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BETWEEN:

RICHARD C. W. ROLKA, ...APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE, ... } RESPONDENT.

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 16(1), 17(2) 126A and 139(5)(a)—Sale of lots to a company for inadequate consideration—Whether vendor and company dealing at arm's length—Fair market value of lots—Indirect payments—Evidence—Solicitor-client privilege—Appeal allowed in part.

Appellant was in the general contracting business and was president and general manager of Rolmac Construction Co. Ltd. of which company he owned all the shares. He also controlled Nelmar Realty Ltd. in which three shares with a par value of one dollar each were issued, all held by persons not related to but well acquainted with the appellant. Appellant sold to Nelmar certain building lots for $29,500 which lots were resold by Nelmar shortly afterward to Cochren Construction Co. Ltd. for $50,000 the deed being made by appellant directly to Cochren on instructions by Nelmar. The profit of $20,500 resulting from this transaction was brought into the income of appellant by the Minister by virtue of s. 17(2) of the Act and from that assessment the appellant appeals to this Court.

The respondent contends that the sale of the lots by appellant to Nelmar was one for inadequate consideration by appellant to a person with whom he was not dealing at arm's length and that the fair market value of the lots claimed to be $50,000 is deemed to have been received

by the appellant. Respondent also contends that if appellant was dealing at arm's length with Nelmar the profit made by Nelmar on the sale of the lots to Cochren was a transfer of money made pursuant to the direction of the appellant for the benefit of Nelmar which by virtue of s. 16(1) of the Act should be included in appellant's income.

The Court found that the appellant arranged the incorporation of Nelmar although he never became a shareholder and that the only shareholders and directors of Nelmar were three friends of appellant, each of whom had given appellant an irrevocable option to purchase his shares; that Nelmar had no office of its own but occupied the same office as appellant's company without paying rent and appellant's private secretary kept Nelmar's books without charge to Nelmar; that the sale of the lots by Nelmar to Cochren was negotiated and settled with the appellant alone and that in any transactions which Nelmar entered into the appellant appeared to act on behalf of Nelmar and that only after the terms of the sale of the lots had been settled between the appellant and Cochren did the latter learn that the sale would be made through Nelmar; that in numerous ways Nelmar looked to the appellant for direction. The introduction of some of this evidence was challenged by appellant on the ground that a solicitor-client privilege existed in respect of certain documents obtained by the Department of National Revenue from appellant's solicitor.

Held: That Nelmar was in fact indirectly controlled by appellant throughout this transaction and he was not dealing at arm's length with Nelmar and s. 17(2) of the Act applies, the fair market value of the property sold by appellant to Nelmar must be included in computing appellant's income which fair market value was less than that claimed by respondent and the assessment must be adjusted accordingly.

2. That the objection to the introduction of certain evidence that documents were the subject of a solicitor-client privilege fails since once a privileged document or secondary evidence of it has been obtained by the opposite party independently even though it be by default of the legal adviser and even by illegal means, the document is admissible in evidence as the Court does not inquire into the manner in which the document came into the hands of parties. The fact is that the originals did come into the hands of the Minister's representative by the voluntary act of the solicitor for appellant and such privilege as may have previously existed in regard thereto was lost.

APPEAL under the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Cameron at Toronto and Hamilton.

E. D. Hickey and *D. M. Mann* for appellant.

W. D. Parker, Q.C. and *J. D. C. Boland* for respondent.

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

1962

ROLKA
v.
MINISTER OF
NATIONAL
REVENUE

CAMERON J. now (December 11, 1962) delivered the following judgment:

This is an appeal from a re-assessment to income tax made upon the appellant for the year 1953 and dated June 2, 1958. In his tax return for that year the respondent showed a taxable income of $12,472 and a tax payable of $3,412.20, and presumably the original assessment (which is not before me) was made on that basis. In the re-assessment, the Minister added to the declared taxable income of the appellant the sum of $52,500, made up as follows:

Item A.	Sale to Murray	$ 600	
Item B.	Sale to O'Hanian	1,400	
Item C.	Sale to Robinson	4,146	
Item D.	Sale to Nelmar Realty Limited	25,854	
Item E.	Sale to Cochren Construction Co. Limited	20,500	
			$ 52,500

The Minister computed the revised taxable income at $64,972 and after allowing for payment on account of $3,412.20, levied tax in the sum of $28,681.90, and interest of $6,954.90—a total of $35,636.80. To that re-assessment, the respondent filed a Notice of Objection dated July 25, 1958. No reply was filed by the Minister under s. 58(3) of the *Income Tax Act*. Accordingly, the appellant filed and served a Notice of Appeal to this Court under s. 60(2) on September 11, 1959; the Minister filed his Reply to the Notice of Appeal on August 18, 1960.

In the Notice of Appeal it was admitted that the amounts of $1,400.00 and $4,146.00 relating to the sales to O'Hanian and Robinson (Items B and C) constituted taxable income of the appellant for 1953 and consequently they need not be further mentioned.

There is now no issue as to Item A. At the trial it was agreed that the amount thereof should be reduced from $600.00 to $365.30, representing the net interest received by the appellant in 1953 in respect of the Murray transaction.

As to Item D, "Sale to Nelmar Realty Limited", counsel agreed that while the total profit of the sales to Nelmar Realty Limited aggregated $25,854 as stated in the re-assessment, there were, in fact, two sales, one made in

1953 and the other in 1954, and that the total net profit therefrom should be apportioned as computed by the appellant in para. 6 of the Notice of Appeal, namely, $12,464.53 for 1953, and $13,035.47 for 1954. In the result, therefore, only Item E remains for consideration.

