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Jan. 9, 10
Feb. 25

Apr. 10

GILLIES BROTHERS & CO., LIMITED ..APPELLANT;

AND

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

Revenue—Income tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 3—Excess Profits Tax Act, S. of C. 1940, c. 32—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 127(1)(e)—Income or capital—Profits on sale of timber limits—"Trade"—"Business"—"Trade or commercial or other business"—"Adventure or concern in the nature of trade"—Appeals dismissed.

Appellant, incorporated in 1944, purchased all the assets and undertaking of Gillies Brothers Ltd., hereinafter referred to as the Company, a firm which had been engaged for many years in the manufacture and sale of timber and lumber in Ontario and Quebec. Included in the assets acquired by appellant were thirty-eight timber licenses held by Gillies Brothers Ltd. authorizing the holder to cut and remove timber from timber lands in the Province of British Columbia. Some of these licences were exercised by loggers under *pay as cut* contracts and appellant acquired the benefit of these contracts as well as the licences, and in subsequent years appellant entered into further similar contracts. Three of the licences acquired by appellant were under contract of sale, the purchase price being payable in instalments and not entirely accrued due, such sales were known as *en bloc* sales. In 1946, 1947, 1948, 1949 and 1950 appellant also made a number of *en bloc* sales of licences for lump sum prices not dependent on the market price of the timber on the tract or the cutting of any of it; in some cases under the terms of the contract of sale the price was

payable immediately, and in others it was payable over periods of several years. The respondent assessed the profit on the sales of the British Columbia licences as income and from such assessment an appeal was taken to this Court. The appellant contends that such profits are capital gains.

Held: That at the time when the Company ceased operations and transferred its assets and undertaking to appellant at or about the end of 1943 the business of that company included that of trading or dealing in British Columbia timber licences since it had acquired licences in considerable volume with a view to turning them to account by methods which included sale of them, it had sold some of them, it had an agent engaged to seek purchasers and arrange sales on a commission based on the selling price of either timber or licence, and it advertised for purchasers and though sales were infrequent when they occurred they were part of the trade rather than realization of investments.

2. That the appellant acquired the remaining British Columbia licences for the purpose of making profit from them either by selling the timber or by selling the licences and it carried out this purpose by using the same methods the Company had used until it had disposed of all of them in one or the other of these ways and in so doing appellant engaged in the business of trading or dealing in British Columbia timber or licences as part of its scheme for turning the licences to account for profit in either of the two ways which it in fact used; the disposals of the British Columbia timber and licences were carried on through the same British Columbia agent, in the same way, on the same commission arrangement, and with the same oversight and direction from the directors as had been followed by the Company in earlier years, and they were disposed of at such times and by such methods as appeared to the directors to be advantageous: such disposals were the final sales in what was in fact the carrying on of a trade with a view to making profit therefrom.

3. That the profit realized from the *en bloc* sales of licences made by the appellant were profits from a trade or other business within the meaning of s. 3 of the *Income War Tax Act* and within the definition of business in s. 127(1)(*e*) of the *Income Tax Act,* and were properly assessed as income.

4. That the contracts of sale made prior to the incorporation of appellant and later transferred to it were not made in the course of the trading or business of appellant nor were the receipts by appellant of the moneys payable under such contracts receipts from its trading or profit-earning operations since what appellant acquired from the Company was a debt plus a licence to hold as security until the debt was paid and sums received by appellant in payment of such debts were realizations of what was assigned to appellant by the Company and if profit were realized by appellant therefrom it was not income but capital gain.

APPEALS under the *Income War Tax Act,* the *Excess Profits Tax Act* and *The Income Tax Act.*

The appeals were heard before the Honourable Mr. Justice Thurlow at Ottawa.

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H. H. Stikeman, Q.C. and *J. N. Turner* for appellant.

