Sault Ste-Marie 1966
Oct. 18, 19
Ottawa
Nov 10

BETWEEN:

HARRY MOLUCH ..... APPELLANT;

AND

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

Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4—Real estate transactions—Whether profits from subdivision of family farm involving construction of roads and installation of services—Capital gain or income—Profit on sale of farm.

In 1937, the appellant acquired 50 acres of uncleared bush land situate in an undeveloped area within the limits of the City of Sault Ste-Marie, for $2,300.00. There was an old frame house on the property without facilities or conveniences other than electricity. Over the years, in the time available to him, after his employment, the appellant, with the help of his wife and family, gradually cleared the land to grow garden and fodder crops for domestic use and repaired the house to make it more comfortable. The property was occupied by the appellant as his home.

In 1944, the appellant was obliged to acquire 5 adjoining acres to overcome a dispute respecting an encroaching farm.

In the 1950's the appellant was obliged, because of his wife's illness and under the advice of her physician, to provide more comfortable living accommodation This he did by undertaking the construction of a house on a part of his land facing a street where water and sewer services

were available. He borrowed $4,000.00 from a private source to terminate this construction. But he required still further funds. He rejected as wholly inadequate an offer of $18,000.00 for his property and undertook to subdivide it and to sell lots. Municipal bylaws required him to file a plan of subdivision and enter into an agreement to install roads, water and sewer services. Although much of the labour was done by the appellant himself, nevertheless this work involved a substantial outlay.

Between 1952 and 1956, the appellant sold lots without real estate agents and with very little advertising upon which he realized a profit.

The issue was whether the appellant abandoned the intention with which the lands were originally acquired and embarked upon a business with the lands as inventory in which the appellant merely realized these lands as a capital asset.

Held, That the appellant's whole cause on conclusion constituted the embarkation of a business and the gains realized were accordingly profit from a business within the meaning of section 3 of the *Income Tax Act*.

2. That although the appellant originally acquired the land without the intention of re-sale at a profit, nevertheless at a subsequent point in time the appellant embarked upon a business using the land as inventory in the business of land subdividing for profit.

3. That whether the steps taken to place a more suitable condition for resale brings a transaction as a whole into the category of carrying on trade is a question of degree depending in the business-like enterprise and actively supervised.

4. That the change effected in the character of the property from raw land to that of serviced lots constitute an element of carrying on a trade, a transformation not similar in the "McGuire case" relied upon by the appellant.

5. That the appeal was dismissed.

APPEAL from a decision of the Tax Appeal Board.

C. B. Noble for the appellant.

L. R. Olsson and *G. V. Anderson* for the respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1], dated November 15, 1965 whereby appeals of the appellant herein against assessments to income tax for the taxation years 1959, 1960, 1961 and 1962 were dismissed.

The issue is the same with respect to each taxation year under review and is whether the appellant abandoned the intention with which certain lands were originally acquired and embarked upon a business with these lands as inventory or whether the appellant merely realized those lands as a capital asset.

[1] 39 Tax A.B.C. 428.

1966

HARRY MOLUCH v. MINISTER OF NATIONAL REVENUE

Cattanach J.

The material facts are as follows:

The appellant, who is now seventy-three years of age, came to Canada from the Ukraine in 1925 and obtained employment as a labourer in a steel mill at Sault Ste. Marie, Ontario. After having established himself he was joined by his wife, some six years later, in 1931.

By conveyance dated April 21, 1937 the appellant acquired title to certain lands being Lot 5 in the Third Concession of the Township of St. Mary's, comprising approximately fifty acres. At the time of its acquisition, the property was uncleared bush land situate in an undeveloped area within the municipal limits of the City of Sault Ste. Marie. There was an old dilapidated two storey frame house resting on sills on the property without facilities or conveniences other than electricity. Water was obtained from a spring and there was no indoor plumbing. During his testimony the appellant incidentally described his efforts to install a more secure foundation. I suspect, although there was no direct evidence on the point, that there were other buildings on the property. The purchase price of the fifty acres so acquired was $2,300, of which $1,200 was advanced under a Federal plan of agricultural assistance and was secured by mortgage. The balance, I believe, was paid in cash from the appellant's savings.

