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# Attribution of Income

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# ATTRIBUTION OF INCOME

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When the contents of Bill C-259 were first revealed to the Canadian public it was inevitable that for a considerable time the spotlight of attention would be focussed on those provisions which had no counterparts in the previous legislation. To the lawyer struggling with new concepts and abstruse calculations, there was at least some comfort to be found in the discovery that not everything in the Bill was totally unfamiliar. At times this comfort may have been mingled with surprise at the government's willingness to continue to live with provisions which were demonstrably defective.

Notable among such provisions are those which in specified cases attribute income to a taxpayer who has transferred proprietary rights to another. The attribution provisions were contained in sections 21(1), 22 and 23 of the 1952 Act[1] and have been carried over unchanged into sections 74(1), 75 and 56(4) respectively. As these sections come into the Act fully grown it seems appropriate in this first year of the new system to review their apparent operation and the accumulation of case law which has been imported with them.[2]

The attribution provisions are directed at specified dispositions of property by which a disponer might otherwise succeed in diverting taxable income from his hands into those of the disponees. Broadly, the dispositions affected are those in favour of a spouse or a minor, those which assign the right to income from property and not the property itself and those which confer equitable interests under a trust in which the disponer retains a reversionary interest, a power of appointment or a power to veto any further disposition.

Although the taxing statutes of most jurisdictions contain provisions of somewhat similar effect, the scope as well, of course, as the wording of the legislation varies considerably. In the United Kingdom provisions aimed specifically at dispositions in favour of a spouse are to a large extent unnecessary in view of the fact that the investment income of spouses is generally aggregated for the purposes of income tax.[3] In the United States, on the other hand,

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[1] The first provision of this kind was enacted as section 4(4) of *The Income War Tax Act*, 1917. It was directed at transfers to a spouse or other member of the transferor's family and did not apply if the Minister was satisfied that there was no intention to evade taxation.

[2] This paper attempts to review the law obtained from the application of ordinary principles of statutory interpretation to the provisions of the Act. It is not concerned with the lore of departmental practice.

[3] From 1968 until the current year the position was similar with respect to the investment income of children. Attribution of such income may now occur under s.437 of the Income and Corporation Taxes Act 1970.

congressional recognition of the community of property principle for such purposes has conferred a considerable degree of legitimacy upon income splitting within the family unit. Hence there are no attribution provisions aimed directly at transfers between spouses. Nor are there provisions dealing specifically with transfers in favour of infant children. In Canada where spouses and their children are taxed separately, the policy of the *Income Tax Act* has been increasingly to deny tax consequences to transfers between spouses and to block attempts to split income by transferring property to infant children.

The statutes of the United Kingdom and the United States do, however, provide useful bases for comparison with the Canadian provisons which are not directed specifically at transfers to a spouse or to minors. Some aspects of the comparison will be considered briefly at the end of this paper.[4]

## 1. TRANSFERS TO A SPOUSE OR A MINOR

### (a) Income from the property

Where a person has transferred property to his spouse or to a person who has since become his spouse, the income from the property will, under section 74(1), be attributed to the transferor while he is alive and resident in Canada and the transferee continues to be his spouse. Similarly where property has been transferred to a person who is under the age of eighteen years, the income from the property for those years prior to the year in which the transferee turns eighteen will, under section 75(1), be attributed to the transferor while he is alive and resident in Canada.[5] Although the identical provisions in the earlier legislation were considered by the Exchequer Court and the Tax Appeal Board on numerous occasions, some difficult questions of construction have been carried over into the new Act. In addition, the interpretation of the subsections may, of course, have been affected by the insertion of new provisions and other changes which appear in the current legislation.

#### (i) Transfers which attract attribution

The word "transfer" is used in several provisions of the statute and is nowhere defined. The necessary inference is that the word is intended to have its normal everyday meaning and is not used in any special sense. In the context of sections 74(1) and 75(1) this inference is supported by the course of judicial interpretation of the similar provisions in earlier legislation. Under the *Income War Tax Act* attribution was effected where "a husband transfers property to his wife or vice versa."[6] Of these words it was said:

> The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made

[4] In what follows my indebtedness to previous commentators and in particular to Marshall A. Cohen's *Income Taxation of Inter Vivos Trusts,* (Toronto: Canadian Tax Foundation, 1964), and to Gwyneth McGregor's case comments in the *Canadian Tax Journal* will be obvious.

[5] At the outset it should be noted that neither section 74(1) nor section 75(1) attribute deductible losses to the transferor: *Stratton* v. *M.N.R.,* [1967] 2 Ex. C.R. 154; *Martens* v. M.N.R., 64 D.T.C. 191, (T.A.B.).

[6] *Income War Tax Act,* S.C. 1917, c. 28, s. 4(4)(b) as amended by S.C. 1926, c. 10, s. 7; *Income War Tax Act,* R.S.C. 1927, c. 97, s. 32(2).

in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say, pass the property from himself to her. The means by which he accomplishes this, whether direct or circuitous, may properly be called a transfer.[7]

This interpretation was carried over into the provisions of the *Income Tax Act,* 1952 which were virtually identical with sections 74(1) and 75(1) of the present Act.

The expression "transferred" in section 22(1) has, in my opinion a similar meaning. All that is necessary is that the taxpayer shall have so dealt with property belonging to him as to divest himself of it and vest it in a person under 19 years of age. The means adopted in any particular case to transfer property are of no importance, as it seems clear that the intention of the sub-section is to hold the transferor liable for tax on income from property transferred or on property substituted therefor, no matter what means may have been adopted to accomplish the transfer.[8]

On the language of the section and on the cases it is clear that outright gifts of the legal and beneficial title to property will be within sections 74(1) and 75(1).[9] It is also clear that gifts made by way of transfers to a trustee on trust, or by declaration of trust in favour of a spouse or a minor, will be within the provisions.[10] Beyond these two propositions some doubt exists.

The most important decision under the previous legislation was that of Thurlow J. in *Dunkelman* v. *M.N.R.*[11] The taxpayer and a trust company executed a voluntary declaration of trust over a building purchased by them with money lent to them in their capacity as trustees by the taxpayer. The loan was secured by a mortgage on the building. Under the declaration of trust each of the taxpayer's three children had a vested beneficial interest which was liable to be divested in the event of his or her death before the youngest child attained the age of twenty-one. In the event of all three children dying before that time there was a gift over in favour of the taxpayer's spouse. The instrument contained no direction or authority with respect to the payment of income and, in fact, the income from the building was used to pay off the mortgage and, thereafter, it was accumulated.

From the commencement of the trust the Minister claimed that the income was to be attributed to the taxpayer. Appeals from the assessments for the first three years were dismissed by the Tax Appeal Board.[12] Appeals with respect to assessments made in later years were upheld in the Exchequer Court on the ground that a loan of money does not fall within the statutory concept of a transfer of property. After affirming the relevance of the construction that was placed on the word "transfers" as it appeared in the

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[7] *Fasken Estate* v. *M.N.R.*, [1948] Ex. C.R. 580.

[8] *Dunkelman* v. *M.N.R.*, [1960] Ex. C.R. 73, 78.

[9] *Eg., Bethune* v. *M.N.R.*, [1958] Ex. C.R. 102; *McLaughlin* v. *M.N.R.*, [1952] Ex. C.R. 225; *Number 648* v. *M.N.R.*, 59 D.T.C. 425, (T.A.B.); *Number 375* v. *M.N.R.*, 57 D.T.C. 8, (T.A.B.); *Pachal* v. *M.N.R.*, 55 T.C. 112, (T.A.B.); *Gross* v. *M.N.R.*, 67 D.T.C. 680, (T.A.B.).

