BETWEEN:

BALSTONE FARMS LTD. ..... APPELLANT;

AND

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

Winnipeg 1966
Sept. 13-16
Ottawa Dec. 1

Income tax—Company incorporated to acquire lands from man and wife in contemplation of death—Whether subsequent sale of lands mere realization of assets or business transaction—Nature of profits, test for determining.

Appellant was incorporated in Manitoba by letters patent in May 1955 at the instance of L in contemplation of the deaths of himself and his wife. Appellant, whose letters patent stated its object as farming, forthwith purchased from L and his wife 1,052 acres, most of which had been acquired by them since 1944 and had been farmed by tenants, and also a 5 acre mink ranch from a company controlled by L. The price for the 1,052 acres was $144,000 which greatly exceeded its cost to L and his wife; this sum was charged on the land and payable on demand. Appellant gave a demand note for $41,700 for the mink ranch. Appellant continued to farm the farm lands through tenants but operation of the mink ranch was discontinued. Shares in appellant were issued to four trustees in trust for the children and grandchildren of L and his wife and for certain charities (these beneficiaries being also those of L's will). In May 1957 an option to purchase 277 acres granted by appellant expired and $15,000 paid therefor was forfeited to appellant. In December 1958 $5,000 was forfeited to appellant on the expiration of an option on 557 acres. In 1958 appellant became entitled to $5,000 in settlement of a claim for breach of a contract to purchase 171 acres. In January 1960 $10,000 was forfeited to appellant on the expiration of an option on 106 acres and in May 1960 a further $5,000 for an extension of the option was forfeited. In that month appellant sold 171 acres at a profit of $93,312.

Held, appellant was taxable on all of the above sums. While the lands were capital assets in the hands of L and his wife they were inventory in the hands of appellant which purchased them with a view to their resale. *Hudson's Bay Co. v. Stevens*, 5 T.C. 424, *C. H. Rand v. Alberni Land Co.*, 7 T.C. 629, *Glasgow Heritable Trust Ltd. v. C.I.R.*, 35 T.C. 196, distinguished; *Alabama Coal Iron, Land and Colonization Co. v. Mylam*, 11 T.C. 232, *Gas Lighting Improvement Co. v. C.I.R.*, [1923] A.C. 729, *C.I.R. v. Westleigh Estates Co.*, 12 T.C. 657 considered; *Salomon v. Salomon & Co.* [1897] A.C. 22, *Ashbury Rly. Carriage & Iron Co. v. Riche* [1875] L.R. 7 H.L. 653, *Ruhamah Property Co. v. Federal Comm'r. of Taxation* (1928) 41 C.L.R. 148, referred to.

The nature of the profits made by a company depends on the nature of its operations and not on the purpose which led to its incorporation. *C.I.R. v. Melbourne Trust Ltd.* [1914] A.C. 1001.

The fact that a transaction falls within the objects declared in a company's letters patent is merely a *prima facie* indication that a profit therefrom is derived from the business of the company. *Anderson Logging Co. v. The King* [1925] S.C.R. 45; [1926] A.C. 140. The question is what did the company do? *Institution Mechanical Engineers v. Cane* [1960] 3 A.E.R. 715.

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INCOME TAX APPEALS.

Stuart D. Thom, Q.C. for appellant.

C. Gordon Dilts and *R. S. Saunders* for respondent.

CATTANACH J.:—These are appeals by the appellant herein against its assessments to income tax for the taxation years 1957, 1958, 1959 and 1960, by reason of the inclusion by the Minister in the appellant's taxable income of the sums of

(1) $15,000 for the 1957 taxation year as a forfeited consideration for an option to buy land from the appellant,

(2) $10,000 for the 1958 taxation year also as forfeited considerations for an option to buy land from the appellant,

(3) $15,000 for the 1960 taxation year as a forfeited consideration for an option to buy land, and $93,-312.88 as a profit realized from a sale of land by the appellant in the same taxation year,

(4) For the taxation year 1959 the Minister added the sum of $4,793.55, which had been paid for legal fees respecting the land transactions, to the deductible business expenses of the appellant rather than permitting them to be charged against the amounts realized by the appellant which the appellant had done on the assumption that the amounts so realized were capital gains.

