Calgary 1966 Nov. 15-16

Ottawa 1967 Jan 6

BETWEEN:

LARS WILLUMSEN .... APPELLANT;

AND

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

Income tax—Building built and sold at profit—Whether trading profit or capital gain—Intention of builder.

Appellant, a building contractor who also was involved in many other enterprises, purchased a leasehold in Banff in 1954 to house persons employed by him in a restaurant. He sold the restaurant in 1958 and then erected a 14-suite apartment building on the property at a cost of approximately $95,000. He was unable to obtain permission from the National Parks authority to rent the suites on a daily basis at high rents, as he had hoped, and the suites were accordingly rented on a monthly basis at lower rents from October 1959 until June 1961 when appellant sold the building for $115,000. He was assessed to income tax on the profit and appealed contending that he erected the building for revenue and sold it because of his dire need for cash in his construction business.

Held, affirming the assessment, appellant had not discharged the onus of disproving the Minister's assumption that the profit was a trading profit. The evidence did not establish a balance of probability that appellant had erected the building for the purpose of deriving rentals therefrom to the exclusion of any purpose for its disposition at a profit.

APPEAL from Tax Appeal Board.

E. David D. Tavender for appellant.

S. A. Hynes for respondent.

CATTANACH J.:—This is an appeal from a decision of the Tax Appeal Board[1] dated July 8, 1965 dismissing the appeal from an assessment to income tax for the appellant's 1961 taxation year on the ground that a profit realized upon the sale of an apartment building constituted a profit from an adventure or concern in the nature of trade within the meaning of sections 3, 4 and 139(1)(*e*) of the

[1] (1965) 39 Tax A.B.C. 70.

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Income Tax Act[1], R.S.C. 1952, Chapter 148, and accordingly was properly included in the appellant's income for that year.

The appellant contends that the assessment by the Minister was in error. The contention was that, upon the evidence which he adduced, the building which the appellant constructed had been created by him as a capital asset for revenue producing purposes and accordingly the gain realized upon the subsequent sale was a mere enhancement of value rather than a gain made in carrying out a scheme of profit making.

The question to be determined is whether the purpose for which the appellant constructed the apartment building was to derive rental income therefrom. If that was the exclusive purpose of the appellant at the time that he acquired the building, as contended by him, then the gain realized from the sale of that building would not be profit from a business or an adventure or concern in the nature of trade. If that was not his exclusive purpose at that time, there can, in the circumstances, be no doubt that the appellant, in erecting the apartment building, had for his purpose or one of his possible purposes the subsequent disposition at a profit, in which event, the resulting profit would be clearly taxable, as is contended by the Minister.

The apartment building was built by the appellant in the City of Banff, in the Province of Alberta. Most, if not all property, in the particular area is owned by the Crown which leases parcels of land for periods of 21 years with an option of renewal. The appellant held such a lease on the

[1] 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

139. (1) In this Act,

. . .

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

. . .

property upon which he built the apartment building. It was agreed between counsel that the matter might be considered as though the appellant held the land in fee simple and there was no dispute between them as to the amount of the gain realized by the appellant. The sole dispute is as to the taxability thereof.

The appellant was a man with multitudinous interests, most of which were carried on in Banff, but his principal business was that of a building contractor, that is, he built on behalf of others and did not engage in speculative building. He came to Canada from Denmark in 1925 and worked as a foreman in the construction of the Banff Springs Hotel. The next year he entered the general contracting business in association with another man with offices in Calgary, Alberta. Most of the construction work was done in Banff on behalf of the Canadian Pacific Railway. He moved to Banff in 1932 in order to better supervise the construction work in which he and his partner were engaged.

In 1943 he continued in the business of a general contractor but on his own behalf under the firm name and style of Larwill Construction Company in which capacity he undertook the construction of several notable buildings, among those mentioned by him in evidence being a ten storey Mobile Oil Building, the Banff School of Fine Arts, an Auditorium in Banff, additional wings to existing Calgary Hospitals, additions to the King Edward and Mount Royal Hotels in Banff and the Greyhound Bus Depot in Banff.

The many other enterprises in which the appellant engaged at various times include the Chuck Wagon Restaurant which was conducted in rented premises in the Greyhound Bus Depot in Banff and a curio and gift shop on the same premises. The restaurant business was acquired by the appellant in 1946 and was sold in 1958 from which sale he obtained between $5,000 and $10,000 in cash. The curio and gift shop was also acquired by the appellant in 1946. He testified that he attempted to sell this business in 1960 and again in 1961 without success. The appellant also owned and operated the Wigwam, a coffee shop and milk bar in Okotoks, Alberta, a town with a population of about 1,000, between Calgary and Banff where he had a home on a farm operated by his sons in addition to his residence in Banff. The appellant had

apparently acquired the farm land to transfer to his sons as a means for their livelihood and did transfer that land to them retaining for a time a quarter section for himself. He acquired the Wigwam Restaurant in 1945, and sold it later, but was obliged to take it back about a month after its sale obviously because the purchaser did not comply with the terms of the contract of sale. The appellant also operated a coffee shop called either the Wellington or Willingdon, I think in Banff, which business was begun in late 1950 and which was subsequently sold at an unspecified date from which sale he obtained between $4,000 and $5,000 in cash.

