
BETWEEN:

KLONDIKE HELICOPTERS LIMITED ..APPELLANT;

AND

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

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THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

CONNELLY-DAWSON AIRWAYS LIMITED ..... RESPONDENT.

New Westminster 1965 Sep. 20-22

Ottawa Oct. 6

Income tax—Capital cost allowances—Sale of business—Allocation of price to depreciable and non-depreciable assets—Amount which can reasonably be regarded as consideration therefor—Income Tax Act, s. 20(6)(g).

In January 1958 Klondike Helicopters Ltd sold its fixed-wing flying business to Connelly-Dawson Airways Ltd for $100,000 and together with its principal shareholder covenanted not to compete with the purchaser for ten years. The contract of sale apportioned the price equally between physical assets and goodwill, a provision insisted upon by the vendor in order to minimize the recapture of capital cost allowances in its hands under the *Income Tax Act*. The physical assets had originally cost $75,500 but at the time of sale had been written down by capital cost allowances to $14,000 for income tax purposes. Their market value at that time was $71,300. In its income tax return

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for 1958 the purchaser claimed capital cost allowances in respect of the physical assets on the basis of a capital cost of $71,300, whilst the vendor claimed capital cost allowances thereon on the basis set out in the contract of sale. The Minister assessed the purchaser on the latter basis, and the purchaser appealed to the Tax Appeal Board, which allowed the appeal. The Minister thereupon re-assessed the vendor on the same basis.

Appeals from the decision of the Tax Appeal Board in favour of the purchaser and from the Minister's re-assessment of the vendor were taken to the Exchequer Court. Both appeals were heard together on common evidence.

Section 20(6)(*g*) of the *Income Tax Act* provides that

> "where an amount can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property of that class . . . and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount;".

The Court found on the evidence that while the value of the goodwill of the vendor's business was doubtful (though put at $57,000 by one expert witness), the covenants of the vendor and its principal shareholder not to compete with the purchaser for ten years were of substantial value to the purchaser, and that the sum of $50,000 was not unreasonably high therefor.

Held, both appeals should be allowed. In the circumstances the part of the price which could reasonably be regarded as the consideration for the goodwill and the restrictive covenants was not less than $50,000 and the part of the price which could reasonably be regarded as the consideration for the physical assets did not exceed $50,000.

[*Herb Payne Transport Ltd. v. M.N.R.* [1964] Ex. C.R. 1 at p. 8, referred to.]

APPEALS from a decision of the Tax Appeal Board and from a re-assessment of income tax.

Jacques Barbeau for appellant Klondike Helicopters Limited.

R. M. Hayman and *A. E. Harvey* for respondent Connelly-Dawson Airways Limited.

T. E. Jackson for Minister of National Revenue.

THURLOW J.:—These two appeals arise from the same transaction and, pursuant to an order of the Court made on the application of the Minister, they were heard together. By the same order it was directed that the evidence adduced by the Minister and by each of the taxpayers should

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be applicable to both appeals. The first is an appeal by Klondike Helicopters Limited from re-assessments of income tax for the years 1958 and 1961 both made on the basis of $71,300 being the amount which could reasonably be regarded as having been the consideration for assets of its fixed wing flying operation falling within class 16 of Schedule "B" of the Income Tax Regulations on the sale of that business with its goodwill and other assets to Connelly-Dawson Airways Limited on or about January 2, 1958. The other is an appeal by the Minister from a judgment of the Tax Appeal Board[1] allowing an appeal by Connelly-Dawson Airways Limited from a re-assessment of income tax for the year 1958 and holding that the assessment and the taxpayer's right to capital cost allowance should be based on the taxpayer having acquired the class 16 assets in question from Klondike Helicopters Limited at a capital cost of $71,300 rather than the $42,050 upon which the re-assessment was based. While the Minister's position as pleaded is thus different in the two appeals both raise the same question as to what part of an amount of $100,000 realized by Klondike Helicopters Limited on the disposition of its fixed wing flying business can reasonably be regarded, for the purposes of s. 20(6)(*g*) of the *Income Tax Act*,[2] as the consideration for the class 16 assets disposed of in the transaction. Both the extent of the liability of Klondike Helicopters Limited, in computing its income for tax purposes, to account for recaptured capital cost allowance taken in respect of these assets in earlier years and the extent of the right of Connelly-Dawson Airways Limited to capital cost allowance in respect of the cost to it of these assets turn on the answer to this question.