The foregoing figures are not in dispute but rather the dispute is as to the taxability thereof. The rival contentions of the parties hereto on this question can be stated quite succinctly. On behalf of the Minister it is contended that the appellant, being a trading company, realized the above mentioned sums as profits from acts done in what was truly the carrying on of a business or an adventure in the nature of trade. On behalf of the appellant it is contended that it was not a trading company but a realization company, that certain lands acquired by the appellant were not so acquired as inventory of a venture in the nature of trade but as a capital asset to be liquidated in an orderly manner and that, until such liquidation, the farming operations, as previously carried on by the former owners of the land,

were to be continued so long as practicable. The principle of law involved is that profits derived from a business or an adventure or concern in the nature of trade are assessable to income tax while the proceeds from a mere realization of or from an enhancement of capital are not income and accordingly not assessable to income tax.

The appellant is a joint stock company incorporated pursuant to the laws of the Province of Manitoba by Letters Patent dated May 9, 1955 with an authorized capital stock of 40,000 shares of no par value which might be issued for a consideration not exceeding in the aggregate the sum of $400,000. The purposes and objects of the company are set out in the Letters Patent as follows:

> To carry on in any capacity the business of farming and the raising of animals for any purpose.

Forthwith upon its incorporation the appellant purchased from Mr. J. T. LePage and Mrs. J. T. LePage approximately 1,030 acres of farm land which they had acquired during the period between 1944 to 1953 and which lands had been continuously farmed on a crop share basis by tenants from the dates of their acquisition by Mr. and Mrs. LePage. In addition the appellant also assumed an obligation of Mrs. LePage to purchase 4 lots comprising 22 acres which gave access to a larger parcel owned by her. Of the total 1,052 acres purchased by the appellant, 663 acres were purchased from Mr. LePage and the remaining 389 acres were purchased from Mrs. LePage. The lands comprised four separate parcels in two different areas. Three of such parcels are in the Rural Municipality of Assiniboia and the fourth is in the Rural Municipality of North Kildonan. Mrs. LePage owned two parcels in Assiniboia. One parcel was river lots 100 and 101 in St. Charles Parish containing approximately 149 acres plus the four lots containing approximately 22 acres which she had contracted to purchase and which afforded access to this particular parcel. The other parcel was river lots 90 and 91 also in St. Charles Parish containing approximately 218 acres. These two parcels were purchased by Mrs. LePage on May 9, 1945 and August 13, 1953 at a cost of approximately $44.50 and $68.50 per acre respectively.

The lands owned by Mr. LePage were also in two parcels. One parcel was also in the Rural Municipality of Assiniboia

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being river lots 97 and 98 containing 106 acres which was purchased by Mr. LePage on June 9, 1944, at a cost of approximately $42.00 per acre. The other parcel owned by Mr. LePage was situate in the Rural Municipality of North Kildonan and consisted of 557 acres which were purchased in two transactions, the first of which was the purchase of 154 acres on December 14, 1944, at an approximate cost of $19.40 per acre and the second was the purchase of 403 acres on November 19, 1950 at a cost of $32 per acre.

All four parcels were farm land and used as such but because of their location on the fringe of the residential and industrial development area of Greater Winnipeg the particular location of each parcel had a direct bearing on its market value.

The Rural Municipality of Assiniboia, in which three of the parcels of land are located, is on the Western outskirts of Greater Winnipeg and North of the Assiniboine River. The parcels are about nine miles west of the corner of Portage and Main which is the business and geographic centre of the City of Winnipeg. The Municipality is not a part of the Greater Winnipeg Water District, nor the Greater Winnipeg Sanitary District and lacked the facilities provided by the Boards of such districts. While water was purchased from the Water District, sewage facilities were not available and would be expensive to install. However the City of Winnipeg had been expanding rapidly particularly in the western suburban Municipality of St. James which lies between Assiniboia and Winnipeg City proper.

The Rural Municipality of North Kildonan, in which the fourth parcel of land is situated, like Assiniboia, is not part of the Greater Winnipeg Water or Sanitary district and likewise lacks the facilities provided for such districts. The property is approximately 5 miles east of the corner of Portage and Main but borders on the town of Transcona which has a population of approximately 7,000. While the greatest growth and development in the Winnipeg area has been westerly, nevertheless, the town of Transcona has experienced some development but to a lesser degree.

