1962
Mar. 27, 28, 29, 30
1963
May 2

BETWEEN:

ALEXANDER B. DAVIDSON .....APPELLANT;

AND

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

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 4, 12 (1)(b), 27 (1)(e), 139 (1)(e)—Stockbroker loss in shares—Capital loss or business loss—Deductibility of loss from taxable income of a previous year—Appeal allowed.

Appellant was a stockbroker and promoter and the senior parter of a brokerage firm. He and an associate had engaged in a venture involving the shares of Eastern Steel Products, Limited as early as 1939 and in 1945 they had succeeded in acquiring 76% of the outstanding shares of that company. Thereafter both served on the board of directors and as President of the company, and in the years following purchased and sold on the stock market a large number of the shares of the company, always retaining substantial holdings therein. He resigned from the directorate in 1953. In 1957 the steel company was in financial difficulties, the market price of the shares dropped and appellant sustained a substantial loss of over $500,000 on his holdings. Appellant deducted this loss from his taxable income as a trading or business loss but the Minister disallowed such deduction on the ground that the loss was a capital loss. Appellant also claimed the right to deduct the unabsorbed portion of his 1957 loss in computing taxable income for 1956. The appellant appealed from income tax assessments for 1957, 1958 and 1959.

Held: That from 1945 to 1958 appellant was engaged in a trading venture in the shares of Eastern Steel Products Limited and that his loss therefrom was a trading loss.

2. That the appellant's trading activities in Eastern Steel Products Limited shares were separate from his other business activities and since he had no income therefrom in 1956, no part of the 1957 loss was deductible in 1956 under s. 27 (1)(e) of the Act as it applied then but the loss was deductible in 1958 and 1959 as provided in the section as amended in 1958.

3. That the appeal be allowed, the assessment of 1957 be vacated and the assessments of 1958 and 1959 be referred back to the Minister for re-assessment.

APPEAL under the *Income Tax Act.*

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

P. B. C. Pepper, Q.C. and *J. G. McDonald, Q.C.* for appellant.

W. J. Smith, Q.C. and *T. Z. Boles* for respondent.

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

THURLOW J. now (May 2, 1963) delivered the following judgment:

This is an appeal from assessments of income tax for the years 1957, 1958 and 1959. In making the assessments the Minister disallowed as a deduction in computing income a loss of $591,495.75 admittedly sustained by the appellant in 1957 in connection with his shareholdings of Eastern Steel Products Limited and the first and main question which arises in the appeal is whether the Minister was right in so doing. The appellant's case is that the loss in question was a trading or business loss while the Minister takes the position that it was a capital loss which was not deductible in computing income. If the Minister was right in disallowing the loss as a deduction that is the end of the matter. But if not, the assessment for 1957 cannot stand because the deduction of $591,495.75 would reduce the appellant's income for that year to zero and leave a business loss balance available for deduction under s. 27(1)(*e*) of the *Income Tax Act,* R.S.C. 1952, c. 148 in computing his taxable income for other years. In that event a second question arises with respect to the amount of such loss available for deduction in computing the appellant's income for 1958 and 1959.

The appellant is a stockbroker and promoter. In 1936 after serving for 12 years as a salesman he left the brokerage firm by which he was employed and founded A. B. Davidson & Co. Ltd. a corporation which has since then been engaged in underwriting and trading as a principal in securities. The

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appellant owns the capital stock of this company and is its president. In 1949 the name of the company was changed to Davidson Securities Ltd. to avoid confusion with a partnership which had in the meantime in 1947 commenced carrying on business under the firm name of Davidson & Co. as a commission or brokerage house acting on behalf of clients.

The appellant is also the senior partner of Davidson & Co. In 1942 he had become associated with Roy Robertson in a similar brokerage partnership known as Robertson and Davidson which operated in Montreal and Toronto, and in that year the firm had acquired seats on the Montreal Stock Exchange and the Montreal Curb. In 1944 it acquired as one of the assets of a going brokerage concern which it purchased, a seat on the Toronto Stock Exchange. This partnership was dissolved in 1947, Robertson taking the Montreal business and seats and the appellant taking the Toronto business and seat. Davidson & Co. was then formed. By 1962 the firm consisted of 12 partners, it had 200 employees and branches in five Canadian cities and its business had grown to the point where the transactions which it handled involved 8 to 14% of the volume of shares traded on the Toronto Stock Exchange.