K. E. Eaton and *G. W. Ainslie* for respondent.

THURLOW J.:—These are appeals from reassessments of income tax and excess profits tax for the years 1944 and 1945 and of income tax for the years 1949, 1950, 1951, and 1952, all of which reassessments were made by the Minister of National Revenue in respect of the appellant's income for the years in question on or about May 31, 1955, and all of which were confirmed by him on March 9, 1956. The appeals were heard together.

The question raised is whether profits realized by the appellant on sales of its British Columbia timber licences, in the circumstances hereinafter set out, are income or capital gains.

Upon its incorporation in 1944 the appellant purchased (with certain immaterial exceptions) all the assets and undertaking of Gillies Brothers Ltd., a firm which had been engaged for many years in the manufacture and sale of timber and lumber in Ontario and Quebec. Included in the assets which the appellant then acquired were some thirty-eight timber licences held by Gillies Brothers Ltd., authorizing the holder to cut and remove timber from about thirty-eight square miles of timber lands in British Columbia. At the time of the transfer some of the licences were being exercised by loggers under contractual arrangements with Gillies Brothers Ltd., whereby the logger was required to cut the whole of the merchantable timber on the tract upon which he was authorized to operate, to pay the licensee certain fixed stumpage fees based on the quantity of merchantable timber cut from the tract, and also to pay the licensee a percentage of the sale price of the logs. These contracts have been known as *pay as cut* contracts. The appellant acquired both the licences and the benefit of these contracts. In 1944 and subsequent years the appellant entered into further similar contracts. Three of the licences transferred to the appellant were under contract of sale, the purchase price being payable in instalments and not entirely accrued due. These sales have been known as *en bloc* sales. In 1946, 1947, 1948, 1949, and 1950 the appellant also made a number of *en bloc* sales of licences for lump sum prices not dependent

on the market price of the timber on the tract or the cutting of any of it. In some cases, under the terms of the contract of sale the price was payable immediately, and in others it was payable over periods of several years. It is the assessments of profits on these sales that have given rise to the appeals.

The appeal in respect of the reassessment for the year 1951 also involved the question whether profit realized by the appellant in that year on the sale of certain Ontario timber limits, known as the McConnell and Mackelcan limits, was income or a capital gain, but the appellant's contention in respect of this transaction was conceded at the opening of the trial by an admission which has been incorporated by an amendment in the respondent's reply. The correctness of the figures set forth in the reassessment notices was admitted at the opening of the trial and accordingly the only remaining issue is whether or not the appellant is liable to be taxed in respect of the whole or any part of the profits made on *en bloc* sales of British Columbia timber licences.

The appellant contends that the profits realized on these sales are capital gains and are not subject to income tax or excess profits tax. The respondent takes the position that these profits are income, those realized in 1944 and 1945 being income from a trade or business as defined in s. 3 of the *Income War Tax Act*, R.S.C. 1927, c. 97, which definition is also applicable under the *Excess Profits Tax Act*, S. of C., 1940, c. 32, and those realized in 1949 and later years being income from a business within the meaning of ss. 3 and 4 of *The Income Tax Act*, S. of C., 1948, c. 52.

Section 3 of the *Income War Tax Act* is as follows:

> 3. For the purposes of this Act, "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be whether derived from sources within Canada or elsewhere; and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source including . . .

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Sections 3 and 4 of *The Income Tax Act*, applicable to the years 1949, 1950, 1951, and 1952, are 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 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.

By s. 127(1)(*e*) of the same Act, it is further provided:

127. (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;

The problem is to determine whether or not the profits in question fall within the description of profits in these definitions. In these appeals the burden of proving facts showing that the profits in question are not profits of the kind mentioned in these sections rests on the appellant.

In *Johnston v. Minister of National Revenue* (1), Rand J. puts the matter thus at p. 489:

Notwithstanding that it is spoken of in section 63(2) as an action ready for trial or hearing, the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant. If the taxpayer here intended to contest the fact that he supported his wife within the meaning of the Rules mentioned he should have raised that issue in his pleading, and the burden would have rested on him as on any appellant to show that the conclusion below was not warranted. For that purpose he might bring evidence before the Court notwithstanding that it had not been placed before the assessor or the Minister, but the onus was his to demolish the basic fact on which the taxation rested.