In May 1955, the date the appellant acquired the lands in question, Mr. LePage was 76 years of age and his wife was two years older. In 1947, when he was 68 years of age, Mr. LePage was advised by his physician to restrict his

business activities and physical exertion because at that time he had a coronary ischaemia with angina pectoris. Later in 1951 his condition worsened and he was advised by his physician to stop work entirely or to restrict his activities most drastically. However, despite his physical afflictions and advancing years, he was mentally alert at all material times. The state of Mrs. LePage's health was much more critical than that of her husband. She was suffering from a variety of ailments in 1954 which caused mental confusion. In 1957 her condition worsened to such a point that she required constant care and attention. She died on March 9, 1959 and Mr. LePage died in 1961.

Prior to 1955 Mr. LePage was acutely aware of the state of his own health and that of his wife. During his actual business life, in addition to his farming operations on the lands above described, he was also engaged in the business of a lumber broker carried on by a joint stock company of which he was the president and majority shareholder. The lumber company owned a five acre plot of land some twenty miles from the City of Winnipeg upon which a mink ranch was operated with variable and uncertain success. However, the bulk of his estate and that of his wife consisted of the 1,052 acres of farm land. About 1955 Mr. LePage optimistically valued this land at $1,000 an acre. There is no question that the land had appreciated in value subsequent to the original purchases and there was every reasonable expectation that the value of the land would increase still further. Because of the imminent possibility of the death of himself or his wife, Mr. LePage, who recognized the inevitability of succession duties which could only be paid from a sale of the land or a portion thereof under circumstances disadvantageous to the vendor, sought professional advice respecting the planning of his own and his wife's estates. He consulted Archie W. Bell, the Manager of the Winnipeg Branch of the Canada Trust Company, James W. Abbott, a chartered accountant who had acted as auditor in Mr. LePage's enterprises and Walter C. Newman, Q.C. his solicitor. Mr. LePage obtained the advice of these three persons individually without consultation among them. All three persons recommended the incorporation of a company to acquire the farm lands but with variations in share ownership and like differences. Mr. Newman, on becoming aware of Mr. LePage's habit of

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obtaining proposals from each of his advisers independently and then seeking advice of the others on any proposal so made, suggested a meeting of all three advisers with Mr. LePage to pool their suggestions and resolve upon an acceptable solution. A meeting took place in 1954, the outcome of which was that a concerted plan was decided upon and was subsequently implemented.

First, two appraisals were obtained from two independent appraisers of the value of the farm lands. One appraiser valued the land at $132,000 and the other at $143,000. The appellant company was then incorporated and four shares were subscribed and paid for by the applicants for incorporation. Of the authorized capital stock 100 shares were issued, 34 shares in the name of A. W. Bell as trustee for Inez Marguerite Fidler, a daughter of Mr. and Mrs. LePage and her children, 50 shares in the name of Leroy Francis Findlay, a son-in-law of Mr. and Mrs. LePage of which 34 were held in trust by him for his wife, Minnie Evelyn Findlay and her children and 16 shares were held in trust for the Missionary Fund of the United Church, 8 shares in the name of James W. Abbott as trustee for the Pension Fund of the United Church and 8 shares in the name of Walter C. Newman also as trustee for the Pension Fund of the United Church. Each of the four shareholders executed a unilateral irrevocable declaration of trust acknowledging that the shares in question were held on behalf of the above named beneficiaries, that the beneficiaries were entitled to all dividends and capital proceeds of the shares, that the Trustee should exercise the voting rights in the shares held by him in his absolute discretion and provision was made that in the event of any interference of the beneficiary with the Trustee's absolute voting discretion the beneficial interest in the shares would cease and the interest would then be held for the other beneficiaries. Provision was also made for the appointment of a new trustee by the surviving trustees in the event of the death of a trustee as well as for the disposition of the funds in the event any beneficiary should be a minor. The shareholders paid no consideration for the shares issued to them. None of the trustees, who were also the shareholders and who also became the directors of the appellant, communicated the purport of the declarations of trust entered into by them to the beneficiaries named therein until the lands were eventually disposed of or in

one instance upon the death of Mrs. LePage. The beneficiaries named in the declarations of trust were also the beneficiaries under the Last Will and Testament of Mr. LePage and in the same proportions.

The lands were transferred to the appellant at a valuation of $144,000, that is at the amount of the higher of the two independent appraisals received of $143,000 plus $1,000.

No cash was paid by the appellant for the farm lands but the lands were charged with a trust deed upon the basis of which debentures were issued to Mr. and Mrs. LePage in the amounts of $80,000 and $60,000 respectively payable upon demand with interest at 5 percent to begin six months after demand having been made. In addition the appellant gave a promissory note to Mrs. LePage in the amount of $1,000 and three promissory notes to Mr. LePage in the total amount of $3,000. No personal guarantees or other security was given with respect to the acquisition of the lands by the appellant.

