BETWEEN:

BROOKVIEW INVESTMENTS LIMITED .. .. } APPELLANT;

1962
Oct. 9, 10, 11
1963
Jun. 12

AND

THE MINISTER OF NATIONAL REVENUE ... . } RESPONDENT;

AND BETWEEN:

FRANK WILSON ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... } RESPONDENT;

AND BETWEEN:

MORRIS WILSON ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... } RESPONDENT;

AND BETWEEN:

SYDNEY WILSON . .. .APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... } RESPONDENT;

AND BETWEEN:

ELLENDALE INVESTMENTS LTD. ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... } RESPONDENT;

1963

BROOKVIEW INVESTMENTS LIMITED *et al.* *v.* MINISTER OF NATIONAL REVENUE

AND BETWEEN:

BRUCE FINKLER .....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... } RESPONDENT;

AND BETWEEN:

ELLIOT L. MARRUS .....APPELLANT;

AND

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

Revenue—Income tax—Income Tax Act R.S.C. 1952, c. 148, ss. 3, 4, 139(1)(e)—The Corporation Act 1953, Ontario, S.O. 1953, c. 19, s. 295(2)—Joint purchase of land—Real estate transaction entered into by group—Land held on behalf of group by Corporation formed for that purpose—Loss on foreclosure of mortgage—Company as trustee for individuals—Loss in real estate transaction—Deductions—Whether loss one sustained from an adventure in the nature of trade—Whether deductible by members of the group—"An operation of business in carrying out a scheme for profit making"—Appeals allowed.

Appellants were members of a group of individuals and corporations formed to acquire a 60% undivided interest in a parcel of land consisting of approximately 200 acres, for development and sale at a profit. One member of the group acted for all as trustee. A down payment on the purchase price was made in April, 1956 by the group and on September 25, 1956 a private company was incorporated to take title to the interest of the group in the land, to give a mortgage back to the vendors for the unpaid balance of the purchase price and to convey the property at the direction of the group, the money required to complete the purchase to be contributed by the members of the group. This transaction was consummated. The existence of the company was disregarded by the group, no officers were appointed, no shares being issued or meetings held, no minute book was begun and the company's letters patent were eventually cancelled for default in filing annual returns. The mortgage was allowed to go by default, the members of the group having decided that the venture was a mistake and not to put up any more money. A final order of foreclosure was obtained by the mortgagees in 1958. The loss sustained was $92,000 and in computing taxable income each of the members of the group claimed a deduction in respect of his or its share of this loss as resulting from an adventure in the nature of trade. The Minister disallowed the deductions and an appeal was taken to this Court.

Held: That the appeals be allowed.

2. That appellants were entitled to deduct from income their respective proportions of the loss incurred in the real estate transaction since

the interest in the land was purchased for sale in the course of "an operation of business in carrying out a scheme for profit making".

3. That the corporation formed by the appellants did not have a beneficial interest in the property but held it as a bare trustee for the group and subject to the obligation to convey it at the direction of the group.

4. That the true nature and substance of the transaction was an adventure in or concern in the nature of trade conducted on behalf of the group members, individually, through the interposition of the corporation, and the loss was therefore deductible by the members of the group in their respective proportions.

APPEAL under the *Income Tax Act.*

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

John G. McDonald, Q.C. for appellants.

W. J. Smith, Q.C. and *M. A. Mogan* for respondent.

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

CATTANACH J. now (June 12, 1963) delivered the following judgment:

These are appeals against the appellants' income tax assessments for their respective taxation years ending March 31, 1958, with the exception of the appellant, Brookview Investments Limited which is an appeal against the assessment for the taxation year ending March 31, 1959 and in the case of the appellant, Ellendale Investments Limited the appeal is against the assessments for the taxation years ending March 31, 1958 and March 31, 1959.

The appellants were members of a group of individuals and corporations (hereinafter referred to as "the group") formed to acquire a parcel of land located in the Township of Toronto, in the County of Peel, consisting of approximately 200 acres.