In 1939 before they became associated in the partnership the appellant and Robertson had been engaged in a venture in connection with shares of Eastern Steel Products Limited. They had obtained options to purchase the shares at fixed prices and over a period of some months they had exercised the options and sold the shares at a profit. The appellant was unable to say whether his share of these profits accrued to him directly or belong to A. B. Davidson & Co. Ltd.

In 1945 the appellant again became interested in shares of Eastern Steel Products Ltd. when he and a Mr. Denton who was a member of Burns Brothers & Denton Ltd. a company engaged in a business similar to that of A. B. Davidson & Co. Ltd. arranged to acquire some 54,000 shares representing 76% of the issued share capital of the company. Shortly afterwards both Denton and the appellant became members of the board of directors of the company. According to the appellant their object was to build up the company and sell the stock to the public to make a profit. The company was paying substantial dividends at that time

and continued to do so for about four years thereafter. It was also negotiating to acquire the stock of W. B. Beath & Sons Ltd. At the end of 1945 the shares of Eastern Steel Products Ltd. were split on the basis of four for one and early in the following year the Beath shares were acquired and paid for with the proceeds of a debenture issue of $1,500,000 which was underwritten and sold by Burns Brothers & Denton Ltd. and A. B. Davidson & Co. Ltd. The same firms also underwrote and sold another debenture issue of Eastern Steel Products Ltd. amounting to $260,000 in November 1947. Interest rates were low at the time and debenture borrowing was considered to be a good way of financing the company without diluting the control of the company which Denton and the appellant had acquired.

The appellant's portion of the new stock amounted to 108,000 shares but he immediately sold about one-third of them to Robertson and a man named Hunter. He also said that he both bought and sold a large volume of the stock in 1945, 1946 and 1947 and from such sales made profits which in 1950 came to the attention of the Department of National Revenue but that he referred the matter to his solicitors and was not taxed on the profits. I see no reason to doubt this evidence.

In the years that followed 1945 the appellant apparently bought more shares of Eastern Steel Products Ltd. than he sold for by the end of 1953 he held 126,527 shares and Davidson Securities Ltd. had on hand a further 8,500 shares amounting together to nearly half of the issued common stock of the company. In the meantime Mr. Denton who had become president of the company in 1947 had died and in May 1949 the appellant had become its president and assumed an active role in the conduct of the company's affairs. He relinquished this office in May 1953 to become chairman of the Board of Directors, a post which he held until October 1953 when he resigned from the Board. At this stage the company which had discontinued paying dividends in 1949 was having troubles with its banker and at the appellant's request a Mr. Pritchard assumed the presidency of the company and the management of its affairs.

Shares of the company were being traded on the Toronto Stock Exchange at that time and throughout 1954, 1955,

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1956 and the first half of 1957 at prices which ranged from a low of $3\frac{3}{4}$ to a high of $8\frac{1}{4}$. Transactions on the Toronto exchange involved 19,036 shares in 1954, 66,959 shares in 1955, 45,381 shares in 1956 and 76,811 shares in 1957. These figures may be compared with purchases and sales by the appellant and Davidson Securities Ltd. involving a total of 28,986 shares in 1954, 50,498 shares in 1955, 47,121 shares in 1956 and 29,345 shares in 1957. Purchases and sales by the appellant personally were as follows:

	Number of Transactions		*Shares Involved*		
	Purchases	*Sales*	*Purchases*	*Sales*	*Total*
1954	78	31	8750	16586	25336
1955	24	2	5700	3044	8744
1956	39	23	4891	7980	12871
1957	55	25	6670	8750	15420
	196	81	26011	36360	

During the same period the appellant made a number of attempts to dispose of the whole of his holdings of Eastern Steel Products Ltd. by a block sale but was not successful.

