1960
Feb. 3
Oct. 30

BETWEEN:

HILL-CLARK-FRANCIS LIMITED ......APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—Income—Income tax—Lumber company purchased to serve as subsidiary sold at a profit—Whether profit on sale income or capital gain—The Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, and 139(1)(e).

The appellant company, a general contractor and trader in building supplies and lumber, had for some years purchased a large portion of its lumber from P. Co. In June, 1952, P. Co. was in financial difficulties and the appellant, with the intention of making P. Co. a subsidiary and thus assuring the continuance of that source of supply, obtained for $100 an option, exercisable up to November 30, 1952, to purchase the latter's outstanding shares for $50,000. In September the appellant, having received from S, a lumber dealer, an offer of $160,000 for the shares, completed the purchase and a few days later sold them to S. In order to ensure that the opportunity to make this sale should not be lost, the appellant had arranged for the modification of the terms of a cutting lease held by P. Co., which S considered too onerous, and had relinquished to P. Co. its right under contract to the bulk of P. Co.'s season's cut of lumber and accepted repayment of $272,000, which had been advanced on the purchase price thereof.

The Minister having treated the profit made on the sale of the shares as income, the appellant appealed from the assessment on the grounds that the option to purchase the shares was a capital asset, that what had occurred was in substance the realization of that capital asset, and that the profit realized from the transaction was capital and not income within the meaning of the *Income Tax Act*.

Held: That what in fact was sold was not the option but the shares, and these were sold after the appellant had acquired them not to keep as capital assets, a purpose which had already been abandoned, but for the purpose of selling them for a profit.

2. That the profit so realized was profit from a business within the meaning of that term in s. 3(*a*) of the *Income Tax Act*, as defined by s. 139(1)(*e*), and was properly treated as income.

APPEAL under the *Income Tax Act*.

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

P. N. Thorsteinsson for appellant.

D. S. Maxwell and *G. W. Ainslie* for respondent.

THURLOW J. now (October 30, 1960) delivered the following judgment:

This is an appeal from a reassessment of income tax for the year 1955. In that year the appellant had an operating profit from which, for income tax purposes, it sought to

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deduct pursuant to provisions of the *Income Tax Act* operating losses allegedly incurred in earlier years. In 1952, however, the appellant had sold at a profit certain shares in Poitras Freres Inc., and the Minister, in making the assessment for the year 1955, treated this profit as income and to that extent disallowed the alleged losses as a deduction from 1955 income. The issue in this appeal is whether he was correct in so doing, and this turns on whether or not the profit on the sale of the shares was income or a capital gain.

The appellant is an Ontario corporation incorporated in 1913 and carries on an extensive business as a general contractor and as a trader in building supplies and lumber. Its sales in 1952 were in the vicinity of $20,000,000. In the course of its business, the appellant purchases large quantities of lumber, some of which is used in its contracting business and some sold through its retail outlets, the remainder, if any, being disposed of in wholesale transactions. It also has a number of wholly owned or controlled subsidiary companies, at least two of which are engaged in producing lumber which the appellant purchases from them. In 1949, besides purchasing lumber from other suppliers, the appellant purchased the total lumber output of twenty-seven suppliers, among whom was Poitras Freres Inc., a corporation organized under the laws of the Province of Quebec. In 1952 there were five or six such suppliers, including Poitras Freres Inc., which supplied about one-third of the appellant's total purchases of lumber. This company, however, appeared to be getting into financial difficulties and, having in mind the loss of this source of supply if Poitras Freres Inc. should discontinue its operations, the appellant, intending to make the company a subsidiary, in June, 1952 obtained for $100 from Roger Poitras, the principal shareholer, an option exercisable at any time up to November 30, 1952 to purchase the outstanding shares of the company for $50,000.

The appellant had never engaged in the business of dealing in timber properties or in shares of timber or other companies, but because, through its subsidiary companies, it controlled substantial timber holdings, it had from time to time received enquiries for timber properties from persons interested in acquiring them. In September, 1952, a

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Mr. Horace F. Strong, who was also engaged in the lumber business and with whom one of the appellant's subsidiaries had had a previous transaction, and who by some means had apparently become aware of the appellant's ability to sell the shares of Poitras Freres Inc., offered the appellant $160,000 for them. Despite the appellant's interest in maintaining Poitras Freres Inc. as a source of supply, this offer was too tempting to resist, and the appellant, thereupon, undertook a number of steps to ensure that the sale should not be lost. Among other things, the appellant arranged for a modification of certain terms of a cutting lease held by Poitras Freres Inc. which Mr. Strong considered too onerous, and it also relinquished its right under contract with Poitras Freres Inc. to the bulk of that company's 1951-52 season's cut of lumber.