The group consisted of Leon E. Weinstein, A. Posluns and his brothers, Frank Wilson, Morris Wilson, Sydney Wilson, Ellendale Investments Limited, Maxwell S. Lewis, Bruce A. Finkler, Elliot L. Marrus and Brookview Investments Limited.

Assessments have not issued with respect to Leon E. Weinstein, A. Posluns and his brothers and Maxwell S. Lewis. However, assessments have issued with respect to the

1963

BROOKVIEW INVESTMENTS LIMITED *et al.* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

remaining members of the group all of whom have appealed against their respective assessments.

As the same problem is involved in all cases, the appeals were heard together.

On April 25, 1956 two agreements of purchase and sale were entered into by Maxwell S. Lewis "as trustee for companies to be incorporated", one with Allanthorpe Holdings Limited for approximately 100 acres and the other with Burnhamthorpe Holdings Limited also for approximately 100 acres. The land which was the subject of the two foregoing agreements together comprised the parcel of land sought to be acquired by the group. Mr. Lewis signed both agreements "as trustee". Mr. Lewis is the senior partner in the legal firm of Lewis, Marrus & Finkler, which firm acted as solicitors for the group as well as participating in the group in their individual capacities. Mr. Lewis was the prime motivator of the venture and acted as manager for the group. The group had individually and collectively decided to purchase the land in question and had instructed Mr. Lewis to act on their behalf.

The purchase price for the 200 acre parcel was $2,725 an acre, a total of $545,000. A deposit of $40,000 was paid by two cheques drawn by Lewis, Marrus & Finkler both dated April 25, 1956 payable to Earle Freeman Real Estate Ltd., the agent of the vendors, Allanthorpe Holdings Limited and Burnhamthorpe Holdings Limited (herein referred to as "the vendors"). A further sum of $110,000 was to be paid on the closing date, being August 24, 1956 and the balance of $395,000 was to become due and payable in half yearly instalments as provided in the agreements.

By letters dated May 11, 1956, Mr. Lewis made an interim report to the members of the group on the transaction, outlining the particulars thereof and the contributions made by the respective members of the group to make up the deposit of $40,000. He also advised that ample notice would be given of the contributions required on closing. The question whether a special company or companies would be formed to hold the land, or if it should be held in the names of the individual members was raised and reserved for future decision.

Prior to the closing date of August 24, 1956 the group concluded that land values were depreciating. Consideration

was given to abandoning the purchase and accepting a loss of $40,000, being the amount of the deposit. However, the group negotiated a further agreement, through the agent of the vendors, whereby instead of buying a 100 percent interest in the land, the group was to buy an undivided 60 percent interest therein at a total price of $321,004.80 of which $40,000 had already been deposited, a further $50,000 to be paid on closing and a mortgage to be delivered to the vendors for the sum of $231,004.80.

This agreement was reduced to writing in a document introduced in evidence as Exhibit 5 and executed under seal by the parties, Allanthorpe Holdings Limited and Burnhamthorpe Holdings Limited as vendors and Maxwell S. Lewis as purchaser on an unspecified date in September 1956. Mr. Lewis was again described as "trustee for a company or companies to be incorporated."

In the recitals to the agreement reference is made to the previous agreements for purchase and sale dated April 25, 1956 and that the parties, who were identical, had agreed to amend the terms thereof.

Paragraph 1 provides for the sale by the vendors, Allanthorpe Holdings Limited and Burnhamthorpe Holdings Limited and the purchase by Maxwell S. Lewis, as trustee of an undivided 60 percent interest in the land described in the previous agreements and sets out the purchase price.

Paragraph 2 then sets out an acknowledgment of the receipt of $40,000 to be applied on the purchase price, that on the closing date a further $50,000 shall be paid and outlines the terms of the mortgage for the balance of purchase price.

Paragraph 3 of the agreement reads as follows:

> 3. The parties hereto agree that the lands shall be owned by them in partnership and they shall proceed in such partnership with the development and/or sale of the lands in question. All costs involved in connection with the carrying charges of such lands, excluding the mortgages hereinbefore dealt with, and the costs of development thereof shall be borne by the parties in the following proportions:
>
> The Companies of the First and Second Parts 40%
>
> The party of the Third Part 60%
>
> The profits shall belong to the parties hereto in the same proportions as have been outlined above, and for the purpose of calculating such profits the cost price of the lands in question shall be $2,725 00 per acre.

