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Apr. 16, 17

Aug. 21

BETWEEN:

McMAHON AND BURNS LIMITED .....APPELLANT;

AND

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

Revenue—Income Tax—Company incorporated to buy and sell securities—Debentures bought as investment sold soon after at profit—Capital gain or taxable income—The Income Tax Act, 1948, S. of C. 1948, c. 52, ss. 3, 4, 127(1)(e).

The appellant was incorporated under the Companies Act (B.C.) as a private company to carry on the business of underwriters and investment dealers in government, municipal and industrial securities and that of stock brokers. By its Memorandum of Association it was authorized to purchase either as principal or agent and absolutely as owner to sell the debentures of any public or private corporation. In September 1949 it joined a nation-wide group of investment dealers in disposing to the public at a profit a $17,000,000 issue of Interprovincial Pipe Line Co. convertible debentures due in 1970. At the same time it purchased on the open market, allegedly for its investment account and not for trading or trading account, $91,500 principal amount of the debentures. In 1950 in two separate transactions it sold part of the debentures so purchased at a profit of $54,776.25. The Minister of National Revenue included the amount in the appellant's taxable income for 1951 ruling that the two profitable transactions constituted a part of the appellant's ordinary business operations, or in the alternative constituted a concern in the nature of a trade. The appellant, contending that the transaction represented a capital gain and that the purchase had no relation to any class of profit-making operation but was intended solely as an investment of its idle funds, appealed to the Income Tax Appeal Board and its appeal having been dismissed, now appeals to this Court.

Held: That the appellant's Memorandum of Association provided for the particular species of business exercised by it in the purchase and sale of the debentures in question and the profit ensuing therefrom was

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correctly included as an item of taxable income. *Anderson Logging Co. v. The King* [1925] S.C.R. 45 at 56 affirmed by [1926] A.C. 140; *Gairdner Securities Ltd. v. Minister of National Revenue* [1952] Ex. C.R. 448, followed.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Vancouver.

Hon. J. W. de B. Farris, Q.C. and *D. L. Vaughan* for appellant.

W. M. Carlyle and *F. J. Cross* for respondent.

DUMOULIN J. now (August 21, 1956) delivered the following judgment:

This is an appeal by McMahon and Burns Limited, of Vancouver, B.C., an investment dealer and stock-broker firm, from a decision of the Income Tax Appeal Board, dated August 9, 1954 (1), dismissing appellant's appeal from a previous decision of the Minister of National Revenue regarding its income tax assessment for the taxation year ending on March 31, 1951.

In assessing the appellant, for that particular year, the Minister of National Revenue, respondent, included in the Company's reported income a sum of $54,776.25, being the total net profit realized through two resales of 4% convertible debentures, October 1, 1970, of the Interprovincial Pipe Line Co.

Incorporated on the 26th of September, 1939, as a private company, under the *Companies Act* of British Columbia, McMahon and Burns Limited carried on a successful trade as underwriters and investment dealers in government, municipal and industrial securities. It also could and did act as stock-broker on the usual commission basis. The firm is presently in the process of voluntary liquidation.

In September 1949, in order to partially implement the construction of its oil transmission system, The Interprovincial Pipe Line Co. called upon a nationwide group of investment dealers to dispose amongst the public of a $17,000,000 issue consisting in 4 per cent convertible debentures due October 1, 1970.

(1) 54 D.T.C. 370; 11 T.A.B.C. 140.

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Appellant joined this group of dealers, marketed an allotted share of this issue, subsequently selling it to its customers at a profit.

Apart from these initial and customary dealings, the appellant firm "in view of the soundness and long term earning potentials of the said debentures, and the common shares into which same were entitled to be converted (on the basis of two common shares for each $100 debenture), determined to purchase and acquire on the open market and hold for itself solely as an investment for its funds, up to $100,000 principal amount of said debentures" (Statement of Facts, para. 5).