The statutory provision under which the matter arises reads as follows:

> 20. (6) For the purpose of this section and regulations made under paragraph (*a*) of subsection (1) of section 11, the following rules apply:
>
> (*g*) where an amount can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property

[1] 31 Tax A.B.C. 286.

[2] R.S.C. 1952, c. 148.

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> of that class, irrespective of the form or legal effect of the contract or agreement; and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount;

In applying this rule the matter for determination is not simply one of interpreting the contract or agreement or of giving effect to its provisions. Rather, when the rule applies the problem is to decide, having regard to all the circumstances of the transaction, what part of an amount representing the consideration for disposition of depreciable assets of a prescribed class and for something else can reasonably be regarded as having been the consideration for the disposition of the assets of the prescribed class and for the purposes of the rule the amount so determined is to be regarded as the proceeds of disposition of such assets regardless of the form or legal effect of the contract or agreement. As pointed out by Noël J., in *Herb Payne Transport Limited v. M.N.R.*[1], in determining this question evidence will be admissible which would be excluded if the contract or agreement alone governed the rights of the taxpayer and the Minister as parties to the proceeding. The making of a contract or agreement in the form in which it exists is, however, one of the circumstances to be taken into account in the overall enquiry and if the contract purports to determine what amount is being paid for the depreciable property and is not a mere sham or subterfuge its weight may well be decisive.

It is to be observed as well that the statutory rule applies only "where an amount can reasonably be regarded as being in part consideration for disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else". An initial question may thus arise as to whether a particular situation falls within the ambit of the provision as so defined. In the present cases, however, no question was raised by either taxpayer as to the application of the provision and, in view of both the form and the indivisible nature of the contract to be described, it seems clear that the sum of $100,000 referred to in it can reasonably be regarded as being in part the consideration for disposition of depreciable property of Klondike Helicopters Limited of prescribed class 16 and as

[1] [1964] Ex. C.R. 1 at p. 8.

being in part consideration for something else. The problem is thus purely one of determining on the facts as disclosed by the evidence what part of that amount can reasonably be regarded as having been the consideration for the depreciable property of class 16 included in the transaction.

In 1957 when the negotiations for the sale in question took place, the name of the appellant, Klondike Helicopters Limited was Callison Services Limited and its president and principal shareholder was Edward Patrick Callison, a commercial aircraft pilot and engineer who had been engaged in commercial aviation for some twenty or more years. From 1947 to the end of 1955 he had carried on, under the name of Callison's Flying Service, a charter and mail flying service based at Dawson City in the Yukon Territory. In 1955 he had purchased the shares of McCormick Transportation Company Limited, one of his customers, and had had the company name changed to Callison Services Limited. Thereafter in 1956 and 1957 the company had carried on its ground transportation operation and the flying service formerly operated by Callison as well.

Both in 1956 and again in 1957 there had been a considerable increase in the flying service operation over what it had amounted to in 1955. When the events giving rise to the transaction in question began the appellant company was operating three aircraft of its own and was making use of two other aircraft supplied by other companies on a rental basis. At the same time Callison was planning to acquire several helicopters and to operate a service with them in addition to the fixed wing flying and ground transportation services already in operation. The flying service was operated under licence from the Air Transport Board and was the only flying service based at Dawson City.

Early in the fall of 1957 Callison negotiated with Ronald Fred Connelly, who was the pilot of one of the leased aircraft and an employee of its owner, a proposed arrangement under which the fixed wing flying operation together with the assets pertaining thereto would be transferred to a new corporation and Connelly, for $50,000, would become owner of approximately one-half of the shares of that company but with Callison holding the controlling interest.

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This proposal proceeded to the point where Callison had consulted an accounting firm with respect to the taxation implications of the proposed transaction, he being aware of the fact that the depreciable assets had been substantially written down for tax purposes, and solicitors for him and for Connelly had been instructed to incorporate the new company, originally named Callison Services (No. 2) Limited and later re-named Connelly-Dawson Airways Limited, and to prepare the documents required to give effect to the transaction. However, these instructions had not yet been carried out when a new proposal was made on behalf of Connelly, his wife, and her father, Mr. Crae Dawson, for the purchase outright of the fixed wing flying operation and assets in question for $100,000.