What, then, is the basic fact on which these assessments rest? In my opinion, the assessments rest on the factual assumptions that the trade or business—that is to say, the profit-earning activities—carried on by the appellant company included the process or practice of trading or

(1) [1948] S.C.R. 486.

dealing in timber licences with a view to making profit from them by selling them, and that the profits in question arose in carrying out that process or practice.

If these assumptions are true, I think it follows that the profits in question are income within the definitions contained in both statutes. If either of the assumptions is not true, it may be that the profits in question are not income as defined in the *Income War Tax Act*, applicable to the reassessments for 1944 and 1945, but, in theory at least, the profits may still be income from a business as defined in *The Income Tax Act*, applicable to the reassessments for 1949, 1950, 1951, and 1952. The meaning of "business" as defined in s. 127(1)(*e*) of *The Income Tax Act* is not co-extensive with that of the expression "trade or commercial or other business" in s. 3 of the *Income War Tax Act*. The former includes the expression "adventure or concern in the nature of trade", which gives a wider import to the meaning of "business" and brings within the definition transactions which, while for one reason or another not falling within the ordinary meaning of *trade*, nevertheless partake of the qualities of trade to a sufficient extent to be classified as being ventures in the nature of trade. *Minister of National Revenue v. James A. Taylor* (1). However, in view of the conclusion to which I have come on the facts, it will not be necessary to consider whether or not any of the profits in question arose from a venture in the nature of trade outside or beyond the scope of trade itself. Nor, for the same reason, is it necessary to consider how much wider is the meaning of the word "business" than the meaning of the word "trade" for, if the transactions in question formed part of the appellant's trade, I think it follows that they also formed part of its business.

In determining whether or not the process or practice which gave rise to the profits in question was a part of the appellant's trade or business, it is clear that neither the number of transactions involved, nor the fact that profit was made on the sales, nor the combination of both these features is sufficient alone to make the transactions part of the appellant's trade or business. Nor do the facts

(1) [1956] C.T.C. 189.

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that the profit was made by a trading company whose sole purpose is to make profits for its shareholders or that the company invested in the property in the expectation of realizing profit from it by selling it at a higher price conclude the matter. These features are all matters to be taken into account and some of them are of the utmost importance, but none of them is, by itself, sufficient to answer the question. The test for answering the question, as expressed by the Lord Justice Clerk in *Californian Copper Syndicate v. Harris* (1) and subsequently quoted and approved in Canada as well as elsewhere, is as follows:

> 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 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 a 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.
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> 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?

The way in which the Lord Justice Clerk applied the test is also of interest. After discussing the objects contained in the company's memorandum of association, he said at p. 166:

> These are shortly some of the main purposes of the Company, and they certainly point distinctly to a highly speculative business, and the mode of their actual procedure was in the same direction. Of the £28,332 realised by shares which were subscribed for, £24,000 was invested in a copper-bearing field in the United States, and the balance was spent in development of the field, and in preliminary and head office expenses.
>
> The Company then were successful in selling the property to the Fresno Company—£300,000 in fully paid up shares being given by the Fresno Company for the property. Although that was a sale, the price to be paid in shares, I feel compelled to hold that this Company was in its inception a Company endeavouring to make profit by a trade or

(1) (1904) 5 T.C. 159.

business, and that the profitable sale of its property was not truly a substitution of one form of investment for another. It is manifest that it never did intend to work this mineral field with the capital at its disposal. Such a thing was quite impossible. Its purpose was to exploit the field, and obtain gain by inducing others to take it up on such terms as would bring substantial gain to themselves. This was that the turning of investment to account was not to be merely incidental, but was, as the Lord President put it in the case of the Scottish Investment Company, the essential feature of the business, speculation being among the appointed means of the Company's gains.

