1962
Mar. 27
Sept. 27

BETWEEN:

ASSOCIATED INVESTORS OF CANADA LTD. ..... } APPELLANT;

AND

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

Revenue—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, and 139(1)(e)—Capital gain or income—Company investing funds from sale of investment certificates—Mortgage discounts or bonuses—Volume of business and organization set-up—Operations those of a business—Appellant's sole incentive to make a profit—Appeal dismissed.

Appellant operated its business by selling investment certificates to the public and re-investing the money so obtained in mortgages, stocks and bonds, paying to the certificate buyers interest at four per cent compounded once annually. The company had assets of over ten million dollars and also a large organization with various departments to carry on its operations. It did not purchase existing mortgages but advanced money to mortgagors usually at a 15 per cent discount. It held the mortgages until they were paid off at or before maturity. Most of the mortgages acquired were for small loans and were of a type unacceptable to insurance and trust companies. The respondent assessed the appellant for income tax on the discounts or bonuses realized from a large number of the mortgages in the years 1955 to 1958. From this assessment the company appeals contending that such discounts or bonuses are capital gains and not taxable.

Held: That the mortgage discounts or bonuses realized by appellant are income and therefore taxable as such.

2. That the operations of the appellant were those of a business in a scheme of profit-making or an adventure in the nature of trade.

3. That the large number of mortgages, the amount of money involved and the organization set up to handle the transactions indicate that the appellant's mortgage operations were not merely incidental to but were an essential feature of the general business of the appellant.

4. That the evidence showed that the appellant's whole incentive in acquiring the type of mortgages in question was to obtain discounts or bonuses and that there was profit to be made in them without undue risk, and it cannot be said that the discounts or bonuses constituted the increment which provided for the additional risk.

APPEAL under the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Noël at Edmonton.

A. F. Moir, Q.C. and *C. C. Curlett* for appellant.

W. G. Morrow, Q.C. and *D. F. Coate* for respondent.

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

NOËL J. now (September 27, 1962) delivered the following judgment:

This is an appeal against the appellant's income tax assessments for the years 1955, 1956, 1957 and 1958. In his assessments, the respondent added to the appellant's reported income for each of the above mentioned years the sums of $1,725, $33,878.30, $2,613.85, $13,266.57 respectively, representing bonuses received by the taxpayer in respect of loans made to mortgagors. These were loans where the amount of the mortgage was greater than that advanced.

The amounts are not in dispute here and the case turns on whether these amounts constitute income from a business within the meaning of ss. 3, 4 and 139(1)(*e*) of the *Income Tax Act,* R.S.C. 1952, c. 148 which read as follows:

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 of 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)(*e*):

(*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.

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In the opening of the hearing, counsel for both parties agreed to tender as exhibits a balance sheet of the appellant (Exhibit 1), an investment certificate (Exhibit 2) and then a series of photostats of documents taken from the appellant's files indicating typical or sample transactions: documents *re* William Kosowan (Exhibit 3), *re* Clarence P. Zimmel (Exhibit 4), *re* Fort Hotel (Exhibit 5), *re* Moss (Exhibit 6), *re* Hawkeye (Exhibit 7), *re* Hamilton (Exhibit 8), *re* Thorpe (Exhibit 9) and the last Exhibit, No. 10, the Department's file, with the certificate by the Honourable the Minister of National Revenue and the notices of appeal, assessment, etc. attached.

The documents indicating sample transactions can be listed and detailed as follows:

Ex.	*Date*	*Name*	*Per Cent*	*Amount of mortgage*	*Bonus*	*Re-fund*	*Paid Off*
3	1/ 3/55	Kosowan	7	$ 6,000	$ 350	nil	23/6/55
4	1/ 9/55	Zimmel	6	$ 9,000	$ 1,200	$600	30/1/56
5	15/10/56	Fort Hotel	7	$ 33,000	$ 3,300	nil	15/5/59
6	1/ 8/57	Moss Holdings	7	$200,000	$25,000	nil	in existence
7	13/ 1/55	Hawkeye	7	$ 1,650		nil	28/2/57
8	15/10/56	Hamilton	7	$ 40,000	$ 5,000	nil	in existence
9	1/ 4/55	Thorpe	7	$ 15,500	$ 3,100	nil	

The only witness heard, and he was so heard on behalf of the appellant, was the President and General Manager of the appellant company (hereinafter sometimes referred to as "the taxpayer"), Mr. Henry G. Curlett, who stated that he had caused the appellant company to be incorporated in the year 1948 and had owned all the shares but two when its capitalization was $100,000; when the capitalization rose to $400,000, Fairborn Investment, of which he owned 60 per cent, owned 3,000 of the shares of the appellant company. He stated however that at all times he was in control of the company. The latter has a mortgage, sales, accounting and legal department.

