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BETWEEN:  
 WILFRED JOSEPH LAWSON ..... APPELLANT;  
 AND  
 THE MINISTER OF NATIONAL }  
 REVENUE ..... } RESPONDENT.

*Revenue—Income Tax—Income Tax Act, R.S.C. 1952, c. 148, s 14(2)—  
 Inventory—Valuation of closing inventory—Cost to taxpayer or fair  
 market value—Whether Stock Exchange price of stock represents its  
 market value—Immaterial that appellant may have artificially  
 inflated Stock Exchange price of shares—FIFO basis for evaluating  
 inventory no better than average cost basis where no evidence of  
 tendency to use oldest share certificates first.*

The appellant carried on business under the name of W J Lawson & Company and during the 1955 taxation year he traded in shares of Maneast Uranium Corporation Ltd. He purchased 1,609,860 of the shares during the year and sold 1,040,960, leaving himself with an inventory of 568,900 shares at the end of the taxation year. The appellant did not include any amount in respect of his profit from trading in the shares when completing his income tax return. The respondent, in reassessing the appellant's income, computed his profit from trading in the said shares by deducting from the amount realized on the sale of 1,040,960 of them the cost to the appellant of the total of 1,609,860 shares less the value of the 568,900 shares owned by the appellant at the end of the taxation year calculated on the average cost basis.

*Held:* That market value is the amount being paid for the shares by those who buy and sell at arm's length in the open market and no evidence was introduced to rebut the presumption or to establish that the prices listed on the Toronto Stock Exchange did not fairly represent that price.

2. That evidence that members of the general public were being incited to buy the shares of this Company in an operation of gambling at prices far in excess of any sensible valuation, by the appellant's carefully planned programme of direct and indirect publicity and market operations, does not make the amount paid by them any less the market price of the shares that they were buying.
3. That since the evidence does not disclose a tendency to use the oldest stock certificates first, it cannot be concluded that the calculation of the cost of the closing inventory on the first in first out (FIFO) basis represents a more realistic assumption than the averaging basis adopted by the respondent.
4. That costing of the closing inventory on the specific identification basis is inapplicable in this case because, although a large proportion of the shares could be traced, some 40,000 of them could not be specifically identified and their cost would have to be fixed by adopting one of the assumptions, so that evidence is not sufficiently precise to permit the costing of the closing inventory on that basis.
5. That the appeal is allowed in part.

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APPEAL under the *Income Tax Act*.

The appeal was heard by the Honourable Mr. Justice Cattanach at Toronto.

*John G. McDonald, Q.C.* and *R. L. Butters* for appellant.

*G. D. Watson, Q.C.* and *T. Z. Boles* for respondent.

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

CATTANACH J. now (July 30, 1964) delivered the following judgment:

This is an appeal from the assessment of the appellant under the *Income Tax Act*, R.S.C. 1952, c. 148 for the 1955 taxation year.

The sole issue relates to the appellant's profit from a business carried on by him under the name of W. J. Lawson & Company, the financial year of which ended on May 31, 1955. The question is whether the Minister erred in computing the appellant's profit for that year from trading in the shares of a company called Maneast Uranium Corporation Ltd. and commonly referred to as "Maneast". In particular the appellant's complaint is that the Minister, in making that computation, attributed too high an amount to the appellant's closing inventory of those shares.

In completing his income tax return, the appellant did not include any amount in respect of his profit from trading in the shares in question, so that the Minister did not

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have the advantage of having the appellant's computation of his profit therefrom for the year when making the assessment.

The Minister computed the appellant's profit for the 1955 taxation year from trading in Maneast shares as follows:

<i>Revenue</i>	
Proceeds from the sale of 1,040,960 shares	\$546,199.58
<i>Cost of Sales</i>	
Opening inventory .....	nil
Purchases of 1,609,860 shares .....	\$608,229.62
Closing inventory	
568,900 shares at average cost of 37½¢ ..	213,337.50
	<hr/>
	394,892.12
	<hr/> <hr/>
Profit from trading .....	\$151,302.46