The appropriate resolution (Ex. 3) was passed on September 19, 1949, to the effect "that the Company purchase for Investment Account, an amount not exceeding One Hundred Thousand Dollars ($100,000.00) Par Value, of Interprovincial Pipe Line Company, 4% Convertible Sinking Fund Debentures, Series 'A', dated October 1, 1949, to mature October 1, 1970, at the market".

Accordingly, from September 19, 1949, and until October 14 of the same year, McMahon and Burns Limited purchased on the open market, allegedly "for its investment account and not for trading or trading account, $91,500 principal amount of the said Debentures."

These purchases, dated October 31, 1949, and the ensuing sales, were entered in the ledger account (Ex. 9), under the caption of: "Investment Account".

On July 31, 1950, the Company, apprehending international complications in the Far East—the Korean war had started—sold $40,500 principal amount of these securities at a profit of $46,038.75.

Another sale of a $5,000-slice was made five months later, December 30, with a profit of $8,737.50, raising the total net gain welling out of these transactions, to the sum of $54,776.25.

The point at issue can be succinctly outlined.

By Notice of Assessment dated December 5, 1952, in respect of appellant's taxation year ending March 31, 1951, the Minister of National Revenue included the above mentioned amount of $54,776.25 in the firm's taxable income, assessing thereon the consequent tax. The respondent feels

justified in so doing because these two profitable transactions "constituted a part of the appellant's ordinary business operations, or in the alternative constituted a concern in the nature of trade". The respondent goes on to say that: "The said transactions were not sufficiently dissimilar to the ordinary dealings of the appellant in its business to warrant treatment different from its other trade transactions". (Reply to Notice of Appeal, para. 6).

Appellant, on the other hand, objects that the profit of $54,776.25 was not a business profit under s. 4 of the 1948 Income Tax Act or income from any of its businesses under s. 3; that it merely was the gathering in of the enhancement in value of a capital asset not subject to tax; and, finally, that the purchase of $91,500 of said debentures had no relation to any class of profit-making operation, nor was it intended as a profit-making scheme but solely as an investment of its idle funds.

Appellant relies upon the 1948 Income Tax Act, ss. 3 and 4; respondent upon the same sections and s. 127(1)(*e*), R.S.C. 11-12 Geo. VI, c. 52.

The testimonial evidence adduced on the company's behalf was practically a repetition of the position taken in its written pleadings.

Mr. John McMahon, president of the brokerage firm in 1949, after outlining the company's financial structure, stated that, during the period September 19 and October 14 of that year, it bought on the open market a block of 915 one hundred dollars Pipe Line bonds for its own "investment purposes".

He then went on to say that a margin of not less than ten per cent plus hypothecation of the particular specialties were required by the bank to guarantee the necessary moneys, i.e. $45,000, advanced to McMahon and Burns. To the extent of this loan, at least, it would appear that appellant was surely not investing any idle funds at the moment.

The Pipe Line debentures were bought for appellant by the company trader, Mr. George Duval Sherwood, conformably to instructions received from Mr. J. McMahon to keep these securities as an "investment".

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Mr. John Lyon Burns, the only other shareholder in the firm, corroborated his partner's evidence, regarding the motives which induced the company to enter upon this purchase of 915 debentures for a price of $91,500, earmarking such commodities to its particular account "as a very promising investment".

The last witness, a Vancouver chartered accountant, Mr. Donald William Smallbone, attended, at all material times, to the firm's accounting and auditing.

The Pipe Line debentures, says the accountant, were listed in a general ledger account sheet (Ex. 9), and pledged with the bank, from whom money had been borrowed "outside of and without any relation to the company's other dealings". I hasten to note that this statement is of slight consequence, since a bank may extend separate loans to the one customer for separate but nevertheless ordinary business and profit-seeking ventures.

This Court is once again requested to decide the time-honoured, yet oft-recurring dispute whether the transaction in issue represented the enhancement value of a capital investment or merely profit taking in line with regular trade operations.

Here, the decisive factor should not be the taxpayer's intention, however candid, but the paramount and transcendent interpretation of the pertinent law in this given set of facts.