The taxpayer operated by selling investment contracts to the public, reinvested the monies received in mortgages, bonds and stocks and paid its holders of the contracts a four per cent compound interest once annually. The first year of operation, Mr. Curlett did most of the selling of certificates and for the first three years did most of the appraisal and examination of the mortgages.

According to Exhibit 1, a balance sheet of the taxpayer for the year 1958, it had assets of $10,854,097.50 and liabilities to the public, including accounts payable and a Department of National Revenue debt of $8,917,798.24. At the end of 1961, Mr. Curlett stated that the assets of the company were roughly over nineteen million dollars and its liabilities to the public, approximately $17,500,000.

The taxpayer, according to Mr. Curlett, took mortgages from those who could not obtain the conventional type or an N.H.A. mortgage; he describes the mortgage taken by the company as a small mortgage or the working man's mortgage and added that his company had taken, in 1949, a great number of mortgages in a locality called Jasper Place, which is a suburb of the City of Edmonton. There were no sewers or water at Jasper Place and those wishing to live there could not obtain conventional mortgage money. According to Mr. Curlett, in order to obtain conventional mortgage money, water and sewage was required, the mortgage owner must have an income of $300 a month, he must have worked two years in his present occupation, be under fifty years of age and have a full basement. Those were five musts and if any one of those were out, then there was no conventional money available. The conventional interest mortgage rate at the time was six per cent and the taxpayer charged this same rate.

Besides taking mortgages in Jasper Place, the taxpayer, as it grew, took conventional type of mortgages on business property, charging an interest rate of seven per cent which compared at the time with the conventional money available from insurance companies.

In addition to the interest rate of six per cent the taxpayer would usually get a bonus of 15 per cent; this bonus was a net amount as the legal and conveyancing costs and so on were also deducted from the mortgage money; in some cases, the total amount of the mortgage money was turned over to the borrower who would return the bonus and, in others, the bonus was deducted before it was turned over to the mortgagor. As a matter of fact, Exhibits 3 to 9 inclusive (the sample documents) reflect both methods.

Exhibit 1 indicates that the taxpayer had invested $562,435 in bonds. These bonds, according to the taxpayer, were retained until maturity unless there was a change in

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interest or they were recalled. In one such instance $300,000 3% Government bonds were replaced by $300,000 3¼% Government bonds.

From the beginning of its operations, the taxpayer placed 2,400 mortgages and Mr. Curlett stated that they had never sold any. In all of these 2,400 cases the taxpayer financed contractors, aproximately twelve in number. The contractors would build houses and arrange for the mortgages and then sell the houses and the purchasers would assume the mortgages and the taxpayer would collect by instalments, both interest and principal on the basis of the original borrowed amount. In no instance did the taxpayer go out and purchase mortgages nor did the taxpayer sell the mortgages to other people but held them all to maturity with the exception of a few which were prepaid. Indeed, in some instances, mortgages were paid in full before term and in such cases, according to Mr. Curlett, the taxpayer would refund a part of the bonus.

In the month of March 1962, the taxpayer held fifteen million dollars in mortgages of which amount $720,000 were bonuses.

The President of the appellant company maintains that his company invested in Jasper Place, a substandard district, although the National Housing Act, as managed through the insurance companies or the conventional lending institutions, refused to make any money available there. In his own words he said at p. 13 of the transcript:

> They were very anxious to have these houses built and I have letters from N.H.A. to make available that kind of money, but it wasn't for that kind of district, we couldn't sell it, it was a substandard district, but in my book it was good, and it has proven itself good. We have built a city out there of thirty-three thousand and it was twelve hundred when we started out there. We now have sewer and water in and I bought the bond issue from the town of Jasper Place to help put the water and sewer in and we are highly regarded in Jasper Place, and they know we have made a discount on the mortgages and they were very happy to have us make it.

In cross-examination, Mr. Curlett admitted that over the years approximately 85 per cent of the business transactions of the taxpayer were in mortgages and 15 per cent in Government or municipal securities and he added that most of these mortgages ($17,500,000) were on home properties and that at least 60 per cent entailed a bonus of some kind or other although six million dollars in commercial loans had no discounts at all.

In answer to a question by the respondent's counsel as to why the taxpayer did not place the mortgage money on the ordinary conventional type of loans at six per cent, he had this to say at p. 18 of the transcript:

A. If you were paying 4% compound, the difference between that and 6% is a very fine figure if you take out your overhead—

Q. So in order to get a bigger margin, you went to the more unorthodox mortgages and got a bonus, is that right?

A. That is right.

The appellant company operates in the provinces of Saskatchewan, Alberta, British Columbia and the Northwest Territories, where they have salesmen. As the President and General Manager of the taxpayer stated, they try to distribute their money where they get it from.