It will be observed that, in that case, the sale of the property in question was the main operation carried out by the company and, as the company was formed to make profit by trading and the sale in question was the main way in which it had, in fact, carried out its object, the inference was readily drawn that making profit by selling the property was, in fact, the company's trade.

A more complicated situation in which to apply the test arose in *Atlantic Sugar Refineries Ltd. v. Minister of National Revenue* (1), where the company's profit-making procedure was to buy raw sugar, refine it, and sell the finished product. Because of unusual developments which threatened the company with a loss in its usual operations, the company undertook a somewhat different operation of buying and selling raw sugar futures and earned profits thereby. These profits were assessed as income under the *Income War Tax Act*, and the assessment was upheld in this Court and in the Supreme Court of Canada. There Kerwin J. (as he then was) delivered the judgment of the majority of the Court and at p. 709, in applying the test, said:

> The company finding itself in an abnormal situation because of the various factors mentioned, Mr. Seidensticker decided to protect the appellant's financial interests by the operations on the Exchange. The company was not investing idle capital funds nor was it disposing of a capital asset. In no sense may it be said that the operations were unconnected with the appellant's business and it is at least an added circumstance that the speculation was made in raw sugar. Even if it were the only transaction of that character, it should be held, in the light of all the evidence, that it was part of the appellant's business or calling and therefore a profit from its business within section 3 of the Act.

From this, it appears that if a trading company has an established type of operation and engages in transactions of a different nature, which transactions on their own do not afford a clear answer to the question whether or not

(1) [1949] S.C.R. 706.

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they are a part of the company's trade, points of connection or relationship between the transactions in question and the company's established trade may serve to show that transactions of the kind in question are part of the company's trade.

Another and wider approach for determining the question is set out by Duff J. in *Anderson Logging Co. v. The King* (1) at pp. 49 and 55, where he said:

> . . . It is difficult to discover any reason derived from the history of the operations of the company for thinking that in buying these timber limits the company did not envisage the course it actually pursued for turning these limits to account for its profit as at least a possible contingency; and, assuming that the correct inference from the true facts is that the limits were purchased with the intention of turning them to account for profit in any way which might present itself as the most convenient, including the sale of them, the proper conclusion seems to be that the assessor was right in treating this profit as income.
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> * * *
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> . . . The essential conditions of assessability (where a profit proposed to be assessed is the profit derived from a sale of part of the company's property) appear to be that the company is dealing with its property in a manner contemplated by the memorandum of association as a class of operation in which the company was to engage, and, moreover, that the governing purpose in acquiring the property had been to turn it to account for the profit of the shareholders, by sale if necessary.

The same approach is evident in the judgment of the House of Lords in *Ducker v. Rees Roturbo Development Syndicate* (2), but with the added fact that the method used to make profit from property of the company was not the line on which the directors would have preferred their business to develop. It was held that this additional feature did not prevent the transaction from being one entered into in the course of the company's trade.

Lord Buckmaster says at p. 140:

> My Lords, I think it is undesirable in these cases to attempt to repeat in different words a rule or principle which has already been found applicable and has received judicial approval, and I find that in the case of the *Californian Copper Syndicate v. Harris*, 5 Tax Cas. 159, it is declared that in considering a matter similar to the present the test to be applied is whether the amount in dispute was "a gain made in an operation of business in carrying out a scheme for profit-making". That principle was approved in a judgment of the Privy Council in the case of *Commissioner of Taxes v. Melbourne Trust*, [1914] A.C. 1001, and it is, I think, the right principle to apply.

(1) [1925] S.C.R. 45. (2) [1928] A.C. 132.