The frame house was occupied by the appellant and his wife together with their two daughters as a home. The appellant continued in his employment at the steel mill but devoted his available time to clearing the land of bush. In this task he was assisted by his wife and daughters. He testified that his wife did the work of two men. Gradually small portions of the land were cleared and were devoted to gardening, the produce of which was used by the family. A team of horses was acquired to be used in removing the heavier trees and stumps. Some cows were also acquired. As more land became available for crops, a portion was used to grow fodder for the animals. None of the crops was sold but all produce was consumed by the appellant's family and livestock. In all some ten acres were rendered tillable over a period of ten years.

In 1944 the appellant was obliged to acquire five adjoining acres to overcome a dispute respecting an encroaching barn.

In the 1950's the appellant's wife became seriously ill and over a period of time underwent three successive surgical operations. The family physician advised the appellant that Mrs. Moluch could not continue the strenuous work she had been doing and that it was imperative that she be moved to more comfortable accommodation. At this time one of the appellant's daughters had married, his younger daughter was attending school and he was still working in the steel mill. He continued in that employment until 1961 when he retired therefrom. However, the appellant was unable to continue the minor farming operation which had heretofore been conducted by himself and his family.

In view of the doctor's advice, the appellant decided to build a new home on the property owned by him but on a site facing on McDonald Street, because there were water, power and sewer services available in that area.

In 1953 he borrowed $4,000 from a fellow worker and bought the materials to construct a house which he began to build in 1954 and upon which he did the bulk of the labour himself.

While the house was under construction the appellant was approached by a building contractor who verbally offered him $18,000 for the 55 acres and the house in its then present state of completion. The appellant testified that he received no other offers for his land and the offer he did receive was spurned out of hand as being ridiculously inadequate.

However, the appellant was in need of funds to complete the house and to discharge the indebtedness which he had assumed. It was decided by the appellant, undoubtedly in concert with his family and at a time which cannot be fixed with accuracy, that funds should be raised by disposing of as much as possible of the 55 acres which constituted his only asset convertible into money. The lands contiguous to the appellant's were changing in character from farming to residential lands. The area to the immediate west was totally occupied by a wartime housing development and the surrounding lands were being subdivided.

The City had passed a by-law pursuant to *The Ontario Planning Act* prohibiting the sale of lands in parcels of less than ten acres without the registration of a plan of subdivision. Further as a condition to its granting approval to a

1966

HARRY MOLUCH v. MINISTER OF NATIONAL REVENUE

Cattanach J.

plan of subdivision, the City required the subdivider to enter into an agreement to provide sewers and water and to arrange for power. The City, as a matter of policy, required development to be progressive, that is that the lands closest to available services should be developed first. To further ensure orderly development the City required that a proposed plan of subdivision should compare favourably with a preconceived master plan of the Planning Board.

In April 1957 the appellant registered a plan of subdivision, known as Moluch Subdivision, comprised of 42 lots and entered into an agreement with the City to provide services to such lots. The appellant engaged a solicitor, now deceased, to negotiate arrangements with the City and to deal with other incidental matters arising from the project. The appellant stated that the advice from his solicitor was to the effect that the difference between the cost of the land and the sale price would be a capital gain and not subject to income tax.

The appellant experienced difficulty in finding a suitable contractor to construct the roads. With the assistance of his son-in-law, he undertook to construct the roads himself. He first rented a used grader in very bad need of repair which proved unsatisfactory. He therefore bought a bulldozer tractor at a cost of approximately $15,200 and a dump truck for about $2,500. He engaged a contractor to install the water lines.