The appellant questions the accuracy of this calculation in only one respect. He challenges the closing inventory figure of \$213,337.50. It is common ground that section 14(2) of the *Income Tax Act* requires that figure to be cost or fair market value, which ever is the lower. In the first place, the appellant says that, notwithstanding that these shares were being traded on the Toronto Stock Exchange in May 1955 at a high of 73 cents and a low of 49 cents and in June 1955 at a high of \$1.03 and a low of 63 cents, the market value at the end of May 1955 was 13 cents per share, being the value of the company's assets pro-rated among the shares or the liquidating value, and that the closing inventory figure should therefore have been computed at that rate. As an alternative, the appellant contends that the shares should be valued at the amount by which the total amount paid by the appellant for Maneast shares exceeded his total proceeds from the sales thereof, which is \$62,000, or approximately 11 cents per share. A third alternative upon which the appellant appeared to rely, although very little was said about this ground in argument, is that even if market value was higher than cost, the Minister should have fixed the cost of the closing inventory, in accordance with the specific identification method, at 31 cents per share.

I have no difficulty in rejecting the appeal in so far as it rests on the appellant's attempt to show that market value of Maneast shares was less than what they cost the appellant. This contention is based on the hypothesis that, if what is being bought and sold in the market has an intrinsic value

less than the price at which it is being bought and sold, the market value is the intrinsic value and not the amount that is being paid in the market. I am of the view that market value is the amount being paid by those who buy and sell at arm's length in the open market and that no evidence was introduced to establish that the prices listed in the Toronto Stock Exchange did not fairly represent that price. Evidence that members of the general public were being incited to buy the shares of this company in an operation of gambling at prices far in excess of any sensible valuation, by the appellant's carefully planned programme of direct and indirect publicity and market operations, does not make the amounts paid by them any less the market price of the shares that they were buying.

It may well be, of course, that a few isolated sales on the market of shares in small quantities can be shown not to be the fair market value of a very large quantity of shares. Here, however, there was a very substantial volume of sales at prices greatly in excess of what the shares cost the appellant and the Toronto Stock Exchange continued to list Maneast shares at prices in excess of cost to the appellant for almost a year after the end of the taxation year. On the other hand, there was no evidence that a reasonable programme of disposition in respect of the appellant's inventory as of the end of May would have brought the market price below cost. It may well be inferred that, if the appellant's whole inventory had been thrown on the market at one time, the price would have dropped to nothing. There was no evidence, however, that by a carefully planned programme, he could not have disposed of all the shares at a price equal to or in excess of his cost. The onus was on the appellant to show that the actual fair market value of the inventory at the end of May 1955 was less than cost and in my opinion the appellant has failed to discharge that onus.

The second position taken by the appellant is based on the evidence of the accounting witness, Ronald Archibald Lachance. In order to give full weight to his evidence, I quote from it at length:

MR. BUTTERS: Q. Mr. Lachance, you stated yesterday that you had heard the testimony of Mr. Lawson and I believe he made reference to certain of these items which you have mentioned today. Considering his testimony as you understood it, could you as an accountant on May 31, 1955, have placed a market value on these shares?

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A. I could, I think, take a stab at calculating one of the definitions of market value, and that would be—

HIS LORDSHIP: Market value or fair market value?

MR. BUTTERS: Fair market value, my lord.

THE WITNESS: I don't know, sir, that I can distinguish between market value and fair market value, but I would say that I might take a stab at determining the replacement cost, which is an accounting element of market value. I would regard Mr. Lawson as a kind of wholesaler, or at least he buys wholesale, anyway, because he at no time ever bought any shares from the company, treasury stock, at any more than one-half of the quoted market price at any time, and it would seem reasonable to assume that his market value replacement cost was considerably lower than the quoted market price. As to the other element of market, being realizable value, when one takes into consideration the highly speculative nature of this whole venture and the experience—and accountants will use their experience in making judgments—the experience that we have had or see in shares of speculative stocks dropping very suddenly, I wouldn't like to venture a guess as to what the realizable value of these shares might be. I don't think anyone could determine it with any degree of accuracy.

Q. Could fair market value, in your opinion, have been lower than cost, as you have already calculated?

A. It is possible.

MR. WATSON: I think, with respect, that should not have been suggested, my lord.

MR. BUTTERS: Q. I will ask the second question—higher than cost?