[10] *Fasken Estate* v. *M.N.R.*, *supra*, note 7; *Mitchell* v. *M.N.R.*, 56 D.T.C. 521 (T.A.B.); *Meade* v. *M.N.R.* 63 D.T.C. 997-33, (T.A.B.).

[11] *Supra*, note 8.

[12] 51 D.T.C. 107.

attribution sections of the *Income War Tax Act* Thurlow J. held that the expression had to be given its "natural meaning".

> The problem is to determine how wide that natural meaning is in the context in which the expression is found, having due regard to the definition of property contained in the statute.[13]

The learned judge relied heavily on dicta in the House of Lords which concerned the interpretation of words in the *Finance Act,* 1940 and concluded:

> I do not think it can be denied that, by loaning money to the trustee, the appellant, in the technical sense, transferred money to them, even though he acquired in return a right to repayment of a like sum with interest and a mortgage on the [building] as security, or even though he has since then been repaid with interest. But in my opinion, it requires an unusual and unnatural use of the words "has transferred property" to include the making of this loan. For who, having borrowed the money and knowing he must repay it would use such an expression to describe what the lender has done?[14]

The decision has been followed in the Exchequer Court[15] and, if it is applicable under the present statute, it indicates a relatively simple method by which attribution can be avoided. There is, however, one caveat which must be mentioned. The definition of property in the present statute is expressly extended so as to include money unless a contrary intention is evident.[16] It is conceivable that this change in the definition might be held to reverse the effect of the *Dunkelman* decision. It is true that it was recognized under the earlier legislation that a gift of money is a transfer of property for the purpose of the section and that it does not appear that the conclusion in *Dunkelman* was based squarely on the proposition that money was not property. The basis of the decision was that a loan of money is not within the natural meaning of the words "has . . . transferred property". The learned judge, however, obviously placed some significance on the definition of property as it then was and it is possible that a court might hold that a loan transaction is a transfer of property now that money is expressly included within the definition.

Although the decision in *Dunkelman* is of considerable importance, it does not help in the formulation of any coherent theory as to the purpose and scope of the attribution provisions. If the legislature has decided that attempts to split income by shifting property from a taxpayer to his spouse are to be blocked, one would expect that temporary transactions such as loans would be the first to attract attribution. If loans do not lead to attribution then, *a fortiori,* one would expect that gifts and sales would be similarly immune. As it seems clear that gifts, whether made by outright transfer of the legal and equitable title to a spouse, or by way of the creation of a trust for the spouse are within section 74(1) and as there are decisions to the same effect with respect to sales to a spouse or to a trust,[17] the decisions with respect to loans are obviously anomalous in policy and can be explained only in terms of the principle which calls for a strict construction of taxing statutes.

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13 *Supra,* note 8, at 79.

14 *Id.* at 81-82.

15 *Oelbaum* v. *M.N.R.,* [1968] 2 Ex. C.R. 380.

16 Section 248(1).

17 *McLaughlin* v. *M.N.R., supra,* note 9; *German* v. *M.N.R.,* 57 D.T.C. 1216, (Ex. Ct.); *Campbell* v. *M.N.R.* 63 D.T.C. 493, (T.A.B.).

(ii) The subject matter of the transfer

In view of the wide definition of property in the Act, a transfer of any valuable rights which are legally enforceable would, *prima facie,* fall within the provisions of sections 74(1) and 75(1). In particular, where the transfer is by way of the creation of a trust it should not be material whether the transferee obtains a capital interest or only an income interest. If this is correct, then a trust under which the taxpayer's spouse is entitled to receive income from capital transferred to the trust by the taxpayer should attract attribution whether or not the spouse has any vested or contingent interest in the capital. Conversely a trust under which the settlor's spouse is entitled to receive the capital at some stage in the future may attract attribution with respect to any income which the spouse may receive in the meantime even though that receipt depends upon the exercise of an unfettered discretion which is vested in the trustees.[18]

The decisions under the earlier legislation afford some support for these propositions. In *Fasken Estate* v. *M.N.R.*,[19] Thorson P. held that income from a trust under which the settlor's wife had a life interest would normally be attributed to the settlor. In *Meade* v. *M.N.R.*,[20] the Tax Appeal Board held that a similar result followed where the settlor's son had a vested capital interest which was liable to be divested in the event of his death under the age of thirty-five but no right to income during his minority. Payments of any income during that period were left to the absolute discretion of the trustees.

Although dicta in *Fasken Estate* and in *Dunkelman* might be interpreted to the effect that there will be no transfer of property for the purposes of the provisions unless the rights of the recipient are vested as distinct from contingent, such an interpretation would be unnecessarily strict. The distinction between contingent interests and interests which are vested but liable to be divested is extremely technical and although it may be imported by the express words of other sections of the Act,[21] there would be no justification for doing so in the absence of express words. It would be peculiar to say the least, if a trust under which the beneficiary's right to receive the capital was contingent on his attaining the age of thirty-five were to attract quite different tax consequences than the trust in *Meade.*

If contingent rights to capital or income are property within the meaning of the provisions, the interests of beneficiaries who have no right to capital

18 On the basis of a more precise analyses of the provisions it can be argued that there should be no attribution unless the spouse or minor derives income from the property right which he or she has received. On this basis there would be no attribution where a beneficiary has an interest in capital but has only a mere expectancy of receiving income under discretionary trusts. The argument is inconsistent with the decision in *Meade, infra,* and if successful would expose a large gap in the provisions. The better interpretation is probably that as long as the beneficiary has received a property right of some kind any income from the trust property (*i.e.* the corpus) which is paid to him will attract attribution.

19 *Supra,* note 7.

20 63 D.T.C. 997-33, (T.A.B.). The reasoning in the opinion is unsatisfactory: see Cohen, *supra,* note 4 at 47-48.

21 *e.g.* section 104(18) deems income to have been payable to a minor if, *inter alia,* his "right thereto had vested".

and whose entitlement depends solely on the exercise of a discretion vested in trustees may not be. The interest of a beneficiary of a discretionary trust varies according to whether the trustees have been given a bare power on the one hand or a trust-power on the other.[22] In the former case the beneficiary's interest is probably not assignable and, technically, does not appear to differ materially from a mere expectancy or possibility.[23] Where the trustees have a trust-power the position is different in that the beneficiaries do have the right to demand a distribution and their interests are assignable.[24] It is clearly arguable that at least in the former case a beneficiary has not received property for the purposes of the attribution provisions.

If the wide statutory definition of property and the decided cases support the view that transfers of income interests fall within 74(1) and 75(1), there is nonetheless an argument to the contrary which should be mentioned. From 1939 until the enactment of the present legislation, the attribution provisions which relate to transfers in favour of a spouse or a minor were followed by the provision which is now section 56(4) and which attributes income to a taxpayer who, in a non-arm's length transaction, transfers or assigns a right to income from property without transferring or assigning the property.[25] Originally inserted as an additional subsection to the section containing the other attribution provisions, this provision clearly assumes a distinction between the right to receive income from property and the property itself. The argument for inferring from the existence of the provision that sections 74(1) and 75(1) do not apply to transfers of rights to income does not depend simply upon the fact that the legislature thought it necessary to provide specifically for transfers of such interests. It depends also on the necessity to give all three provisions a sensible and consistent application.

