1958

Feb. 4

July 4

BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT.

AND

ALFRED MANASTER ..... RESPONDENT.

Revenue—Income Tax Act, R.S.C. 1952, c. 148, s. 5, 6(v), 139(1)(aj)—Income or capital—"Retiring allowance"—Money paid to partner to terminate his interest in agreement—Method of payment—Amount received by respondent not compensation in nature of a retiring allowance—Appeal from decision of Income Tax Appeal Board dismissed.

Respondent in association with his father and a brother caused to be incorporated a joint stock company which engaged in the business of building and selling residential properties, the shares and interests of the company being equally divided among the three. Later they entered into an arrangement with another group known as Schouella Bros. & Co. of Canada to carry on the business of purchasing and subdividing land and constructing and selling buildings erected thereon. Two agreements entered into by the parties provided for the incorporation of companies and the methods to be followed by them in their operations, the business relationship of each of the groups or parties and their respective rights and interests in the companies.

The companies operated for a time when difficulties arose between the parties and a final agreement was entered into between them by which the prior agreements were cancelled, the respondent and his associates sold their shares in the two companies to Schouella Bros. for a certain sum of money and were also paid by Schouella Bros.

a further sum for the cancellation and termination of the agreements of which sum the respondent, his father and brother each received $10,833.33. In assessing his income the appellant added this amount to his declared income. On appeal to the Income Tax Appeal Board this assessment was set aside. The appellant appealed from such decision to this Court.

Held: That the receipt of the sum of $10,833.33 by respondent was in the nature of a capital asset and not an income receipt to be included in computing his income.

2. That the agreements entered into between the parties were not commercial contracts; they created companies to operate in certain fields of activities and realise profits which, in the framework of the agreements, would be distributed equally between the parties; the agreements were not for the engagement of personnel or employees.

3. That the amount received by the respondent is not a compensation in the nature of a retiring allowance; he was not a member nor an officer of the Schouella Bros. of Canada, having never been employed by that organisation.

4. That the mode of payment of the sums agreed upon for the termination of the agreements, whether made in cash, by cheque or cheques of the parties obligated, or by cheques of outsiders, is immaterial as the money was received for the cancellation and termination of the respondent's activities as a builder in association with the Schouella Bros. of Canada.

APPEAL under the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Fournier at Montreal.

Paul Ollivier and *Claude Couture* for appellant.

S. W. Weber, Q.C. and *J. H. Blumenstein* for respondent.

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

FOURNIER J. now (July 4, 1958) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board dated January 7, 1957, allowing the appeal of the then appellant, Alfred Manaster, in respect of his income tax assessment for the taxation year 1954.

The respondent in his return of income for the taxation year 1954 reported as taxable income the amount of $3,855.56. The appellant assessed the taxable income at $14,881.89 so as to include a sum of $10,833.33. The respondent objected to this assessment on the ground that the sum of $10,833.33 received in the above taxation year

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did not constitute taxable income but was a receipt of a capital nature. The appellant, some time later, confirmed the assessment as having been made in accordance with the provisions of the *Income Tax Act*. The respondent appealed to the Income Tax Appeal Board from this assessment. The appeal was heard and allowed and the Board referred the assessment back to the Minister for reassessment, so that the amount of $10,833.33 be deleted from the respondent's taxable income for the taxation year 1954.

It is from this decision that the appellant appeals to this Court.

The appellant contends that in computing the respondent's income for 1954 he included the amount of $10,833.33 because the receipt of same fell within the framework of sections 5, 6(*a*)(*v*) and 139(1)(*aj*) of the *Income Tax Act*, which deal with the question of income from office, employment and retiring allowances, and that the sum received was in the nature of a retiring allowance and consequently taxable income.

On the other hand, the respondent submits that he received the said sum in pursuance to the terms of an agreement which establishes that the consideration for the payment was twofold. First, the payment was made in part for the sale and transfer of shares of two incorporated companies to the Schouella Bros. group, and, second, for the termination and annulment of certain agreements. In both cases the receipt would be of a capital nature and non-taxable.