The appellant resides at Burlington, Ontario, and is president and general manager of Rolmac Construction Co. Ltd. (which I will hereafter refer to as Rolmac) in which he owns all the shares except the qualifying shares, and which company carries on a general contracting business such as building schools, institutions and housing projects for industry on a contractual basis. He became construction superintendent with Hamilton Construction Company in Hamilton in 1948. Then he acquired an interest in and became general manager and secretary-treasurer of Elliott Construction Co. Ltd., building houses and stores for sale in the Hamilton area. Rolmac was incorporated in 1948 and was engaged in highway and other heavy construction work, and Elliott owned one-half of its shares and operated it, the appellant being its general manager. In 1950, it was decided to separate Elliott Construction Co. Ltd. from Rolmac and accordingly the appellant sold all his shares in the former and acquired all the shares in Rolmac.

Item E. (*supra*), referred to as the sale to Cochren Construction Co., relates to lots in Chamberlain Park Survey in the City of Hamilton. By instrument dated December 22, 1950, Rolmac gave an exclusive option to the appellant to purchase some 113 lots in Chamberlain Park Survey for $4,000, such option to be irrevocable up to December 31, 1952 (Exhibit 1). In the settlement with Elliott Construction Co. Ltd. Rolmac had taken over all but two of these lots at the agreed figure of $1,800. On December 20, 1952, the appellant notified Rolmac that he would exercise the option (Exhibit 3) and by deed dated December 23, 1952 (Exhibit 4), Rolmac conveyed the property to him. On April 1, 1953, the appellant accepted an offer to purchase 10 of the said lots from J. E. Robinson for $4,500. (Exhibit 5) and by deed dated April 6, 1953 (Exhibit 6), the appellant conveyed those lots to Robinson. The profit of $4,146 of that sale (Item C) is now admitted to be taxable income of the appellant.

1962

ROLKA
v.
MINISTER OF
NATIONAL
REVENUE

Cameron J.

On April 2, 1953, Nelmar Realty Ltd. (hereinafter to be called Nelmar) offered to purchase the remaining lots of the appellant in the Chamberlain Park Survey (Exhibit 7) for $29,500, of which $2,000 was paid as a deposit, the offer being accepted by the appellant on the same date. In implementation of that offer and acceptance, a formal agreement of sale dated October 1, 1953 (Exhibit 9) was entered into between the appellant as vendor and Nelmar as purchaser. Thereby, the balance of $27,500 with interest at 5 per cent., was to be due and payable on October 1, 1955. The agreement further provided:

> It is understood and agreed that the purchaser may obtain deeds from time to time covering any part of the property hereby sold upon payment to the vendor of $15 per foot frontage, and any payment so made will apply in reduction of the purchase price, or the purchaser may pay on the basis of $500 per building lot whichever is the lesser.

The profit on that sale totalled $25,854 (Item D *supra*), but as I have said, the parties have agreed that only $12,464.53 thereof is income of the appellant in 1953, the balance being income for 1954. Up to this point, the above facts are not in dispute.

I turn now to the evidence relating particularly to the main dispute, namely, to Item E which in the memorandum attached to the reassessments is as follows:

> Sale to Cochren Construction Co. Limited—tax assessed to R. C. W Rolka under s. 16(1) of the *Income Tax Act* as being a transfer of money, rights or things to Nelmar Realty Limited made pursuant to the direction of, and with the concurrence of R. C. W. Rolka.
>
> | | |
> |---|---|
> | Selling price | $ 50,000 |
> | Less cost | 29,500 |
> | | $ 20,500 |

The appellant did not, in fact, convey any of the lands mentioned in the agreement of sale with Nelmar (Exhibit 9) to Nelmar. Exhibit 10 is a letter dated October 15, 1953, from Nelmar to the appellant and is as follows:

> *Re—Sale of Lots Chamberlain Park Survey*
>
> This is to advise you that Nelmar Realty Limited has sold certain of the lots on East Thirty-second Street to Cochren Construction Co. Limited.
>
> The lots sold by Nelmar Realty Limited to Cochren Construction Co. Limited are as follows:
>
> The northerly 13 feet of Lot 168, all of lots 169 to 185 inclusive, all of lots 229 to 256 inclusive, and the westerly one-half of lot 257, all in Chamberlain Park Survey registered Plan 561.

Nelmar Realty Limited hereby requests and directs you to convey the said lots by deed to Cochren Construction Co. Limited, the said deed being dated 8th October, 1953.

Nelmar Realty Limited hereby advises that under the terms of the Agreement for Sale between Richard C. W. Rolka and Nelmar Realty Limited dated 1st October, 1953, Nelmar Realty Limited will pay for the said lots at the rate of $500 per building lot, making a total payment of $12,500.

Nelmar Realty Limited hereby authorizes its solicitors herein, Messrs. Martin & Martin, to deduct from the purchase price paid by Cochren Construction Co. Limited the sum of $12,500, and to send the same to Mr. Richard C. W. Rolka to be applied in reduction of the balance due under the said Agreement for Sale dated 1st October, 1953.