In paragraph 4 it was provided that neither party should sell its interest in the land without first offering such interest

1963

BROOKVIEW INVESTMENTS LIMITED *et al.* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

to the other party. If not purchased by the other party the interest could then be sold to any other *bona fide* purchaser subject to the right of the other party to purchase the interest desired to be sold at the same price and under the same terms as it would be sold to the prospective *bona fide* purchaser.

Meanwhile on August 7, 1956 the corporate name of Armley Investment Limited had been reserved with the Provincial Secretary of Ontario in contemplation of an application for incorporation thereunder.

By letters patent dated September 25, 1956 Armley Investments Limited (hereinafter referred to as "Armley") was incorporated pursuant to the laws of the province of Ontario following an application therefor by Maxwell S. Lewis, Bruce A. Finkler and three other members or employees of the legal firm, all of whom were named in the letters patent as first directors.

At the time of entering into the agreement of September 1956 (Exhibit 5) the application for incorporation of Armley had been made.

A letter dated September 27, 1956 was sent by the legal firm of Lewis, Marus and Finkler to all members of the group setting out a schedule of further payments required of each member to make up the amount of $50,000, and costs to be paid on closing under the agreement of September 1956.

By letter dated September 28, 1956 the firm of Lewis, Marrus & Finkler requested the solicitor for the vendors to make the conveyance in the transaction, entered into with them by Maxwell S. Lewis, as trustee, to Armley Investments Limited.

On October 1, 1956 an agreement was entered into between Armley and all members of the group which agreement was filed in evidence as Exhibit 11. The agreement recites that Maxwell S. Lewis, as trustee for a company to be incorporated, had entered into an agreement to purchase a 60 percent interest in the land in the Township of Toronto, that Armley had been incorporated and that the members of the group had agreed the land was to be purchased in the name of Armley as trustee for them in their individual capacities. The operative portion of the agreement then provided that the members agreed to contribute

such sums as were required to complete the purchase in the proportions stipulated in the agreement and that Armley held the land as trustee only for the members of the group and undertook to convey the land to the members of the group in accordance with their respective proportionate interest therein as and when called upon to do so by them.

As requested in the letter from Lewis, Marrus & Finkler dated September 28, 1956 to the vendors' solicitor, the vendors conveyed an undivided 60 percent interest in the land to Armley "to have and to hold to and for its sole and only use forever" by deed dated October 9, 1956 and on the same date a mortgage of the land securing payment of the unpaid balance of the purchase price was given by Armley to the vendors.

The amount of $50,000 agreed to be paid on closing was so paid by a cheque dated October 9, 1956 drawn on the trust account of Lewis, Marrus & Finkler payable to the vendors.

The total amount contributed and paid by the group was $92,213.76 made up of (1) the deposit of $40,000 paid on April 25, 1956, (2) $50,000 paid on closing the transaction on October 9, 1956 and (3) $2,316.76 for legal fees and disbursements.

This amount was apportioned among the members of the group in the following percentages and amounts:

Brookview Investments Limited	33⅓—	$30,848.67
Leon E. Weinstein	13⅓—	12,339.46
Wilson Brothers	13⅓—	12,339.46
Posluns Brothers	13⅓—	12,339.46
Ellendale Investments Limited	13⅓—	12,339.46
Lewis, Marrus & Finkler	13⅓—	12,110.25
TOTAL	100%—	$92,316.76

The transaction with respect to the land was considered subsequently by the group as likely to be unsuccessful. The land was not developed or sold as contemplated in paragraph 3 of the agreement of September 1956 (Exhibit 5) between the vendors and Maxwell S. Lewis, as trustee.

