1961
Sept. 29
1962
Dec. 28

BETWEEN:

VANCOUVER PILE DRIVING & CONTRACTING COMPANY LIMITED ..... APPELLANT;

AND

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

Revenue—Income tax—The Income Tax Act, R.S.C. 1952, c. 148, s. 12(1)(b)—Loss incurred on purchase of bonds to provide security for performance of a construction contract—Deductible expense in earning income or capital loss—Appeal from Tax Appeal Board dismissed.

Appellant carried on a general contracting business specializing in bridge and wharf construction and in the course of business was awarded a contract to construct a bridge in British Columbia and was required to deposit as security for the performance of its contract, either a certified cheque in the sum of $55,000 or Dominion or Provincial government guaranteed bonds of equal value. It chose to deposit Dominion of Canada bonds of principal value of $55,000 to purchase which on the open market it borrowed that amount of money from its parent company. When the bonds were returned to it they were depreciated in value and they were later sold at a loss of $6,531.25. Appellant deducted this amount in computing its income. The respondent disallowed such deduction and the Tax Appeal Board held that the loss was a capital one from which decision an appeal was taken to this Court.

Held: That the bonds were purchased not for the purpose of satisfying the trading obligations of the appellant but rather for the purpose of providing security for the performance of its obligations. *M.N.R. v. Tip Top Tailors Ltd.* [1955] Ex. C.R. 144 and *Imperial Tobacco Co. v. Kelly* (1923) 24 T.C. 292; [1943] 2 All E.R. 119, distinguished.

2. That the fact that the taxpayer actually had no idle funds to invest but invested money which it had borrowed and did not intend to keep the bonds as a permanent investment but invested in them only temporarily during the course of construction and that the bonds were purchased to fulfil the requirement of a particular contract entered into in the course of ordinary business operations of appellant did not make the loss one incurred in its normal business operations.
3. That the loss on the sale of bonds was not a loss in respect of circulating capital as the loss was not incurred in the course of trading operations but was one on capital account.
4. That the appeal must be dismissed.

APPEAL from the Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Thurlow at New Westminster.

W. M. Carlyle and *John Fraser* for appellant.

George S. Cumming and *T. E. Jackson* for respondent.

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

THURLOW J. now (December 28, 1962) delivered the following judgment:

This is an appeal from a judgment of the Tax Appeal Board[1] dismissing an appeal by the appellant from a reassessment of income tax for the year 1957. The appeal raises the question whether the appellant is entitled, in computing its income for income tax purposes, to deduct a loss of $6,531.25 sustained on the sale of certain bonds which had been purchased for use as a security deposit required in connection with a contract made in the course of the appellant's business.

The appellant was incorporated in January 1953 under the *Companies Act* of the Province of British Columbia and at all material times since then has carried on a general contracting business specializing in pile driving and bridge and wharf construction. In the course of this business besides entering into and performing construction contracts the appellant occasionally sub-lets the whole or portions of such contracts to other contractors. Most of the appellant's work is financed by borrowings either from its banker or from another company of which the appellant is a subsidiary, the capital invested in the appellant being quite

[1] 25 Tax A.B.C. 369.

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small compared with the volume of work undertaken and consisting only of $50,000 in sums paid in for no par value shares and $15,000 for preferred shares.

In February 1955 the appellant tendered for a contract to be let by the British Columbia Toll Highways and Bridges Authority for the construction of what was known as the Middle Arm Bridge and as required by the instructions to bidders deposited with the Authority as security for the due performance of the contract, if awarded to the appellant, a certified cheque for $55,000 representing 10 per cent. of the appellant's bid. The appellant had borrowed the amount of the cheque from its banker at 6 per cent. interest.

Such a deposit was a normal requirement in connection with government contracts. In the case of the tender in question a note on the prescribed form of tender stated:

> NOTICE TO BIDDERS.—At the time of signing the contract the successful bidder may, with the consent of the British Columbia Toll Highways and Bridges Authority, substitute for the certified deposit cheque, referred to in the advertisement, Dominion or Provincial Government Guaranteed Bonds of equal value. No Registered Bonds will be accepted unless accompanied by a fully executed transfer form surrendering title to the British Columbia Toll Highways and Bridges Authority.
>
> Alternatively the deposit cheque, as aforesaid, will be cashed by the British Columbia Toll Highways and Bridges Authority, and the amount realized will be held without interest by the British Columbia Toll Highways and Bridges Authority as security for the due and faithful performance of the contract.