Pursuant to that notice, the appellant says he conveyed the lots mentioned therein directly to Cochren Construction Co. Limited by deed dated October 8, 1953 (Exhibit 11). Subsequently, and again upon the instructions of Nelmar, he executed two further conveyances direct to Cochren Construction Co. Limited: (*a*) Exhibit 12, dated April 8, 1954; and (*b*) Exhibit 13, bearing the same date. The affidavits taken under the *Land Transfer Tax Act* by H. A. Martin, solicitor, indicate that the sale prices in the three conveyances were respectively $17,500, $16,250 and $16,250—a total of $50,000. The lands so conveyed comprised all the lands which the appellant agreed to sell to Nelmar by the agreement of sale, Exhibit 9, for $29,500.

The appellant says that at the time of that agreement he received a deposit of $2,000, that in 1953 on completion of the first deed to the Cochren Construction Co. Limited, he received $12,500; and that in 1954 on completing the two deeds to Cochren Construction Co. Limited, he received the balance of his sale price, namely, $15,000.

His main submission is that he had no contract or agreement with Cochren Construction Co. Limited or any dealings in connection with that company except to execute the three deeds to it at the direction of Nelmar; and that consequently he received no profits in respect of the Chamberlain Park Survey lots save that made on the sales to Robinson and to Nelmar.

The Minister, however, in re-assessing the appellant, took a different view of the matter. Nelmar made a profit of $20,500 on the transaction, being the difference between the sale price to Cochren Construction Co. Limited of $50,000 and the amount it had agreed to pay the appellant, namely,

1962

ROLKA
v.
MINISTER OF
NATIONAL
REVENUE

Cameron J.

$29,500. In the reassessment, that profit was added to the appellant's taxable income, the Minister purporting to act under s. 16(1) of the *Income Tax Act*, which then read:

16. (1) A payment or transfer of money, rights or things made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person shall be included in computing the taxpayer's income to the extent that it would be if the payment or transfer had been made to him.

In the Minister's Reply to the Notice of Appeal, the following clauses appear:

5. The sale of the said balance of the lots to Nelmar Realty Limited was a sale by the Appellant to a person with whom he was not dealing at arm's length.

6. The fair market value of the said balance of the lots at the time of the sale to Nelmar Realty Limited was not less than $50,000.

And in "The Statutory Provisions and Reasons upon which the respondent intends to reply":

8. The Respondent says that at all times material to this appeal the Appellant and Nelmar Realty Limited were persons not dealing at arm's length with each other.

9. The Respondent says that the onus is on the Appellant to establish that the fair market value of the balance of the lots sold by him to Nelmar Realty Limited was less than $50,000.

10. The Respondent says that since the Appellant has sold the lots to a person with whom he was not dealing at arm's length at a price less than the fair market value, the fair market value of the said lots for the purpose of computing the Appellant's income is deemed by virtue of s.s. (2) of sec. 17 to have been received or to be receivable therefor.

11. The respondent says that in computing the Appellant's profit from the sale of the said lots to Nelmar Realty, the $50,000 at which the Appellant is deemed to have sold the said lots to Nelmar Realty, is to be included by virtue of para. (b) of s.s. (1) of Sec. 85B, notwithstanding that part of the purchase price was not receivable until a subsequent year.

12. Alternatively, the purchase price for which the lots were in fact transferred is to be included by virtue of para. (b) of s.s. (1) of Sec. 85B, notwithstanding that part of the purchase price was not receivable until a subsequent year.

13. Alternatively, if the Respondent was dealing at arm's length with Nelmar Realty Limited, the Respondent says the payments of money made by Cochren Construction Co. Ltd. to Nelmar Realty Limited on the sale of the said lots were made pursuant to the direction of or with the concurrence of the Appellant to Nelmar Realty Limited for the benefit of the Appellant or as a benefit that the Appellant desired to have conferred on Nelmar Realty Limited and are to be included in the Appellant's income.

14. The Respondent relies on Sec. 3, 4, s.s. (1) s. 16, s.s. (2), s. 17, para. (*b*) of s.s. (1) of s. 85B and para. (*e*) of s.s. (1) of s. 139.

In his argument, counsel for the Minister agreed with the appellant's counsel that on the facts disclosed no case had been made out which would bring the case within s. 85B of the Act, and accordingly paras. 11 and 12 of the Reply to the Notice of Appeal need not be considered. He also agreed that if the profit of $20,500 made by Nelmar on the sale to Cochren should be found to be taxable income of the appellant, that profit should be taxable as to part in the taxation year 1953 and the balance in 1954.

For the appellant it is submitted that the profit of $20,500 made by Nelmar on the sale to Cochren Construction Co. Ltd. is properly taxable in the hands of Nelmar and is not taxable to the appellant either as a payment or transfer under s. 16(1) or as a non-arm's length transaction under s. 17(2). The evidence suggested that Nelmar had included that amount as taxable income in its returns and counsel for the appellant therefore submits that if it were again taxed to the appellant, there would be double taxation of the same profit. The matter is not too clear, but I understand from the argument that while Nelmar may have included that amount in its returns, such returns showed an annual loss and consequently Nelmar was not taxed in regard thereto.

For the Minister it is submitted first that the sale of the lots in Chamberlain Park Survey to Nelmar was not an arm's length transaction; that the fair market value of the lots at the time of the sale was $50,000; and that the onus is on the appellant to establish that the fair market value was less than that amount. He relies on the following sections of the Act:

> 17. (2) Where a taxpayer carrying on business in Canada has sold anything to a person with whom he was not dealing at arm's length at a price less than the fair market value, the fair market value thereof shall, for the purpose of computing the taxpayer's income from the business, be deemed to have been received or to be receivable therefor.
>
> 139. (5) For the purposes of this Act,
>
> (a) a corporation and a person or one of several persons by whom it is directly or indirectly controlled, . . .
>
> shall, without extending the meaning of the expression "to deal with each other at arm's length", be deemed not to deal with each other at arm's length.