To solve the question as to whether the sum involved in this appeal is income or capital in character, one has to carefully consider the facts of the case and the law applicable to those facts. It has been repeatedly said that there is no single or infallible test for settling the question of whether a receipt is of an income or capital nature. Each case depends on its own particular facts and circumstances.

In *Simon's Income Tax*, 2nd ed., vol. 1, p. 32, para. 44, the rule is put in the following words:

> There being "no single, infallible test" it is nevertheless useful to consider some of the factors which have been held, once the particular facts of the case have been ascertained and any relevant documents construed, to throw light on the character of an item for the purpose

now under discussion. Attention must be concentrated on the receipt or payment itself; the fact that the consideration for it is of a revenue or capital nature is not determinative, for just as an item of income, such as an annuity, may be purchased from capital, so the right to future payments of income may be commuted for a capital sum.

The evidence before the Court covers the relevant background and activities of the persons involved directly or indirectly in this dispute; their negotiations leading to the signing of agreements which have a considerable bearing on the issue; the agreements; and, finally, the termination and cancellation of these agreements and the consideration for the payment of the sum received by the respondent.

The respondent, his father and a brother were associated in the business of constructing buildings of various types and were known as "the Manasters". In 1952 they had set up and incorporated a joint stock company, known as The Century Construction Company. Its objects were varied, but its main purpose was the erection and sale of buildings, mostly of residential structures. The shares and interests of this company were equally divided among the three Manasters. From the date of the incorporation of their company in June 1952 up to January 1954, they were engaged in the building of bungalows and duplexes. During that period 100 units were erected. As there was a ready market for these types of houses, every home built was sold. As the Manasters had a long and wide experience in the building business, their company seems to have been a success.

Some time during the last months of 1953 and January 1954, another group of persons known as the Schouella Bros. & Co. of Canada, a registered partnership composed, it would seem, of 11 members of the same family, some of them being conversant with the fact that the Manasters had experience in construction business, approached them with a proposition to join together to set up a joint stock company to purchase land, have it subdivided and construct and sell buildings, mostly of the residential type. The Manasters would bring in the operation of the company their know-how and funds and the Schouellas would put up most of the capital required and their experience in land dealings.

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After exhaustive negotiations, the parties arrived at an understanding which was put down in detail in a series of three agreements, one executed and signed on January 28 and two on February 12, 1954, before Notary M. J. Garmaise. These agreements have been produced as exhibits and form part of the evidence in this case.

In the first agreement, the parties state that they have incorporated a company by Letters Patent of the *Quebec Companies Act* under the corporate name of "Meteor Homes Ltd." for the object of building small homes and also for other purposes, as they may, from time to time, see fit. The financial set-up is then described—the shares to be divided equally between the two groups. The capital required for the building operations to be supplied equally by the parties, but not for the land. The purchase of the land to be financed by the Schouella group by way of loans to the company. The association for the conduct of the affairs of the company was to be for five years, unless the company was dissolved earlier in the case of losses or dissatisfaction of a majority of the directors of the conduct towards the company of its directors or share-holders. The parties stipulated and agreed that the shares of the company should not be transferred to third parties until they had been offered respectively to the parties to this agreement. In the event of dissolution, the price at which such shares would be offered was the value set upon such shares in the last annual balance sheet of the chartered accountant, who was then the auditor of the company. The parties being respectively the owners of a one-half interest in the company, and, to prevent a dead-lock at any time in the operation of the affairs of the company, they each divested themselves of one fully paid and non-assessable share of the common stock of the company in favour of their notary (Max Garmaise), who would become a director of the company and who would have a deciding vote; the parties holding an equal number of shares and having each two directors.

The discussion before the Court dealt mostly with clause 7 of the agreement, which reads as follows:

7. In view of the greater building experience of the first parties (the Manasters), it is agreed that salaries shall be established to be divided among the first parties as they see fit, to a total of Twenty-One Thousand Dollars ($21,000.00) per year, and that the salaries shall be established to be

divided among the second parties (the Schouellas) active in the enterprise as they may see fit, in the amount of Fourteen Thousand Dollars ($14,000.00) per year. These salaries, however, shall start only from the actual date of construction.

This clause was amended and modified, as to the amount of the salaries, by agreement of February 12, 1954. The figures of $21,000 and $14,000 were deleted and replaced respectively by the figures "$14,000" and "$7,000".