The President and General Manager of the appellant company, Mr. Curlett, expresses his confidence in real estate and at p. 26 of the transcript explains why his company loaned money on mortgages at Jasper Place:

A. The 15 houses which I had sold and had mortgages or agreements for sale on them in the Town of Westlock, that had no water or sewer, and only three of them had foundations, but I didn't lose a dollar on them. That's why I felt quite sound in my field in Jasper Place. The other one was the Montreal Light, Heat and Power that I didn't lose on. Every other investment I had and which the Bank of Montreal considered was a pretty smart investment portfolio, believe me, I thought was the weeds by the end of 1932.

Q. So that you had more faith in places like Jasper Place, without sewage, as it then had, than N.H.A. for example?

A. I built a hotel out in Jasper Place at a cost of about $375,000 before water and sewer was there. I put my own water and sewer in for that hotel, but I knew we couldn't live along side of a city of 150,000 without getting water and sewer, just a matter of coming in.

Q. As a matter of fact, the faster you helped the contractors develop Jasper Place, the quicker sewer would come, is that right?

A. Very correctly.

He also stated that his company never advertised for mortgages in the newspapers or elsewhere and they always had more mortgages than they could handle.

At p. 27 of the transcript he had this to say in this connection:

Q. There were lots of people beating at your door to discount mortgages?

A. And we have yet.

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Q. I'm sorry.
A. And we have yet, too.
Q. So you can pick what you want?
A. That's right.

Mr. Curlett denied that the taxpayer had ever purchased mortgages at a discount although he admitted that there might have been the odd one, but if so, it certainly was not the taxpayer's line of business.

The question to be decided is whether the proceeds from the taxpayer's bonus mortgage operations are income or capital gains. This matter has been given considerable attention in the last year or so and has been dealt with in a number of decisions of this Court: cf. *Minister of National Revenue v. Minden*[1]; *Minister of National Revenue v. MacInnes*[2]; *Minister of National Revenue v. Rosenberg*[3]; *Minister of National Revenue v. Wolfe*[4] and a decision of the Supreme Court of Canada in *Irrigation Industries Limited v. Minister of National Revenue*[5].

In no case, however, with the exception of the Irrigation case, has the taxpayer been a company and although the Irrigation case dealt with the problem of deciding whether the amounts received were of a capital or income nature, they were not in that instance proceeds from mortgage discounts or bonuses.

It is a trite statement of the law of income tax that when one holds an asset not for resale, but for what the asset can produce in and of itself, the gain on sale of that asset is usually one of a capital nature. However, the proceeds of such an investment which might, in most cases, be non-taxable may become taxable when they are entered into, even as an asset acquired to be retained until maturity, to such a degree and in such a manner that they become a veritable business.

This is very clearly set down by Lord Justice Clerk *in re Californian Copper Syndicate (Limited and Reduced) v. Harris*[6]:

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

[1] [1962] C.T.C. 79.
[2] [1962] C.T.C. 350.
[3] [1962] C.T.C. 372.
[4] [1962] C.T.C. 466.
[5] [1962] C.T.C. 251.
[6] 5 T.C. 165.

of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation 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 purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, 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 realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making.

Further authority can also be found *in re Smith Barry v. Cordy*[1], the facts of which can be summed up as follows: In 1937 the appellant embarked on a carefully worked out scheme whereby between July 1937 and February 1939 he laid out his capital in the purchase of a large number of endowment policies on other people's lives with such dates of maturity as would provide £7,000 a year until 1960.

The Special Commissioners held that:

On consideration of the particular facts of this case and the evidence before us, having in mind especially the number of purchase transactions over a period of about 18 months, together with the manner in which the policies were selected and purchased in pursuance of an organised scheme, we hold that the appellant engaged in a concern in the nature of trade, resulting in profits—the fruit of the capital laid out—which are assessable to income tax under Case 1 of Schedule D.

This decision was confirmed on appeal and at p. 255 Macnaughten J. in connection with the matter of intention had this to say:

The question, therefore, is whether a person who buys endowment policies with no intention of selling them is engaged in a concern in the nature of trade. It is conceded that a single purchase would not be a concern in the nature of trade, but, it is suggested, if there are many purchases, then it would form a trade, even though there was no intention whatever of reselling the policies. No other inference of fact is open to me.

And to use an expression of Rowlatt J. *in re Graham v. Green*[2]: A person can organize himself to do that (namely to buy) "in a commercial and mercantile way and the profits which emerge are taxable profits, not of the transactions but of the trade".

[1] 28 T.C. 253. [2] 9 T.C. 313.

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And to paraphrase the learned President of this Court (Thorson P.) in *Minister of National Revenue v. Spencer*[1]: No single criterion can be adopted to decide whether a transaction or a number of transactions are adventures in the nature of trade, each case depending on its facts and the thing to do is to determine the true nature of the transaction or transactions in each and every case.