Under section 56(4) attribution would seem to be effected whatever the relationship between the taxpayer and the assignee, whatever the age of the latter and whether or not the taxpayer continues to reside in Canada. On this view, if a taxpayer assigns his right to interest from notes or bonds to his children for ten years, the income for that period would be attributed to him notwithstanding the fact that each of the children may have attained the age of eighteen years before the assignment or before the expiration of the period. The same consequences would ensue in the case of a similar transfer to a spouse notwithstanding the fact that the marriage was dissolved during the period in which the assignment was effective.

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[22] For an explanation of the distinction, see *Re Baden's Trust Deed*, [1971] A.C. 424.

[23] See the discussion of the nature of such interests for the purposes of legislation imposing death taxes in the United Kingdom: *Gartside* v. *I.R.C.*, [1968] A.C. 553; *I.R.C.* v. *Holmden*, [1968] A.C. 685. In *Re Smith*, [1928] Ch. 915 there is a *dictum* that suggests that such interests are assignable (see at p. 919).

[24] *Re Smith, supra*, note 23; *Re Nelson*, [1928] Ch. 920n. In *Re Weir's Settlement Trusts*, [1971] Ch. 145, the Court of Appeal followed the decision in *Gartside, supra*, note 23 and held that even a beneficiary under a trust-power did not have an "interest" for the purposes of section 2(1)(b) of *The Finance Act*, 1894.

[25] S. 56(4) is derived ultimately from s. 32(4) of the *Income War Tax Act* which was enacted by S.C. 1939, c. 46, s. 14. The principal Act contained no definition of the term "property" at that time.

It seems clear that section 56(4) would be emasculated if it were not to be interpreted in this way and yet to do so leads inexorably to the conclusion that the provision not only overlaps considerably with section 74(1)[26] and section 75(1) but that its intended operation is based on a completely different concept of property.

The matter was referred to in *Fasken Estate* in which Thorson P. was concerned with the validity of assessments made for years prior to the enactment of the predecessors of section 56(4). The learned Judge held that, notwithstanding the fact that the legislature had subsequently enacted the provision directed at assignments of income rights, such interests were within the definition of property for the purposes of the provision which is directed at inter-spousal transfers.[27]

Although it is possible that it might be held that the existence of section 56(4) impliedly restricts the meaning of property in section 74(1) and 75(1) to capital interests and although if the matter were to be considered *de novo* this would seem to be the better view, it is probably unlikely that the Federal Court and the Tax Review Board will now depart from the wider construction.

If there has been a transfer of property within the terms of section 74(1) and 75(1), attribution will not be defeated or terminated by the fact that the recipient subsequently disposes of the property and acquires other property in substitution for it. Nor is it material that property acquired in substitution is subsequently exchanged for other property. No matter how many substitutions occur, the income received from substituted property will be attributed to the transferor.[28]

(iii) Indirect transfers of property

Transfers of property to a spouse or a minor attract attribution whether the transfer is made "directly or indirectly by means of the trust or by any other means whatever". The reference to other means has been held to be directed to "the means or procedure by which transfers may be accomplished, rather than to the scope of the expression 'has transferred property' and . . . they do not expand that scope beyond the natural meaning of the expression."[29] It would seem therefore that, in accordance with the authorities quoted above, even an indirect transfer must produce the effect that property rights pass from the taxpayer to the other person. Some attempts to take advantage of this restriction have failed notwithstanding the fact that only in a very loose sense could it be said that the spouse had received proprietary rights which had previously been vested in the taxpayer.

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26 For an example of a case in which either provision might have been applied, see *Pachal* v. *M.N.R.* 55 D.T.C. 113.

27 *Supra,* note 7, at 593.

28 Section 75(3). Prior to the original enactment of this provision it had been held that attribution ceased after one substitution: *M.N.R.* v. *MacInnes,* [1954] Ex. C.R. 181; *Number 141* v. *M.N.R.* 54 D.T.C. 44, (T.A.B.).

29 *Dunkelman* v. *M.N.R., supra,* note 8, at 82.

In *Fasken Estate*,[30] counsel for the taxpayer argued unsuccessfully that there was no transfer between the husband and the wife where the husband released his rights against his debtor in consideration of the debtor assuming an obligation to a trust of which the wife was beneficiary. In *Naiberg* v. *M.N.R.*,[31] a scheme whereby each of the three taxpayers transferred shares to the wife of one of the others in consideration for the wife assuming an obligation to pay the value of the shares to her husband was similarly unsuccessful. It was held that each husband had indirectly transferred his shares to his wife. Among the grounds on which the decision was based was the fact that upon completion of all the transfers the same number of shares remained "in the family".

Although it is impossible to estimate how far the principle of these decisions will be extended, they provide a clear warning that there is at least a danger of attracting attribution where the end result of a transaction or series of transactions is that the spouse of the taxpayer receives rights which are of substantially the same kind or, perhaps, of the same value as rights which, at the commencement of the transaction or transactions, were vested in the taxpayer.

The extent to which the corporate veil will be ignored for the purposes of the attribution provisions has not been finally determined. Suppose for example that a company is incorporated and all its shares are owned by the taxpayer's wife. Suppose, further, that the taxpayer sells property to the corporation in return for a non-interest bearing demand note. Has the taxpayer made an indirect transfer to his wife for the purposes of attribution? A negative answer is implicit in one decision of the Tax Appeal Board. In *Mitchell* v. *M.N.R.*,[32] the taxpayer had settled property on separate trusts for each of his four children all of whom were under the age of nineteen years. The trustee invested the trust assests in the common shares of a holding company which was created for the purpose. The taxpayer then sold a number of shares of a second company to the holding company in return for redeemable preference shares. When the second company paid a dividend to the holding company the Minister included the dividend in the taxpayer's income despite the fact that the holding company had retained the money and had not itself declared any dividend. Before the Tax Appeal Board the Minister contended that the shares sold to the holding company were to be regarded as property substituted for the property originally transferred to the trustees by the taxpayer. The contention was rejected.

> It seems to me that the respondent has fallen into the error of trying to strip away the corporate entity of the [holding company], which must stand as an ordinary corporation, its business being its own, and its property — including the [shares of the second company] — being its own. It is well-known law that the property of a corporation is its own, and not that of its shareholders. It follows that each of the trusts in question is not interested in the [shares of the second company]; these shares are the property of the [holding company] and not of the shareholders.[33]

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30 *Supra*, note 7.
31 69 D.T.C. 361, (T.A.B.).
32 56 D.T.C. 521, (T.A.B.).
33 *Id.* at 524.

The Chairman of the Board agreed that, if the holding company had declared a dividend, attribution would have been effected. But as the trusts had received no income, the attribution provisions were inapplicable.

Although it does not appear whether it was argued that the sale of shares to the holding company was itself an indirect transfer to the children, the passage quoted from the Opinion of the Board suggests clearly that such an argument would not have been accepted.

Although there appear to be no other decisions which bear directly on the point, the decision of the Supreme Court of Canada in *Army and Navy Department Stores Ltd.* v. *M.N.R.*[34] displays a similar reluctance to ignore the separate legal personality of a corporation. In that case it was held that the shareholders of two holding companies did not own "directly or indirectly" any of the corporate shares registered in the names of the holding companies for the purpose of a provision which defined the term "related corporations."[35]

These cases can be contrasted with the position under the *Income and Corporation Taxes Act* of the United Kingdom. A provision of that Act attributes income to the settlor of a trust of which the beneficiaries are the settlor's children.[36] The term "settlor" is defined as including "any person who has provided or undertaken to provide funds directly or indirectly for the purpose of the settlement". It has been held by the Court of Appeal that a person who provides funds for a company indirectly provides funds for its shareholders.[37] Although such a conclusion does to some extent ignore the existence of the corporate entity, it does perhaps, less violence to the words of the English statute than a decision that a transfer of property to a corporation is an indirect transfer to its shareholders for the purpose of the Canadian Act.