The group concluded the venture had been a mistake and therefore resolved to put no further monies into it. This conclusion began to be formed between the negotiation of

1963

BROOKVIEW INVESTMENTS LIMITED *et al.* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

the first agreements of sale and purchase by Mr. Lewis as trustee dated April 25, 1956, which uncertainty prompted the group to acquire the lesser interest of 60 percent in the land rather than a 100 percent interest. This doubt became a certainty shortly after closing the transaction on October 9, 1956.

Accordingly no payments were made under the mortgage delivered to the vendors to secure the balance of the purchase price. By letter dated May 9, 1957 the vendors' solicitor advised Armley of its default of interest and principal pursuant to the terms of the mortgage and demanded payment by May 13, 1957. This letter was unanswered. A further letter was written by the vendors' solicitor, dated May 30, 1957, to Armley reiterating the demand for payment and intimating if payment was not received by June 3, 1957 further action would be taken. This letter was also ignored.

A writ of foreclosure was then issued on September 13, 1957 on behalf of the vendors as plaintiffs against Armley as defendant to recover payment due under the covenant, to recover immediate possession of the mortgaged premises and claiming the balance of the monies under the mortgage.

On September 18, 1957 Lewis, Marrus & Finkler, as solicitors for Armley, the defendant in the mortgage action filed a notice of desire to redeem, which was a step taken on the initiative of Mr. Lewis to obtain further time although it was admitted the group had no intention of redeeming.

A final order of foreclosure was issued on May 8, 1958.

Meanwhile the corporate proceedings of Armley were cavalierly disregarded. No organization meeting was held following the incorporation of the Company on September 25, 1956, but it could function as a legal entity by reason of section 295 of the *Ontario Corporation Act,* 1953 S. of O., c. 19, subsection (2) of which reads as follows:

> The first directors of the Corporation have all the powers and duties and are subject to all the liabilities of directors.

Armley took title to the land on October 9, 1956. It executed a mortgage to the vendors, Bruce A. Finkler signing the instrument as president and it also entered an appearance in the foreclosure action through its solicitors on Septem-

ber 18, 1957. Armley also entered into the agreement with all members of the group on October 1, 1956.

However, no officers were appointed, no shares were issued, no meetings of shareholders or directors were held and no minute book was begun. A corporate seal was obtained but no meeting was held authorizing the adoption of a seal.

On November 19, 1956, Lewis, Marrus and Finkler in response to an inquiry from the Department of National Revenue, advised that Armley Investments Limited had not commenced carrying on active business, but that when it did returns would be filed.

On September 11, 1958 the Deputy Provincial Secretary wrote to Armley pointing out its failure to file Annual Returns of Information for the years 1957 and 1958. On November 13, 1958 the Deputy Provincial Secretary again brought this omission to Armley's attention and pointed out the statutory penalties. Both such letters were ignored.

On April 2, 1959 the Comptroller of Revenue for Ontario wrote to Mr. Lewis at his home address pointing out the failure of Armley Investments Limited to file its Corporation tax return for December 31, 1957. Mr. Lewis was advised that the obligation to file such return existed whether the Company was operating or not and that penalties were imposed on the directors personally.

This letter elicited a reply from Mr. Lewis dated April 8, 1959 that the Company had been incorporated for the purpose of holding a title to certain lands, but after the acquisition thereof a final order of foreclosure had issued pursuant to foreclosure proceedings and accordingly the Company was without assets.

The Comptroller of Revenue for Ontario then suggested by letter dated April 27, 1959 that the letters patent be forwarded to him with an affidavit of an officer of the Company that it had ceased carrying on business, was entirely without assets and no distribution had been made to its shareholders. When such material was received it was suggested that consideration would be given to cancelling the letters patent.

A statutory declaration in such terms was completed by William Slater, as secretary-treasurer of the Company and

1963

BROOKVIEW INVESTMENTS LIMITED *et al.* v MINISTER OF NATIONAL REVENUE

Cattanach J.

forwarded to the Comptroller of Revenue for Ontario under cover of a letter dated April 20, 1959.

On August 3, 1960 the Deputy Provincial Secretary advised that by order of the Provincial Secretary dated July 25, 1960 the letters patent had been cancelled for default in filing annual returns and the Company was dissolved as of August 29, 1960.