In October 1956 the appellant registered a second plan of subdivision known as Moluch "A" subdivision comprised of nine lots. An agreement with the City was not necessary because these lots were already serviced. It was in this subdivision that the appellant had constructed his own house.

In January 1958 the appellant registered a third plan of subdivision known as Moluch "B" subdivision comprised of 62 lots. The appellant entered into an agreement with the City to provide services in terms similar to those respecting the first subdivision.

In April 1964, which is subsequent to the taxation years under review, the appellant registered a fourth plan of subdivision. In the agreement entered into between the appellant and the City more improvements and much more rigorous standards were imposed than in the previous agreements.

The appellant developed the property in accordance with the minimum requirements of the plans of subdivisions and his agreements with the City. He did not provide any additional improvements. However, the subdivisions did present a continuous problem to the City officials. The roads built by the appellant became impassible thereby impeding fire protection and accessibility. There were constant complaints from residents who had purchased lots from the appellant and built homes on them. The City, therefore, rebuilt the roads and installed adequate drainage wherever required and charged the appellant for that work.

When the first subdivision was completed the appellant immediately began selling the lots. He did not employ a real estate agent, nor did he employ planning consultants, although he did employ a land surveyor. At the outset he sold lots for $1,000 each, a price which he determined himself as being the then current market value. Prices were increased later. Prospective purchasers knew of the availability of the lots from their personal observation of the development work, from enquiries at the City Hall and, in some instances, from persons who had already made purchases from the appellant. All purchases were negotiated directly with the appellant. No signs were erected on the premises and when sales slackened or when more funds were required by the appellant advertisments were inserted in the classified section of the local newspaper. The total cost of newspaper advertising during the years in question was $70.05.

The appellant's records, if existing at all, were extremely haphazard. This was due to the appellant's inexperience and because, as he stated, he had been advised by his deceased solicitor that he need not keep records since the proceeds from the sale of lots would be capital gains in any event.

However, when enquiries were made by the officials of the Department of National Revenue, the appellant's younger daughter, who had meanwhile graduated from a commercial course, reconstructed a statement of expenses from her own memory, the recollections of her parents and from those receipts that were available to her.

In preparation for the assessment of the appellant to income tax the officers of the Department painstakingly reconstructed a record of the appellant's affairs, the results

1966

HARRY MOLUCH v. MINISTER OF NATIONAL REVENUE

Cattanach J.

of which were appended to the Notice of Re-Assessment dated July 17, 1963 and consist of (1) a Statement of Profit and Loss for the years 1959 to 1962 inclusive, (2) a Statement of Cost of lots sold, (3) a Computation of Land Inventory and (4) a Schedule of Capital Cost Allowance.

In paragraph 12 of the Notice of Appeal it is stated that "The appellant does not quarrel with the quantum of the assessments as herein recited".

I construe the foregoing recital as being an admission that the Departmental officials' reconstruction of a record of the appellant's affairs is accurate and that there is no dispute as to the amounts but only as to the taxability thereof.

I, therefore, reproduce salient extracts from the statements so prepared.

The Statement of Profit and Loss is as follows:

	1962	1961	1960	1959
Sales	$ 20,000.00	$ 21,350 00	$ 36,950 00	$ 22,800 00
Cost of lots sold	8,640 00	7,680 00	13,440 00	9,600 00
Net profit	$ 11,360 00	$ 13,670 00	$ 23,510 00	$ 13,200 00

The Statement of Cost of Lots Sold is as follows:

Estimated fair market value of land (55 acres)		$ 35,000.00
Improvements: ...		
Roads and sewers, including Capital Cost Allowance per Schedule B	$ 73,864.58	
Survey costs	2,716 50	
		76,581.08
Legal fees		2,438 25
Municipal taxes		9,286 10
Advertising		70 05
Total Costs		$123,375.48

The cost for each serviced lot was computed at $960. It is obvious from the immediately foregoing statement that the main item of cost to the appellant was the labour and monies expended by him for roads and services totalling $76,581.08.