He also constructed and participated in the operation of the Timberline Hotel in Banff. The building was constructed by the appellant in his capacity as a general contractor for a joint stock company in which two shares of capital stock were issued, one of which was owned by the appellant and the other share by another person. The value of this building was estimated at between $600,000 and $800,000.

The appellant also owned 70,000 shares without nominal or par value in the capital stock of Mechanical Pin Resetter Company, Limited. The authorized capital stock consisted of 810,000 shares of which the appellant testified about 400,000 shares were issued and outstanding as fully paid. The appellant was the largest shareholder in and president of the Company. The Company was incorporated with a private status. The appellant testified that he acquired the shares he held at varying prices averaging about one dollar per share. During the year 1961 this Company was contemplating converting its status from that of a private to a public company and offering its share for public subscription. This step was taken, after the times material to the present appeal, and the shares then commanded a market price ranging between $2.25 and $2.75 per share. Further in 1961 the Company also had available a substantial undistributed surplus.

The appellant acquired the lease to the property upon which the apartment was built in 1954. He acquired this leasehold as an adjunct to the operation of the Chuck Wagon Restaurant. There was an old building on the land which was used by the appellant to house employees of the

restaurant during the peak of the tourist season when approximately forty persons were employed, twenty of whom were accommodated in the building. The appellant derived a benefit from the accommodation so provided his employees by way of an adjustment to their salaries to the extent permitted by the labour laws of the Province of Alberta. The building was so used from 1954 to 1958. In 1958 the appellant disposed of the restaurant because it was losing money but he retained his lease of the property which had been acquired by him as employees quarters. At that time the building was condemned by the appropriate authority, who ordered that it be demolished.

From his years of business experience in this particular community, the appellant concluded that the leasehold he possessed could be best and most profitably utilized as the site of an apartment. Accordingly the construction of a fourteen (14) suite brick and frame building was begun by the appellant and was completed on October 1, 1959 at a cost of $95,234.33. This building was the first of its kind in Banff and the appellant foresaw very lucrative returns. He sought a first mortgage of $85,000, which was his estimate of construction costs, but was successful in obtaining a mortgage for $75,000 at 7 percent, a firm commitment for which was given prior to the commencement of construction. The mortgage was repayable in monthly instalments of principal and interest of $625.30. The appellant's equity in the building at the outset was approximately $10,000 but, upon completion of the building, stood at approximately $20,000 due to increased construction costs. However, the ultimate cost of $95,000 was far less than could have been achieved by a person other than the appellant. He was his own general contractor and because of his years in the trade he obtained and benefitted from concessions from his architect and sub-tradesmen. He, therefore, ended up with a building costing $95,000 but with a normal construction cost in excess of that amount and a market value also in excess of that amount.

In addition to the repayment of the mortgage the appellant also arranged with the Hudson's Bay Company to supply furniture and other necessary equipment for the suites under a conditional sales agreement repayable at $675 monthly.

The appellant also made an estimate of other fixed charges such as heating, insurance, maintenance, taxes and the like. Subsequent events proved his estimates to be accurate with the exception of taxes.

He estimated an annual cash "flow" of $25,000 from rental income which would result in a net income of between $11,000 and $12,000.

However, the appellant's estimate of an annual cash flow of $25,000 was predicated upon the suites being rented upon a daily basis for which permission was required from the National Park authority. Upon enquiry to that body, the appellant was informed, as a matter of policy, rental of the premises on a daily basis was prohibited but it was suggested that he make formal application to do so. This the appellant did, and periodically made representations, but authorization was not forthcoming until two years after the original application and then at a time when the appellant no longer owned the building. During the period of the appellant's ownership the suites were rented on a monthly basis at $125.

For the period October 1, 1959 to December 31, 1959 gross rentals of $4,403 were received.

For the year 1960, $18,056.33 in rentals were received with expenses amounting to $9,267 thereby yielding a net income of $9,350.33.

For the three month period from January 1, 1961 until June 26, 1961, the gross rentals were $6,521.98, the expenses were $4,277.80 with a resultant net of $2,244.18. By the operation of the apartment on a monthly rental basis the appellant was able to meet the expenses and make the profits above indicated.