It was common ground that if demand were made for payment of the debentures then the appellant would be obliged to sell the lands or a portion thereof to meet that demand because the land was the only asset it possessed.

In May 1955 the appellant also purchased the mink ranch which had been operated by the lumber company which was owned and controlled by Mr. LePage at a cost of $41,727.45 being the book value of the assets. The appellant gave Mr. LePage a promissory note for that amount.

The farm lands continued to be farmed by the appellant on a crop share basis which provided funds to meet current expenses but yielded no substantial profits. The operation of the mink ranch, which had in some of the previous years yielded a profit and which the directors considered as a possible source of income, was discontinued because of a disaster which struck the mink and because of the hazardous nature of the undertaking and the land was thereafter held by the appellant merely as land.

On March 15, 1956 the appellant was approached by Sarah Diamond with an offer to purchase 277 acres of the farm lands in the Rural Municipality of Assiniboia at $1,250 an acre and requested an option for a period of one year. The directors of the appellant, conscious of their

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obligations as trustees, considered it expedient to ascertain if any other persons were interested in purchasing the lands at a higher price, inserted a small advertisement in the classified section in one issue of a local newspaper which resulted in two enquiries.

The advertisement read as follows:

> Balstone Farms Ltd. must sell all or part of two large blocks of farm acreage. Kirkfield Park district, 496 acres, Transcona district, 557 acres more or less. Details of land and buildings can be obtained at 401 Somerset Bldg. Options will be considered.

Having received the request from Sarah Diamond for an option on a portion of the lands, Mr. Bell, on the letterhead of The Canada Trust Company and as manager thereof wrote to Mr. and Mrs. LePage advising them that it would be in their best interests to make a demand upon the appellant for payment of the debentures held by them. Mr. and Mrs. LePage both did so on March 26, 1956. The other directors were aware of Mr. Bell's letter to Mr. and Mrs. LePage and had, in fact, concurred in the advice conveyed and delegated Mr. Bell to convey it.

On April 13, 1956 the appellant entered into an option with Sarah Diamond the consideration therefor being $15,000. The option expired on May 1, 1957 without being exercised. In accordance with the terms of the option the consideration therefor of $15,000 became forfeit to the appellant and was taken into its books of account as a surplus item and not as income. However, in assessing the appellant for its 1957 taxation year the Minister brought this amount into the appellant's income for that year which gives rise to the first item in the present appeals.

On January 3, 1957 the appellant executed an option on the 557 acres in Transcona and in the Rural Municipality of Kildonan in consideration of $5,000 at a price of $1,250 an acre to Model Homes Limited for a period of two years. Model Homes Limited was a reputable company possessed of the resources necessary to conduct a subdivision and housing development operation. An option for two years was an inordinately long period, the usual period of options in accordance with the custom of the trade in Winnipeg being normally six months. The option agreement represented the best terms obtainable after considerable negotiation. The option expired on December 1, 1958, without being exercised and the consideration therefor of $5,000

became forfeit to the appellant which amount was taken into its accounts as surplus. In reassessing the appellant for its 1958 taxation year the Minister added the amount of $5,000 to the appellant's income.

On June 25, 1958, the appellant entered into an agreement for the sale of 171 acres situated in the Rural Municipality of Assiniboia (part of the land previously under option to Sarah Diamond) to Philip Ricci. A deposit of $5,000 was made. Apparently Ricci and his associates attempted to sell lots illegally and before a subdivision of the lands had been approved. The appellant, therefore, began a court action to set aside the agreement for sale. During the currency of this litigation an option was asked for by and given by the appellant to Metro Subdivisions Limited dated July 15, 1959, on the lands which were the subject matter of the litigation at $2,100 an acre. A settlement of the action against Ricci was effected whereby the deposit of $5,000 was retained by the appellant which the Minister added to the appellant's income for its 1958 taxation year.

The foregoing two amounts totalling $10,000 constitute the second item in the present appeals.

On June 30, 1959 the appellant gave an option to Urban Home Builders Land Development Limited to purchase 106 acres in the Rural Municipality of Assiniboia (which land was also part of the lands which were previously under option to Sarah Diamond) at a price of $2,000 an acre for a consideration of $10,000. The option expired on January 2, 1960. An extension of that option was granted by the appellant to May 30, 1960 for a consideration of $5,000. A further extension was requested and refused. Accordingly the considerations for the option and for the extension thereof were forfeited to the appellant.

