THE MEANING OF INCOME IN THE LAW OF INCOME TAX. By F. E. LaBrie. 
Toronto: University of Toronto Press, 1953. Pp. xii, 380. $15.00.

The stated objective of this book is to examine the approach and substance of the case law in Canada and England on the meaning of income for tax purposes. The author, however, is not concerned merely with a correlation of the judicial decisions, a goal which he competently achieves, but rather with a larger effort to distill basic principles from the decided cases as a guide to the future development of Canadian law.

Any discussion of the meaning of taxable income must initially be related to the statutory language imposing the tax, and any analysis of what the courts have said and done must be viewed against the specific statutory background. The volume therefore opens with a review of the fundamental characteristics and definitions of the Canadian and English Acts, contrasting the charging scheme under the English Acts, which divides income into five main "schedules" or categories, with the more familiar pattern of the Canadian Acts which measures the tax by the total "income" or "taxable income." The author cautions the reader that in applying English decisions to Canadian tax controversies, care must be exercised to distinguish decisions based on legal principles of general application from those founded wholly or in part on the specific requirements of the English Acts. A similar admonition is appropriate to any use of English or Canadian decisions in resolving issues under the United States Internal Revenue Code. In accenting the differences between the Canadian and English income statutes, Professor LaBrie draws the logical line thin in characterizing the former as a tax on persons measured by income, and the latter as a tax on income. Certainly there are major distinctions in structure, reach, and methods of collection which amply justify the author's words of caution, but the difference between a tax measured by income and a tax on income is not one of them, or at least is not a particularly happy form of expressing the fundamental differences.

The second part of the book is devoted to Gross Income and is divided into three chapters paralleling the old definition of income as "the gain derived from capital, from labor, or from both combined":1 "Income from Property," "Income from Personal Services," and "Income from Business." It is here that the author develops his first cardinal principle in defining and limiting the meaning of income for tax purposes: "income includes only amounts arising from the pursuit of gain," or stated alternatively, "income does not include the realized value of a source of income."2 The primary thrust of this principle is to recognize and, at the same time, to circumscribe the area of tax-free capital gains under English and Canadian law. In the author's view the distinguishing feature between taxable and nontaxable gain is "the difference in the attitude with which each form of gain is acquired. In one case there has

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2. P. 21.
been set in motion, according to design, a plan calculated to bring about a gain, while in the other case the element of pursuit of gain is entirely lacking.”

Little is said in an effort to justify, theoretically, the freedom from taxation of realized capital gains which do not arise from the “pursuit of gain.” We are told that “[w]ith respect to total availability for expenditure or consumption, capital accretions and income do not normally rest equal.” If the author is speaking of “realized” capital accretions, the reason for the statement is not apparent. We are also advised that a gain not related to trade or business “may be regarded as of the nature of an unearned increment resulting from any rise in the money value of an asset”; but why unearned increment is not a particularly appropriate subject for taxation is not indicated. Finally, the argument is made that “in the absence of a very complete and, of necessity, complicated system of averaging, the imposition of income tax on capital accretions would result in unfairness in taxing in one year the gain which might have been acquired over a long period of years.” The last is of course an argument which the United States Internal Revenue Code and earlier Revenue Acts have attempted to meet by affording various degrees of special treatment to gains from capital assets, either modifying the applicable rates of taxation or limiting the extent of capital gain recognition, or both.

The point of reference in the chapter relating to “Income from Property” is to “distinguish income from capital, or, more broadly, to distinguish income from the source of income.” The line of distinction is largely drawn by the question whether the receipts represent compensation for the use of property, or, instead, compensation for the sale of property including the sale of a source of income. Difficulties have been encountered in Canada, as in the United States, in situations involving the “sale” of real property, patents or copyrights in consideration of future payments measured by production or use; in transactions involving “discounts” and “premiums” on the issue and redemption of securities; in cases of stock dividends, and distributions of corporate obligations. Apart from the academic interest one may have in learning how these problems were worked out in other jurisdictions, it may be some comfort to United States taxpayers to learn that by statute or judicial decisions, our brethren to the north have frequently adopted tax concepts which are less advantageous to the taxpayer than those that have been adopted in the United States in similar circumstances. For example, an amount received on a sale of property is taxed as ordinary income if it depends upon the use of, or production from, the property; certain loans to shareholders and distributions of earnings in liquidation of a corporation are taxed as dividends; and the “unrealized” appreciation in value of assets has been subjected to a corporate tax upon the distribution of such assets in kind to shareholders. There are of

4. Ibid.
5. Ibid.
6. Ibid.
7. P. 135.
course instances in which Canadian tax treatment is more favorable than our own, notably in the granting of a credit of 10 percent of all dividends paid to shareholders of Canadian corporations. The reasons which led to the recent enactment of this dividend credit provision in Canada have a familiar ring: to placate the complaints against double taxation and to encourage "a steady flow of venture capital."²⁸

Payments received for labor or services are rather plainly within the statutory expressions of taxable income in England and Canada. The analysis of "Income from Personal Services" is therefore not as much concerned with pure judicial doctrine as with underscoring the effects of specific statutory language on court decisions. Illustrative is the development traced in the decisions distinguishing tax-free gifts from taxable "gratuities" for services. But the contrast between income and capital is not wholly absent; the issue is raised in cases where payments have been received for negative covenants, for termination of employment contracts, and for property derived from labor. To one familiar with the history of similar problems under the Internal Revenue Code, it may be somewhat surprising to learn that tax-free capital gain treatment has been achieved in a limited group of cases involving negative covenants and employment contracts, and that, without particular statutory direction, gain from the sale of the fruits of labor have been taxed as income even in the case of the isolated sale of a literary work.