The appellant sold the apartment building to Mechanical Pin Resetter Company, Limited on June 26, 1961, that is some twenty-one months after its completion on October 1, 1959. The sale was effected at a price of $115,000 for the building and $30,000 for the furnishings. (The suggestion that the Company should purchase the apartment building was made to the appellant by two of its directors because the Company had an undistributed surplus which it could use for that purpose and it had just previously purchased a bowling alley adjacent to the apartment.) The profit so realized gives rise to the present appeal.

The appellant had reached his decision to sell the apartment building prior to the date of the actual sale because some eight months before that date he had listed the property with one or more real estate agents and had done considerable newspaper advertising himself. At least one offer was received by him at a price some $10,000 in excess of the eventual sale price to Mechanical Pin Resetter Company, Limited. The appellant did not accept that offer because, he testified, the cash he would receive would be $20,000 whereas his immediate need was for cash in a greater amount.

Accordingly the appellant made a comparatively quick decision to sell the apartment after its completion, and the sale which resulted in the profit now in question was consummated shortly after that decision was made.

That decision to sell, made shortly after completion of the building, followed by a sale and resulting profit, if unexplained, would give rise to the inference that the transaction was "an adventure or concern in the nature of trade" within the meaning of those words as used in the definition of the word "business" in the *Income Tax Act*.

As I conceive it the correct approach to the solution of a problem of this kind of case in any given set of circumstances is first to examine the taxpayer's acts and operations objectively, bearing in mind that the question is one of fact in each particular case and that the appellant's statement at the trial is only part of the evidence and must be considered along with all the objective facts. If, after consideration of these facts, it should be concluded that the inference to be drawn is one of "trading", then the matter must be considered to ascertain if there is some satisfactory explanation, consistent with the facts as found, which would negative that *prima facie* inference. If from the facts that are proved it appears to the satisfaction of the Court that, at the time of acquisition, the purpose of the operation was exclusively to provide the taxpayer with a satisfactory investment and that there was not in contemplation at that time the possibility of sale, then the inference of trading would be rebutted.

The onus of disproving the Minister's assumption, in assessing the appellant as he did falls on the appellant.

My next task is, therefore, to consider the appellant's explanation as to the circumstances which prompted his

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decision to sell the apartment building and to determine whether, on the balances of probabilities, that explanation is a more acceptable explanation of what has happened than the assumption of the minister.

The explanation proferred by the appellant was that he was in dire need of cash to salvage Larwill Construction Company, which was his principal activity, which circumstance necessitated the sale of the apartment building. He intimated that up to the year 1959 the general contracting business carried on had been reasonably good but in the three next ensuing years that business had deteriorated to the point where the accounts payable exceeded the accounts receivable and that the subtradesmen were pressing for the payment of overdue accounts.

The appellant had dealt with the same bank for a period of twenty years. As is common in businesses of this type, the appellant financed his general construction business by means of a bank loan and overdrafts.

Up to 1958 the bank loan remained fairly static at $75,000. On March 23, 1959 the loan had been reduced to $55,000 but on March 26, 1959 two loans of $10,000 each were obtained by the appellant from his bank, which raised this loan indebtedness again to $75,000. The amount of the loan remained at that figure until March 1961 when the loan was raised to $95,000. The appellant's balance remained at that figure until the loan was paid in full in 1964. It would appear that the bank, in March 1961, transferred the amount of the appellant's then overdraft to a loan account secured by promissory notes.

The appellant conducted and financed his current business by means of bank overdrafts. From 1958 to 1959 the amount of his overdrafts varied little. Overdrafts were frequent and the appellant's account was more often red than black. There was no perceptible change from 1959 to 1961.

On September 15, 1960, the bank obtained security for the indebtedness of the appellant to it by way of a general assignment of book debts and the deposit of the appellant's shares in Mechanical Pin Resetter Limited, as well as other shares and rights to royalties owned by him. The bank did not realize on any of the securities it held.

The appellant attributed his financial predicament to three factors, *viz*: (1) the decline in his general construc-

tion business, which resulted in the position where the accounts payable exceeded his accounts receivable; (2) a claim for income tax for previous years in an amount of $14,000 and (3) a sharp curtailment of his overdrafts by his bank and its refusal to extend him further credit.

He stated that his cash position was at nil and that if he had not sold the apartment building he was close to bankruptcy.

Apparently the appellant considered the apartment to have been his most readily liquable asset. The Chuck Wagon Restaurant had been sold in 1958. The curio and gift shop was not readily saleable because the appellant's continuous efforts to sell it had been unsuccessful. The Wigwam Restaurant had been sold but that sale proved abortive. His other principal assets upon which monies might have been realized were, in addition to the apartment building, his half interest in the Timberline Hotel, which was free of all encumbrances and had a conservative value of $600,000, and the 70,000 shares owned by him in Mechanical Pin Resetter Company, Limited.