Clearly if substance rather than form is to be stressed there is no doubt that attribution should occur whether the immediate recipient is a trust of which the taxpayer's wife or infant children are beneficiaries or a corporation of which they are shareholders. If, as is at the present the more authoritative view, form is to prevail over substance, there exists a comparatively simple way of avoiding attribution.

In *Reese* v. *M.N.R.*[38] it was held that the income from property acquired during a marriage which was subject to community of property under the law of California did not give rise to attribution notwithstanding the fact that the taxpayer had purported to assign one-half of the property to his wife. In reaching this decision the Tax Appeal Board relied on evidence of Californian law to the effect that, on the acquisition of property subject to the community, each spouse automatically acquired a vested one-half interest in the property. The Board empasized that its decision was not necessarily applicable to other

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34 [1953] 2 S.C.R. 496.

35 See the discussion in David A. Ward, *Current Tax Planning* (Toronto: Carswell 1971), §192.4 (c).

36 1970, c. 10, s. 437.

37 *Crossland* v. *Hawkins*, [1961] Ch. 537; and see *Mills* v. *I.R.C.*, [1972] I W.L.R. 473.

38 55 D.T.C. 488, (T.A.B.).

systems of community of property and this caveat was confirmed by the decision of the Supreme Court of Canada in *Sura* v. *M.N.R.*[39] In that case, it was held that under the law of Quebec the substantial rights given to the husband in his capacity as administrator of community property justified the conclusion that all the income from such property was taxable in his hands quite independently of the attribution provisions.

The decisions in *Reese* and *Sura* should be contrasted with that of Thurlow J. in *Wertman* v. *M.N.R.*[40] There the taxpayer and his wife had contracted into a system of community of property under Polish law. Under that system the husband was entitled to manage the property subject to the community but was liable to account strictly for his management. The learned judge held that the difference in the status of the husband was sufficient to distinguish the Polish system from that in force in Quebec and, on that ground together with the fact that the community existed by virtue of a contract, he concluded that the decision in *Sura* was inapplicable.

The decision in *Wertman* was that property acquired by the husband both before and during the marriage was automatically transferred to the wife by virtue of the pre-nuptial contract. Although it would make little sense to confine attribution to the income from property acquired prior to the marriage the decision clearly requires some modification of the notion that a transfer involves the divesting of proprietary rights which were formerly vested in the taxpayer.

A strict construction of section 75(1) could give rise to difficulties with respect to inter vivos trusts created in favour of a class which may increase in the future. Suppose, for example, that a trust is created in favour of the settlor's children who shall attain the age of eighteen years and that the trustees are empowered to sprinkle income among the children in the meantime. Suppose that at the creation of the trust the settlor has two children and a third is born thereafter. Can it be said with respect to the third child that the settlor "has . . . transferred property to a person who was under eighteen years of age, either directly or indirectly by means of a trust or by any other means whatever"? Despite the obvious difficulty of saying that the transfer was made to a person who was under the age of eighteen years at the date of the transfer, the policy of the provision obviously calls for attribution in such a case.

Two decisions of the Tax Appeal Board imply that the onus is on the Minister to adduce evidence from which it could be inferred that a transfer was made.[41] Notwithstanding the obvious justice of such a rule it is doubtful whether it is consistent with the general principles applied to the Act in the Supreme Court of Canada.[42] It seems clear that at least the ultimate burden

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39 [1962] S.C.R. 65.

40 64 D.T.C. 5158, (Ex. Ct.).

41 *Del Grande* v. *M.N.R.* 51 D.T.C. 104, (T.A.B.); *Maziade* v. *M.N.R.* 51 D.T.C. 411, (T.A.B.).

42 *Johnston* v. *M.N.R.*, [1948] S.C.R. 486; and see *M.N.R.* v. *Dufresne*, [1967] 2 Ex. C.R. 128.

of proof or the risk of non-persuasion rests upon the taxpayer.[43] In seeking to support an assessment, the Department of National Revenue has been prepared to trace property back through several transactions to its original source in the taxpayer. Even though, in form, the transfer was made by a third party the Board and the Exchequer Court have examined carefully any part that the taxpayer played in the transaction.[44] Thus, where the taxpayer and his father were conducting a business in partnership, the taxpayer was unsuccessful in his contention that purchases in favour of his wife and infant children were in fact made by his father. The evidence disclosed that the taxpayer helped to provide the consideration for the purposes, gave oral instructions to the vendor and "at all material times, played an active part behind the scenes".[45]

(iv) The income must be from property

The provisions of sections 74(1) and 75(1) apply only to the income from property as distinct from income from a business or office or employment. Thus if a taxpayer makes a gift of money to his spouse who uses it to purchase a business, the income from the business will not be attributed. Similarly if the business itself is transferred to the spouse there may be no attribution of income. Although there is an earlier decision of the Tax Appeal Board to the contrary,[46] these propositions would seem to be established by the decision of the Exchequer Court in *Robins* v. *M.N.R.*[47] In that case the taxpayer had advanced the money necessary to buy his wife into a partnership which was dealing in real estate. Noel J. held that the income subsequently received by the wife was not to be attributed to the taxpayer. The learned Judge based his decision on the grounds that the income was derived from a business and not from property, and that the advancement was either made in repayment of an earlier loan from the wife to the husband or alternatively was a loan from the husband to the wife.

By a parity of reasoning, if a husband transfers shares to his wife in order to qualify her as a director any salary that the latter receives by virtue of that position should not be attributed.

(v) Only income of the transferee is attributed

The attribution provisions deem the income from property transferred to be the income of the "transferor and not of the transferee." The words quoted appear to contemplate that, were it not for the attribution, the income would be taxed to the transferee and it is clear that in all the reported cases in which the provisions have been applied this would have occurred. It is important to consider, however, whether it is an essential prerequisite to the operation of section 74(1) and 75(1) that the income from the property would otherwise

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[43] *Wertman* v. *M.N.R.*, *supra*, note 40.

[44] See, *e.g.*, *Number 375* v. *M.N.R.* 57 D.T.C. 8, (T.A.B.); *O'Brien* v. *M.N.R.* 57 D.T.C. 580, (T.A.B.); *Fasken Estate*, *supra*, note 7.

[45] *Nathanson* v. *M.N.R.*, 67 D.T.C. 80, (T.A.B.).

[46] *Trinca* v. *M.N.R.*, 51 D.T.C. 91, (T.A.B.); and see the *dictum* of Cattanach J. in *Minden* v. *M.N.R.*, [1964] Ex. C.R. 179 at 199.

[47] [1963] Ex. C.R. 171 p. 175; *cf.*, on the facts, *Minden* v. *M.N.R.*, *supra*, note 46.

be treated as income of the transferee. It would seem that strictly this should be so. Quite apart from any implication that might be discovered in the words quoted above, the requirement that the income must be from property and not from a business or employment presupposes the necessity to analyse the nature of the receipts by reference to the actions of the recipient with respect to the property. If, for example, a taxpayer who is engaged in the business of trading in real estate transfers realty to his infant children it is clear that any profits made subsequently on the sale of the realty would not be attributed to him. Although such profits would have been income of the taxpayer if the realty had not been transferred to the children, they would have the character of capital gains in their hands.[48]

Moreover, unless the income which is attributed is the income which would otherwise be taxed to the transferee, there would be apparently insoluble difficulties with discretionary trusts under which the trustees have power to distribute or accumulate all or any part of the income as they see fit. Suppose, for example, under such a trust the trustees are authorized to sprinkle income among the taxpayer's children until the youngest attains the age of eighteen years, on which event the trustees are directed to distribute the corpus among the surviving children in equal shares. In such a case there would be no objection or difficulty in attributing to the taxpayer income which the trustees have paid to infant children. But unless the only income which can be attributed is that which would otherwise be taxable to those beneficiaries, there would seem to be no other ground on which it could be argued that income which has been paid to adult children or, indeed, accumulated is not to be attributed to the taxpayer.