The question as to whether or not persons and/or corporations are dealing at arm's length is a question of fact to be determined by a consideration of all the relevant facts and

1962

ROLKA
v.
MINISTER OF
NATIONAL
REVENUE

Cameron J.

circumstances and the statutory provisions. In this case, the evidence is clear that the appellant was never the registered owner of any shares in Nelmar and it cannot therefore be said that he controlled that company directly by holding a majority of its shares.

Nelmar was incorporated as a private company under the *Companies Act* of the province of Ontario on September 23, 1952. Exhibit 5 is the minute book containing a copy of the charter, the bylaws, the minutes of the directors and shareholders, the record of the shareholders and the transfer of shares. Its purposes and objects included (a) the buying, holding, selling and dealing in real and personal property; and (b) the erecting, maintaining and managing of buildings and generally carrying on the business of a real estate and improvement company and the sale and development of land. The authorized capital consisted of 40,000 shares without nominal or par value. The original incorporators and provisional directors were Mr. W. M. Martin (the firm's solicitor and also the appellant's personal solicitor, and solicitor for Rolmac) and two of his office employees, each of whom subscribed one dollar for one share. The three dollars so subscribed was the only capital put into the business at any time. As shown by the minutes of the meeting of the provisional directors held on October 8, 1962, the provisional directors resigned and transferred their shares to Harry M. Coutts (a salesman employed by Building Products Limited), John Dreim (a barber) and H. P. Wright (an accountant, who was also an accountant for the appellant and for Rolmac), all of Hamilton and all friends of the appellant. Mr. Coutts was appointed president and Mr. Dreim secretary-treasurer, but later, at some unspecified date, Mr. Wright was appointed secretary-treasurer.

Nelmar had no separate office of its own. It occupied the office of Rolmac without payment of rent, and Rolmac also supplied free of charge the use of its furniture and telephone; and Mr. Rolka's private secretary kept the books under the direction of Mr. Wright without any additional compensation. There is no evidence that Nelmar ever had any staff or employees.

It is abundantly clear that in all its transactions, Nelmar was closely connected with either the appellant or his company, Rolmac. Such construction as was done on its property was carried out by Rolmac. There were three main real

estate transactions in which it was involved, the first one having been already referred to, namely, the purchase and disposition of the lots in Chamberlain Park Survey, acquired from the appellant and previously owned by Rolmac, the profit from that transaction being the issue in this appeal.

Ancaster Development Co. Ltd. in 1952 owned property in or near Hamilton, and the appellant and one J. H. Young (now deceased) each held 45 per cent. of its shares. In that year, the appellant had an option to purchase about 24 lots from Ancaster at $500 each. In the same year he gave up the option and with his approval, Ancaster at once agreed to sell those lots to Young for $500 each, but subject to an agreement between Young and the appellant that Young could not sell them to anyone but Nelmar without the appellant's consent. Young acquired the lots in three parcels and almost immediately thereafter sold them to Nelmar at $1,200 per lot and Nelmar in turn sold them to the appellant's company Rolmac at $1,500 per lot. On these purchases and sales Young made a profit of $16,800. On completion of the sales, Young made gifts to the appellant of $5,000 by cheque and bonds of a value of about $5,200. The appellant first said that he did not know if the gifts had anything to do with the above transactions but later suggested that they may have been in appreciation of business which the appellant had directed to Young in previous years.

The facts of that devious transaction, in which the appellant could have acquired lots for building purposes for his own company, Rolmac, at $500 each, but for which Rolmac paid $1,500 to Nelmar, all within a very short time, clearly indicate in the absence of any satisfactory explanation that the appellant controlled the entire matter; that he arranged that the property would pass through the hands of Nelmar which would make a small profit, and that Rolmac would be subject to lower taxation since the cost to it of the lots would be $1,500 each, instead of $500. I am satisfied, also, that it was arranged so as to avoid a direct sale of the lots by the appellant to Rolmac (which would have been a non-arm's length transaction) and as a scheme by which the profits made by Young would be shared with the appellant.

The other main transaction by Nelmar was the acquisition of "Edgecliff", a country estate of about five acres situated on Lake Ontario near Burlington. On August 6, 1952, the

1962

ROLKA
v.
MINISTER OF
NATIONAL
REVENUE

Cameron J.

appellant purchased it from one Maynard (Exhibit 14), paying $70,000 for the land and buildings and $6,500 for furniture. He made a down-payment of $35,000 (part of which he borrowed from Rolmac) and gave back a first mortgage for $41,600. He has resided on the property since that date.

On December 1, 1952, Nelmar offered to purchase the lands and buildings comprising "Edgecliff" for $78,000, paying $500 as a deposit, assuming the Maynard mortgage for $41,600, and the balance by giving its demand note for $35,900, with interest at 5 per cent. to the appellant (Exhibit 15); on December 5, 1952, the appellant accepted that offer which included the following clause: "The sale is conditional upon Mr. Rolka entering into a lease agreement, whereby the aforesaid R. C. W. Rolka agrees to lease the property for a period of two years for the amount of $1,200 annually. We have agreed to give Mr. Rolka an option to extend the lease period for a further two years."