This, as previously mentioned, was about one-third of the appellant's total purchases of lumber. It was expected to amount to about 4,000,000 f.b.m., and up to the time of the sale of the shares to Mr. Strong, the appellant had advanced $272,000 to Poitras Freres Inc. on account of the purchase price of it. Most of the lumber had at that time been sawn but remained undelivered. At that time, the net value of the shareholders' equity in Poitras Freres Inc., as indicated in its balance sheet, was $71,129.59. On the face of the transaction, this equity, represented as it was by the shares, was what Mr. Strong was paying $160,000 to obtain, but in the transaction the appellant relinquished its right to the undelivered timber and accepted repayment of the advances, a matter which I think played its part in bringing the transaction to fruition. It was not, however, suggested that the transaction was in substance a manner of disposing of the timber or that the appellant entered into it for that purpose.

The actual purchase of the shares by the appellant was made on or about September 24, 1952, some time after the offer had been received, and they were sold to Strong under a contract dated September 30, 1952, which provided for completion of the sale on the following day.

The question to be determined is whether in the circumstances these transactions were made in the course of the appellant's business or in the course of carrying on an undertaking or an adventure or concern in the nature of trade. If

so, the profit therefrom was income for the purposes of the *Income Tax Act*, under ss. 3, 4, and 139(1)(*e*). The test to be applied for resolving this question is that stated in *Californian Copper Syndicate v. Harris*[1]. *Vide Minerals Limited v. Minister of National Revenue*[2]. The appellant's contention was that the option to purchase the shares was acquired, not with a view to disposing of it or of the shares, but for the purpose of making Poitras Freres Inc. a subsidiary, that the option, when acquired, was accordingly an asset of the appellant acquired for a capital purpose, that the sale of the shares was in substance the realization of that capital asset, and that the proceeds of such realization were, therefore, capital and not income within the meaning of the *Income Tax Act*.

On the evidence, I find that the intention of the appellant, when acquiring the option, was indeed to make Poitras Freres Inc. a subsidiary company and, in the circumstances as described in the evidence, I would draw no inference from the appellant having taken an option that it intended at that time to sell the shares or that it took the option for the general purpose of turning it or the shares to account for profit by whatever favourable means might be available. But I do not think that these findings dispose of the matter in the appellant's favour for, even assuming that the purpose for which the option was acquired was entirely a capital purpose as distinct from a revenue or trading purpose, it does not, in my opinion, follow that the shares, when acquired, were acquired for the same capital purpose or that they ever became or represented capital, as distinct from revenue assets of the appellant. It should not, I think, be overlooked that what the appellant acquired for a capital purpose was not shares at all but an option for which it paid $100. Had the appellant gone on and acquired the shares with the same purpose in mind and carried out its plan to make Poitras Freres Inc. a subsidiary, the shares might well have constituted in the appellant's hands assets of a capital, as opposed to a revenue, nature. What happened in fact was, however, quite different, and I do not regard it as in any real or practical sense the equivalent of a mere realization of the capital asset represented by the option. Much more than the option and its value was involved in the

[1] (1904) 5 T.C. 159 at 165. [2] [1958] S.C.R. 490 at 495.

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transaction with Mr. Strong. By the time the contract with him was completed, the sum of $50,000 had been invested in the project, and in the course of and as part of the deal an important contract for a year's cut of lumber had been abrogated. Moreover, the purchaser did not buy or pay for, nor did the appellant sell the option. I do not doubt the credibility of the evidence as to why the appellant did not want to sell the option itself, but the reason for not selling it cannot change the fact that it was not sold. What was in fact sold was the shares, and these were sold after the appellant had acquired them, not to keep as capital assets, a purpose which had already been abandoned, but for the purpose of selling them in the transaction which ensued.

At this stage, there was clearly a scheme on foot for profit-making by acquiring and selling the shares in question, and the actual purchase of the shares for which the appellant paid out $50,000, something which it was not bound to do, as well as the contract for the sale of the shares and the various steps taken by the appellant to secure it and to carry it out, including the giving up of its right to the 1951-52 cut of lumber, were all, in my view, steps taken in the carrying out of that scheme. To my mind, the fact that the appellant, in carrying out this scheme, made use of a capital asset in the form of the option no more by itself stamps the whole transaction as a realization of that asset than the giving up in the same transaction of a revenue asset in the form of a right to the 1951-52 cut of timber by itself characterizes the transaction as one on revenue account. But in my opinion, in the whole of the circumstances, the fact that the appellant, having a right to acquire the shares, proceeded to exercise that right not for the purpose originally intended (which nothing whatever prevented it from following) but as a matter of business judgment, for the purpose of disposing of the shares for profit, and thereafter did dispose of them in carrying out its scheme for making profit therefrom in a transaction which involved more than a mere sale of the shares so acquired, marks both the purchase and the sale as transactions of a trading character, rather than as steps in the mere realization of a capital asset. The profit so realized was, accordingly, profit from a

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business within the meaning of that term in s. 3(*a*) of the *Income Tax Act,* as defined by s. 139(1)(*e*) and was properly treated as income.

The appeal will be dismissed with costs.

Judgment accordingly.