The suggested interpretation is supported by *Pichosky* v. *M.N.R.*,[49] a decision which has received more than its share of criticism. The taxpayer had transferred money to trustees on trust to pay the income to the taxpayer's wife during her lifetime and then to the taxpayer's sons until they should attain the age of thirty years. The trustees used the money to acquire the shares of a personal corporation which itself held shares in another company. When the personal corporation received a dividend the Minister attempted unsuccessfully to attribute it to the taxpayer. Jackett P. held that although the trustees, as shareholders of the personal corporation, were deemed to have received the dividend in the year in which it was received by the corporation, there was no provision in the Act which made the dividend taxable to the beneficiaries of the trust. The learned President was emphatic that attribution will not occur unless the income will otherwise be taxable in the hands of the transferees.

Two learned commentators have regarded as one of the main issues in this case the question whether the attribution rules take precedence over the provision which stipulates that a beneficiary of a trust is taxable only on the income which is payable to him.[50] It is suggested with respect that to

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48 See *Fine* v. *M.N.R.* 61 D.T.C. 628, (T.A.B.).

49 [1964] Ex. C.R. 946.

50 Cohen, *supra*, note 4, at 54; McGregor, *Elliptical Reasoning* (1964), 12 Can. Tax J. 238-241.

characterize the issue in this way is not helpful and that the decision turned simply on the question whether attribution is limited to income which would otherwise be taxed in the hands of the transferee. The Act draws a clear distinction between the income of a trust and the income of its beneficiaries and there is nothing in the attribution provisions which deems the trust to be the transferee, or its income to be that of its beneficiaries.

The decision in *Pichosky* is quite consistent with the slightly earlier decision of the Tax Appeal Board in *Loeb* v. *M.N.R.*[51] but the reasoning in the opinions delivered in the two cases cannot be reconciled. In *Loeb* the taxpayer had transferred shares in a company to his wife and minor children. They subsequently transferred the shares to a personal corporation of which they were the sole shareholders. Dividends declared on the original shares were paid to the personal corporation and assessed to the taxpayer. An appeal from the assessment was dismissed on the ground that prior to its receipt by the personal corporation the dividend had been attributed to the taxpayer by virtue of the provisions of the 1952 Act which were equivalent to sections 74(1) and 75(1). This reasoning is obviously inconsistent with the proposition that there can be no attribution of income which would not otherwise be taxed to the transferee. The decision can, on the other hand, be justified and distinguished from *Pichosky* on the ground that under the 1952 Act the income of a personal corporation was deemed to have been distributed to, and received by, the shareholders on the last day of the corporation's taxation year.[52] In such circumstances, there was no reason why the attribution provisions should not then have become applicable.

Dicta in the opinion of the Tax Appeal Board in *Mitchell* v. *M.N.R.*[53] can possibly be reconciled with the decision in *Pichosky* by reasoning of much the same kind. It will be recalled that in *Mitchell* the taxpayer had transferred money on separate trusts for each of his infant children. The trustee had used the money to purchase shares of a holding company to which the taxpayer subsequently sold shares in a second company. Although it was held that a dividend paid to and retained in the holding company was not attributed to the taxpayer, the Chairman of the Board stated that the position would have been otherwise if the holding company had declared a dividend with respect to the dividend it had received. On the facts of the case it is submitted, with respect, that this statement was justified only if the provision of the 1952 Act, which deemed income to be payable to an infant beneficiary whose right to income had vested, was applicable.[54] The report does not reveal whether the conditions for the application of the provision were satisfied.

Although it is submitted that the reasoning in *Pichosky* cannot be faulted as an exercise in statutory interpretation, the decision does indicate once again that the attribution provisions are defective if they were intended to apply whenever a taxpayer transfers property for the benefit of his spouse or

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51 64 D.T.C. 214.

52 R.S.C. 1952, c. 148, s. 67(1).

53 *Supra*, note 32.

54 *Supra*, note 52, s. 63(10), (now s. 104(18) of the 1971 Act).

infant children. Perhaps the most startling implication of the decision was that there would be no attribution of income accumulated in a trust. This aspect of the decision has lost much of its significance since the introduction of a high flat rate of tax to be applied to such accumulating income.[55]

It has already been suggested that income which is deemed to be payable to an infant beneficiary under the provisions of section 104(18) may be attributed and the same conclusion should follow with respect to income which is allocated to a spouse or minor pursuant to a preferred beneficiary's election under section 104(14).

(vi) Residence in Canada

It is clear that only income which accrues during a taxation year in which the taxpayer was resident in Canada can be attributed under sections 74(1) and 75(1). Whether such income will be attributed if the property was transferred at a time when the taxpayer was not resident in Canada is perhaps not quite so clear. In *Wertman* v. *M.N.R.*[56] Thurlow J. explicitly rejected "the contention that [section 21(1) of the 1952 Act] does not apply to transfers made by the appellant to his wife prior to their coming to Canada . . .". It has been noted already that on the facts of the case the learned judge found that property acquired by the taxpayer prior to his marriage was, by virtue of his pre-nuptial contract, transferred to his wife at the time of the marriage and that property acquired thereafter was similarly transferred when it was reduced into his possession. Despite the findings and the decision in *Wertman* it has been held subsequently in the Tax Appeal Board[57] that there will be no attribution of income derived from property which was transferred prior to the taxpayer's immigration to Canada. The dictum to the contrary in *Wertman* was characterized as *obiter* on the ground that in that case there had been no transfer prior to the taxpayer's arrival in Canada. This reasoning is curious in view of the conclusion of Thurlow J.:

> In the result therefore I am of the opinion that whatever interest the appellant's wife had in the funds in the Swiss banks must for the purposes of this case be regarded as property transferred to her by the appellant within the meaning of s. 21(1). . . .[58]

For the reasons already given it may be that the conclusion is not beyond question. It does, however, make it difficult to accept the view that the learned judge's finding that the attribution provisions may apply in respect of transfers made before the taxpayer acquired a Canadian residence was not an essential part of the reasoning on which his decision was based. It is submitted that the dictum of Thurlow J. does contain the more authoritative, if less equitable, view. It is submitted further that there is nothing in the Act which would support the more restricted construction adopted by the Tax Appeal Board.

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55 Section 122(1) stipulates that the minimum rate at which federal tax is to be levied on income accumulating in an *inter vivos* trust will be 39%. Provincial income taxes are imposed over and above this.

56 *Supra*, note 40.

57 *Duplessis* v. *M.N.R.*, 71 D.T.C. 153, (T.A.B.).

58 *Wertman* v. *M.N.R.*, *supra*, note 40, at 5164.

The fact that a trust was formally created by a non-resident should be of no significance, if the beneficiary is the spouse of a resident taxpayer who has transferred property to the trust.