Before reading the statute, it should be kept in mind that appellant, by Article 3(*a*) of the Memorandum of Association (Ex. 1), is authorized, *inter alia*: "to underwrite, subscribe for, purchase, or otherwise acquire and hold, either as '*principal*' or agent, and 'absolutely as *owner*' or by way of collateral security or otherwise, and to sell, exchange, transfer or otherwise dispose of, or deal in the bonds or debentures . . . or securities of any public or private corporation, government, or municipality, etc.".

It can hardly be denied that the acquisition and disposal of securities as "principal and absolute owner" constitutes one of the main and basic corporate powers conferred upon appellant.

This, I know, is not the sole standard, since the Supreme Court of Canada, in *Sutton Lumber & Trading Co. Ltd. v. Minister of National Revenue* (1), held:—

> That the question to be decided is not as to what business the company might have carried on under the memorandum, but rather what was in truth the business it did engage in.

Still it is of interest to ascertain that the business it effectively engaged in was not foreign to the memorandum.

In the same line of reasoning, Mr. Justice Cameron, in *Gairdner Securities Ltd. v. Minister of National Revenue* (2), in considering whether the transaction there in question constituted an investment, said:

> . . . its true nature is to be determined from the taxpayer's whole course of conduct, viewed in the light of all the circumstances. Now on the facts . . . it seems to me impossible to conclude that there was here any investment. . . . On the contrary, I think it was in fact *a speculation essentially of the same character . . . as it* [the appellant] *had previously engaged in* and one which it was specifically empowered to do . . . the appellant was empowered to acquire and hold, and to sell and exchange stocks in other securities as principal (as well as in the capacity of agent), as one of the essential features of its business and as one of the appointed means by which it could carry on business for profit. What was done was . . . exercise of the very powers for which the company was incorporated.

This decision met with the unanimous approval of the Supreme Court (3).

Reverting, in the former case, to the important factor that Gairdner Securities had previously engaged in a *"speculation of the same character"* as the moot one, it should be said that McMahon and Burns Limited, on the same day, viz. September 19, 1949, it began buying Interprovincial Pipe Line debentures for its "Investment Account", also purchased for resale to clients another $50,000 block of these identical securities (*vide*: Mr. John McMahon's evidence).

Buying for Jack or buying for Jill seem pretty well alike, and it would require a subtler mind to single out any real objective distinction in this case, so as to bestow upon each of these twin operations a different "family name". The disposal by appellant of its individual holdings after a lapse of nine and fourteen months is quite consistent with

(1) [1953] 2 S.C.R. 77; C.T.C. 237; 53 D.T.C. 1158.

(2) [1952] Ex. C.R. 448 at 457-58.

(3) [1954] C.T.C. 24.

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the able pursuit of a purely commercial and speculative venture. This may be the proper place for recalling, if necessary, the presumption in favour of the assessment's validity, and so far but slim grounds were afforded me in rebuttal thereof. Finally, it should also be remembered that in *Anderson Logging Co. v. The King* (1) affirmed by the Judicial Committee of the Privy Council (2), Mr. Justice Duff, as he then was, held that:—

> The sole *raison d'être* of a public company is to have a business and to carry it on. If the transaction in question belongs to a class of profit-making operations contemplated by the memorandum of association, *prima facie*, at all events, the profit derived from it is a profit derived from the business of the company.

Considered in its proper light, this decision is not necessarily at variance with the subsequent pronouncement, above cited, in *Sutton Lumber & Trading Co. Ltd. v. Minister of National Revenue.*

Appellant's distinguished counsel referred the Court with particular insistence to the case of *Minister of National Revenue v. British and American Motors Toronto Ltd.* (3).

Here, Mr. Justice Cameron, after an exhaustive sifting of every relevant aspect, material and legal, reached the conclusion that of two transactions, outwardly similar: a disposal of automobiles, the first, comprising a single car, was the disposition of a capital asset and non-assessable; the second, including nine vehicles, constituted a profit-making deal consonant with British and American Motors' regular trade.

I must quote at some length to insure a fair understanding of the reasons which impelled the learned judge to draw the dividing line in this case.

