

1964

BETWEEN :

June 11

DAVID WALFISH APPELLANT;

June 18

AND

THE MINISTER OF NATIONAL }
REVENUE } RESPONDENT.

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148—Income or capital gain—Purchase of second mortgages at a discount and held to maturity—Whether purchased in course of a business or as investment—Whether profit realized on maturity income from a business.

The appellant, a solicitor practising in Toronto, Ontario, was during the years 1957 to 1960 a silent partner in Power Investments and Mortgage Company, which carried on business as a mortgage broker next door to the appellant's law office in a building owned by the appellant. The appellant also had an interest in Gledhill Investment Company, a partnership of three limited companies, namely, Sandbill Investments Limited, all of the shares of which were owned by the appellant, Trebwall Investments Limited, all of the shares of which were owned by the appellant's brother-in-law, and Sepal Investments Limited, all of the shares of which were owned by the appellant's brother. During the years 1957 to 1960 inclusive the appellant purchased fifty-seven second mortgages at discounts as high as fifty per cent, all of which he held until maturity. The evidence disclosed that a substantial part of the appellant's income was derived from sources other than his law practice

The respondent assessed the gain made by the appellant on the second mortgages as income.

Held: That the second mortgages were purchased by the appellant as a means of income, in the course of a business, and were not purchased as investments.

2. That the appeal is dismissed.

APPEAL under the *Income Tax Act*.

The appeal was heard by the Honourable Mr. Justice Gibson at Toronto.

Wolfe D. Goodman for appellant.

D. J. Wright and M. Barkin for respondent.

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

GIBSON J. now (June 18, 1964) delivered the following judgment:

This is an appeal by the appellant from the income tax assessments made by the respondent, dated October 15, 1962 wherein taxes in the sums of \$9,371.12, \$1,765.25, \$17,296.93 and \$11,563.13 were levied in respect of the income of the

appellant for the respective taxation years 1957, 1958, 1959 and 1960. The specific subject of the appeal is whether the gain made by the appellant on the realization of certain second mortgages purchased by him in the years 1957 to 1960 was a capital gain or income.

The appellant is a practising barrister and solicitor in the City of Toronto, was called to the Bar in 1940 and has practiced continuously in Toronto since 1945. The appellant conducts what is known as a general law practice and does real estate transactions, is engaged in negligence and domestic relations litigation, does certain collection work and carries on an estate practice, but at least 50 per cent of his time in practising law is devoted to real estate transactions for private clients.

The appellant also, besides practising law, is and was a partner in the business known as Power Investments and Mortgage Company which conducts its business next door to the office of the appellant, but in the same building, which building is owned by the appellant.

In this business, the appellant is a silent partner and the business is that of a mortgage broker and the appellant receives as his share of the profits a part of the finder's fees paid in connection with the placing of the mortgages by this company. The appellant also has an interest indirectly in a company known as Gledhill Investment Company which is a partnership consisting of three limited companies, namely, Sandbill Investments Limited, the beneficial ownership of all of which shares is in the appellant, Trebwall Investments Limited, the beneficial ownership of all of which shares is in the appellant's brother-in-law, one Lambert, and Sepal Investments Limited, the beneficial ownership of all of which shares is in Henry Walfish, a brother of the appellant.

There were fifty-seven individual second mortgage contracts which produced the gain, during the material times, which is the subject-matter of this appeal.

The appellant ceased to purchase second mortgages after the year 1961 and in that year purchased only one second mortgage.

The appellant gave evidence that he ceased to purchase second mortgages because he felt the real estate market in Toronto, Ontario, was not satisfactory for this purpose, because of the low down-payments purchasers were being

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permitted to make in buying homes, and the longer terms being granted by vendors for the payment of the purchase price of the properties.

After the appellant ceased to purchase second mortgages, he became engaged in the car financing business in which he continues up to the present time.

In respect to the second mortgage transactions, the appellant prior to 1953 put the payments made by the mortgagors into his regular law office accounts bank account, but after that time, he deposited the payments in a separate bank account of his own.

The payments on the second mortgages were made by the mortgagors through his law office and were handled by the clerical staff there.

All the second mortgages were held until maturity by the appellant.

The second mortgages in the main were purchased by the appellant from clients who had sold their houses and had taken back a second mortgage as part of the purchase price. These mortgages for the most part were acquired by the appellant within three to four weeks of the time they were drawn.

Exhibit A-1 in this appeal contains a list of these mortgages, and shows, among other things, the rate of interest and the bonuses or discounts earned.

These mortgages bear the same rate of interest as the first mortgages which were placed on the various premises which were also charged with these second mortgages at the time of the sales of the premises. These second mortgages were purchased by the appellant from various persons at varying amounts of discount from the face amounts of the mortgages, up to 50 per cent discount.

All these second mortgages were on older houses in the general area where the appellant had his office in Toronto, Ontario, and all of the mortgages were on residential houses which the appellant described as "working-men's houses".

From the income tax returns of the appellant, which are filed on this appeal, it is patent that a substantial part of the income of the appellant is derived from sources other than his law practice.

Exhibit R-16 is a statement prepared by the Department of National Revenue and among other things it indicates

the gain obtained by the appellant, during the material times, in respect to the second mortgage purchases made by him. This statement indicates that in the year 1957 he realized a bonus or gain of \$2,000 in respect of these transactions; in the year 1958 he realized a gain of \$6,870; in the year 1959 he realized a gain of \$11,333.42; and in the year 1960 he realized a gain of \$6,575.

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On the facts of this case, I am of the opinion that these second mortgages were purchased by the appellant in the course of a business and not as investments; that the fact that they were held to maturity and not substituted prior to maturity is irrelevant in the circumstances here; that the gain is not a realization of an investment; and that the intent was to earn income notwithstanding that the form of the transactions was such as to make the same appear to be in some degree analogous to the bond security discount cases.

I am further of the opinion that the bond security discount cases, in which a security underwriter doing business in this country in the usual financial markets, sells a bond at a discount, which discount a purchaser realizes as a gain if he holds such bond to maturity, is not relevant to the adjudication in this case of second mortgages as to whether the gain is capital or income.

The bond market in this country is governed by market conditions quite separate and distinct from those which obtain in the so-called second mortgage market.

The second mortgages purchased in this particular case, in my opinion, were purchased as a means of income for the appellant, in the course of a business, and were not purchased as investments within the meaning of the jurisprudence of our Courts establishing their status under the *Income Tax Act*.

The appeal is dismissed with costs.

Judgment accordingly.