On May 24, 1960, Metro Subdivisions Limited exercised its option dated July 15, 1959, to purchase 171 acres as a result of which sale the appellant realized a profit in the amount of $93,312.88.

In assessing the appellant for its 1960 taxation year the Minister added to the appellant's income the considerations for the option and extension thereof, in the total amount of $15,000 which were forfeited to the appellant and the

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amount of $93,312.88 as profit realized on the sale to Metro Subdivision Limited. These amounts constitute the third item in the present appeals.

The proceeds of the sale to Metro Subdivision Limited were used by the appellant to pay off the balance owing on the debentures held by Mr. LePage and the estate of Mrs. LePage, Mrs. LePage having died on March 9, 1959. The debentures were paid off in June 1961 having been in default since the demand for payment made on March 26, 1956.

Subsequent to the taxation years now under review because the appellant could not farm the remaining lands on a profitable basis due to increased taxes and similar reasons all the lands were sold on July 25, 1961, to LePage Foundation Land Development Co., Limited which was incorporated for the express purpose of buying the said lands and disposing of them.

In assessing the appellant as he did the Minister did so on the assumption that the appellant acquired the lands owned by Mr. and Mrs. LePage in 1955 with a view to trading in, dealing with, or otherwise turning it to account at a profit. If the Minister's assumption is correct it follows that the appellant realized a profit of $93,312.88 from the sale of a portion of the lands in 1960 to Metro Subdivision Limited which profit would be taxable as income from a business within the meaning of the *Income Tax Act*. If the view of the Minister is correct in this respect, I would then be of the opinion that the amounts of $15,000, $10,000 and $15,000 received by the appellant in its 1957, 1958 and 1960 taxation years from the options forfeited in those years would likewise constitute taxable income as profits from a business.

However the appellant, as has been previously mentioned, challenges the basic assumptions of the Minister upon which the assessments were made and contends that the lands in question were acquired as a capital asset for the ultimate purpose of orderly, and I might add advantageous, liquidation in accordance with a carefully preconceived plan.

There is no question whatsoever in my mind that the lands in the hands of Mr. and Mrs. LePage were capital assets and if sold by them any gain which might have been

made would be a realization of an enhancement in value. It would not be a gain made in an operation of business in carrying out a scheme of profit making and accordingly not subject to income tax.

But Mr. and Mrs. LePage are not the appellants herein. They sold the lands to a company, which is the appellant, in consideration for debentures, secured by a trust deed, and promissory notes. They were not shareholders in the company and were entirely devoid of any voice in its affairs.

It is not uncommon to hear it said that a company is only the alter ego or the agent of an individual and that its activities are so coloured by his interests and directions and intentions. This was the root of the unsuccessful argument in *Salomon v. Salomon & Co.*[1] which established the legal nature of a company. Lord Halsbury L.C. said at page 30:

> ....it seems to me to be essential to the artificial creation that the law should recognise only that artificial existence—quite apart from the motives or conduct of individual corporators...short of such proof (that is that the company had no real existence) it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.

(The words in brackets are mine)

In *Commissioner of Taxes v. The Melbourne Trust, Limited*[2] three Australian banks went into liquidation. Their respective assets were transferred to three asset companies, each of which issued debentures and shares to the creditors of the bank concerned. These companies realized their assets to an extent sufficient to redeem the debentures. Melbourne Trust Limited was then formed to take over and dispose of the remaining assets of the three companies. An assessment to income tax was made in respect of the surplus realized. A special case was referred to the Full Court of the Supreme Court of Victoria. The Court (Hood and a'Beckett JJ., Madden C.J. dissenting) held that the respondent was incorporated with the object of selling the assets acquired and if possible making a profit for the benefit of the shareholders; that it was immaterial that the creditors of the banks could never be paid in full; that,

[1] [1897] A.C. 22.

[2] [1914] A.C. 1001.

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under these circumstances, the surplus realized was liable to income tax as profits earned. Madden C.J., in dissenting, was of opinion that the three vendor companies were a mere agency or device for realizing the assets for the benefit of the banks' customers, and that the respondent was the amalgamation of the three companies, standing in the same positions as they did, and that there could be no profits liable to income tax until the shareholders had received an amount equal to the indebtedness of the banks to their creditors.