(b) Capital gains from subsequent dispositions

Under section 3 of the Act both a taxpayer's income from property and the excess of his taxable capital gains over his allowable capital losses for a taxation year are specifically included in determining his income for the year. Although the contrary has been argued, in view of the structure of section 3 and the fact that it is nowhere provided in the Act that taxable capital gains or the excess of taxable capital gains over allowable capital losses from the disposition of property are included within the meaning of "income from property", it seems that the terms of sections 74(1) and 75(1) are not appropriate to attribute to the taxpayer taxable capital gains from subsequent dispositions of property which has been transferred within the meaning of those provisions. This conclusion is confirmed by the enactment of section 74(2) which expressly attributes to the transferor taxable capital gains which have been incurred on property which has been transferred to his spouse. There is no corresponding provision for taxable capital gains on property which has been transferred to a minor within the terms of section 75(1) and it seems clear that no attribution is intended to occur in such a case.

Where a transfer of property falls within section 74(2) the amount attributed is determined by adding the taxable net gains from dispositions of listed personal property[59] which has been transferred (or substituted for property transferred) and the taxable capital gains from dispositions of other transferred property (or property substituted for it) and subtracting the allowable capital losses incurred from dispositions of transferred property other than listed personal property.

The provision does not permit allowable capital losses to be attributed to the transferor and, on a strict construction, it would seem that such losses cannot be applied by the transferee against taxable capital gains on other property or, in future years, against taxable capital gains from transferred property. Such a result would seem to be unduly harsh and it is to be hoped that at least the excess of allowable capital losses over the aggregate of taxable capital gains and taxable net gains on transferred property will be available to offset any such gains which may be incurred in future years.

Apart from the restriction of the provision to transfers made after 1971, the conditions for the application of section 74(2) are worded in substantially the same terms as are to be found in sections 74(1) and 75(1) and the accumulated case law which, for the purposes of those provisions, bears on the meaning of direct and indirect transfers, on the subject matter of a transfer

[59] "Listed personal property" is defined in section 54(e) and includes items such as jewellery, stamps, coins and works of art. For the purposes of section 74(2) the taxable net gain from such property is determined as if the recipient had never owned listed personal property other than that received from the taxpayer.

and on the significance of the transferor's residence outside of Canada at the time of the transfer is presumably applicable to section 74(2). In particular, in view of the fact that only dispositions of the property which has been transferred to the spouse will attract attribution, it would seem to be necessary to analyse precisely the nature of the proprietary rights which the spouse has received. If, for example, under a trust *inter vivos* the transferor's spouse has only an income interest and the capital interests in remainder are vested in the transferor's children, no attribution should result if capital gains are realized by the trust during the spouse's lifetime. If the suggestion which was made earlier[60] is correct, the existence of a discretion in the trustees to encroach upon capital for the spouse should not affect this result. The possibility that the spouse might receive capital under such a power would not be a proprietary right.

## 2. TRUSTS WITH INTERESTS OR POWERS RESERVED TO THE SETTLOR.

The possibility of splitting income by transferring property to a trust over which the settlor retains a measure of control or under which the property may ultimately return to him is one to which the leglislature has understandably directed its attention. If the conditions of section 75(2) are satisfied, a person who has contributed property to the corpus of a trust will be treated as if he were still the owner of the property as far as income, losses, taxable capital gains and allowable capital losses from the property are concerned. The terms of the provision are very broad and the dearth of reported decisions may indicate that it operates effectively *in terrorem.*

A trust will fall within section 75(2) if it satisfies any one or more of three conditions.

### (a) Interests reserved to the settlor

Attribution under the provision will be attracted if the property, or property substituted for the property, which the trust has directly or indirectly received from a person may revert to him. The terms of this part of the provision are appropriate to cover both trusts under which the settlor has reserved a power of revocation and trusts under which the settlor has reserved a vested or contingent equitable remainder or an interest by way of resulting trust. Thus there is nothing in the provision to exclude a trust under which the trustees are directed to transfer the corpus to the settlor's son if and when he attains the age of forty years. In the absence of the gift over which one would normally expect to find, the settlor's interest under the resulting trust would seem to bring him within the term of section 75(2).[61] Similarly a trust under which income is payable to the settlor's mother during her lifetime and the capital is to be distributed to the settlor if he should be alive

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[60] *Supra*, p. 98.

[61] *Cf. Vandervell* v. *I.R.C.* [1967] 2 A.C. 291.

at the date of his mother's death would seem to fall squarely within the provision.[62]

There may be more doubt with respect to mere possibilities that the settlor may receive the original property or substituted property by virtue of the exercise of a discretion which is vested in the trustee. In such a case it would seem at least to be arguable that the property is not "held on condition that it . . . may revert" to the settlor. The argument would be that the notion of property being subject to a condition of reverter necessarily involves either a revesting in the settlor by operation of law or, at the most, a withdrawal of property from the trust by the settlor rather than a payment out of the trust at the option of the trustee. The argument is hardly compelling and in policy it may well have been intended to guard against the possibility of a complaisant trustee.

Perhaps the most curious feature of section 75(2) is its emphasis on the settlor's control over, or interest in, the corpus of the trust. The fact that he may be, for example, one of a class of income beneficiaries under discretionary trusts does not appear to bring him within the provision.

It is to be noted that section 75(2) does not, in terms, refer to transfers of property. The taxpayer to whom attribution is effected is identified in the subsection as "the person from whom the property or property for which it was substituted was directly or indirectly received". There seems to be no reason why the argument that was successful in *Dunkelman*[63] should apply to these words and there seems to be no reason why money loaned to the trust should not be regarded as property received from the lender. It seems, however, that the mere fact that a person lends money to a trust should not be sufficient to bring him within the terms of section 75(2). The fact that the loan has to be repaid is arguably not sufficient in itself to satisfy the condition that the property or property substituted for it may revert to the person from whom it was received. The terms of the provision seem to require that the possibility of reverter should exist under the terms of the trust and not merely by virtue of the obligation to repay the loan. A similar argument would be applicable to sales to a trust in return for a demand note. The trustee's obligation to make payment on the note or even a provision in the sale agreement for reverter on default in payment would appear not to amount to a condition for reverter under the terms of the provision.[64]

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[62] Cohen, *supra*, note 4, at 51 relies on *National Trust Company Limited* (Exors. of *E.R. Wood*) v. *M.N.R.* [1949] S.C.R. 127 as persuasive authority for the proposition that there should be no attribution where the possibility of reverter is quite remote. Although one would hope that the proposition would commend itself to the Department of National Revenue, it would seem to be unwise to rely upon the case cited. The decision in *Wood Estate* turned on the very fact that the deceased had reserved an interest contingent on his daughter predeceasing him. As he had never disposed of the interest it was held that its existence did not preclude the application of a provision of the *Dominion Succession Duty Act* which exempted gifts where the donor was excluded from the property subject to the gift. The terms of section 75(2) appear quite appropriate to cover interests which are reserved.

[63] *Supra*, note 8.

[64] *Cf.*, *Wolfson* v. *I.R.C.*, (1949), 31 T.C. 141.

If the reasoning in the preceding paragraph is correct, the thrust of this part of the section can be avoided. Nonetheless, in cases in which that reasoning is not applicable the ambit of the provision seems excessively broad. Unlike similar provisions in the United States and in the United Kingdom[65] there is nothing in its terms to prevent its application in cases where the reverter or the revocation is likely to or, indeed, must occur many years in the future. Moreover, there is nothing in the provision which would exclude attribution in a case where the possibility that the settlor's interest will fall into possession is highly unlikely.