In compiling their income tax returns for their taxation years ending March 31, 1958 each appellant claimed as a deduction from other income their respective proportion of the amount of $92,316.76 as a loss incurred in the real estate transaction described except in the case of the appellant, Brookview Investments Limited, where the deduction was claimed in its income tax return for the taxation year ending March 31, 1959.

By notices of assessment and reassessment issued to the appellants, the Minister disallowed their respective claims for deduction.

It is from these assessments that appeals are brought to this Court.

The sole issue for determination is whether the appellants are entitled to deduct from other income their respective proportions of the loss incurred in the real estate transaction.

The determination of this issue is, in turn, dependent upon whether the transaction constituted a business or an adventure or concern in the nature of trade.

By section 3 of the *Income Tax Act* the income of a taxpayer for a taxation year for the purposes of Part I of the Act is declared to be his income from all sources inside and outside Canada and includes income for the year, *inter alia,* from all businesses. By Section 4 income from a business is declared to be, subject to the other provisions of Part I, the profit therefrom for the year and by section 139(1)(*e*) business is defined as including a profession, calling, trade, manufacture or undertaking of any kind whatsoever and as including an adventure or concern in the nature of trade.

The classical test of such an issue is that stated in *Californian Copper Syndicate v. Harris*[1] as follows:

> It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment

[1] (1904) 5 T C 159 at 165.

chooses to realize it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax But it is equally well established that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on or carrying out, of a business The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realization, the gain they make is liable to be assessed for Income Tax.

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

Applying the foregoing test to the facts in the present appeals as outlined herein, I have no hesitation in finding that the undivided 60 per cent interest in the lands in question was purchased for sale in the course of "an operation of business in carrying out a scheme of profit making".

In my view Armley held no beneficial interest in the lands or the transaction.

The agreements for purchase and sale dated April 25, 1956 and the agreement of September 1956 (Exhibit 5), entered into by Lewis as trustee for a company to be incorporated enured to the benefit of Armley by reason of section 285 of *Ontario Corporations Act, 1953* reading as follows:

Every corporation shall, upon its incorporation, be invested with all the property and rights, real and personal, theretofore held by or for it under any trust created with a view to its incorporation.

The partnership contemplated in paragraph 3 of the agreement of September 1956 did not come into effect. An agreement to carry on business at a future time does not render the parties to it partners before they actually carry on business since the test of partnership is the carrying on business and not the agreement to carry it on. Authority for the foregoing proposition is found in Lindley on Partnership, 1962 Edition at p. 17.

Therefore, what Armley held was title to an undivided 60 percent interest in the land.

1963

BROOKVIEW INVESTMENTS LIMITED *et al.* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

It is manifest from the evidence that the function of Armley was to take and hold title to the land, give a mortgage back to the vendors, and to convey the property at the direction of the group. This arrangement is recorded in the agreement dated October 1, 1956 between Armley and the members of the group.

The land was purchased with money supplied by the group.

Accordingly I conclude that the land was held by Armley as a bare trustee for the group and subject to the obligation to convey it at the direction of the group.

Assuming that a profit had been realized, such profit would not represent taxable income of Armley, for as Thorson P. said in *Kenneth B. S. Robertson v. M.N.R.*[1] and approved by Taschereau J. as he was then, in delivering the unanimous decision in *Sura v. M.N.R.*[2]

> . . . it lacks the essential quality of income, namely, that the recipient shall have an absolute right to it and be under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

Conversely it follows that the loss incurred is clearly deductible as a loss from a business or adventure or concern in the nature of trade and it further follows that the loss is that of the appellants in the proportion of their respective contributions, the true nature and substance of the transaction being that it was a business transaction in the nature of trade conducted on their behalf through the interposition of Armley.

Therefore, in my opinion, the amounts claimed by way of deductions are so deductible.

Accordingly the appeals herein are allowed with costs.

Judgment accordingly.

[1] [1944] Ex. C.R. 170, 184.

[2] [1962] S.C.R. 65 at 68.