The Timberline Hotel was not prospering. One of the accounts receivable in the appellant's construction business was an advance to the Timberline Hotel of $150,000 which had been outstanding for a long period of time without any payments being made thereon. The appellant testified that his efforts to raise funds by way of a first mortgage on the Timberline Hotel were unsuccessful, although in 1964 subsequent to the period under review, a mortgage of $375,000 was placed on those premises. This the appellant attributed to the vagaries of the mortgage market.

At the time of the appellant's need for cash in a substantial amount, Mechanical Pin Resetter Company, Limited was a private company but the directors had in contemplation a change in its status to that of a public company and a public offering of its shares. In the appellant's view a disposition of any of his shares, bearing in mind that he was its president and largest shareholder, would destroy public confidence and depress the market value of the shares. For this reason he refrained from realizing on this asset. At this point I might refer to a discrepancy in the appellant's testimony. He testified that the bank held no security whereas, in fact, the appellant's shares in this Company had been deposited with the Bank as security for

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his indebtedness on September 15, 1960. It may have been that the appellant was referring to a time prior to September 15, 1960, but in any event the shares were not available to him for some time after that date.

The financial predicament which the appellant faced was not a sudden emergency. Upon an examination of the balance sheets of Larwill Construction Company for the years December 31, 1956 to December 31, 1961 I have observed that, with the exception of December 31, 1959 and December 31, 1961, the accounts payable were in excess of the accounts receivable. I have extracted the following figures from the financial statements above referred to:

	Accounts receivable	*Accounts payable*
December 31, 1956	$112,808.20	$260,552.80
December 31, 1957	159,761.85	236,041.12
December 31, 1958	120,184.66	177,485.93
December 31, 1959	180,413.26	179,944.92
December 31, 1960	69,749.24	119,434.76
December 31, 1961	241,280.25	109,798.93

I do not consider the fact that the appellant was obliged to pay arrears of income tax to have had a vital bearing upon his decision to sell the apartment building because the tax was paid before the building was sold, although this pressing claim may well have accentuated his already precarious financial position.

Despite the fact that the appellant was admittedly short of cash, nevertheless, for the years 1955 to 1962, but excluding the year 1961, he made the maximum gifts permitted without attracting tax to members of his family. These gifts, the appellant sought to explain as being merely book entries. I fail to follow such explanation, nor can I follow how such gifts could not have had the effect of further reducing the appellant's assets.

Neither can I perceive there to have been any radical change in the appellant's loan or overdraft position with his bank over the span of years from the records for those years which I have had the opportunity to review.

While the only formal demand for payment made by the bank upon the appellant is contained in a letter dated December 16, 1963, nevertheless I accept the appellant's evidence that he had received frequent verbal demands from the bank to improve his debit position and that the bank did rigidly curtail and supervise his credit.

However, the appellant was an extremely experienced business man and it is inconceivable to me that, when he saw his general contracting business deteriorating, he did not also foresee the possibility of being required to dispose of some of his other assets and further it seems probable that this possibility was present to his mind at the time construction of the apartment building was begun.

The appellant was a man of many business interests and his history indicates that he was not adverse to disposing of any one of his business enterprises when it was expedient to do so.

At the time when it became necessary for the appellant to realize upon some one or other of his assets it is quite apparent from his evidence that he was well aware that the apartment building was the most readily saleable. Since I have concluded that there was no radical change in the appellant's financial position from the time the apartment building was built until it was sold, it follows that the appellant's awareness must relate back to that prior time.

Further the appellant's equity in the apartment building was not particularly great. Because of his experience and advantages as a builder he acquired the building at a much lesser cost than the market value thereof.

I do not have any doubt whatsoever that the appellant from his wealth of experience in the Banff business community correctly forecast that an apartment would yield lucrative rental returns but his more optimistic forecast was based upon suites being rented on a daily basis. The authority so to rent was not forthcoming during the appellant's ownership of the building and while the rentals he received on a monthly basis were adequate to carry the project, nevertheless, that income was more modest than he had anticipated.

Admittedly the appellant was not a speculative builder, but he was a builder and as such he would have some knowledge of the closely allied field of building for sale.

As stated at the outset the onus of disproving the assumption that the profit realized by the appellant was a profit from a business or an adventure in the nature of trade that was made by the Minister in assessing the appellant as he did, falls on the appellant. In my view he has failed to discharge that onus.

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The question of fact as to what was the appellant's purpose in acquiring the apartment building is one that must be decided after considering all the evidence. The appellant's evidence at the trial that his purpose was to derive rental income from the apartment building is only part of the evidence.

After having given careful attention to all the evidence, I am not satisfied that there is a balance of probability that the appellant erected the apartment building for the purpose of deriving rental income from it to the exclusion of any purpose of its disposition at a profit.

Accordingly, it cannot be said that the assumption of the Minister in assessing the appellant as he did was not warranted.

The appeal is, therefore, dismissed with costs.