A second agreement was executed and signed by the same parties, before the same notary, on February 12, 1954, to set up and incorporate another company, to be known as The Meteor Century Builders Ltd. This company would have an authorized capital of $1,000,000. Each party was to subscribe immediately for 100 common shares of $100 each and 900 preference shares, also of $100 each; $20,000 to be paid by each party immediately and the balance to be paid later. The object of this new company was to take over the financing of the purchases of land required by Meteor Homes Ltd. for its building operations. This document recites most of the clauses of the first agreement and deals at length with matters of corporate financing which are of no relevancy to this dispute.

These agreements determined the methods to be followed by the companies to be set up in their operations, the business relationships of each of the groups or parties and their respective rights and interests in the companies. The companies were then organized and incorporated. When this was done, the companies proceeded to purchase lands for building sites and to erect small homes. During the life of the agreements, from January 28 to July 9, 1954, Meteor Homes Ltd. put up between 36 and 40 houses. One model house had been completed and 36 were in various stages of construction, up to the latest stage of plastering, at the termination of the agreements, and the moneys expended on the project amounted to about $300,000.

Serious difficulties arose between the two parties in their relations as shareholders of the companies and as parties to the agreements. The trouble stemmed from the doubts and suspicions of one group as to the honesty and integrity of the members of the other group, though it would seem that the suspicions were not well founded. At all events,

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their lack of understanding and harmony were such that their relations became intolerable, impossible and culminated in their termination of their association.

This was finalized by another agreement between the same parties, executed and signed on July 9, 1954, before Notary Max Garmaise, who was a shareholder and director of the two companies and who acted as conciliator and arbitrator between the parties.

This agreement declares that the agreement of January 28 and the two agreements of February 12, 1954, are hereby cancelled and annulled. The first parties (the Manasters) sell to the second parties(the Schouella Bros.) all the shares of the common and preferred stock of The Meteor Homes Ltd. issued to them for the sum of $25,000, which they acknowledge having received, and agree to sign on demand all necessary documents for the transfer of the said shares. The same transaction between the same parties takes place as to the shares of The Meteor Century Builders Inc. The shares owned directly or indirectly by the Manasters are sold to the Schouella Bros. for the sum of $20,000; payment is made and received and the transfer of the shares is agreed to. An additional sum of $32,500 was paid by the Schouellas to the Manasters for the cancellation and termination of the agreements.

Clauses (4) and (5) of the agreement, the subject of the whole discussion between the parties in this appeal, read as follows:

(4) In consideration of the termination of the Agreement between the parties and of the assumption by the Second Parties of the undertaking, the Second Parties agree to pay to the First Parties the sum of Thirty-two thousand five hundred Dollars ($32,500.00) which the First Parties acknowledge to have received to their satisfaction at the execution hereof and whereof quit.

(5) The Parties agree that the termination of the said partnership and the payments herein above specified are made in full and final settlement of any claim of whatever nature of the First Parties against the companies involved or against the Second Parties and of any claims of whatever nature of the companies or of the Second Parties against the First Parties, the parties acknowledging to have settled all accounts between them and to be content and satisfied therewith.

This amount of $32,500 was divided equally between the Manasters. The respondent received 1/3 of the amount, to wit $10,833.33. The same amount was received by Joseph

Manaster and Leon Manaster. In the case of the two first named, the appellant in assessing their income added $10,833.33 to their declared income. As to the third named, his income for 1954 has not been assessed.

Is this sum of $10,833.33 taxable income and does it come within the ambit of the terms of the sections of the Act on which the appellant relies? This is the question to be answered.

The sections mentioned are 5, 6(*a*) (*v*) and 139(1)(*aj*); they read as follows:

Sec. 5—Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year . . .