> When it (British and American Motors Ltd.) commenced business in 1944, it acquired the assets of a predecessor company, including one 1942 Chevrolet car. Until that car was sold in 1949 it was always treated as a capital asset and depreciation thereon was claimed and allowed in each year . . . (at p. 178).
>
> The second item of $7,220.81 relates to nine new Chevrolet cars acquired by the respondent in 1948 and assigned to the use of company personnel in that year. In its income tax return for 1948, the respondent showed them as capital assets under the heading "Service cars and trucks", claimed depreciation thereon at the rate of 25 per cent of costs, and that claim was allowed in the assessment. All nine cars were sold in 1949 but no depreciation thereon was claimed for that year . . . (at p. 179).

(1) [1925] S.C.R. 45, 56. (2) [1926] A.C. 140.

(3) [1953] C.T.C. 177; 53 D.T.C. 1113.

The two items in dispute must receive separate consideration. The first item has already been mentioned. That vehicle—a used Chevrolet car—was purchased and paid for in 1944. Thereafter, until sold, it was used in the service of the company by one of the employees engaged in soliciting sales of parts to independent garages throughout Toronto. Throughout it was treated as a capital asset in the category of "Service cars and trucks", and depreciation was claimed and allowed annually. It was acquired for the purpose of being used as a service car and was used for that purpose and no other. When it was practically worn out it was sold to a firm of wreckers and the proceeds were credited to the inventory of used cars. Under these circumstances, it is conceded that normally it would be properly treated as a capital asset . . . (at page 180, 4th paragraph).

It is my opinion (continues Honourable Justice Cameron), that where it is clearly established that a motor vehicle has been bought for use as a capital asset in the necessary service of the taxpayer, has been used in the same manner and to the same extent as a capital asset would normally be used, and has always been treated and recognized as a capital asset, the profit which may arise upon its disposition is a capital profit. I am satisfied upon the evidence that the 1942 Chevrolet car sold by the respondent in 1949 falls within that category . . . (at page 181).

I turn now to the second item, the profit of $7,220.81 made upon the sale of the nine Chevrolet cars. The respondent employed a large staff and for some time there had been a practice of furnishing certain of its key personnel with cars owned by the company . . . All were sold between January 8 and April 9, 1949, and the employees were given new cars to replace the cars sold. On an average the nine cars in question were used by the key personnel for about six months before being sold. The item itself refers to these cars as "Inventory demonstrators". In view of the evidence, I think that term is incorrect for they were not used as demonstrators in the ordinary sense except possibly on very rare occasions. It is established that in 1948 and 1949 the demand for automobiles was much greater than the supply; salesmen were instructed not to "push" sales of cars and demonstrators were not needed. . . . There is abundant evidence to establish that these vehicles in the main were not used exclusively as service cars . . . (at page 182).

The conclusion reads:

It follows, therefore, that the profit realized on the sale of the nine cars was an inventory profit . . . (at page 186).

I need only add that, moreover, as a matter of fact, similitude is hardly tenable between automobiles and debentures, between the two completely different trades implied.

In view of the evidence adduced, oral and written, the relevant law offers no difficulty of interpretation.

Section 127(1)(*e*) and ss. 3 and 4 of chapter 52, R.S.C. 1948, are, respectively, as follows:—

S. 127(1)(e). In this Act . . . "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade. . . .

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S. 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses;

(*b*) property, and

(*c*) offices and employments.

S. 4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

It was previously seen that the appellant's Memorandum of Association provides for the particular species of business exercised in the purchase and sale of Pipe Line debentures, and that a profit ensued from the exercising of such business.

The Company may have entertained the mistaken notion that the transaction at bar was a realization of a capital asset, but under the circumstances, notwithstanding appellant's so ably propounded arguments to the contrary, I cannot divorce the intention from the error.

The appellant has failed to show error in the assessment appealed from. Profit from its transactions in the Interprovincial Pipe Line debentures, in respect of its taxation year ending March 31, 1951, amounting to $54,776.25, was correctly included as an item of taxable income. Therefore, the appeal must be dismissed with costs against appellant.

Judgment accordingly.