A. It could be higher or lower, I wouldn't know.

Q. You don't know what the market value is, I assume, and you have calculated cost on the FIFO basis for us?

A. Yes.

Q. And you stated that you have a choice between these two prices?

A. Yes.

Q. Just what do you do as an accountant when you are faced with a unknown and a known and are asked to compare the two?

A. I view this situation as totally unlike any normal trading business—hardware or foodstuffs, for instance. The only other situation with which I could draw an analogy would be that of a person who, three weeks before Christmas, buys 1,000 Christmas trees for, say, \$1,000 and starts to sell them. In my view it would be entirely improper for him to say that he had made a \$2 profit after selling his first tree for \$3. He knows before he makes any profit he has to recover the \$1,000 that he laid out in the first place. It is pretty obvious that he will not be able to determine his profit or loss with accuracy until the day after Christmas, on which day the trees in his inventory will be worthless. One could apply the same generally accepted costing techniques that I described earlier to this Christmas tree merchant on any day during the three-week period and come up with an apparent profit, but I don't believe that is profit, at that time in this case, because the results would not make good sense, and it is my judgment that those techniques can't be applied in Mr. Lawson's circumstances for the same reason. At May 31, 1955, Mr. Lawson had some \$62,000 of his original investment tied up in the Maneast

shares. It would be my view that unless he recovered this money there would be no certainty that he had made a profit. It seems to me that in order to say that someone has made a profit he must have made that profit and have some choice as to how he is going to use it. In this case, because of the nature of this venture, as I understand it, he was locked into it and he didn't have any profit to enjoy. The effect of this approach would be to value the 568,900 shares of Maneast at \$62,000, that is about 11 cents a share, being the unrecovered cost of the venture at that date.

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Q. Could that \$62,000 figure in your opinion represent the cost of closing inventory to Mr. Lawson?

A. I think it would be described as such, although it is more like the cost of his venture to date. I would be satisfied to call it the cost of his inventory to date.

The substance of the foregoing, as the witness puts it, is that he would value the 568,900 shares in the closing inventory at \$62,000 being the amount by which the total cost of such shares to the appellant exceeds the proceeds of sale of the shares that the appellant sold before that time.

The simple answer to the opinion of this witness that the closing inventory should be included at \$62,000, if such opinion is admissible evidence, is that it is neither the fair market value of the shares in the closing inventory, nor the cost of the shares in the closing inventory and therefore it cannot be the correct amount to use in respect of closing inventory under either section 14(2) of the Act or the regulations made thereunder.

The remaining question is whether the appellant has shown that the figure of \$213,337.50 used by the Minister in respect of the closing inventory is excessive on the cost basis.

It would appear that, if the cost of the inventory had been fixed on the first in first out basis (FIFO), the appropriate figure would have been approximately \$172,000. No evidence was given, however, that would lead to the conclusion that this assumption was closer to reality than the averaging basis adopted by the Minister. In other words, the evidence as to which stock certificates were used for particular sales did not lead to the conclusion that there was a tendency to use the oldest certificates first. That being so, there is no balance of probability in favour of the view that the certificates on hand at the end of May, 1955 actually cost \$172,000 rather than the amount placed on them by the Minister on the averaging basis and the onus of proof to show that the Minister was wrong was on the appellant.

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With regard to costing on the specific identification basis, I have been unable to satisfy myself that this was worked out on the evidence. In argument, counsel for the appellant says:

The specific identification of the shares on hand at the year-end worked out to 31 cents on an acquisition cost basis. I think Mr. Newton agreed that, assuming the specific identification which appears from Exhibits 8 and 10, the assumption on his calculations would not be appropriate, and following the actual known fact we come up with 31 cents.

A review of the evidence, and in particular that of Mr. Newton, does not show that it was established that certain stock certificates on hand at the brokers on May 31, 1955, representing 568,900 shares, belonged to the appellant and cost him an average of 31 cents per share. While a large proportion of such shares can be traced on the evidence, there remains over 40,000 shares which cannot be specifically identified and the cost thereof would have to be fixed on one of the assumptions. The evidence is not sufficiently precise to enable me to cost the closing inventory on the specific identification basis and, therefore, I do not come to any conclusion as to whether it is appropriate in the circumstances.

Accordingly, I am left with the Minister's assessment and I would dismiss the appeal were it not for the submission made by counsel for the Minister that the proper figure for valuing the appellant's closing inventory is 34.1 cents per share instead of 37.5 cents per share, because of averaging over a lesser period than the entire fiscal year. As this is favourable to the taxpayer, I accept that submission and judgment will therefore go that the appeal is allowed and the assessment is to be varied as indicated. As the appellant is unsuccessful on the issues that occupied the most of the time at trial there will be no costs.

*Judgment accordingly.*