On appeal Griffith C.J. and Barton J. took a similar view to that held by Madden C.J. while Isaacs J. concurred with the view of Hood J. and a'Beckett J. In a broad sense the majority took the view that the respondent was doing practically what a liquidator would have done.

However the Privy Council, looked upon the transactions in the same light as Isaacs J. in his dissenting judgment in the Court below.

Lord Dunedin said, "...the whole object of the company was to hold and nurse the securities it held, and to sell them at a profit when convenient occasion presented itself". The main question was, as I see it, whether the nature of the profits made by a company in the ordinary course of its business is to be determined by the purpose which led to its incorporation. The decision of the Privy Council rested on the principle that the nature of a company's profits depends on the nature of its operations. The legal position of the company and its shareholders could not be affected by circumstances which took place prior to the company's incorporation.

However one is not entitled to infer from the circumstance that a company has been incorporated for trading purposes that a particular transaction in which it engages necessarily constitutes a part of the company's trading operations. The fact that a particular transaction falls within the objects contemplated by the Letters Patent is merely a *prima facie* indication that a profit so derived is a profit derived from the business of the company; see *Anderson Logging Co. v. The King*[1].

The question to be determined is what did the company do and whether what it did was a business.

[1] [1925] S.C.R. 45; [1926] A.C. 140.

In the circumstances of the present appeals it is of no consequence that the objects and purposes stated in the Letters Patent incorporating the appellant are far removed from what the appellant actually did.

In *Institution Mechanical Engineers v. Cane*[1], Lord Denning took the view that in cases of a body incorporated by charter and an unincorporated body, regard must be had to what purposes the corporation or society actually carries on regardless of those stated in its constating instruments. He said at page 728, "I do not think that this question is to be solved by looking at the royal charter alone and construing it as if you were sitting aloft in an ivory tower, oblivious of the purposes which the institution has, in fact, pursued".

If you are considering a statutory limited liability company incorporated by memorandum of association and articles of agreement you know that the purposes are determined exclusively by its memorandum of association. No fresh purpose can, in law, be pursued, even with the consent of all the shareholders; see *Ashbury Railway Carriage & Iron Co. v. Riche*[2]. But when you are dealing with a limited liability company incorporated by the exercise of the Royal prerogative delegated to a Minister of the Crown either in the right of Canada or one of the Provinces, as in the case of a company incorporated by Letters Patent, the doctrine of *ultra vires* has no place.

The appellant was so incorporated pursuant to the laws of the Province of Manitoba.

Such a company has in law the self-same capacity as a natural person. The "divers clauses", as Lord Coke said, "are not of necessity, but only declaratory, and might well have been left out"; see *Sutton Hospital* case[3]. If it should pursue purposes other than those set out in its Letters Patent, its activities are perfectly valid. It is true (at common law and in many instances in the statutes governing the incorporation of companies by Letters Patent) that any shareholder or person who is injured by a violation of the Letters Patent can take proceedings in the name of the Crown to revoke the Letters Patent (see *Attorney-General of Canada v. Hellenic Colonization Association*)[4]. But if

[1] [1960] 3 A.E.R. 715.
[2] [1875] L.R. 7 H.L. 653.
[3] (1612) 10 Co. Rep. at p. 306.
[4] [1946] 3 D.L.R. 840.

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the Crown takes no such steps, it does not lie in the mouth of the company to say that the purposes which it in fact pursues are *ultra vires* or beyond its powers; see Blackburn J. in *Riche v. Ashburn Railway Carriage & Iron Co.*[1]

Isaacs J. in his dissenting opinion in *Ruhamah Property Co. Ltd. v. Federal Commissioner of Taxation*[2], said at page 165, "It seems to be thought, and this in my opinion is one of the fallacies in the appellant's contention, that once established that there is a realization or change of investment and there is an end of the matter. That is not so: it may be all that and something more. If a company does that, and what is done is also 'an act done in what is truly the carrying on, or carrying out of a business' (*Commissioner of Taxes v. Melbourne Trust Ltd.,*) then the profits resulting are proceeds liable to income tax as proceeds of a business".

Here what the appellant did was to acquire real property and turned it to account by disposing of it to advantage, which was its avowed purpose and in my view, applying the foregoing authorities, those acts amount to the conduct of a business.

Counsel for the appellant, during his argument cited, and placed great reliance on, *Hudson's Bay Co. v. Stevens*[3], *C. H. Rand v. Alberni Land Co.*[4], and *Glasgow Heritable Trust, Ltd. v. C.I.R.*[5], as well as other cases.