The inequity which would follow from a strict application of the terms of the provision may have had some influence in the Income Tax Appeal Board in the case of *Number 40* v. *M.N.R.*[66] The taxpayer and his wife had entered into an agreement to sell shares in a company to their sons. Under the terms of the agreement the shares were to be held by a trustee until the purchase price was paid in full. Until that time the voting rights attached to the shares were to be retained by the vendors and the shares could not be transferred, assigned or encumbered by the purchasers. Dividends declared were to be the property of the sons but were to be applied to the payment of the purchase price. The Minister's contention that a dividend declared on the shares was to be attributed to the taxpayer was unsuccessful.[67] In the opinion of the Board, the transaction was substantially a sale to which the creation of the trust was merely incidental. The provision that a default in payment should cause the property to revert to the vendors was regarded as insufficient to bring the transaction within the provision. The only reason given for this conclusion was that such a stipulation is "common to most sale agreements".[68] Although the decision is difficult to justify on the words of the subsection it provides perhaps some oblique support for the submissions made earlier with respect to sales to trusts where the terms of the trusts do not themselves provide for reverter.

(b) Powers of appointment reserved to the settlor

The second type of trust which will attract attribution under section 75(2) is one under which the property may pass to persons to be determined by the settlor at a time subsequent to the creation of the trust. Although this limb of the subsection does not appear to have received judicial consideration in any reported decision, its wording seems singularly inappropriate for a provision designed to apply to the most flexible dispositive device known to the law of property.[69] It is, presumably, sufficiently clear that a trust under which the settlor alone has a general power of appointment over the corpus is within the provision. How much further its words extend is a matter for

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65 The effect of these provisions is outlined *infra*.

66 52 D.T.C. 16, (T.A.B.).

67 There was no evidence as to the age of the sons. The Minister apparently relied solely on section 22(2) of the 1952 Act.

68 52 D.T.C. 16, at 17.

69 In particular one might have thought that the concept of property "passing" had given enough trouble under other revenue statutes.

speculation.[70] Consider for example the following cases: (i) a trust under which the settlor can make an appointment of the corpus only with the consent or co-operation of another person; (ii) a trust under which the settlor has a special power to appoint the corpus among a class with a gift to the class in default of appointment; (iii) a trust under which the settlor has a special power over the corpus with a gift in default to a different class or to a specified person; (iv) a trust under which the settlor has a power to appoint income only during the lifetime of a specified person with a gift over after that person's death. The difficulty of ascertaining any policy behind the provision is exemplified by the fact that the trust in example (iv) appears to be most appropriate for attribution and yet is the one which is most likely to be held to fall outside the provision. Despite the decisions which have held that an income interest is property for the purposes of the predecessors of sections 74(1) and 75(1), the reference to property in section 75(2) seems clearly to be directed at the corpus of the trust rather than at its income. In short, it seems that the second limb of the provision may catch trusts which hardly call for attribution and have no effect on trusts under which the settlor has control over the destination of the income.[71]

(c) Settlor's power to prevent dispositions of the corpus

The third condition which, if satisfied, will bring a trust within section 75(2) is the existence of a power in the settlor to prevent a disposition of the property in his lifetime. Once again the reference to property appears to be a reference to the trust corpus and this part of the provision seems, therefore, to be directed at trusts under which the settlor has retained control over the investment of the trust assets,[72] or has the power to veto any discretionary distributions of corpus. To attract attribution however this control must, under the terms of the trust, be retained until the settlor's death. A power of veto dispositions for a fixed period or for some other period not determinable by reference to the settlor's death would therefore not be sufficient to bring the trust within the provisions. For this reason the vendor's power to control dispositions of the property pending payment of the purchase price in *Number 40* v. *M.N.R.*[73] was held to be outside the terms of the provision.

## 3. ASSIGNMENTS OF RIGHTS TO INCOME

The enactment from which section 56(4) and its immediate predecessor

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[70] Apart from this provision, powers of appointment have been virtually ignored by the draftsman of the Act. It is not clear, for example, whether the exercise of a power is in any circumstances to be regarded as a disposition for deemed proceeds which may result in a taxable capital gain or whether there are any capital gains consequences of the exercise of a testamentary power of appointment.

[71] It is conceivable that a trust under which the settlor has a power to direct the distribution of the income may attract attribution under section 56(2) which was formerly section 16(1) of the 1952 Act. One of the difficulties in regarding this provision as applicable to trusts is that the width of its terms would seem to be sufficient to cover all trusts and not merely those under which the settlor has a power to allocate income.

[72] *Contra,* Spindler and Timbrell, *Canadian Estate Planning,* (Don Mills: C.C.H., 1966), 56.

[73] *Supra,* note 66.

were derived was inserted into the *Income War Tax Act* in 1939[74] in order to remedy one deficiency which was thought to exist in the provisions which have been considered under the preceding heading.[75] As has been seen, section 75(2) is in its terms restricted to cases in which the taxpayer has contributed to the corpus of a trust. It is arguable that it does not apply where the taxpayer has merely assigned a right to income from property without assigning the property itself. This distinction between income rights and the property from which the income is derived is hard to reconcile with the definition of property in the current legislation and with the interpretation that the provisions which now appear in section 74(1) received in cases like *Fasken Estate*. It is likely that the assignment of an income right to a trust, which in all other respects satisfies the requirements of section 75(2), would now be held to attract attribution under that provision. It is clear, however, that assignments of income rights to trusts which do not fall within section 75(2) may result in attribution under the terms of section 56(4).

Although the latter provision is not confined to assignments of rights to receive income from property it is only with respect to such rights that this paper is concerned. The provision affects attribution of income from property if all of the following requirements are satisfied: the taxpayer has assigned a right to receive an amount which would otherwise have been included in computing his income for the taxation year; the assignment was in favour of a person with whom the taxpayer was not dealing at arm's length; and the property from which the income was derived was not itself assigned.

Assignments of income rights may occur under specifically enforceable contracts, under the *Conveyancing and Law of Property Act*,[76] under declarations of trust or under the principles of equity which permit the assignment of choses in action.[77] As the effect of section 56(4) is that such an assignment in a non-arm's length situation will result in income attribution unless the property which produces the income is also assigned, the distinction between property and income rights is crucial to any attempt to apply or avoid the operation of the provision. For the purpose of the distinction, the statutory definition of property is not helpful and it seems that the only available guiding principle is the familiar but unsophisticated analogy of the fruit and the tree. Where the income is from land or from the use of a chattel there should be no difficulty. Where, however, the income is derived from a chose in action, the distinction may be less easy to draw.

One proposition which appears to be valid is that income from a business is not income from property, notwithstanding the fact that the income may arise under a contractual agreement. The reasoning in *Robins*[78] would seem to be equally applicable to section 56(4) as to section 74(1). A taxpayer should

74 S.C. 1939, c. 46, s. 14.

75 H.C. Debates, May 24th, 1939, pp. 4483-4484.

76 R.S.O. 1970, c. 85, s. 54(1).

77 See, generally, *Sanderson* v. *Halstead*, [1968] 1 O.R. 749, (Ont. H.C.); *Norman* v. *Federal Commissioner of Taxation* (1963), 109 C.L.R. 9, (H.C. of Aust.); Ford and Cullity, *Gifts of Future Income From Choses in Action* (1966), 30 The Conveyancer and Property Lawyer 286.