Sec. 6—Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

(*a*) amounts received in the year as, on account or in lieu of payment of, or in satisfaction of

(*v*) retiring allowances,

Sec. 139(1)(*aj*)—"retiring allowance" means an amount received upon or after retirement from an office or employment in recognition of long service or in respect of loss of office or employment (other than a superannuation or pension benefit), whether the recipient is the officer or employee or a dependant, relation or legal representative;

The above provisions of the Act relate to one source of income provided for in paragraph (*c*) of s. 3 of the *Income Tax Act*. The Act does not define income nor capital; it only indicates and describes the different sources of income and the methods of computing same. It also details the classes of income to be included in the computation. The appellant in this instance submits that the sum involved is not income from businesses or property but is income derived from office and employment, particularly as a retiring allowance.

There is no doubt that the sum of $10,833.33 was paid to the respondent after difficulties and disputes arose between the parties. The agreements were cancelled and terminated following negotiations which led to the signing of an agreement whereby, in consideration of the termination of the agreements which existed between the parties, the respondent received a lump sum. Nothing was said about a contract of hire between the parties which entitled them to receive salaries or retiring allowances. It was made in settlement of any claim of whatever nature the parties

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may have had against each other or the companies involved and the parties acknowledged to have settled all accounts between them.

The main object of the agreements was to have incorporated two companies and determine the methods and principles to be applied in their operations; also the business relationship between the parties and the companies and the results of the activities of the companies to be shared by the parties. The companies were set up to purchase building sites and to erect small houses. The agreements were terminated but the existence of the companies was not affected. The only change made was the transfer of common and preference shares of the two companies by the members of the first party to the members of the second party and the dissolution of their partnership. When the associates of both parties worked for the companies they were paid for the services rendered, and nothing else. The moneys received by the respondent for services rendered to The Meteor Homes Ltd. were duly reported in his return of income. The agreements were in existence for a very short period and the companies were in no position to justify, as provided for in the agreements, a balance sheet of their annual operations.

The more one studies the agreements and the facts of the case, the more one finds similarities between these agreements and facts and the agreements and facts of the *Van den Berghs Ltd. v. Clark* case[1].

In that case two companies, in competition, carried on an extensive business as manufacturers of margarine and other substitutes for butter. The companies entered into an agreement to carry on their business independently and to share profits and losses in the proportion which, on an average of five years, the profits of the rival tradings in margarine bore to each other. Two other agreements intervened to the same effect but relating to other activities. Disputes arose and became subject to an arbitration of such complexity and duration that the companies came to terms by which the agreements were rescinded and one company paid to the other a certain sum "as damages", but the parties did not specify the cause of action in respect of which the damages were paid.

[1] [1935] A.C. 431.

The House of Lords held "that this sum was in the nature of a capital asset and not an income receipt to be included in computing the income of the receiving company."

At page 442 of the report, Lord Macmillan made the following observations:

> The three agreements which the appellants consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products, or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their trading profits when earned should be distributed as between the contracting parties. On the contrary the cancelled agreements related to the whole structure of the appellants' profit-making apparatus. They regulated the appellants' activities, defined what they might and what they might not do, and affected the whole conduct of their business. I have difficulty in seeing how money laid out to secure, or money received for the cancellation of, so fundanmental an organization of a trader's activities can be regarded as an income disbursement of an income receipt. ... The agreement provided the means of making profits, but they themselves did not yield profits.

In my opinion the agreements in the present instance were to the same effect. They were not commercial contracts; they created companies to operate in certain fields of activities and realize profits which, in the framework of the agreements, would be distributed equally between the parties. They related to the whole structure of their profit-making companies. They regulated the companies' activities, defined what they might and might not do, and affected the whole conduct of their business. The agreements were not for the engagement of personnel or employees. They established the structure and mechanism of their income earning machine. This machine had been wisely and carefully devised, defined, organized and regulated and was an asset which would have operated successfully if circumstances and the relationship of the parties had not intervened to hamper its operations. Disputes arose and difficulties encountered were such that it was only after lengthy negotiations that the parties arrived at a settlement of the situation. The terms of the settlement are embodied in the agreement of cancellation and termination of their agreements of association. Now, was the sum involved received on the compromise of the dispute arising out of operations of the companies by the shareholders or officers or as a compensation in the nature of a retiring

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allowance? The evidence as a whole is foreign to the idea that the parties were entitled to a retiring allowance in the event of a dissolution of the association or that the sum involved was paid or received for that object.