At p. 141 Lord Buckmaster applies the test as follows:

> Turning to the findings of the Commissioners, I find that they set out in detail the circumstances connected with the working of this company, and, in particular, the reports, which begin in 1907 and continue down to 1918. These reports show that the directors were contemplating from the beginning the possibility of the sale of some of these patents. It is quite true that they preferred not to sell them if a sale could be avoided, but the statement in para. 11 of the case is quite plain, that "the possibility of the sale of the foreign patents or rights has always been contemplated by the appellant company in respect of such interest as it possessed in the foreign patents". It is one of the foreign patents with which this appeal has to do, and the agreements, which are set out, showing the way in which the foreign patents in the case of France and of Canada have also been dealt with, show that that statement was not a statement of a mere accidental dealing with a particular class of property, but that it was part of their business which, though not of necessity the line on which they desired their business most extensively to develop, was one which they were prepared to undertake.

I think it is clear that, in each of these cases, the Court treated the transactions in question on the basis of their being part of the trade or business of the company within the ordinary meaning of the word "trade" rather than as being beyond the ordinary meaning of the word but within the meaning as extended by the expression "adventure or concern in the nature of trade" or any similar expression contained in the particular statute to be applied. In the *Atlantic Sugar Refineries* case, the expression "adventure or concern in the nature of trade" was, of course, not in the statute under consideration.

With these considerations in mind, I propose to deal first with the nature of the licences in question and thereafter to consider the objects with which the appellant acquired them and what it was that the appellant did with them.

The licences are known as timber licences. They are in standard form and are issued pursuant to the *Land Act,* Statutes of British Columbia, 1908, c. 30, as amended by 1910, c. 28, and pursuant to the *Forest Act,* Statutes of British Columbia, 1912, c. 17. In each case, the licence covers an area of approximately one square mile and, by it, in consideration of an annual renewal fee and a royalty on the timber taken, the holder is authorized *to cut, fell, and carry away timber* upon all the particular tract of

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land described in the licence. The authority is for one year only but is renewable from year to year, as provided by the statutes upon payment of annual renewal fees.

By virtue of the statutes above mentioned and of the licence issued pursuant to it, the holder becomes entitled to the timber on the limit when it is cut and by whomsoever it may be cut. Until the timber is cut, it remains part of the realty which still belongs to the Crown. If timber has not been cut when the licence expires, the title to it never vests in the licensee. The licensee does not own the timber unless it is cut within the year and, of course, in any case he owns not all the trees but only the trees that are cut.

The owner of a licence may make use of it in several ways. He himself may cut the trees, in which case they become his property and he can sell, manufacture, or otherwise deal with them as he sees fit. Or he may authorize some other party to cut and remove the whole or part of the timber under any of a variety of contractual arrangements between himself and the logger. Upon the cutting, the property in the timber becomes that of the licensee, and through such contractual arrangements it may immediately or later become the property of the logger or other persons. But whether the licensee himself cuts the timber or authorizes some other party to do so, the nature of the process is that the licensee's rights under the licence are exercised; the licence itself is used. To my mind, it makes little difference, for the purposes of this appeal, whether, after cutting the timber or having it cut, the licensee intends to saw the timber himself or to have it sawed or simply to sell the logs, or whether the licensee sells the timber on a stumpage basis. In any of these cases, what the licensee is doing, insofar as the licence is concerned, is making use of it in his business to earn profits. While the trees, when cut, may be used or dealt with in many different ways, the only way the licence itself can be used is by cutting the trees. When being so used, it will, in most cases, have the character of a capital asset. In this process the licence itself may become valueless, and ultimately it may be allowed to lapse. But it is not sold. What is sold is the timber which is the fruit or product of the licence.

There is, in my opinion, a distinction between making profit by use of a licence in any of the ways above mentioned and making profit by selling the licence itself. Profit can, of course, be made in both ways; by cutting the timber either personally or through another, or by trading in the licences—buying them and selling them at a profit. Moreover, the same person may make profit in both ways and from the same licence. But the two profit-earning processes are quite different. One is a making use of the licence to earn profit, the other is the treatment of the licence itself as stock-in-trade in an ordinary process of buying and selling for profit.

It will be seen that the appellant made use of some of its licences and made profit thereby. This was done, in general, through contracts of the kind previously mentioned with loggers who undertook to cut timber from the tracts and to pay the appellant certain stumpage payments and a percentage of the sale price of the logs cut. These are the contracts which have been known as pay as cut contracts, and the profits realized by the appellant through them were treated as income and assessed accordingly. No question as to such profits arises on these appeals.