The appellant sold the following number of lots in the years indicated:

1955 — 5 lots	1959 — 11 lots
1956 — 23 lots	1960 — 12 lots
1957 — 18 lots	1961 — 10 lots
1958 — 10 lots	1962 — 7 lots

In his testimony the appellant frankly stated that it was his hope and intention to sell every lot in the subdivisions excepting his own home.

It is apparent from the Minister's allowance of $35,000 as the market value of the land that the Minister conceded that at the time of the appellant's acquisition of the land he had no intention of turning it to account by profitable resale and accordingly the Minister credits the appellant with an enhancement in value from $2,300 (the purchase price) to $35,000 (the appreciated value) in assessing the appellant as he did.

There is no doubt whatsoever in my mind that when the appellant originally acquired the lands in question he did not do so with an intent to turn it to account for profit by selling it. This fact was readily conceded by counsel for the Minister in presenting his argument. However, even if, at the time of acquisition, the intention of turning the lands to account by resale was not present, it does not necessarily follow that profits resulting from sales are not assessable to income tax. If, at some subsequent point in time, the appellant embarked upon a business using the lands as inventory in the business of land subdividing for profit, then clearly the resultant profits would not be merely the realization of an enhancement in value, but rather profits from a business and so assessable to income tax in accordance with sections 3 and 4 of the *Income Tax Act*, R.S.C. 1952, chapter 148[1]. Support for the foregoing proposition, if any be needed, is found in *Cooksey and Bibbey v. Rednall*[2], where Croom-Johnston J. said at page 519:

> I have no doubt that if there had been evidence here that at some time after the original purchases of a lot of this property these two gentlemen together had gone in for a system of land development with regard to that or part of it, it would have been open to the Commissioners to find that they had turned what had been an investment into the subject matter of a trading in land.

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[1] 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

[2] (1949) 30 T.C. 514.

1966

HARRY MOLUCH v. MINISTER OF NATIONAL REVENUE

Cattanach J.

As stated at the outset, the issue for determination is, therefore, a clear cut one of whether the conduct of the appellant, as above described, constituted an embarkation upon a business by him as contended by the Minister, or whether it was the realization of the lands in a manner most advantageous to the appellant by way of a series of sales, as contended by him.

In *Cragg v. Minister of National Revenue*[1], Thorson P. said,

> . . . the Court must be careful before it decides that a series of profits, each one of which would by itself have been a capital gain, has become profit or gain from a business. Such a decision cannot depend solely on the number of transactions in the series, or the period of time in which they occurred, or the amount of profit made, or the kind of property involved. Nor can it rest on statements of intention on the part of the taxpayer. The question in each case is what is the proper deduction to be drawn from the taxpayer's whole course of conduct viewed in the light of all the circumstances. The conclusion in each case must be one of fact.

Counsel for the appellant in his argument relied heavily upon the decision of Hyndman D.J. in *McGuire v. Minister of National Revenue*[2]. There the appellant had purchased a farm for a home intending to live on it and at the time of hearing of the appeal was living on it. He found that the land did not pay as a farm but he still wished to live there. He received an offer for the purchase of lot but learned that he could not give title because the *Planning Act* required the filing and approval of a plan of subdivision before an area of less than 10 acres could be sold. On the advice of the Municipal authorities he registered a plan of subdivision comprised of fifty-two lots of which he sold twenty over a period of four years. Hyndman D.J. found that the appellant did not purchase the land as a venture or speculation. He could see no "distinction between selling the land as a whole or selling half of it or selling a quarter of it or selling 50 parts of it. It was his land to sell and he felt that was the best way to dispose of some of it and that is what he did". The learned judge was not aware of any case, and apparently none were cited to him,

> which would have a bearing on the incident of selling a whole property or parts of a property where selling part of it like this, a subdivision, would make any difference unless it was a business in the regular business sense.

