinary meaning of the words "partner" and "partnership," or conferring on the Minister the right to allocate the income of the partnership in any special way between the partners (as for example between "husband and wife" partnerships as in s. 31), the partners thereunder have the right to determine who will be their partners and the share to which each is entitled in the income therefrom; and if, under all the circumstances of the case, they are shown to be partners in fact, the members of the partnership are entitled to the benefit of s. 30 and to pay tax only on their individual shares in the partnership income.

As I have stated above, the wives and daughters by the terms of the agreement not only shared in the income, but were liable for losses incurred. That finding, together with the other circumstances, is sufficient in my opinion to constitute them partners, in fact.

In Lindley on Partnership, 11th Ed., p. 47, it is stated:

> An agreement to share profits and losses, in the sense of making good the losses if any are sustained, may be said to be the type of a partnership contract. Whatever differencce of opinion there may be as to other matters, persons engaged in any trade, business, or adventure upon the terms of sharing the profits *and* making good all losses arising therefrom, are necessarily to some extent partners in that trade, business or adventure; nor is the writer aware of any case (unless it be *Re Jane*) in which persons who have agreed to share profits and losses in this sense have been held not to be partners . . . .

But it does not follow that each of several persons who share profits and losses has all the rights which partners usually have. For example, a person may share profits and losses and yet have no right actively to interfere with the management of the business; or he may have no such right to dissolve as an ordinary partner has; or he may have no right to share the goodwill of the business on a dissolution; and other instances of restricted rights may be suggested. What in any given case the rights of a particular partner are depends on the agreement into which he has entered; but unless the word *partner* is to be deprived of all definite meaning its proper application to persons who share profits and losses in the sense referred to can hardly be questioned.

The obvious intention of the agreement was to make the wives and daughters partners, in fact, and to avoid conferring annuities upon them. That was done very deliberately and no doubt with the tax position in mind. While the agreements are substantially different from the usual partnership agreements, such differences in my opinion are not either severally or collectively sufficient to prevent their being agreements of partnership in fact.

Moreover, in the year in question, it was not illegal for a firm of patent agents to have in its firm partners who were not qualified patent agents. Even under the Register of Patent Agent Rules, 1948, enacted pursuant to s. 15 of the Patent Act, 1935, as amended, any firm could be registered if at least one member was qualified and entered on the Register.

There remains one further contention made on behalf of the respondent. It is submitted that a distinction must be drawn between a trading partnership in which the income is earned by the entering into of a series of contracts such as buying and selling, and a partnership of professional men, the income of which is earned by the services rendered by the individual partners. It is contended that under s. 3 of the Income War Tax Act, the income earned by a professional man is in fact his income and taxable as such. It is pointed out that in this case the whole income of "Q and Co." was earned by the active partners and it is submitted, therefore, that the assessments as made were correct.

I think that the answer to that submission is found in s. 30 (*supra*). No distinction whatever is drawn between a trading partnership and a partnership of professional men. The sole requirement is that "two or more persons

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

are carrying on business in partnership" and if that requirement is met, then it is provided that the respective shares in the income of the partnership—not, be it noted, the share which each partner has earned—shall be the taxable income of the partners. It would be indeed a difficult matter in the case of a partnership to endeavour to apportion the total income between active and dormant partners, between those who contributed services or skill in varying degrees, and between those who contributed services and those who contributed capital, except on the basis of distribution as agreed on by the parties themselves; and I think that was the method intended by s. 30, except in cases such as those included in s. 31(1), which is as follows:

> 31(1). Where a husband and wife are partners in any business the total income from the business may in the discretion of the Minister be treated as the income of the husband or wife and taxed accordingly.

It seems to me that that subsection was enacted as an exception to the general provisions of s. 30 relating to the taxation of partnership income, and as a means of preventing the avoidance of tax by a person who brought his wife into a business as a partner, although such wife did not contribute anything to the partnership, or, at most, nominal capital or services only. The power conferred on the Minister to treat the whole of the income as that of the husband or wife is discretionary and no doubt in exercising that discretion he would take into consideration the contributions made in services and capital by the partners. The subsection appears to recognize the fact that there may be partners carrying on business in partnership who contribute little or nothing to the earning of the income, as in the present case, but inasmuch as its provisions extend only to partnerships comprised of husband and wife, it cannot directly or by implication reach the appellant.

For these reasons, I have reached the conclusion that the appellant is entitled to succeed. I think it was agreed that there was no substantial difference between the written agreements in relation to the wife and daughters of "X" and the somewhat informal agreements made with the wife and daughter of "Y", and my decision, therefore, will be applicable throughout the three years in question.

1952

MR. W. v. MINISTER OF NATIONAL REVENUE

Cameron J.

I find that the wives and daughters of "X" and "Y" were in fact partners with the active partners in carrying on the business of the firm of "Q and Co." for the several periods mentioned above, and that the appellant in respect of his income derived from that firm was liable to income tax only to the extent of his share therein as agreed upon by all the partners. My recollection is that it was agreed that the returns made by the appellant were accurately made on that basis, but if there is any difficulty in the matter it may be spoken to.

My opinion has not been reached without considerable hesitation, particularly because the precise point has not previously been raised in Canada. I am not unaware of the difficulties which may follow in other cases and for that reason I desire to emphasize the fact that my opinion was arrived at because of the particular facts of this case and inasmuch as the good faith of the appellant was not in any way challenged.

The appeal, therefore, will be allowed, the decision of the Board and the assessments made upon the appellant for the years 1946, 1947 and 1948 will be set aside and the matter referred back to the Minister to reassess the appellant upon the basis of this decision.

The appellant will be entitled to his costs after taxation.

Judgment accordingly.