But the appellant also sold a number of its licences and thereby made profits which are involved in these appeals. Of the licences so sold, some had been or were being used in pay as cut contracts and some had not been so used. It accordingly becomes necessary to examine the facts closely to determine whether or not the appellant's trade or business in the years in question included the acquiring of timber licences with a view to making profit from them in ways which included that of selling them.

The appellant was incorporated in 1944 under the *Dominion Companies Act* with objects and powers wide enough to embrace all the activities to be mentioned and many other kinds of activities which have never been pursued. As previously mentioned, upon incorporation the appellant acquired the assets and undertaking of Gillies Brothers Ltd., and it has proceeded to carry on that undertaking. In the discussion of the facts which follows, Gillies Brothers Ltd. is referred to as "the company". The purpose of the new incorporation, transfer of assets, and

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winding up of the company was to provide a method of withdrawing capital from the company. In the transaction, the appellant simply took the place of the company so far as the business and undertaking were concerned, with the same shareholders each holding in the same proportions, with the same directors and officers, and with the same policies and designs.

In my view, the question to be determined must be resolved on the basis of what the business and undertaking of the appellant was and included in 1944 and subsequent years, rather than what the business and undertaking of the company may have been at any earlier time, but the history of the business and undertaking of the company, its acquisition of the licences, and its policies and conduct in regard to them afford evidence of what the business and undertaking included in 1944 when the appellant acquired them.

The company was incorporated in 1893 and at that time acquired a timber and lumber manufacturing business which had been started many years earlier and had been operated and built up in the meantime in the provinces of Ontario and Quebec. Its principal place of business was at Braeside in Ontario. For the purposes of its operations from time to time it acquired timber limits in those two provinces and on occasion, though rarely, it disposed of limits by selling them, in most, if not in all cases, after the timber required by the company had been removed. Between 1902 and 1919 it made four sales of limits, all of which had been purchased prior to 1900. In 1927 it transferred a tract to the Ontario government as part of a transaction by which it acquired another tract, and in 1951 the appellant sold two limits which had been purchased by the company in 1922 with a view to supplying a new mill which the company was then planning to set up and operate. These were the only sales or disposals of timber lands in Ontario and Quebec by the company and the appellant since 1900. In the meantime, between 1904 and 1956, the company and the appellant made purchases of twelve additional limits. In my opinion, it is clear on the evidence that the acquiring of timber limits by both companies in Ontario and Quebec was for the sole purpose of making use of them in its manufacturing operations,

and at no time was either the company or the appellant engaged in the practice of acquiring limits in those provinces with a view to making profits from them by selling them. It may be added that throughout the existence of the company and of the appellant, from 1944 to the present time, the business and undertakings in these provinces have been by far the main business and undertakings of the respective companies. In comparison with the eastern operations, the activities in British Columbia have been of minor importance and extent.

However, in 1910 and later years the company, with an eye to the future, became interested in the prospects of expansion and development of the lumbering industry in British Columbia.

In 1913, following correspondence between the company and Messrs. Clark and Lyford, a firm of forest engineers operating in British Columbia, the company invested approximately $17,000 in acquiring an interest in 13 British Columbia timber licences. The remaining interest was held by Messrs. Clark and Lyford, and the terms on which the venture was undertaken appear fully from the correspondence and contracts relating to them which are in evidence. To my mind, it is clear beyond doubt that the method, and the only method, then contemplated of deriving profit from this venture was through the sale of the licences. One of them was, in fact, sold in 1916 at a profit. No further sale of any of this group of licences was made until 1941, when the company made an agreement to sell one of them. This sale resulted in a loss. The only other sale of any of the group made by the company was on December 31, 1943, shortly before the transfer to the appellant. One additional licence, referred to as the Seabird licence, had been acquired outright by the company in 1914 and sold in 1917, whether or not at a profit does not appear. Between 1920 and 1940 the market for timber fell and during most of the period continued so low that no profit could be made from sales of the licences, if indeed sales of them could be made