By deed dated December 29, 1952, the appellant conveyed the property to Nelmar (Exhibit 16) on the terms above stated. Exhibit 17 is a lease of "Edgecliff" from Nelmar to the appellant dated December 29, 1952, for a period of two years from January 1, 1953, at $1,200 per annum (Nelmar paying taxes) with an option for a renewal for a further period of two years at the same rental. Exhibit 18 is a further lease of "Edgecliff" to the appellant dated August 20, 1957, for a period of five years from September 1, 1957, at an annual rental of $2,400, Nelmar again paying taxes and covenanting to keep all buildings in a reasonable state of repair, damage by fire, lightning and tempest excepted. While there is no clear evidence as to a further extension of that lease, it may be noted that in the unsigned minutes of a meeting of the directors held on April 27, 1960, reference is made to the "present ten-year lease between the company and Mr. R. C. W. Rolka". It is shown that for each of the first four years of the lease Nelmar incurred liabilities in respect of "Edgecliff" for interest, taxes, insurance, repairs, maintenance and gardening, in an amount which exceeded the annual rental by over $4,000; and in subsequent years the average expenses exceeded $5,000 per annum, while the rental was $2,400.

During his tenancy, Nelmar for the use of the appellant, but at its own expense, constructed a three-car garage on the property at a cost of about $2,600. In 1958 or 1959, Nelmar needed funds and a second mortgage was placed on the property which the appellant guaranteed at the request of the mortgagee. The purchase note taken back from Nelmar by the appellant was at once assigned to Rolmac, but little or no interest was ever paid thereon and in 1960 it was cancelled and Nelmar gave a third mortgage to Rolmac for the amount then owing.

Since 1956 at least, Nelmar has been inactive and its only asset has been "Edgecliff" now subject to three mortgages, and, with its substantial annual operating losses, it is likely to be in bankruptcy soon, as Mr. Wright stated.

I think it is clear that prior to the time when the appellant purchased "Edgecliff", he planned the incorporation of a realty company to which it and other properties would be transferred, that he selected three of his friends to be the shareholders, that he would not himself be the registered owner of any shares, but that he would secure from the shareholders irrevocable options giving him the right to acquire their share holdings. Wright did not know either of the other shareholders until he met them in the solicitor's office, presumably at the time the shares were transferred to them by the original incorporators. He stated also that before the appellant purchased "Edgecliff", the latter came to him and discussed the formation of a new realty company and the incorporation of Nelmar. In part, Wright said:

> Mr. Rolka came and during one of his visits said: "How would I like to be interested in a realty company which would acquire Edgecliff?"

And in explanation of Nelmar's purchase of "Edgecliff", Wright said:

> Yes I have nothing to lose. Mr. Rolka indicated he thought, in considering that on a long range, he assured me in the long range view there would be profit in this property and also assured me further real estate deals might be introduced into the company, and in fact, all these minutes—it didn't appear there was going to be any loss because all I could lose was one dollar.

Exhibit E is an undated memorandum in Wright's handwriting. It records information given to him by the appellant as to the proposed incorporation of a realty company, the name then suggested being Nelson Realty Ltd., later changed to Nelmar Realty Ltd. It refers to the acquisition

1962

ROLKA
v.
MINISTER OF NATIONAL REVENUE

Cameron J.

of "Edgecliff" from Maynard by either the appellant or Rolmac at a total cost of $76,500 and the formation of Nelson Realty Company, in which three persons (including Wright and Mrs. Rolka) would each hold one-third of the shares and that "each executes irrevocable option in favour of Dick Rolka" (the appellant); and also to the proposal that the new company would purchase the Chamberlain Park lots from Rolka and the Ancaster lots from Young at $1,200 per lot after Young had purchased them from Ancaster at $500 per lot. All the matters so referred to were in fact carried out, though in part on terms somewhat different from the proposals then made; and Nelmar did acquire "Edgecliff", the Ancaster lots, and the lots in Chamberlain Park Survey. Moreover Wright, by letter dated January 12, 1954 (Exhibit F) returned to Rolka the option agreement in connection with his share in Nelmar. The appellant could not recall having received that letter or the option, but would not deny that he had received them.

In reference to the options, which the appellant urged were not options but agreements to give options, he said that in late 1953 he had a verbal understanding with all three shareholders that he would be given the first opportunity to buy their shares in Nelmar if they wanted to sell out and without any time limit; that he reduced it to writing in the form of a memorandum which each signed; that he remembers specifically only that of Dreim which he had destroyed in the winter of 1953-54 after advising the shareholders that it was of no value to him. He said that no such options were now outstanding and added that they contained no sale price which would be a matter of discussion later.

I should also state here that on many points I found the appellant's evidence to be very unsatisfactory and evasive. On a number of matters that should have been definitely within his knowledge, he was vague and uncertain and frequently said that he could not remember or that he could not recall definitely. Specifically, he said that he first knew of Nelmar when he sold "Edgecliff" to it at the end of 1952. I am satisfied that that statement was wholly untrue and that he planned its incorporation, selected the shareholders and knew of its incorporation from the beginning. Moreover, in view of the information contained in Exhibit F, it is clear that the appellant planned before the incorporation

of Nelmar to secure irrevocable options to purchase the shares. I cannot accept his explanation at the trial that he secured the options because Nelmar at the time owed Rolmac a large amount of money which he had previously guaranteed to the bank, and "naturally I wanted to protect myself as much as possible from Nelmar by any chance of their selling it to anyone who may not sign the note".

