BETWEEN:

DONALD C. BROWN ..... APPELLANT;

AND

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

1960
Apr. 22, 23

1961
Aug. 15

Revenue—Income tax—Income Tax Act, S. of C. 1948, c. 42, s. 14(1) and the Income Tax Act, R.S.C. 1952, c. 148, s. 85B(1)(b)—Capital or income—Profit on real estate transaction—Assessment on a cash received basis.

Appellant with ample funds on hand in the form of negotiable securities, borrowed from his bank for the purpose of purchasing a lot in the City of Vancouver intending to build a small hotel on the land in order to set up his son in business. Shortly after the acquisition of the property he sold it at a profit.

Respondent assessed the appellant for income tax on the profit resulting from this transaction and from that assessment appellant appealed to this Court contending that such profit is capital gain.

Appellant also in partnership with another entered into an agreement with two wholesale grocers to erect a warehouse on property leased from the C.P.R. and rent to the wholesalers. This was done and the transaction provided a large profit to the appellant who appealed from an assessment for income tax on that profit and from the manner in which it was made.

Held: That the profits realized by appellant from both deals are income and assessable for income tax and such assessment to be in accordance with the provisions of the law regulating taxation of income returns accepted on a cash received basis as set forth in s. 14(1) of the *Income Tax Act*, S. of C. 1948, c. 42 and s-s. (1), Para. (*b*) of s. 85B of the *Income Tax Act*, R.S.C. 1952, c. 148.

APPEAL under the *Income Tax Act.*

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The appeal was heard before the Honourable Mr. Justice Dumoulin at Vancouver.

C. C. Locke, Q.C. and *W. M. Carlyle* for appellant.

G. S. Cumming and *T. E. Jackson* for respondent.

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

DUMOULIN J. now (August 15, 1961) delivered the following judgment.

This is an appeal from a decision of the Tax Appeal Board, dated the 27 day of May 1959, which affirmed two re-assessments made by the Minister of National Revenue, whereby the amount of appellant's net income for taxation year 1951 was increased by $5,000, and the net income for 1954 by the addition of a sum of $28,041.13.

Mr. Donald Cameron Brown, of Vancouver, B.C., has, for many years, been engaged, on an equal basis, with a partner, in the flour milling business under the name and style of Wild Rose Mills Ltd.

In 1951 and again in 1954, this appellant made two transactions which he looks upon as capital investments, whilst, on the other hand, the respondent would have them considered as dealings in real estate, constituting income from a business within the meaning attributed to that word in the *Income Tax Act.*

Two old houses, situate at the intersection Burrard and Smythe Streets, in Vancouver City, were purchased in late May or early June, by Donald C. Brown, as a promising opportunity for his son, a former airman, now engaged in the hotel and restaurant trades. The price paid was $40,000, borrowed at 4½ per cent interest from the Royal Bank of Canada; the purchaser electing not to disturb his holdings of $150,000, of which $130,000 consisted in government bonds.

Brown testified that he intended building a small 25-room hotel, with a possibility of enlarging it should conditions so require. This plan, however, was not disclosed to Brown, junior, before being carried out in May or June of 1951 as already noted.

A few days after he acquired this property, an agent of a car washing concern, Miss Mary Brooks, approached Brown, and asked if he would consider selling his very

recent purchase. Corroborating this statement, Miss Brooks (now Mrs. de Angelis) went on to say that: "We (her firm) earnestly considered going along with the project of building a small hotel with the financial assistance of Mr. Brown as we could not do so on our own".

An offer of $45,000 was finally accepted by D. C. Brown; the terms of payment being $10,000 in cash, and the $35,000 balance by monthly instalments of $100 from August 1, 1951, to September 1, 1955, the residue of $30,000 to be paid in a lump sum on August 1, 1961, with interest at 10 per cent a year in the meantime, payable each month.

Some adverse conditions, for instance the hum and vibration engendered by the car washing machinery, militated against the idea of erecting a hotel or rooming establishment over the cleaning garage.

Nevertheless, the deed of sale was duly completed and signed by all parties concerned on July 30, 1951, or two months after Brown had acquired the ownership (cf. exhibit 1).

Re-assessed as to his profit of $5,000, for taxation year 1951, the appellant objects that the originating transaction was not entered into . . ."pursuant or in relation to any class of profit-making operation . . . but (was) . . . acquired by the appellant to hold as investment" (cf. Statutory Provisions upon which the appellant relies, s. 1(*c*)).

It is a well known proposition, frequently re-asserted, that most cases under the Income Tax law are borderline ones, to be decided in the light of their own particular circumstances, the venerable fount of this practical wisdom being the Lord Justice Clerk's speech in the 1904 suit of *Californian Copper Syndicate v. Harris*[1].

Although not necessarily conclusive by themselves, the tests applied to a deal usually focus in the proper direction that ambiant light just mentioned.