He then proceeded to find, on the facts before him, that the appellant was not engaged in business but was merely sell-

[1] [1952] Ex. C.R. 40. [2] [1956] Ex. C.R. 264.

ing his own property in the most advantageous way which it was his right to do and accordingly allowed the appeal.

The *McGuire case (supra)*, I think, may be taken as authority for the proposition that the filing of a plan of subdivision and selling lots thereunder does not of itself constitute a business in the absence of other circumstances.

I am disposed to think that there are other elements and incidents which will take the case of an isolated acquisition of property and the subsequent sale thereof in a series of transactions out of the category of a mere realization of an enhanced value and bring the transaction as a whole into the category of carrying on a trade or business.

Merely putting the article into a more suitable condition for favourable sale would not necessarily have this effect, as, for example, having a house repainted or jewels cleaned and the like. I am disposed to think that the matter is one of degree depending upon the businesslike enterprise and activity displayed. I should also think that the element of carrying on a trade would be introduced if a purchaser were by himself, or his own employees or by a contractor through an expenditure of effort and monies to change the character of the property (*vide C.I.R. v. Livingston*[1]). This is what I think the appellant did. He took the raw land which he owned and by the expenditure of money and effort he ended up possessing a number of fully serviced residential lots for sale.

Neither do I think that he was forced by circumstances to adopt the course that he did because no alternative course was available to him. He voluntarily made the decision to subdivide his land with the full knowledge that he would be obliged by his agreement with the City to provide the services required. It is reasonable to conclude that the appellant foresaw, from the inadequate verbal offer by a contractor for his land and house and from the state of development about his property, an opportunity, by the exercise of his own efforts and resources, to reap a more substantial return for himself by increasing the marketability of his property. This to me is the very essence of business.

Moreover I am unable to distinguish what the appellant did after his decision to subdivide had been reached from

[1] 11 T.C. 538.

1966

HARRY MOLUCH v. MINISTER OF NATIONAL REVENUE

Cattanach J.

what a person engaged in the business of land development would do once he had acquired a parcel of property.

I do not think that the manner in which the appellant conducted his sales, the unbusiness like records he maintained, the lack of aggressive advertising or his failure to set up an efficient organization to conduct his affairs have any material bearing. He had the facilities he considered to be adequate for his purposes.

Neither do I attach particular significance to the circumstance that the appellant had never before engaged in the purchase and sale of real estate. As the Lord President (Clyde) said in *Balgownie Land Trust, Ltd. v. C.I.R.*[1]:

> "A single plunge may be enough provided it is shown to the satisfaction of the Court that the plunge is made in the waters of trade."

As is indicated in the extract from the decision of Thorson P. in the *Cragg case (supra)* the question in each case is the proper deduction to be drawn from the taxpayer's whole course of conduct reviewed in the light of all the circumstances and the conclusion in each case is one of fact.

I have carefully read the reasons for judgment in the *McGuire case (supra)* as well as later decisions when similar conclusions were reached. The facts in the *McGuire* case are distinguishable from those in the present appeal in that there the effect of filing a plan of subdivision was merely to divide the land into a number of smaller parcels which were sold piecemeal without effecting any physical change in the land, whereas in the present appeal, the character of the raw land was changed to that of serviced lots by the expenditure of considerable effort and money, in addition to the land being divided into a number of smaller parcels.

Like the Chairman of the Tax Appeal Board I cannot refrain from commending the appellant and his family for their industry and perspicacity by which they improved their material circumstances. Nevertheless, I am of the opinion that the appellant's whole course of conduct constituted the embarkation upon a business and the gains realized are accordingly profit from a business within section 3 of the *Income Tax Act*. In my opinion the Minister was, therefore, right in including that profit in his assessments.

It follows that the appeal is dismissed with costs.

[1] 4 T.C. 684.