According to the statute, "retiring allowance" means an amount received upon or after retirement from an office or employment. The Schouella Bros. of Canada was a partnership of which the respondent was not a member nor an officer, having never been employed by their organization. He was only a member of one of the parties who signed the agreements. Had he been employed by the Schouellas, the sum could perhaps have been paid in recognition of long service. But even that condition could not have been met, the agreements having been in force only some five months. Or, says the statute, in respect of loss of office or employment. He could not lose what he did not have. In my view the amount received by the respondent cannot be considered as a compensation in the nature of a retiring allowance.

It was contended that the sum of $32,500 paid by the Schouellas to the Manasters could not have been paid for the sale and transfer of the shares of The Meteor Homes Ltd. and The Meteor Century Builders Ltd. held by the Manasters and sold and transferred by them to the Schouellas, because they had received the amounts they had paid for the said shares. This may be literally true. But were the amounts received equivalent to the value of those shares? We will never know, because the agreements provided that, if it were deemed advisable to dissolve their association before the expiration of the life of the agreement, the value of the shares of the companies would be that set upon such shares in the last annual balance sheet rendered by the chartered accountant who was then the auditor of the companies, without regard to profit or loss in the interval—the word "interval" is mine. The agreement mentions the word "interview", which has no meaning in the sentence and must have been written through a clerical error. An annual balance sheet was never rendered, on account of the duration of the agreement.

It was also argued that the fact that the sum was paid by a cheque of The Meteor Homes Ltd. indicates that the company was paying this amount as a compensation of the

loss of salaries which the Manasters would have received if they had continued to erect the buildings during the life of the agreement. The document cancelling and terminating the agreements had nothing to do with the above company. There is no evidence that the company had obligated itself to pay the salaries mentioned in clause 7 of the first agreement. This was an undertaking of the parties to the agreement.

In my opinion, the mode of payment of sums agreed upon for the termination of the agreements, whether made in cash, by cheque or cheques of the parties obligated, or by cheques of outsiders, is immaterial to the issue in this case.

Furthermore, the document states that the payment was made in consideration of the termination of the agreement and the assumption of the undertaking by the Schouella Bros. of Canada. The termination of the agreement and the payments made put an end to any dispute concerning the accounts, claims or counterclaims which may have existed between the parties and the companies. Though it was not specified what the termination meant to the parties, it can readily be deduced that the Schouellas wished to take over the two companies in which both parties had an equal interest and to force or have the Manasters agree to abandon their interest in the association. This association, created by the agreements, constituted, in my opinion, an "asset" which, in the words of Lord Atkinson, "ought not to be confined to something material". See *British Insulated and Helsby Cables Ltd. v. Atherton*[1].

I believe that the Schouellas having acquired experience in the construction business felt that they had no more need of their associates and did their best to buy them out. Having succeeded, they became the sole owners, through the companies, of an income producing enterprise, which was clearly to their advantage.

On the other hand, the Manasters, having been, by circumstances, forced to agree to the cancellation and termination of the agreements, certainly sustained a loss, which seems to have been acknowledged, at least tacitly in the agreement, and agreed that the sum of $32,500 would be sufficient compensation for their consent to the dissolution

[1] [1926] A.C. 222.

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of the association. It seems unreasonable to me to believe that they would have agreed to withdraw from the association just for the reimbursement of the sums they had put up to purchase the shares.

In the *Van den Berghs v. Clark* case above cited Lord MacMillan, concluding his remarks, says (p. 442, *in fine*):

> I have difficulty in seeing how money laid out to secure, or money received for the cancellation of, so fundamental an organization of a trader's activities can be regarded as an income disbursement or an income receipt.

This statement, in my opinion, is applicable to the facts of this case, even if the money received by the respondent was by way of a cheque of The Meteor Homes Ltd. What means the Schouellas employed to have a cheque issued by the company to the Manasters is of no concern of the Court and does not affect the issue.

So I find that the sum of $10,833.33 received by the respondent was in the nature of a capital asset and not an income receipt to be included in computing his income, because it was not income covered by the provisions of sections 3, 5, 6(*a*)(*v*) and 139(1)(*aj*) of the *Income Tax Act*.

The appeal is dismissed with costs.

Judgment accordingly.