In July 1957 the company's bank called in its loan and in consequence the market price of shares declined to about 50¢ and the appellant sustained the loss already mentioned. A portion of this loss was, however, retrieved early in the following year when the appellant disposed of substantially all of his shares of Eastern Steel Products Ltd. at $1 per share.

On the main question raised in the appeal I am of the opinion that the appellant throughout the period from 1945 to 1958 was engaged in a venture in trading in shares of Eastern Steel Products Ltd. and that the loss in question was a trading loss. I do not think for a moment that he or Denton bought up the control of the company with an eye only to the dividends which the company was paying and I am satisfied that their purpose was to make profit through their ownership of the shares and the control of the company which this ownership gave them in any way that might appear expedient including taking dividends, directors' fees and salaries, and underwriting the company's financing transactions, but above all by promoting investor interest in the company and selling the shares either in block or piecemeal at higher prices than they had paid for them. For

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the appellant the scheme fell short of a complete success but that the appellant was engaged in such a scheme and acted as a trader throughout in my view clearly appears from the facts. He bought shares over a considerable period both when dividends were being paid and when no dividends were being paid and borrowed money to do so. He sold shares during the same period. He made purchases to support the market, a course scarcely consistent with a long term investment object, and at the same time sold shares to dealers at less than market price in order to maintain their interest in making sales and thus prevent the market from fading away. While the number of shares involved in his personal transactions was not large in comparison with the number of shares he controlled, in the years 1954, 1955, 1956 and 1957, it represented a substantial volume compared with the volume of trading of the stock on the Toronto exchange. Dealing in stocks and bonds and promoting companies was his calling and with the facilities available to him through the commission house in which he was the senior partner and through his company he required nothing in the way of an organization to carry on his trading. Throughout the whole period he was in my view trying to stimulate a market in which he could unload his holdings at a profit and awaiting the opportunity to do so. Had he made such a profit on disposing of his holdings in my opinion it would clearly have been a trading profit subject to tax as income from a business within the meaning of the definition in s. 139(1)(*e*) of the *Income Tax Act* and the loss which he in fact sustained was equally a trading or business loss rather than one of a capital nature. This conclusion is I think further supported by the evidence of trading by the appellant in shares of United Asbestos Corp. Ltd., Peruvian Oils & Minerals Ltd. and Quebec Chibougamau Ltd. but I would reach it even in the absence of such evidence.

It was conceded at the argument that if the loss was a trading loss the assessment for 1957 would be reduced to nil and it follows from this and from my conclusion that the loss was a trading loss that the assessment in respect of that year cannot stand.

I turn now to the other question in the appeal relating to the assessments for 1958 and 1959. As applicable to the

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years 1958 and 1959 s. 27(1)(*e*) of the *Income Tax Act* read as follows:

27(1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted from the income for the year such of the following amounts as are applicable:

. . .

(*e*) business losses sustained in the 5 taxation years immediately preceding and the taxation year immediately following the taxation year, but

(i) an amount in respect of a loss is only deductible to the extent that it exceeds the aggregate of amounts previously deductible in respect of that loss under this Act,

(ii) no amount is deductible in respect of the loss of any year until the deductible losses of previous years have been deducted, and

(iii) no amount is deductible in respect of losses from the income of any year except to the extent of the lesser of

(A) the taxpayer's income for the taxation year from the business in which the loss was sustained and his income for the taxation year from any other business, or

(B) the taxpayer's income for the taxation year minus all deductions permitted by the provisions of this Division other than this paragraph or section 26.

