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Oct. 23
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BETWEEN:

INDEPENDENCE FOUNDERS LIMITED ..... APPELLANT;

AND

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

Revenue—Income—Income tax—Capital or income—Appeal allowed.

Appellant operates an investment trust business and uses as agents two trust companies. Its clients are allowed to buy by instalments fractional shares in blocks of securities that are lumped together. Holders of these fractional interests may buy further interests at market price at any time and can also compel appellant to buy them back at any time at the market price. Appellant's source of income is its right to be paid various fees and emoluments deducted on a percentage basis from all moneys that pass through its hands. Appellant was assessed for income tax on the increases in market value of securities that have been lying passive in its hands.

Held: That any profit made by appellant can be made not from sale and re-purchase transactions but only while the appellant has no transactions in those securities and any increases in value are capital increment and not taxable income.

APPEAL under the Income War Tax Act.

The appeal was heard before the Honourable Mr. Justice Sidney Smith, Deputy Judge of the Court, at Vancouver.

J. L. Lawrence and *B. W. F. McLoughlin* for appellant.

Dugald Donaghy, K.C. and *F. J. Cross* for respondent.

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

SIDNEY SMITH D.J. now (January 31, 1952) delivered the following judgment:

The Company appeals from assessments for income tax covering several years, and also from assessments for excess profits tax which do not cover quite the same period. But since all the assessments seem to be governed by the same principles, I need not go into details.

The Company operates an investment trust business and the main difficulties that arise in the case are due to the complexity of the relations between the Company and its agents and clientele. The Company makes use of two trust companies and there is a multiplicity of agreements between one or more of the Companies and the clientele. I need not conjecture whether these complications serve any useful practical purpose; but it is necessary to find the essential legal relations of these parties, stripped of unessential complexities. It seems to me that the two trust companies are nothing but agents for the appellant Company, and that this case should be dealt with as though the appellant Company itself carried out all transactions into which the clientele enter.

Without elaborating on the tortuous courses pursued, I may say that I view the appellant's business as one for giving investors an opportunity for investing in securities without having to pay for them in full. Clients are allowed to buy by instalments fractional shares in blocks of securities that are lumped together. One peculiarity of the arrangement is that holders of these fractional interests can buy further interests at market price at any time, and can also at any time compel the appellant to buy them back at the market price. Consideration of the scheme shows that, though the client gains or loses by fluctuations of the market, the appellant neither gains nor loses on interests that are outstanding in the hands of clients, though the appellant is affected by market fluctuations in securities that are merely passive in the appellant's hands and are not the subject of any transaction at the time.

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INDEPENDENCE FOUNDERS LTD. v. MINISTER OF NATIONAL REVENUE

Sidney Smith D.J.

What have been assessed in this case are the increases in market value of securities that have been lying passive in the appellant's hands. Appellant claims that these increases in value are capital increment and not income at all; the Minister claims that they constitute a profit in a commodity that it is the appellant's business to deal in, and so are income within the relevant Acts. The Minister points to the fact that the appellant's memorandum of association lists the buying and selling of securities as one of the appellant's objects. This, however, though a factor to be considered, is far from conclusive. The question is not whether a company can carry on a particular business, but whether that is in fact its business.

As I have said, the appellant has neither profits nor losses on securities while they are the subject of deals with clients. Though it can gain or lose on securities that are lying passive in its hands, it is as liable to lose as to win, according to the general market. The real source of income or profit that is its *raison d'être* is its right to be paid various fees and emoluments which are given various fancy labels and are deducted on a percentage basis from all moneys that pass through its hands.

The effect of all this is that, though buying and selling interests in securities are essential to the appellant's business, these transactions are not its livelihood. In fact, with regard to these transactions, the appellant is in much the position of a broker relying on commissions. It is only on fluctuations in the market for shares not being bought or sold that appellant can make a profit. It does not seek the profit, which is just as likely to be a loss. If profit, it is a fortuitous profit.

It is true, as respondent says, that these securities are held for the very purposes of the appellant's business. But that is not in itself enough to make them taxable. A logging company may hold timber lands essential to its business, but if it is not a trader in timber lands, an increase in their value is capital, not income. The respondent will answer that that is an isolated transaction, and the land is not bought for re-sale; that here there is a course of dealing in securities, and they are bought for re-sale. Again, I do not think that is necessarily enough.

Take the case of a man who runs a picture gallery, and counts on making his profit by charging admissions. To keep clients interested he may have to keep his collection constantly changing, and so constantly to keep buying and selling pictures, even though he has no desire to be a dealer, and even though he is as likely to lose as to gain by his deals. I cannot believe that his gains or losses would have any bearing on his taxable income; he is a showman, not a dealer. Similarly the appellant keeps securities not as a dealer, but as an inducement to persuade clients to buy and to pay it commissions. These securities are like the tools of a trade; the user of tools must keep replacing them, and may be lucky enough to have them rise in value after replacement; but I quite fail to see how the increase could be treated as income. Or there might be a music-teacher who stocked flutes and supplied them at cost to pupils, so that he could make money giving them lessons. I cannot believe that any rise in the value of his stock could be taxed as income.

The respondent would have more to go on if the appellant actually made profit from sales and re-purchases, even if this was fortuitous and unsought, though I very much doubt whether even then the profit would be income. Here, however, the profit, far from being made from sale and re-purchase transactions, can only be made while the appellant has no transactions in those securities. That seems to me decisive; so I hold that the increases in value are capital increment and not taxable income.

This conclusion makes it unnecessary for me to consider the appellant's other argument that even if a profit made by market gains was taxable, this could not be taxed until it was realized by re-sale; though I appreciate the strength of that submission too.

I would allow the appeal.

Judgment accordingly.