If it is trite but true to say that an "investment" in contradistinction to "speculation", gives rise to a corollary notion of at least a relatively "long term" duration, then such an ear-mark does not apply to real estate bought in June 1951 and resold a few weeks later, July 30. Then again, there may be something in the fact that Brown chose to borrow $40,000 from the bank, when he could have

[1] (1904) 5 T.C. 159.

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acquitted the debt out of his own funds. I believe it would have seemed more consonant with the alleged intent of setting up his son in business had Brown engaged in this venture a requisite portion of his capital, rather than solicit a call loan from a bank.

The appellant also told the Court that the hotel or motel business was doomed to failure without a liquor permit and suggested three reasons why he could not hope to get one: firstly, on account of the impossibility of competing with the neighbouring hotels; secondly, because no licenses are granted in the vicinity of a school, and a large one was located nearby; thirdly because he, Brown, was not interested in this particular trade. Serious considerations no doubt, but as easily ascertainable before as after the transaction. Apparently, the weight of evidence fails to substantiate the appellant's contention and falls short of rebutting the statutory presumption which s. 42(6) of the *Income Tax Act* (11-12 Geo. VI, Ch. 52, 1948) decreed in favour of the respondent. I must then look upon this $5,000 gain as the yield of a profit-making scheme and consequently assessable for income tax purposes.

This point solved, another difficulty comes to the fore. Section 10 of the Notice of Appeal, applying to both the latter deal and the Taylor Street one, *infra,* raises the following objection:

> 10. At all times material to this appeal, the Appellant has reported his income on a cash received basis.

Section 9 of the "Reply to Notice of Appeal" does not admit this allegation, reaffirmed in the appellant's testimony and allowed to remain uncontradicted. Furthermore, in its Notice of Appeal, the appellant specifically relies, *inter alia,* upon s. 14(1) of the *Income Tax Act,* S.C. 1948, Ch. 42, hereunder cited:

> 14(1). When a taxpayer has adopted a method for computing income from a business or property for a taxation year and that method has been accepted for the purposes of this Part, income for the business or property for a subsequent year, shall, subject to the other provisions of this Part, be computed according to that method unless the taxpayer has, with the concurrence of the Minister, adopted a different method.

The Court, satisfied that appellant's plea on this matter was fully vindicated by the evidence, must then proceed to apportion the income tax due for 1951 on the basis of cash receipts.

At the hearing, in the assumption that such a finding might ensue, the respondent agreed "on principle" that:

1. The proportion of the $5,000 profit received in 1951 is the amount that the cash proceeds paid in 1951 bear to the total sale price, eg.
   The total sale price was $45,000.
   The portion thereof received in 1951 was $10,500.
   The calculation is:

$$\frac{\$10,500 \times 5,000}{\$45,000} = \$1,166.66$$

2. The same principle would be applied in subsequent years and the profit would be allocated on the same basis.

Accordingly, Donald C. Brown's net income for taxation year 1951 should be raised by adding to it a sum of $1,166.66 only, instead of $5,000.

The Taylor Street Lease.

We now reach the second ground on which the instant appeal rests.

It will be remembered, as said at the start of these notes, that Brown exploited a flour milling enterprise, jointly with a partner. In 1948, their company, "Wild Rose Mills Ltd.", leased from the Canadian Pacific Railway, for a ten years' duration, renewable for a similar period, some vacant land along Taylor Street, Vancouver City, on which Brown and his associate Weaver erected a warehouse they subquently rented to Wild Rose Mills Ltd.

Some years later, two wholesale grocers, Messrs. Fong and Tim Louie, inquired of Brown whether he and a now different partner for that particular enterprise, one Helge Pearson, would build for them a 40,000 square feet storage shed on an adjacent lot, belonging to the CPR, but under a rental option to Brown.

This offer was accepted and by November of 1953, the warehouse completed and delivered to the Louie Brothers, the land lease, however, persisting in the name of the joint builders, of whom, one, Helge Pearson, was a contractor by trade. Exhibit "5", dated August 1, 1954, a statement of adjustment, has, for its first entry the following: "To purchase price: $170,000", that, to all intents, may be taken to be the total cost of the 40,000' warehouse, with, probably though unrevealed at trial, an additional consideration for the assignment, July 31, 1954, of the ground lease by Brown and Pearson to the Louies, for the balance of a term of 10

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years from the first day of July, 1953 (cf. ex. 6). On July 31, 1954, the residuary sum still owing by Fong and Tim Louie amounted to $86,397.74, secured by a corresponding mortgage, executed also on July 31, 1954 (cf. ex. 7).

Under oath, Donald C. Brown testified that this deal brought in an over-all profit of $56,000, his one half share being $28,000, which, we know, was added to his net income for 1954.