The appellant's tender was accepted and in June 1955 when the contract was signed it took advantage of the alternative so provided and substituted for the cheque which had been deposited at the time of the tender, Government of Canad bonds of the principal amount of $55,000 bearing $2\frac{3}{4}$ per cent. interest. These bonds had been purchased for this particular purpose with the proceeds of a loan of $55,000 at 5 per cent. obtained from the appellant's parent company and on the cheque being returned the appellant repaid its earlier loan from its banker. This was the first and only occasion when the appellant substituted bonds for a cash deposit on such a contract and it did so on this occasion to reduce the cost of the borrowed funds used to make the deposit which otherwise would have been lying idle and yielding no income while the construction work was in progress. The appellant had no other bonds or securities

and but for its purpose to use the bonds in question as security for the performance of the particular contract, would not have bought them. They had been purchased at $99 per hundred but unfortunately by November 1956 when they were released by the Bridges Authority on completion of the work their market value had fallen to $87 or $88 per hundred. The appellant therefore did not dispose of them immediately but held them, hoping for an increase in their market price, until October 1957 when owing to the need to raise money for one of its undertakings the appellant sold them at $86 or $87 per hundred, the loss on them being the amount of $6,531.25 in question which the appellant seeks to deduct in computing its income for tax purposes.

The question for determination, as I view it, is whether or not the loss in question was one of an income nature or one of capital within the meaning of s. 12(1)(*b*) of the *Income Tax Act*, R.S.C. 1952, c. 148. The section provides that:

> 12. In computing income no deduction shall be made in respect of
> (*b*) an outlay, loss or replacement of capital, a payment on account of capital, or an allowance in respect of depreciation; obsolescence or depletion except as expressly permitted by this Part.

In s. 11 of the Act permission is expressly given to deduct *inter alia* interest on borrowed money used for the purpose of earning income from a business or property and such capital cost allowances and depletion allowances as may be allowed by regulation but neither in the section itself nor in the regulations is any provision made expressly allowing deduction of a loss of the kind here in question. By s. 4 income for a taxation year from a business or property is declared, subject to the other provisions of Part 1 of the Act, to be the profit therefrom for the year.

In approaching the problem whether the loss in question was a loss of capital within the meaning of s. 12(1)(*b*) it is I think important to note that the appellant's business was that of making and carrying out construction contracts and that it did not include dealing in bonds. From this it appears to me to follow, *prima facie* at least, that a gain or a loss through appreciation or depreciation of bonds held by the appellant would find no place in a computation of the profit from its business but would simply be an item of capital. Moreover in my opinion neither the fact that the purpose of the company when purchasing the bonds was to hold

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them only for a short or limited time nor the fact that the company had no idle funds available for investment—other than a sum borrowed for the purpose of making a security deposit—would serve to change the *prima facie* nature of the purchase of such bonds from that of a capital transaction into one on its trading or business account or the gain or loss that might result from their subsequent appreciation or depreciation into one of a trading as opposed to one of a capital nature. Accordingly it is only if the additional fact that the purchase of the bonds was made solely for the purpose of using them as the security deposit required in connection with the Middle Arm Bridge contract and thus obtaining interest revenue to set against the interest payable on the loan, serves in the circumstances of the case to characterize the purchase as one within the realm of the appellant's trading operations that the *prima facie* conclusion that the purchase was a transaction on capital account and the loss one of capital may be regarded as displaced.

The case most strongly relied on by the appellant on this point was *Tip Top Tailors Ltd. v. M.N.R.*[1]. In that case the taxpayer's trading operations included the purchasing in Great Britain of quantities of cloth for which the taxpayer was accustomed to make payment in sterling funds. Expecting that the pound sterling would be devalued in the not distant future, the appellant made an arrangement with its banker in Great Britain under which the banker from time to time paid to the suppliers of the cloth the amounts due them and thus permitted a sizeable overdraft of sterling due to it from the appellant to accumulate. The Court held that the transactions, including those between the taxpayer and its banker being part of the process involved in purchasing and paying for cloth for the purposes of the appellant's business, were trading transactions and that the profit realized on the devaluation of the pound sterling, which enabled the appellant to repay the overdraft at substantially less than would formerly have been possible, arose from the appellant's trading operations.