He also pointed out that the desired end sought to be achieved by the financial and legal advisers of Mr. and Mrs. LePage, by the incorporation of the appellant and the sale of land to it, was to secure for them an immediate accretion in the value of their land, to fix the value thereof for succession duties, to facilitate the disposition of a particular parcel to pay succession duties in the event of the death of either Mr. or Mrs. LePage and to ensure that the beneficiaries under the last will of Mr. LePage would receive any further appreciation in the value of the lands. The mink ranch, owned by a company which Mr. LePage controlled, was included in the land acquired by the appellant, I believe, as a convenience and as an afterthought. I accept the foregoing objectives as being the motives which

[1] (1874) L.R. 9 Exch. at pp. 263, 264.
[2] (1928) 41 C.L.R. 148.
[3] 5 T.C. 424.
[4] 7 T.C. 629.
[5] 35 T.C. 196.

actuated the advisers of Mr. and Mrs. LePage to advise them as they did and which advice was accepted and acted upon by them.

The plan as outlined above was conceived by the solicitor for Mr. and Mrs. LePage with the full knowledge of the decisions in the cases cited immediately above and with the incidence of income tax also in mind. There is no impediment to a taxpayer so ordering his affairs as to escape or reduce tax but the substance of a transaction must be determined from the legal rights which flow therefrom ascertained upon ordinary legal principles; see *Duke of Westminster's* case[1].

I have concluded from the authorities before mentioned that the motives which led to the incorporation of the appellant and the purposes and objects set out in its letters patent are to be disregarded and what must be looked at is the nature of its operations.

It is incontrovertible that in cases of this nature the question to be decided is one of fact.

In the three cases above cited the Court found, in each instance, that on their respective facts there was no evidence that the companies there involved were engaged in trading.

In the *Hudson's Bay* case (*supra*) the property sold had not been acquired in trade, but as part of a consideration for the surrender, by the company, of all their rights and territories within Rupert's Land. It was not the case of a purchase with a view to resale, the property was an "inheritance", and, when disposed of it was in law simply a "patrimony" turned into cash. The facts of the *Hudson's Bay* case are distinguishable from those in the present case in that there was no purchase of land with a view to resale as there was here.

In *C. H. Rand v. Alberni Land Co. (supra)* Rowlatt J. based his decision on the fact that all the company had done was to provide machinery for carrying out the projects of other people.

Subsequently in *Alabama Coal Iron, Land and Colonization Company, Limited v. Mylam*[2], Rowlatt J. said at page 256, and I think correctly, that the *Hudson's Bay* case was "a very special case, owing to the antecedents of the land for one thing, and that the *Alberni* case, was

[1] [1936] A.C. 1. [2] 11 T.C. 232.

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again a very special case". He also said of the appellant in the *Alabama Coal* case at page 255, "but on the whole I think they have conducted a trading concern, as opposed to mere realization, which prescribes a very special state of facts in the case of a company".

I do not think that the basis of the decision in the *Alberni* case can survive the criticism of Lord Sumner in *Gas Lighting Improvement Company, Limited v. Commissioners of Inland Revenue*[1] where he said at page 741, "Assuming, of course, that the company is duly formed and is not a sham (of which there is no suggestion here), the idea that it is mere machinery for effecting the purposes of the shareholders is a layman's fallacy.", nor that Warrington L.J. who said in *The Commissioners of Inland Revenue v. The Westleigh Estates Co., Ltd.*[2]:

> It was contended that the company was merely in the position of an ordinary landowner dealing with his land and granting leases thereof and so receiving rents and profits. But, assuming that in the case of an individual to do such things would not be to carry on a trade or business, it does not at all follow that the conclusion would be the same in the case of a company the end and object of whose being is to transact the business in question.

In my view the *Glasgow Heritable Trust Ltd.* case (*supra*) is also a very special case. A company was formed to acquire tenement properties previously owned by a partnership of speculative builders. The shares of the company were taken by the former partners or members of their families. Sales of flats took place to sitting tenants or when flats became vacant. The question was whether the company was engaged in trade or merely realized some of its capital assets.

The Court of Session, after two remits to the Commissioners, found that the purpose which "informed" the partnership was to carry on for profit a speculative builder's business in tenements. The purpose which "informed" the company was to salve something from the wreck of a type of trading enterprise which had ended.