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at all. The carrying charges, however, mounted annually during the period. In each of the years 1924, 1925, 1927, 1928, 1930, 1931, and 1932 some money was derived from the limits under pay as cut contracts, but the company found the contracts very unsatisfactory as they afforded insufficient protection against cutting only the best of the timber on the limits and for the recovery of the money payable to the licensees. Early in 1933 the profit-sharing feature of the arrangements between the company and Messrs. Clark and Lyford was abrogated by mutual agreement, it being the opinion of the parties that no profit was likely to accrue to Messrs. Clark and Lyford. The licences then became the sole property of the company. It may be noted that at that time the company was still contemplating sale of the licences as, before taking over the Clark and Lyford interest, it inquired as to the prospects of selling them and, upon the transfer, made an arrangement with Clark and Lyford for payment to them of a commission on sales of timber or licences which they might make. At the same time the company expressed its preference for sale of these *limits* on a lump sum basis. In each of the years 1933 to 1940 inclusive, and in 1943, the company derived money from pay as cut contracts relating to these licences.

Three of the licences were allowed to lapse, one in 1939, one in 1941, and one in 1942, in each case following pay as cut contracts relating to them. In the case of one of these three licences, the company realized a profit; on the other two, it sustained losses. As previously mentioned, by the end of 1943 three of the 13 licences had been sold.

The remaining seven were transferred to the appellant, and the appellant disposed of all seven of them by selling them, three in 1946, one in 1950, one in 1951, and two in 1956. Prior to sale, it entered into a pay as cut contract in regard to one of them.

So much for the history of what are known as the Clark and Lyford and Seabird licences. I come now to another group of licences acquired, held, and disposed of over

approximately the same period but with at least a partially different object in mind. These are the Drury Inlet licences.

In the years following the first venture of the company in acquiring British Columbia timber licences, other offers were made to it which, for one reason or another, it did not accept. In particular, it did not accept any further offers to purchase on a profit-sharing basis, as the directors objected to this arrangement. It will be apparent that acquiring licences for sale on a profit-sharing basis would not fit into a design which the directors later had in mind to acquire timber for the ultimate purpose of supporting a lumber manufacturing operation to be undertaken by the company in British Columbia. They considered, but did not accept, offers of timber licences covering tracts in Smith Inlet and Rivers Inlet. The correspondence shows that they were aware that the timber was inaccessible in that it would either have to be towed in open water, which involved extra risk, or it would have to be manufactured in the inlet, and they directed inquiries as to the quantity of timber available and the milling opportunity. I regard these inquiries as being related to ascertaining the value of the licences, rather than as indicative of any intention on the part of the directors to undertake a milling operation. There is, however, other evidence that they, in fact, had such an intention, but that intention was developed somewhat later. The company also rejected several offerings of large groups of licences (one of which included a mill) for several reasons, the lack of sufficient available capital to finance purchases of half a million dollars or more being one reason, the state of the markets for lumber being another, and the uncertainty of prospects for the future being a third. In correspondence with Clark and Lyford in September, 1917, the company expressed itself as not interested in a working property at that time but only in timber at low price which could be held *for investment*, and as late as October 28, 1918

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the company, in making an offer of half of what it shortly afterwards paid for a block of 40 licences, in another letter to Clark and Lyford said:

> You can appreciate our difficulty in being at this distance and not in touch with local conditions but this may give us a better view in that we look at lumber conditions as a whole and not from the B.C. viewpoint only, and consequently that only offerings which are unquestionably cheap would be advisable for us as a holding proposition.