The wide range of activities which combine labor and capital in the pursuit of gain is embraced in the chapter designated "Income from Business." The freedom from taxation of capital gains in England developed under charging statutes which were directed to "annual profits or gains . . . arising . . . from any trade," and which gave rise to the broad doctrine restricting the concept of income to gains occurring "in trade." Having first established the principle that any gain on the sale of property was not taxable unless related to a trade or business, English courts applied this rule to determine the taxability of gains derived from sources and transactions other than the sale of property. Where gain arises solely through labor or the ownership of capital, the "trade or business" test has not usually been invoked, but in other cases the courts appear to have given primary consideration to the presence or absence of "trade or business." Professor LaBrie takes issue with the judicial emphasis which has thus been placed upon the "factual" question of trade or business and with the objective tests normally employed to resolve that question. He also enters his dissent from the adoption of the English concept in Canada where it is not justified by statutory language.

The author does not find fault with the results generally reached by English and Canadian courts where the taxpayer was admittedly engaged in trade or business and the alleged capital transaction was of an isolated, occasional, or unusual nature. In these cases the courts have often shown a willingness to enlarge the meaning of "trade or business," and to conclude that the gain
occurred in the trade or business. However, where the alleged capital transaction involved a taxpayer not otherwise engaged in trade or business, the courts have apparently applied the narrow concepts of trade or business and granted tax-free capital gains treatment, although the transaction may have been entered into for the very purpose of the profit which was realized. The true common denominator in all cases, we are told, is, or should be, the taxpayer's intention of "pursuit of gain" rather than any seemingly objective standard of what constitutes a gain occurring in "trade or business." Many of the evidentiary facts which would be used to establish "intention" are presently used by the courts to determine the existence of a "trade or business," but the author asserts that the subjective approach of "intention" is the more fundamental and logically consistent consideration.

The final section of the book is devoted to the problem of "Deductions" and the author's second cardinal principle governing the meaning of income: "income means net income, or 'incoming' less certain 'outgoing' or expenditure, to be determined according to commercial principles." In the United States the allowance of deductions in arriving at taxable income has been recognized as essentially a matter of legislative grace and available only upon express statutory direction. Except perhaps for the allowance for cost of goods sold or investment, the concept of deductions from receipts is not based on any consideration of constitutional law or judicial doctrine. However, the English and Canadian statutory provisions governing deductions for expenditures have been, at least until recently, largely negative in approach with emphasis on what may not be deducted rather than on what may be deducted. Accordingly, judicial decisions concerning expenditures to be deducted in arriving at "profit or gains" or "income" or "net income" were less expressly guided by statutory language than the decisions in the United States in the same field. It is for this reason that the author presents his principle relating to deductions for expenditures as inherent in any summary of the case law on the meaning of income for tax purposes.

Professor LaBrie maintains that the initial consideration in determining the deductibility of any expenditure is whether such expenditure is a proper charge in computing profits or gains according to commercial principles. If that question is answered affirmatively, the deduction should be allowed unless there is statutory language which is clearly less permissive than commercial principles. As may be expected, these two tests are not easily gleaned from the decisions. An extended and persuasive discussion develops LaBrie's thesis that a proper reading of the cases decided under the English Acts would, if correctly applied to cases arising under the Canadian Acts, supply the basic rule governing deductions, namely, to allow deductions for expenditures incurred in the pursuit of, or for the purpose of, earning income, other than capital expenditures and expenditures deemed "overly remote." His criticism of the judicial decisions interpreting Canadian Acts and applying English

cases is that they have improperly restricted deductions to those incurred in the immediate *process* of earning income, and from that false premise have not only erroneously expanded the meaning of capital expenditures (*e.g.*, to include expenditures to protect capital assets) but also have, without warrant, contracted well-recognized concepts of deductible expenditures (*e.g.*, expenditures made to reduce recurring expenses). But the author finds a recent trend in Canadian case law toward acceptance of the view that the negative statutory expressions in the Canadian Acts concerning deductions for expenditures should be narrowly applied, and that the judicial concept of expenditures related to the income earning process should conform as closely as possible to business principles.

This book offers the American reader a stimulating excursion into the tax law of Canada and England, not through any detailed account of the provisions of the income tax acts, but by way of a thorough exposition of the basic problems presented in the determination of the meaning of income in those countries. And on the way the American reader may well pause to consider the mixed blessings of tax-free capital gains, and to recognize that the adoption of a similar concept in this country would not eliminate taxation of all “capital gains” as we define them, but in all probability would subject a large portion of such gains to taxation as ordinary income. It is the very effort to distinguish correctly a non-taxable “capital accretion” from an item taxable as “income” which furnishes the primary force for the author’s principle that “income” covers only amounts arising or resulting from the pursuit of gain.

From the author’s account of the Canadian and English cases, and from our own experience with the tax laws and interpretations in this country, we must recognize that the judicial approach has been to determine the meaning of “income” on a case by case basis, with due regard for precedent, but without strict reliance on definitions. Essentially, income “is a fluid content, determined by the interplay in particular cases of common usage, accounting concepts, administrative goals, and finally, judicial reaction to these forces. Each force and the judicial reaction reflect an underlying judgment as to what types of receipts should be taxed under an ‘income tax,’ such judgment being in turn derived from the connotations drawn from a tax of this type.” The author's effort to evolve a restatement of the meaning of income was not intended to introduce any rigidity into the definition, but rather to supply a more logical and consistent guide for the courts than presently is said to exist. But in application, the new look will generate its own problems, and the question whether the new is less thorny than the old can only be answered by the judicial process.

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