There are also a number of other documents in evidence which seem to suggest that Nelmar looked to the appellant for direction. Exhibit A is a letter from Wright to him dated June 12, 1953, under the heading "Nelmar Realty Limited", and enclosing the tax assessment for 1953 (on "Edgecliff") with a request to check the assessments "and if in order pass it over to your accountant for payment". It will be recalled that under the terms of the lease Nelmar was responsible for the taxes. Exhibit B is a letter from Wright to Rolka dated January 5, 1954, enclosing an account from National House Builders, billed to Nelmar and stating: "Will you kindly indicate if you authorized this, and if so, please instruct us to have payment made".

Exhibit C is a letter dated July 12, 1955 from Mr. Wright's son, an employee of his father's firm of accountants, to the appellant as follows:

Re: Nelmar Realty Limited. We enclose herewith Department of National Revenue T-5 return for the 1954 taxation year in duplicate. One copy of this return, marked "This Copy for Federal Income Tax" should be signed by Mr. Coutts and forwarded immediately to the Director of Income Tax, Hamilton. The second copy, marked "Retain this Copy for your Files" may be retained in the Company's files for future reference.

We further enclose "Request to File a Return", form TX 11 dated July 7, 1955 which we suggest be filed with your copy of the T-5. This return has been completed at the request of the taxation authorities and we suggest the return be filed as requested.

No satisfactory explanation is given as to why this matter was sent to the appellant instead of to the office of Nelmar.

The part played by the appellant in the sale of lots in the Chamberlain Park Survey to Cochren Construction Co. Ltd. indicates clearly the relationship of the appellant to Nelmar. I accept without reservation the evidence of Thomas Cochren, the owner of the Cochren Construction Co. Ltd., as to the manner in which he made that purchase. He said that in October, 1953, after one or more telephone conversations with the appellant, he went to the latter's office, that all the terms of the sale were negotiated and

1962

ROLKA
v.
MINISTER OF NATIONAL REVENUE

Cameron J.

settled with the appellant alone, and that immediately thereafter the appellant took him to Mr. Martin's office, gave the latter instructions as to the agreed terms of the sale, and that he (Cochren) knew nothing of Nelmar until he heard the appellant instruct Martin that the sale would be made through Nelmar. There is no evidence which suggests that in the meantime the appellant had contacted any of the directors of Nelmar or secured their approval. It is significant to note that Nelmar's letter dated October 15, 1953, to the appellant (Exhibit 10) purporting to notify him of the sale by Nelmar to Cochren and directing him to convey the lots direct to that company, is dated one week after the date of the deed (Exhibit 11) and later than the date of the affidavit as to its execution by Rolka. I reject as untrue the evidence of the appellant that he did not negotiate the terms of sale with Cochren or settle the price, and that after introducing Cochren to Martin, he did nothing further in the matter until he received the letter (Exhibit 10) directing him to convey the lots to the purchaser. I accept, also, Mr. Cochren's evidence that the sale of the balance of the lots in April, 1954 was negotiated and settled in the same way with the appellant alone.

At the trial, counsel for the Minister tendered certain other documentary evidence, the admissibility of which was challenged by counsel for the appellant, alleging a solicitor-client privilege, and I must now determine that question. On September 12, 1956, Mr. R. D. Atkinson, an investigator employed by the Income Tax Division, with an associate and with the authorization of the Minister as provided in s. 126(1) of the Act, went to the office of Mr. Martin and showed him his authority. After some discussion as to whether the documents in Mr. Martin's possession were privileged, Mr. Martin handed to Mr. Atkinson a number of documents, including the originals of Exhibits I and J, but retained two other documents (the originals of Exhibits G and H) which were placed in an envelope and sealed. Section 126A of the Act relating to the procedure to be followed when a solicitor-client privilege is claimed was then in effect, but that procedure was not followed by the solicitor, although it was brought to his attention by Atkinson. On November 5, 1956, when Mr. Atkinson returned to Mr. Martin's office, the envelope was opened and the originals

of Exhibits G and H were delivered voluntarily to Mr. Atkinson and his associate. Subsequently, Mr. Atkinson had photostatic copies made, returning all originals to Mr. Martin, and at the trial produced such copies, namely, Exhibits G, H, I and J. By the provisions of s. 126(5) such a copy, made pursuant to s. 126, "is admissible in evidence and has the same probative force as the original document would have if it had been proven in the ordinary way."

All four documents are typewritten memoranda bearing the typewritten initials of Mr. Martin. Exhibit I, dated August 19, 1952, records communications made to him by the appellant at interviews on August 18 and 19. It refers specifically to the proposed purchase of "Edgecliff" by the appellant, and states: "Rolka authorized me to take title in his name and he intends to turn it over to a new company to be formed later."

Exhibit J, dated August 19, 1952, records a communication made to him by the appellant on that date relating to the formation of a new company in which there would be three shareholders holding shares equally, one of whom would be Wright, but Rolka would not be a shareholder. The new company would purchase Rolka's home, land from Rolmac, and the lots in Ancaster Development Company. Rolka would get a lease of his home from the new company "at very little money". Exhibit G is a record of a telephone call made by the appellant to Mr. Martin on September 12 when certain points were settled, including the appellant's agreement to the name of Nelmar Limited, and that Mr. Martin should proceed to apply for letters patent on the basis of a conversation between Wright and Martin. It outlines the proposed sale of the Ancaster lots to Young who would sell at a profit to Nelmar, most of the profit therefrom to be given by Young to Rolka as a gift. The proposed sale of the Chamberlain Park Survey lots is also mentioned. The memorandum continues:

> Dick wants to stand (start?) building on this land next spring . . . and it is one of the most important things Rolmac has to do next year. He sees the point that Nelmar should make money but he does not want them to make too much money . . . he is willing to pay a rent of $1,200 for the Trafalgar property (i.e., "Edgecliff").