Callison realized that such a sale might give rise to liability for tax and he did not accept the proposal. Through his accountant or his solicitor he countered with an offer to sell for $125,000 and when later informed that $100,000 was the limit to which the Connellys and Mr. Dawson would go he was prepared to accept $100,000 only if he would be able to get that amount without reduction because of liability for tax. His accountant, Mr. Farley, then suggested that the sale be made on the basis of 50 per cent. of the proposed price being paid for the physical assets of the operation and the other 50 per cent. for the goodwill. The evidence of both Mr. Callison and Mr. Farley indicates that Farley went to some pains to explain this feature of the proposed transaction and its tax implications to Mr. and Mrs. Connelly in the presence of the solicitor acting for them and for Mr. Dawson. Mrs. Connelly does not deny that an explanation was given but says that if one was given she did not fully understand the implications, that her concern was with the price of $100,000 and that it didn't matter to her how it was broken down. Neither Mr. Connelly nor Mr. Dawson nor the solicitor was called as a witness.

When the transaction took place Mrs. Connelly was twenty-five years of age. She had had a high school education and had become an aircraft pilot and had had some seven years experience as a flying instructor and commercial pilot but had had no business experience. I see no reason to doubt that an explanation of the tax implications of the proposed transaction was given and that she

appeared to Mr. Farley to understand the consequences but I am not satisfied that she did fully understand what these implications were for the purchasing company. At the same time I see no reason to think that her solicitor did not fully and clearly understand the tax implications for the purchaser in such a transaction or that the imperfection of her personal understanding of such implications can have any bearing on the transaction or its results.

The contract as eventually executed was a three party transaction made between Klondike Helicopters Limited, then Callison Services Limited, as vendor and Connelly-Dawson Airways Limited, then Callison Services (No. 2) Limited as purchaser, with Callison personally joining in some of the covenants given by the vendor. After reciting that the vendor had agreed to sell to the purchaser and that the purchaser had agreed to buy "the buildings, appurtenances, equipment, stock-in-trade and the benefit of all agreements and good will hereinafter mentioned in respect of that portion of the vendor's business known as the 'Fixed-Wing Flying' business on the terms and conditions" therein contained and that Callison was the principal shareholder of the vendor the document witnessed that in pursuance of the said agreement and in consideration of the amounts thereinafter enumerated to be paid by the purchaser the vendor sold and assigned to the purchaser the several physical and other assets then described. It then proceeded:

THE PURCHASE PRICE for the said buildings, equipment, stock-in-trade and the benefit of all agreements and good will shall be as follows:

(*a*) The Aeroplanes, buildings, equipment and stock-in-trade described in Schedule "A" to this Agreement, the sum of $50,000.00

(*b*) For the benefits of all contracts and engagements as of the 2nd day of January, 1957 (sic) and for the good will, the sum of $50,000.00

THE PARTIES HERETO COVENANT AND AGREE that the total sale price in consideration of the sale of the said Aeroplanes, buildings, stock-in-trade, equipment and the benefit of all Agreements and good will as aforesaid shall be the sum of One Hundred Thousand ($100,000 00) Dollars, payment whereof shall be as follows:

The contract went on to provide for a down payment of $40,000 and for the securing of the remaining $60,000 by a mortgage on most of the physical assets included in the transaction. Only two of the remaining provisions need be

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mentioned. By one of these the vendor agreed that it would, at the expense of the purchaser, do all such acts as might be necessary for transferring to the purchaser *inter alia* all licences held by the vendor relating to the carriage by air of passengers and freight and it was provided that if for any reason any of such licences should not be transferable or issuable to the purchaser the agreement should be void. By the other Callison joined with the vendor in covenanting that they would not engage directly or indirectly in any fixed wing flying business in the Yukon Territory for ten years.