Another case on which the appellant relied was that of *Imperial Tobacco Co. (of Great Britain and Ireland) Ltd. v. Kelly*[2] decided by the Court of Appeal in England. There the taxpayer was an English company whose business in-

[1] [1957] S.C.R. 703.

[2] (1943) 25 T.C. 292.

cluded the purchasing of tobacco in the United States. In the early months of 1939 the company bought $45,000,000 of United States currency to be used later in the year in making purchases of tobacco and deposited these funds with its bankers in New York. On September 8 shortly after the outbreak of the war the British Treasury requested the taxpayer to stop all further purchases in the United States and on September 30 required the taxpayer to sell its remaining dollars to the Treasury. In the meantime the value of United States dollars in terms of sterling had risen and a substantial profit accrued to the taxpayer. The Court took the view that the purchase of the dollars was the first of several steps involved in the acquisition of tobacco in the course of the taxpayer's trading operations and that the resulting profit was accordingly income from the trade.

To my mind the present case is distinguishable from the *Tip Top Tailors* case and the *Imperial Tobacco* case in that while the purchase of the bonds was made because they were needed for the purposes of the security deposit under the contract and were in fact used for that purpose they remained throughout the property of the appellant and they were not used, as was the sterling in the *Tip Top Tailors* case, nor were they purchased to be used, as were the dollars in the *Imperial Tobacco* case, to pay obligations incurred in the course of trading operations. They might of course have been sold and the proceeds turned to the payment of trading obligations and while they were deposited as security they were undoubtedly subject to the right of the Bridges Authority to sell them and to apply the proceeds in discharge of the appellant's obligations under the contract, if occasion therefor should arise, but that in my opinion is far from indicating that the bonds were acquired or deposited to pay trading obligations or, to put it another way, as a step toward the discharge of such obligations. *Vide Davies v. The Shell Company of China Limited*[1] where Jenkins L.J. said at p. 156:

> If the agent's deposit had in truth been a payment in advance to be applied by the Company in discharging the sums from time to time due from the agent in respect of petroleum products transferred to the agent and sold by him the case might well be different and might well fall within the *ratio decidendi* of *Landes Bros. v. Simpson* 19 T.C. 62 and *Imperial Tobacco Co. v. Kelly* 25 T.C. 292. But that is not the character of the deposits here in question. The intention manifested by the terms

[1] (1951) 32 T.C. 133.

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of the agreement is that the deposit should be retained by the Company, carrying interest for the benefit of the depositor throughout the terms of the agency. It is to be available during the period of the agency for making good the agent's defaults in the event of any default by him; but otherwise it remains, as I see it, simply as a loan owing by the Company to the agent and repayable on the termination of the agency; and I do not see how the fact that the purpose for which it is given is to provide a security against any possible default by the agent can invest it with the character of a trading receipt.

The situation in the *Shell* case was of course different from that in the present case in several respects and particularly in that the matter for determination was the nature of the deposits in the hands of the recipient whereas in the present case the problem is to determine the nature of the deposit from the point of view of the appellant's business but this difference appears to me to be immaterial on the particular point.

The *Tip Top Tailors* case and the *Imperial Tobacco* case accordingly in my opinion do not conclude the present case in favor of the appellant. On the other hand, I do not think the present case is within the principle of the judgment of the Privy Council in *Income Tax Commissioner v. Messrs. Motiram Nandram*[1] which was cited on behalf of the Minister for in that case the deposit was made in connection with the acquisition of an agency which was regarded as an enduring benefit of a capital nature while in the view I take the Middle Arm Bridge contract involved in the present case was itself not a capital but a revenue asset. Had the contract been assigned in whole or in part or sublet in the course of trade, as part of it probably was, any profit resulting from such assignment or sub-letting would I think have been income.

In none of the cases cited therefore was the problem precisely similar to that in the present case but in none of them nor in any other case of which I am aware has a purchase of property, of a kind not ordinarily the subject of the taxpayer's trading activities, to be used merely as a security for the performance of a contract made in the course of trading been treated as a trading transaction. Nor can I see on principle any satisfactory reason for so classifying such a purchase for, barring the case of a purchase which is itself made in the course of a venture in the nature of trade, the purchase of property of a kind not ordinarily

[1] [1940] A.C. 339.

involved in the taxpayer's trading activities appears as nothing but a mere investment and the depositing of the property as a mere setting aside of capital to answer an obligation if it arises and is not otherwise discharged and the property itself becomes involved in the trading process only if and when resort is had to it for that purpose. The fact that the bonds in the present case were purchased solely for the purpose of providing the security deposit required by the particular contract accordingly in my opinion does not affect the result and I have therefore come to the conclusion that the transaction in which the bonds were purchased was a capital transaction, that the bonds themselves were a capital as opposed to a revenue asset of the appellant's business and that the loss through depreciation in their sale value was a loss of capital within the meaning of s. 12(1)(*b*) of the Act.