Let us now examine the facts here. It appears from the evidence that the taxpayer company was formed for the purpose of selling investment certificates to the public, the money so obtained carrying a compound annual rate of interest of four per cent. From the evidence of its President and General Manager it also appears that in order to be able to so pay this interest and make a profit the money so obtained was reinvested in other securities such as shares, bonds but principally in mortgages. These activities of the taxpayer, in my opinion, point clearly to a speculative business.

The mortgages, as we have seen, were obtained from contractors at a discount and the obtention of so many of these mortgages, the manner in which they were processed and the magnitude of the amounts involved indicate to me, and I have no hesitation in so saying, that the mortgage operations of the taxpayer were not merely incidental but were an essential feature of the general business of the company.

Authority on this point can be found *in re Scottish Investment Trust Co. v. Forbes*[2]:

> As its name indicates, this is an Investment Company, and the Memorandum makes it plain that its profits are to be derived from various operations relating to the investments. The third head of the Memorandum professes to state the objects of the Company, and in head (6) of this enumeration occur the words "to vary the investments of the Company, and generally 'to sell, exchange, or otherwise dispose of, deal with, or turn to account any of the assets of the Company' ".
>
> It is true that the doing of any of these things might be incidentally necessary in the conduct of the business of any company. It is also true that this Memorandum states in the latter heads of the same article several things which are less properly described as objects of a Company than as incidental acts of administration. But from the structure of the Memorandum it appears that *the varying the investments and turning them to account are not contemplated merely as proceedings incidentally necessary, for they take their place among what are the essential features of the business.* In my view such speculations are among the appointed means of this Company's gains. Accordingly, I should consider it legitimate

[1] [1961] C.T.C. 130. [2] 3 T.C. 234.

for the directors to divide profits so made, although in determining the amount divisible they would necessarily have regard, not alone to the individual transaction yielding profit, but to the general results of their changes of investments. It would be right that they should maintain as strictly as possible the relative rights of separation between capital and income, and make all apportionments necessary in that behalf.

The taxpayer, in the present case, as we have seen, did a very considerable amount of business in its mortgage operations and to do this he had set up an imposing organization with various departments. Such a set up in my opinion would also tend to indicate that all the operations of the taxpayer, and particularly its mortgage operations, were that of a business in a scheme of profit-making or at least an adventure in the nature of trade. As stated by Thorson P. in *Minister of National Revenue v. Spencer (supra)*: "I have already referred to the decision that establishes that it is not essential to a transaction being an adventure in the nature of trade that an organization should have been set up to carry it into effect. But, obviously, the fact that there was such an organization goes a considerable distance towards the conclusion that such an adventure was contemplated."

The mortgage operations here were not admittedly of the conventional type but were not, from the admission of the taxpayer's President and General Manager, of a risky nature. Indeed, a mortgage turned down by a trust company is not necessarily a poor one. The very performance of the taxpayer, in my opinion, showed there was money to be made without undue risk in mortgages unacceptable to life and trust companies, the traditional sources of mortgage funds. It cannot, therefore, be contended that the bonus was the increment which provided for the additional capital risk. Indeed, Mr. Curlett's faith in the Jasper Place development for instance, was such that he built a hotel there at a cost of about $375,000 before water and sewer were there which surely indicates that the investment, at least as far as the taxpayer was concerned, was a solid investment as well as a successful and profitable one.

Considerable emphasis was laid by counsel for the appellant on the fact that no resort was made to advertising in connection with the mortgage operations of the taxpayer; it appears, however, that there was no necessity for so doing as the taxpayer admitted it had more demands than it could satisfy.

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The taxpayer's intent in entering into the mortgage transactions, whether it was attracted to these transactions because of the profit it would make or the interest it would receive, or a combination of both, is clear in this case as the President and General Manager of the company quite frankly admitted: he could not go out and get the ordinary conventional loan because it would not have been enough margin of profit and he had to get the bonuses to get the profit. The bonus, therefore, was the whole incentive here. The fact that the taxpayer was using someone else's investment to make its profit would also tend, in my estimation, to indicate that we have here a veritable business.

The fact that the greater number of mortgages were held to maturity cannot in itself, as we have seen, make them non-taxable investments. In our opinion, their retention until maturity was in accordance with the general scheme of business of the taxpayer and was necessary to enable it to make the payments which would allow it to pay the four per cent compound interest and, therefore, was an important feature of its business operations. In view of the above, I find that the appellant was engaged in operating a business in the ordinary sense of the term and that its mortgage operations were a very important part of same. In the result, therefore, the appeal will be dismissed with costs.

Judgment accordingly.