Appellant's interest in the transaction, namely $85,000, or one half of $170,000, was payable to him . . . "as to the sum of $41,801.13 by cash or by way of adjustments, and as to the balance of $43,198.87 by 119 consecutive monthly instalments of $359.99, commencing on the 1st day of August, 1954, and ending on the 1st day of June, 1964, plus one final instalment of $360.06 on the 1st day of July, 1964, together with interest . . ." (cf. para. 8 of the Notice of Appeal).

The transaction at issue comprises two elements: 1. the erection of a storage shed, 2. the assignment of a nine-year lease, both, of course, for a profit.

Of these, the construction of a building in partnership with a professional contractor, working in the regular line of his calling, the ownership reverting to a third party, the Louie Brothers, is hardly reconcilable with a long term investment, if one does not confuse the venture itself with its terms of payments. If I may use such an expression, all the traditional lineaments of a speculation are vividly outlined in this commercial operation. Its second element, assignment of the lease, a mere right of temporary possession, a *jus ad rem* instead of a *jus in re*, hardly falls in the investment class. Here again, as in the Burrard Street case, we are confronted with a venture in the nature of trade, conformably to the definition that s. 139(1)(*e*) of the *Income Tax Act* (R.S.C. 1952, ch. 148) gives of the expression "business". Consequently any profit accruing therefrom to the taxpayer is liable to income taxation in keeping with ss. 3 and 4 of our Act.

A knottier difficulty in this instance is whether or not the entire gain of $28,041.13 was properly added by respondent to the taxpayer's net income for the one year, 1954? It is of record that Brown's annual income returns were made

and accepted on a cash received basis: Exhibit 7 stipulates 120 monthly instalments for payment of the balance owing to wit: $43,198.87. For 1954, the cash receipts and adjustments were $41,801.13 out of a total owing to Brown of $85,000 (*vide* Notice of Appeal, para. 8). Surely the appellant cannot be denied the elementary right of recouping his costs, or $56,958.87, before figuring on any profit, and the acknowledged returns, by cash and adjustments, for the material year left a gap of $15,157.74 between costs and profits (i.e. $56,958.87—$41,801.13=$15,157.74).

The respondent, virtually conceding the incongruity of its initial taxation, now says in para. 14 of its Reply to Notice of Appeal, that . . . "he is prepared to re-assess the Appellant for his 1954 taxation year so as to allow him as a deduction the sum of $13,657.32 pursuant to paragraph (*d*) of subsection (1) of section 85B".

This statutory enactment relates to . . . "property sold in the course of the business" of a taxpayer, in relation to which the amount included "in computing the income from the business for the year or a previous year . . . is not receivable until a day

(i) more than two years after the day on which the property was sold, and

(ii) after the end of the taxation year."

In the instance foreseen by s. 85B(1)(*d*) "there may be deducted a reasonable amount as a reserve . . . for the unpaid balance of the profit". However close to a solution this may appear, I am inclined to think that para. (*b*) of s-s. (1) of 85B is closer still, and I quote its text:

> 85B (1) In computing the income of a taxpayer for a taxation year,
>
> (*b*) every amount receivable in respect of property sold or services rendered in the course of the business in the year shall be included notwithstanding that the amount is not receivable until a subsequent year unless the method adopted by the taxpayer for computing income from the business and accepted for the purpose of this Part does not require him to include any amount receivable in computing his income for a taxation year unless it has been received in the year. (underlinings are mine.)

Section 85B, s-s. (1)(*d*), it would seem, is applicable when the method of accounting provided by 85B(1)(*b*), may not be properly resorted to. On this score, my opinion is strengthened by the schedule suggested in connection with the Burrard Street sale and accepted by both parties.

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In the latter instance, then, as in the former, the proportion of the $28,000 profit, received in 1954, should be the amount that the cash proceeds paid in 1954 bear to appellant's share ($85,000) of the total sale price. The record being referred back to the respondent for rectification, it is unnecessary that I should affix the figures consequential to the above equation.

In brief, the appellant fails in his contention that the Burrard and Taylor Streets transactions were meant as investments; they were on the contrary ventures in the nature of trade, pursuits of so many profit-making schemes, legitimately liable to income tax.

On the other hand, appellant's claim that for the material years, 1951 and 1954, he should be assessed on a cash received basis, appears justified and admissible. Therefore s. 14(1) of the *Income Tax Act,* 1948, and s. 85B, s-s. (1)(*b*) of the 1952 Act, should govern the annual ratio of taxation. The circumstances of the suit do not warrant the allocation of costs to either party.

For the reason given this Court doth order and adjudge that the sum of profits realized by appellant in the Burrard and Taylor Streets deals are assessable to income tax, but in accordance only with the provisions of the law regulating taxation of income returns accepted on a cash received basis, being ss. 14(1) of both the 1948 and 1952 Acts, and s-s. (1) para. (*b*) of s. 85B, 1952. Appeal allowed in part.

The record will be returned to the Minister for the corollary rectification and apportionments of tax relative to taxation years 1951 and 1954. No costs.

Judgment accordingly.