As some delay was experienced in obtaining the decision of the Air Transport Board on the application for transfer of its licences two further amending agreements were executed to provide for the interim operation of the business but these in my view have no effect on the material provisions of the contract. In the latter part of May 1958 the purchaser's solicitors received a letter stating that the Air Transport Board regarded as excessive the valuation of the goodwill of the business at $50,000 and requesting the provision of a *pro forma* balance sheet of the new company showing the value of goodwill at an amount not exceeding $25,000. The letter went on to say that "In this connection it should be noted that the $25,000 eliminated from the goodwill valuation may be shown in a 'Property Acquisition Adjustment' account."

On this letter being brought to his attention Callison's view was that the contract could not be carried out and was therefore to be treated as at an end. On May 30, 1958, he wrote and sent the following on the letterhead of his company:

Mr. Connelly & Dawson
Dawson City. Yukon.

Re sale of Callison Services Ltd. fixed wing flying business.

From what we have been advised and the letter from the A.T.B. dated May 20th. 1958. rejecting the agreement presented to them. It is now necessary if we go ahead with the sale to have a new agreement drawn up and signed by all parties concerned.

Before we will agree to the new agreement the following will have to (be) included in the new agreement.

No. 1. Connelly & Dawson pay us now 47 per cent of the $25,000.00 increase value of equipment as requested by the A.T.B.

No. 2. Connelly & Dawson pay us now for inventory taken over April 1st. for gas. Oil. and all insurance to June 18th.

No. 3. That Connelly & Dawson agree to pay 6 per cent interest on all money owing by them instead of 3 per cent.

No. 4 New agreement will read that we will be required to stay out of the fixed wing flying business for a period of five years not ten years in the Yukon.

No. 5. New agreement will read that they Connelly & Dawson will be required to stay out of the helicopter flying business in the Yukon for a period of five years.

However, no agreement was reached on these terms. Instead Callison was advised by his solicitor that the requirement of a balance sheet on the lines stipulated by the Board's letter was a matter between the purchaser and the Board with which the vendor was not concerned and thereafter the transaction was completed on the terms of the original contract.

Besides the class 16 assets, which consisted mainly of three aeroplanes, the sale included certain depreciable assets of other classes, such as a building and a truck, and a quantity of expendable supplies, such as gas and oil. In its income tax return for the year 1958 Klondike Helicopters Limited allotted an amount of $7,950 as the consideration for these other depreciable and expendable assets and computed its income on the basis of $42,050 having been the consideration for disposition of the class 16 assets. Connelly-Dawson Airways Limited, however, computed its income on the basis of $75,000 having been the consideration for the corporeal assets acquired in the transaction and of this amount treated $71,300 as having been the capital cost to it of the class 16 assets. Thereafter the Minister assessed both taxpayers on the basis of $42,050 having been the consideration for the class 16 assets whereupon Connelly-Dawson Airways Limited appealed to the Tax Appeal Board. The appeal having subsequently been allowed the Minister launched his present appeal to this Court but also re-assessed Klondike Helicopters Limited for the years 1958 and 1961 on the basis of $71,300 having been the consideration for the class 16 assets in question and following notice of objection by the taxpayer confirmed the re-assessments. Klondike Helicopters Limited then launched its appeal to this Court. No issue is raised in either appeal as to the amount to be attributed either to the depreciable assets other than those falling within class 16 or to the expendable assets included in the sale and it was stated by counsel

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at the hearing that the only matter requiring consideration is whether $71,300 or $42,050 is the right amount to regard as the consideration for the class 16 assets.

It is agreed that the fair market value of the class 16 assets of the business at the time of the sale was $71,300. These assets had been acquired by Klondike Helicopters Limited at a total capital cost of $75,543 but for income tax purposes they had been depreciated to $14,088. On their sale at any price higher than the latter amount the vendor in computing its income for tax purposes would be obliged under the provisions of the *Income Tax Act* to account for any sum in excess of that amount up to the original capital cost.