A similarly worded provision had been in the Act for some years prior to 1957 but the words "and his income for the taxation year from any other business" were not present in subclause (A) of clause (iii) prior to the enactment of s. 12(1) of S. of C. 1958, c. 32, which by s. 12(3) of the same Act was made applicable to 1958 and subsequent years. The permissible deduction was thus limited in 1957 and earlier years to the amount of the taxpayer's income for the taxation year from the business in which the loss was sustained. *Vide M.N.R. v. Eastern Textiles Limited*[1], *Utah Company of the Americas v. M.N.R.*[2] and *Orlando v. M.N.R.*[3]. Accordingly, if there was profit in the year 1956 from the business in which the 1957 loss was sustained that loss would first be applicable as a deduction in computing income for 1956 and applicable only to the extent of the balance of such loss in computing taxable income for 1958 and 1959. It is agreed that for the year 1956 the appellant's taxable income excluding trading losses was $338,269.74 of which $338,082.41 was income from Davidson & Co., and that in that year the appellant sustained a loss of $19,863.07 on

[1] [1957] C.T.C. 48. [2] [1960] Ex. C.R. 128.
[3] [1962] S.C.R. 261.

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Eastern Steel shares and an overall loss of an even greater amount on his investment income and his business activities, other than Davidson & Co., taken as a whole. The 1957 loss on Eastern Steel trading is accordingly deductible in computing the appellant's taxable income for 1956 only if the appellant's trading in Eastern Steel and his activities in Davidson & Co. were activities of the same business. If so, most of the 1957 loss would be deductible in the computation of the appellant's taxable income for 1956 leaving a small amount for deduction in 1958 and nothing for deduction in 1959. On the other hand, if the loss was incurred in a different business from that of Davidson & Co. none of it would be deductible in computing the appellant's taxable income for 1956 and the whole loss balance remaining after computing his income for 1957 would be available for deduction in subsequent years including 1958 and 1959 in accordance with the statutory provisions applicable thereto.

Counsel for the appellant submitted that the appellant had only one business, that of trading in stocks and bonds whether as principal or as commission agent at his Adelaide Street premises and that in this business he used his corporation, Davidson Securities Ltd., to support his operation as a commission agent and trader. From this position he argued that the loss was first deductible in 1956 to the extent of practically the whole of the appellant's income for that year and that the remainder of the loss would be deductible in 1958 but that if the loss was not deductible in the 1956 computation, it would be deductible in 1958, 1959 and subsequent years.

I do not agree with the submission that the appellant had only one business. The trading by the appellant as principal was his alone. The trading transactions of Davidson & Co. on the other hand were not his alone but transactions to which his partners were parties as well. The latter were not transactions as principals but transactions as agents. They were carried out to earn commissions rather than to earn profits from the transactions themselves. The partners were not concerned with whether profit was arising from the transactions or not. Moreover, where these transactions concerned the appellant, he was treated as a customer of the firm and was charged a commission for the services rendered. His securities like those of any other customer indebted to

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the firm were used by the firm as collateral for its financing. The firm had its own employees and accounting system which so far as appears were used entirely for the purposes of recording the firm's transactions rather than those of the appellant except insofar as he was a customer. While the appellant in his trading made use of the firm's facilities as a customer, it does not appear that his trading activities were interwoven with those of the firm except as a customer or that there was either interdependence of the one upon the other or union of the two into a single operation. Moreover, though the appellant was the president and the sole owner of the capital stock of Davidson Securities Ltd., and no doubt dictated its courses of action, there is nothing in the evidence to indicate that the company was in fact or in law an agent for the appellant in carrying out its transactions or that its business was not its own and a separate one from that of the appellant. In my opinion, the appellant's trading activities in Eastern Steel Products Ltd. shares were not part of or carried out in the course of a single business embracing such activities as well as the brokerage activities of Davidson and Co. and the trading activities of Davidson Securities Ltd. but were separate both from those of Davidson & Co. and those of Davidson Securities Ltd. It follows that no part of the appellant's 1957 loss in Eastern Steel Products Ltd. trading was deductible in computing his taxable income for 1956 and that the loss is deductible to the extent indicated in s. 27(1)(*e*) in computing his taxable income for 1958 and 1959. As no account has been taken of this by the Minister in making the assessments for 1958 and 1959, it becomes necessary to refer these assessments back to him to be revised accordingly.

The appeal will therefore be allowed with costs, the assessment for 1957 will be vacated, and the assessments for 1958 and 1959 will be referred back to the Minister for re-assessment in accordance with these reasons.

Judgment accordingly.