The Lord President (Cooper) outlined the basic underlying facts at page 213 as follows:

> The findings disclose that prior to 1909 the now defunct firm of Duncanson & Henderson were engaged in the trade or business of speculative builders, constructing in Glasgow tenements of flatted houses for sale. They had been doing so since the early 1890's and it is common knowledge that in those days the enterprise was a familiar one, for "stone and lime" was then regarded as a favoured investment. The legislation of

[1] [1923] A.C. 723. [2] 12 T.C. 657.

1909 paralysed this form of enterprise, which received its death blow from the outbreak of war in 1914 and the subsequent introduction of rent restriction. As is evident from many successive statutes and the Bill now before Parliament, most tenements in Glasgow and certain other centres have long ceased to be marketable as tenements and the unfortunate owners of such properties have in many instances found their assets transformed into ruinous liabilities. The letting market for individual houses in the tenements survived and survives (subject to rent restriction), and sales of individual houses could sometimes be effected with vacant possession or to sitting tenants: but it is hardly too much to say that during the First War tenements as such became *extra commercium,* as they still are forty years later and are likely to remain for an indefinite time to come...

Previously he had said at page 210:

...Under the old regime the trade consisted of the erection of tenements and the sale of these tenements at a profit. Under the new regime the position has been transformed as a result of changed conditions which have notoriously resulted in making tenement dwelling-house property in Glasgow all but *extra commercium,* and in extinguishing the business of the speculative builder of such property. The Company took over 46 tenements each burdened with a bond, the bonds aggregating over £100,000, and the 46 bonds were until 1937 real burdens on each of 46 tenements. The only way in which this large capital debt could be paid off was, we are told, by realising assets: but the Company never were able to sell whole tenements and, so far as appears, never even tried to do so, but contrived, as opportunity offered, to dispose of single flats in some of the tenements, each sale reducing the security for the bond over the whole tenement and exposing the debtor to the necessity of making a fresh bargain with the creditor in the bond. It is found that no profits from such sales were ever distributed, and that no entry is found in the profit and loss accounts as respects the sales of the flats. It appears to me that this was correct accounting, the sales being truly transactions on capital account and the proceeds not being profits available for dividend. After 1937 the outstanding bonds were combined in a single omnibus bond for £70,000 of which £23,500 was still outstanding at the close of the relevant accounting periods. Until at any rate the whole of the heritable debt was paid off, the proceeds of the successive sales of flats properly fell to be treated as receipts on capital account and not as profits. To put the matter in another way, the tenements were stock-in-trade in the hands of the partnership but they were capital assets in the hands of the Company, to be held as investments or fractionally realised, as circumstances might dictate. In point of fact, the Company has been holding these assets, so far as not realised by sales of flats, as revenue-earning investments for upwards of 35 years.

As I understand the above quoted passages, the Court is saying that in the hands of the partnership the tenements were its stock-in-trade. The partnership built tenements with the view to their sale. Because of the circumstances referred to in the above extracts that business came to an end. The properties came into the hands of the Company as revenue earning assets. The revenue, by way of rentals received, was applied in the reduction of the outstanding liabilities. As such the tenements were capital assets in the

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hands of the Company and any subsequent dispositions, when circumstances permitted, were, therefore, the disposition of a capital asset and incidental to the Company's principal purpose of receiving rental income.

The facts in the *Glasgow Heritable Trust* case, (*supra*) in my opinion differ radically from those in the present appeals. Here the lands were purchased by the appellant with the view to their resale and any income received during the interval prior to their sale was incidental to that principal and acknowledged purpose. The lands in the hands of the appellant were its inventory rather than capital assets which is the direct opposite to the facts as found in the *Glasgow Heritable Trust* case.

As was stated by Rowlatt J. in the *Alabama Coal* case *(supra)* a mere realization prescribes a very special state of facts in the case of a company which state I do not think prevails in these appeals.

The only way in which I could accede to the appellant's contention would be to treat the appellant company as mere machinery for the purposes of those instrumental in securing its incorporation which, on the authorities above quoted, I am not entitled to do. Neither can I treat the appellant as a sham as that is not in accordance with the facts. Accepting the principle that the nature of the appellant's gains depend on the nature of its operations, it follows that the activities of the appellant amount to the conduct of a business and the profits so derived are profits from a business and so subject to income tax in accordance with sections 3 and 4 of the *Income Tax Act.*

In my opinion the Minister was, therefore, right in assessing the appellant as he did from which it follows that the appeals are dismissed with costs.