What the true value of the goodwill of the business was is not very clear. There is evidence given by Callison that he valued it at $75,000. James Grant Halpin, a chartered accountant who has had experience over many years in matters involving the valuation of goodwill expressed the view, based on an arithmetical calculation and information respecting the growth of the business that the goodwill was worth $57,000 to $58,000. Charles Allison Johnson, also a chartered accountant, while acknowledging Mr. Halpin's experience and reputation expressed the view that the latter's opinion of the value of the goodwill in question was unrealistic and that on the information available to him, which was substantially that available to the Court, he would be unwilling to venture any opinion as to the value. Assuming that goodwill is to be taken as having the meaning attributed to the expression by Thorson P., in *Losey v. M.N.R.*[1] that is to say, the advantage of the reputation and connection of the person who had built up the business, that its value is what a purchaser would be willing to pay for the chance of being able to keep the connection of which it consists and that it includes neither a covenant by the vendor not to compete nor a right to the personal services or the business ability of the former proprietor of the business I find it difficult to conceive of anyone being prepared to pay as much as $57,000 for the opportunity which this business as described presented. Moreover in my opinion no great value is to be attributed to the two mail

[1] (1957) C.T.C. 146 at 150-152.

contracts which the vendor had at the time of the sale and which were the only firm contracts which it had with customers.

However, the total price of $100,000 referred to in the contract in my opinion must be regarded as the consideration for all the advantages accruing to the purchaser under it and these included the covenant not to compete given not only by the vendor but by Callison personally as well. There is evidence that without a licence to operate a commercial service the corporeal assets included in the sale would have been useless and there is also evidence that with the work available it would not have been financially feasible for two competing services to be operated from Dawson City. It is plain, therefore, that apart from what might have been in fact capable of transfer to the purchaser as the goodwill of this business the covenant of the vendor and of Callison, with his experience in the business, not to operate a fixed wing flying service anywhere in the Yukon Territory for ten years must have been of substantial importance to the consummation of the transaction. Without it there would have been no sale of the business just as there was in fact no sale of the physical assets without the goodwill or of the goodwill without the physical assets. In these circumstances the exact value of the goodwill by itself does not appear to me to be of importance to the determination of the question involved in these appeals. What appears to me to be important is (1) that the goodwill had a considerable value which a person of Mr. Halpin's standing and experience did not shrink from putting at $57,000; (2) that the chance of retaining the business of the former owner, which was quite substantial and in effect almost a monopoly, was enhanced by its covenant and that of its chief shareholder not to compete; (3) that with his knowledge of how to operate the business and considering the success he had had in doing so the giving up of his right to operate such a business was a substantial consideration in itself; and (4) that the parties to the contract, who were bargaining at arm's length, agreed upon $50,000 as the amount to be paid for the benefit of the existing contracts and goodwill. These features of the situation persuade me that the amount of $50,000 so set by the contract cannot be regarded as an unreasonably or outrageously high figure to stipulate as the

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price of the opportunity which the vendor and Callison were giving to the purchaser to operate the business without competition from either of them.

Moreover whether $50,000 bore any close relationship to the market value of the goodwill or not it is I think manifest on the facts that the vendor and Callison were not prepared to part with the goodwill and give the covenant not to compete except on the condition that half of the total consideration of $100,000 would be paid for the goodwill. Callison's reaction to any other terms was made clear by his desire to nullify the transaction entirely when it seemed to him that the distribution of the purchase price might be affected by the requirements of the Air Transport Board and by his terms requiring an immediate additional payment of $11,750 if the price of the physical assets was to be raised to $75,000, a reduction of the term of the covenant not to compete to five years and a covenant by the purchaser not to compete with the vendor's helicopter service.

In my opinion in the circumstances described the part of the total purchase price of $100,000 which can reasonably be regarded as having been the consideration for such goodwill and opportunity is not less than the $50,000 stipulated therefor in the contract and the part of the price which can reasonably be regarded as having been the consideration for the physical assets included in the sale does not exceed the $50,000 stipulated therefor in the agreement. For the purpose of s. 20(6)(*g*) of the *Income Tax Act* the part of the $100,000 purchase price which can reasonably be regarded as having been the consideration for the class 16 assets is thus, notwithstanding their much higher fair market value, $42,050.

The appeal of Klondike Helicopters Limited will be allowed and the re-assessments will be referred back to the Minister to be varied so as to give effect to this finding. The appeal of the Minister from the judgment of the Tax Appeal Board in the case of Connelly-Dawson Airways Limited will also be allowed and the re-assessment will be restored.

The parties to both appeals having so agreed at the conclusion of the argument there will be no award of costs in either appeal.