78 *Supra*, note 47.

not, therefore, be able to claim to have transferred a right to income from property when all he has done is to assign his rights under contracts for services he has provided in the way of his business.[79] Consider, however, the following cases: (i) an assignment of rights to future income from bonds or loans; (ii) an assignment of rights to future royalties due under a licence agreement relating to a copyright, patent or franchise: (iii) an assignment of rights under an annuity contract; (iv) an assignment of an income interest under a trust. In the first case it seems probable that a court would hold that the property consists of the capital sum and has not been assigned. In the second case the decision is likely to be the same unless the copyright, patent or franchise has also been assigned. In the third case, if the assignor has divested himself of all his rights under the contract, the assignment is presumably outside the scope of section 56(4). In the fourth case the result would probably be the same unless the assignor has also an interest in the corpus of the trust which is vested in possession. It should not matter in the fourth example whether the assignment is of the entire income interest or of some fraction of it. An assignment of the interest for a limited period would probably lead to attribution.

## 4. GENERAL COMMENTS

The provisions which have been considered were originally enacted piecemeal during a period of more than twenty years. In their present form they reflect a general policy of attributing income from property which has been transferred to a spouse or to minors and, whoever the recipient, from property which has been the subject of something less than an outright transfer. Some specific defects in the wording of the provisions have been indicated. A more general criticism, which applies to some extent to each of the provisions but more particularly to sections 75(2) and 56(4), would emphasize not so much the individual cases which either attract or escape attribution but rather the generality of the approach which the legislature has been prepared to adopt. In short, despite the gaps in the provisions, their general thrust smacks very much of over-kill.

It has been held that the transfers which fall within section 74(1) and section 75(1) include those which are made for valuable consideration.[80] Although it has been argued[81] that the relevant decisions should be reconsidered in the light of the *Dunkelman* case it is clear that the reasoning on which that decision was based would not lead to the desired conclusion.[82] Whether sales should be excluded from the provisions is open to debate. On the one hand, it has been said that there is no reason why attribution should occur if a taxpayer has merely transferred one piece of income-producing

[79] See *Number 727* v. *M.N.R.* 61 D.T.C. (T.A.B.). The case was decided on a different ground; *i.e.*, that the contracts were executory and therefore incapable of voluntary assignment. For the distinction between mere expectancies and property rights, see *Norman* v. *Federal Commissioner of Taxation, supra,* note 77; *Shepherd* v. *Federal Commissioner of Taxation* (1965), 113 C.L.R. 385, (H.C. of Aust.).

[80] *Supra,* note 17.

[81] Cohen, *supra,* note 4, at 45.

[82] *Supra.*

property in return for another of equal value which could be used to produce the same amount of income.[83] The argument is not altogether compelling. A policy decision that individuals will not be permitted to minimize tax by rearranging from time to time the ownership of assets held by themselves, their spouses and infant children is hardly illegitimate or excessively harsh.

The breadth of the provisions dealing specifically with trusts and income rights is, however, more open to attack. As has been seen, those provisions apply whatever the period for which the taxpayer has divested himself of his property or right to income and, in the case of trusts, however unlikely it may be that the property will revert to him. It is not at all clear, for example, why income should be attributed to an individual who has transferred property on trust to pay the income to his mother or adult daughter for life with a provision that on her death it is to revert to him if he should still be living. Nor is it altogether clear that attribution is appropriate where a person has settled property on trust to pay the income to his adult children during his lifetime and then to distribute the corpus among such of his children as he should appoint. Similarly, it seems unnecessarily severe to attribute income to a taxpayer who has irrevocably assigned the right to receive that income for the period of his life or for some fixed period of considerable length.

Perhaps the most curious aspect of the way in which sections 75(2) and 56(4) have been drafted is the fact that the determining criterion is the settlor's retention of some interest in, or some control of, the corpus. The possibility that he may control the destination of the income or receive the benefit of the income is not in terms attacked. Thus a trust under which the taxpayer has reserved a special testamentary power over the property transferred may be contrasted with a trust under which the income is to be accumulated during his lifetime and then distributed among his children as he should by will appoint. Only the former would seem to fall within section 75(2).[84]

The provisions of sections 671-678 of the *Internal Revenue Code* of the United States offer an instructive contrast with those of sections 75(2) and 54(6) of the Canadian legislation. The provisions of the Code are directed at trusts which are of the same broad type as those which fall within section 75(2). There the similarity ends. Instead of the crude drafting technique which substitutes deterrence for guidance and departmental discretion for determinate legal rules, the Code reflects an attempt to indicate with some precision the interests and powers which, if retained by the settlor, will attract attribution. The provisions are consequently at the same time more elaborate and more equitable. Reversionary interests attract attribution whether they are in income or in corpus but only if they may reasonably be expected to fall into possession within ten years of the transfer of the particular property to the trust and are not expectant on the death of a life tenant. Subject to the

83 La Brie, *The Principles of Canadian Income Taxation,* (Don Mills: C.C.H., 1965), at 364.

84 On the assumptions that elections under section 104(14) would be possible, the flat rate of tax on accumulating income could be avoided. The validity of the assumption depends on the content of the regulations, which, at the time of writing, have not been issued.

same ten year qualification, the interest of the grantor under discretionary trusts of income will attract attribution unless the consent of an adverse party is required before income can be allocated to the grantor. Powers of revocation will not attract attribution if the co-operation of an adverse party is required for their exercise. Nor will they result in attribution if they can only affect the beneficial enjoyment of the income after the ten year period. Attribution is attracted if the settlor retains a power of appointment over corpus or income. Excepted from this general principle, however, are powers of various types which include those which require the consent of an adverse party, those which are exercisable by will alone, those which can only be exercised in favour of charities, those which are limited by a reasonably definite standard and those which can only affect the beneficial enjoyment of the income after the expiration of the ten year period. Perhaps the greatest contrast exists between the sweeping and ambiguous terms of section 75(2)(b) which effects attribution if the settlor can prevent a disposition of the trust corpus and those of section 675 of the Code which spell out in some detail the administrative powers which are regarded as sufficient to justify attribution. The powers included are those which, in general terms, would enable the settlor to obtain incidental benefits by dealing with the trust property. Powers to control investments, for example, are included only so far as the trust funds consist of corporate securities in which the holdings of the grantor and the trust are significant with respect to voting control.

Although the provisions[85] of the United Kingdom legislation are still more elaborate, they contain many of the same features which are to be found in section 671-678 of the Code. As one would expect, the settlor's interest in, or control over, the corpus of a trust is not emphasized to the exclusion of his interest in the income. Discretionary trusts of income for the benefit of a class which includes the settlor are specifically dealt with. The short term trust is again treated differently from the long term trust. Not all reversionary interests attract attribution.[86]

In this paper a number of the defects of the Canadian provisions have been canvassed. The fact that the relevant sections have been carried over into the new act must reflect to some degree the nervousness that the Department of Finance has customarily revealed whenever it has been forced to consider the use of trusts in tax planning. In other areas the Department has not been reluctant to take advantage of the precedents to be found in the legislation of other jurisdictions. In this area it is submitted that the provisions in force in the United States, in particular, might well serve as a model for reform.

It is not suggested that there are no points of obscurity and ambiguity in the relevant provisions of the Internal Revenue Code. It is suggested that they are far more precise, more equitable and generally more responsive to the problem of income splitting through the use of trusts than their Canadian counterparts.[87]

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[85] *Income and Corporation Taxes Act* 1970, sections 434-459.

[86] For a full discussion of these provisions, see Whiteman and Wheatcroft, *Income Tax and Surtax*, (London: Sweet and Maxwell, 1971), at 661-662.

[87] As the writer's attempt to burst into print on the subject of estate and gift taxation was greeted by the repeal of the relevant legislation, the preparation of this paper has been undertaken as a public service.