It remains to deal with several other points which were raised during the argument on behalf of the appellant. It was said first that there was no investment objective, that the appellant had no idle funds for investment and that the bonds were not purchased or at any time held for normal investment reasons but would have been sold immediately on their release if it had not been for the depressed price. The reason for obtaining the bonds however was to secure a return on funds which otherwise would have been lying idle while the bridge was under construction and even though the occasion for making a deposit and requiring bonds for that purpose arose from the contract the purchasing of them for such a purpose in my opinion has all the earmarks of a temporary investment of idle funds. I therefore see nothing in the point which would suggest a different conclusion from the one I have reached.

Next it was said that no asset of an enduring nature was acquired, that the bonds were not acquired for a permanent purpose but to serve a purpose that was temporary and that the expenditure for them was not one made once and for all either with a view to bringing into existence an asset or advantage for the enduring benefit of the appellant's business or for the purpose of preserving, protecting or enhancing any of its capital assets. In this connection reference was made to *Evans v. M.N.R.*[1] and *B.C. Electric Ry.*

[1] [1960] S.C.R. 391.

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v. M.N.R.[1] and to the test formulated by Viscount Cave L.C. in *British Insulated and Helsby Cables Limited v. Atherton*[2]. The test so propounded is undoubtedly an important guide in many situations in which the question of whether an expenditure is one of a capital or of an income nature may arise but it is not formulated as an exhaustive test of what is a capital expenditure and does not purport to say anything on the subject of what is not an expenditure of a capital nature. In the present situation even granting the temporary nature of the appellant's purpose in purchasing the bonds, I do not think the test indicates that the loss in question was not of a capital nature and I am unable to derive assistance from trying to apply it.

Nor do I think it is of any assistance to say as was submitted, that the loss was not part of the cost of providing capital and did not relate to the appellant's financial arrangements, as did the payments considered in *Bennett & White Construction Co. Ltd. v. M.N.R.*[3], since the appellant owed no more or less by reason of the purchase of the bonds and the purpose in purchasing them was simply to fulfill the requirements of the particular contract as cheaply as possible or to the least disadvantage. The point is purely negative and as I see it leads to no conclusion.

Finally it was submitted that the loss was not one of fixed or permanent capital but one of circulating capital. In *Reynolds & Gibson v. Crompton*[4] Jenkins L.J. referring to the distinction between fixed and circulating capital in a business said at p. 511:

> For my part, however, I do not think the importation into the Case of the somewhat debatable distinction between fixed and circulating capital really contributes anything to the solution of the question in issue. After all, if I understand the cases correctly, "circulating capital" is simply an expression used to denote capital expended in the course of the trade with a view to disposal at a profit of the assets produced or acquired by means of such expenditure, and represented at different stages of its career by cash, assets into which the cash has been converted, and debts owing from customers to whom those assets have been sold.

If this definition is applied to the facts of the present case the loss does not appear to me to be one of circulating capital for the bonds were not purchased in the course of trade with a view to disposal of them at a profit. Moreover,

[1] [1957] S.C.R. 121.
[2] [1926] A.C. 205.
[3] [1948] S.C.R. 287.
[4] [1950] 2 All E.R. 502.

as already pointed out, they were not purchased to be used in discharging trading obligations nor were they used for that purpose. They were simply deposited as a security against eventualities which might but did not arise. Thus even assuming that it would favor the appellant's case to regard the loss as one of circulating capital, I do not think a case for so regarding it has been made out. To say that the loss was one of circulating capital is however in my opinion of no significance. The question is not what kind of capital was lost but whether the loss arose from the circulation of capital in the course of trading, and that to my mind merely raises again the question which has already been dealt with, of whether the loss arose from transactions in the course of trading or from transactions on capital account.

I am accordingly of the opinion that the loss in question was a loss of capital the deduction of which in computing income for tax purposes is prohibited by s. 12(1)(*b*) of the Act and that its deduction was properly disallowed.

The appeal therefore fails and it will be dismissed with costs.

Judgment accordingly.