1962

ROLKA
v.
MINISTER OF NATIONAL REVENUE

Cameron J.

Exhibit H, dated September 12, 1952, is a memorandum made by Mr. Martin of a conversation with Wright on the previous day when a number of things were discussed, and settled, including the name of Nelmar. It continues:

4. We discussed the three separate transactions that Rolka was considering and we settled as follows,

(a) The Port Nelson property could be sold by Rolka to the New Company on the basis that the advantage to Rolka was that he was getting a low rent, and on the basis that the advantage to the company was that it was buying property which could be carried without too much expense and which might ultimately either be developed or sold for a very much larger sum as a capital profit. He thinks that Rolka in addition to paying a rent of $500 a year should agree to keep the place in repair and maintain grounds, etc. He thinks that we should in the company assume the existing mortgage and pay Rolka by a 4% note. He thinks the lease of Rolka ought to be for two years or three years, but not five years.

(b) On the question of the lands of Ancaster Development Limited—26 lots—which Rolka has, he says that he thinks that it would be all right for Rolka to sign this Option to Young, who in turn would give it to Nelmar, who in turn would give it to Rolmac at $1,800 per lot. It would be necessary for Dick to set the prices. It would also be necessary for cheques to be actually issued by the necessary parties, although, of course, they could be deposited at one time.

(c) In his opinion the mountain property which is now owned by Rolmac cannot be sold to Rolka who in turn sells it to Nelmar who in turn sells it back to Rolmac. He thinks this is too bare faced. He says, and I quite agree with him, in fact it is my idea that Rolka is already getting two benefits out of this, namely cheap living in a house, a capital profit of the Ancaster Development land, and he should not attempt to get another capital profit by such a bare faced scheme as the present one. He thinks that what should be done is that Dick should sell all or some of the land from Rolmac to this new Company, and let them sell it to speculators or builders or even go to the extent of having the land actually built on Rolka. The trouble with that of course would be that there would have to be deeds and mortgages, and cheques issued and the Nelmar Company would actually become quite active.

It was settled that I could go ahead and apply for Letters Patent of the Company after checking the name with Rolka but that he would have to think over again the third alternative after I had discussed the thing with Dick and see if we could not work out something different.

In my opinion, these documents are admissible. It is not necessary to decide whether they would have been privileged as communications between solicitor and client, if the provisions of s. 126A had been invoked. The fact is that the originals did come into the hands of the Minister's representative by the voluntary act of the solicitor and such privilege as may have previously existed in regard thereto

has been lost. Reference may be made to Phipson on Evidence, 9th Ed., at p. 202, where on the authority of *Calcraft v. Guest*[1], the principle is stated thus:

> But, unlike the rule as to affairs of State, if the privileged document, or secondary evidence of it, has been obtained by the opposite party independently, even through the default of the legal adviser, or by illegal means, either will be admissible, for it has been said that the Court will not inquire into the methods by which the parties have obtained their evidence.

From the evidence as a whole, only one reasonable conclusion can be drawn, namely, that the appellant arranged the incorporation of Nelmar for his own purposes; that the shareholders and directors exercised no independent judgment as to any of the business transactions, but were guided solely by the directions of the appellant; that they took office at his request and that he alone determined the properties which would be conveyed to it, the terms and the prices to be paid therefor, and the terms on which Nelmar would dispose of its assets. There is not a tittle of evidence which suggests that the directors ever exercised any independent judgment on any matter. Mr. Wright, who was a shareholder, director and secretary-treasurer, was called as a witness on behalf of the respondent, but gave no evidence which would suggest that he or the other shareholders in Nelmar at any time gave independent consideration to the purchase and sale of the properties. The appellant did not see fit to call either of the other shareholders.

It is settled law that when the Minister by his assessment has concluded that the relevant transaction was not one at arm's length, the onus lies on the appellant to show error on the part of the Minister in this respect. Reference may be made to *Miron & Frères Ltd. v. Minister of National Revenue*[2] and to *Johnston v. Minister of National Revenue*[3]. I must also keep in mind the judgment of the Supreme Court of Canada in *Minister of National Revenue v. Sheldon's Engineering Ltd.*[4], where at p. 645 Locke J. in delivering judgment for the Court referred with approval to the statement of Lord Cairns in *Partington v. Attorney-General*[5]:

> . . . as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be.

[1] (1898) 1 Q.B. 759 (C.A.).
[2] [1955] S.C.R. 679 at 682.
[3] [1948] S.C.R. 486.
[4] [1955] S.C.R. 637.
[5] (1869) L.R. 4 H.L. 100 at 122.

1962

ROLKA
v.
MINISTER OF
NATIONAL
REVENUE

Cameron J.

On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.

In the instant case, it is clear that the appellant at no time held any shares in Nelmar and it cannot therefore be said that he directly controlled Nelmar by reason of holding a majority of its voting shares. But the provisions of s. 139(5)(*a*) refer not only to direct, but also to indirect control, neither term being defined in the Act. Indirect, in the primary sense, means, of course, not direct. In the Shorter Oxford English Dictionary, a number of definitions are given, but I think the ones here applicable would be: "Not taking the straight or nearest course to the end aimed at"; "Roundabout"; "Devious". In *Minister of National Revenue v. Kirby Maurice Co. Ltd.*[1], I had under consideration a vendor and purchaser transaction between an individual and a corporation and stated in part at p. 84:

> It is sufficient to state that in my opinion, in a vendor and purchaser matter, an arm's length transaction does not take place when the purchaser is merely carrying out the orders of the vendor, and exercising no independent judgment as to the fairness of the terms of the contract, or seeking to get the best possible terms for himself. That was precisely the situation here. In effect, Maurice was both vendor and purchaser, and while he was not actually a shareholder at the time the agreement of October 1, 1952, was signed, he had in fact full control of the entire operation.

In view of the evidence to which I have referred and the reasonable inferences to be drawn therefrom, I have come to the conclusion not only that the appellant has failed to satisfy the Court that at the time of the sale of his property to Nelmar he did not indirectly control Nelmar, but that in fact he did control it indirectly. The conclusion is inescapable that the shareholders were merely his nominees, prepared at all times to carry out his wishes and instructions (and, in fact, did so) and exercised no independent judgment or sought to get the best possible terms for Nelmar. In my view, the appellant arranged for the incorporation of Nelmar entirely for his own purposes, including that by which he would be able to occupy as a tenant a very valuable property at a purely nominal rental. It follows that the parties to the transaction were not dealing at arm's length and that for the purpose of computing the appellant's

[1] [1958] Ex. C.R. 77.

income, the fair market value of the property must be deemed to have been received by the appellant, under s. 17(2). In view of that finding, it is unnecessary to consider the alternative submission of the Minister as contained in para. 13 of his Reply to the Notice of Appeal.

I must now endeavour to determine the fair market value of the lots sold by the appellant to Nelmar on April 2, 1953. The burden of proof is on the appellant to show that it is less than $50,000, the amount fixed by the Minister in the re-assessment and which is based on the two sales to Cochren Construction Co. Ltd. on October 8, 1953, and on April 8, 1954.

The evidence on this point is confusing and uncertain, partly because certain of the evidence relates to *building* lots of an area of 40 ft. by 100 ft., while other evidence relates to the *Survey* lots as shown on the registered plan which was not produced. I gather, however, that the Survey lots are substantially smaller than the building lots and that 10 Survey lots are roughly equal to 6 building lots. There is no evidence that at any given time any of the lots were more valuable than others.

The appellant relies mainly on the evidence of Mr. Cochren, proprietor of Cochren Construction Co. Ltd. His first purchase in October, 1953 was of 25 building lots for $17,500 or $700 each. His second purchase in April, 1954 was of 34 building lots at $32,500 or about $960 each. In his opinion, these prices were fair and reasonable, values having steadily increased due to the excessive demand for and the low supply of building lots in that area. In his opinion, $500 per building lot would have been a fair market value in April, 1953. He stated also that a purchaser buying lots in substantial quantities would expect to pay less than another buyer who purchased only a few.

In the light of other evidence, I cannot accept Mr. Cochren's opinion as to the value in April, 1953. He is a speculative builder who purchased lots for his own purposes; he is neither a real estate agent nor a land appraiser; he produced no records or any evidence of other sales made at any time and I think his opinion was little more than a very rough estimate. The evidence of the appellant himself is that when he discussed prices with Cochren in October, 1953, he advised him of the prices paid by Robinson and that Cochren suggested that consideration should be given to

1962

ROLKA v. MINISTER OF NATIONAL REVENUE

Cameron J.

the fact that he wished to purchase more lots and should pay somewhat less per unit. There was then no suggestion that either the appellant or Cochren considered the lots to have increased in value beyond the price paid by Robinson in April, 1953.

The best evidence of value at the date of the sale to Nelmar is that of the sale by the appellant to Robinson, made one day earlier of 6 building lots for $4,500, or $750 each. There seems no doubt that that was an arm's length transaction and fairly represented the then value of lots in Chamberlain Park Survey. If the remaining 59 building lots had then been sold at the same rate by the appellant to Nelmar, he would have received $44,250. There is no evidence as to what concession would be made to a purchaser buying a large number of lots at one time, but accepting the fact that some such allowance would be made, I think it would not exceed 15 per cent. On that basis, I find that the fair market value of the lots sold to Nelmar by the appellant on April 2, 1953, was $37,613.

As to Item D of the re-assessment, the parties, as stated earlier, have agreed that the appellant made a profit of $25,854 on the basis of the sale price of $29,500, that profit being apportioned between the taxation years 1953 and 1954, as previously mentioned. The additional profit of $8,113 will also by agreement of the parties be apportioned between those years and if agreement cannot be reached on the precise amounts, the matter may be spoken to.

Accordingly, the appeal will be allowed in part, and the matter referred back to the Minister to re-assess the appellant in accordance with my findings and the agreements reached at the trial as above stated.

I have carefully considered the question of costs and have reached the conclusion that in the circumstances of this appeal, no costs should be awarded to or against either party. Success has been divided and while the appellant has succeeded in having his 1953 assessments reduced somewhat, the substantial issue was whether or not the appellant in the sale in question was at arm's length with the purchaser and on that point the respondent has succeeded. Further, I am satisfied that if full disclosure of all the surrounding facts had been made, no dispute would have arisen.

Judgment accordingly.