Later in 1918 the company accepted an offer and purchased 40 licences on Drury Inlet for $200,000. These licences, according to the evidence of Mr. D. A. Gillies, who was a director of the company from 1909 onward and president of it from 1938 and subsequently of the appellant were purchased as the nucleus of timber holdings to be acquired whenever it was possible to do so on favourable terms, to build up a sufficient supply to support a manufacturing operation which the company had a long term policy to undertake, if and when markets and future prospects became bright enough to justify that course. According to Mr. Gillies' evidence, this purchase was the initial step in carrying out the new policy in regard to British Columbia timber. He said:

> ... It was a very definite and a very big decision on our part and the idea was and my idea was at that time we changed from the idea of the small lot to formulate a policy in the back of our mind—and this group formed the main background of it—that we would gradually build up a quantity of timber through purchase on the British Columbia coast sufficient to justify our entering into the manufacture of lumber on the Pacific coast as we had done in the east over several generations.

The 40 limits were all in one block and bordering on tide water and within towing distance of mills. The quantity exceeded five hundred millions of feet but, in the opinion of the directors, it was by itself insufficient to sustain an undertaking of the kind the directors had in mind for a sufficient number of years. In December, 1918, shortly after the purchase, upon receiving an inquiry as to a price for 25 or all these licences the directors set a price of $10,000 per licence, but no sale was made.

The wording of the directors' minute regarding this incident is as follows:

Clark and Lyford writing *re* 40 cedar limits recently purchased and stating they had a prospective buyer for 25 or all of them and asking bottom price we would accept. *As these were bought* under war conditions and *for rise in value after times became normal,* decided to name $10,000 per limit as minimum price exclusive of 5% commission to Clark and Lyford with possibility of dropping later to not less than $8,000 at lowest. These limits were under option at $10,000 each by the same parties before we bought them and two limits were sold to loggers on terms of $17,500 each.

When asked to explain how the figure of $10,000 per limit was arrived at, Mr. Gillies replied:

I don't recall it except that it shows that we evidently were scotch enough that we are not going to sell any less than what we paid for it and I might also add that it was in a special case if you got 100 per cent on your purchase price anyone who was willing and open to make a deal would be willing to accept it, you would get the new money and you would be in a position to go out and buy further timber at probably less and lower prices again and that does not in any way shape or form change the general idea that we were still trying to build up a block of timber behind the possible mill. The fact that we were willing to sell some of the 40 licences we bought does not mean we had given up or changed our general policy of buying a block of timber which would justify the construction of a plant later.

About a year after the purchase of the 40 limits, the company in a letter to Clark and Lyford said:

Re Southern Timber Limits. We are not anxious to sell the Drury Inlet lot immediately but bought it rather for holding.

We would, however, be willing to sell any or all of the original lot of limits in which you have a joint interest, provided these can be sold at a profit. Some of these carry considerable cedar and at the present time pulpwood should be in good demand.

In 1925 the company purchased one additional licence on Drury Inlet.

The purchase of timber licences as an investment to hold is, in my opinion, consistent with a number of different designs as to what is to be done with them. So long as they are simply held, they are burdensome in that there are annual expenses to be paid and they produce no revenue. The intention to hold them is, I think, quite consistent with an intent to use them in the future in any way in which they can be used, that is, by cutting the timber or having it cut, or to sell them at a profit or with no other intent than to turn them to account for profit in any way which might present itself.

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While I do not doubt the evidence that the company had long-range intentions of undertaking lumber manufacturing in British Columbia, if and when conditions made it an attractive undertaking, and bought these limits with these intentions in mind as a source of supply for the operation, I think this was but one of the company's ideas as to what might be done with these limits to turn them to account for profit. The company's plan for manufacturing lumber in British Columbia being of an indefinite character and still in its earliest stages, I cannot but think that in purchasing these 40 limits *for rise in value after times became normal* the directors also had in view the other course for making profit from them by selling them. And this, to my mind, is borne out by their setting a price on them and contemplating a lower price to achieve a sale of them very shortly after they had been purchased. Even though they may not have been anxious to dispose of them and even though selling them may not have been the way in which they may have preferred their best opportunity in respect to them to arise, they were quite prepared to sell them to make profit. However, none of them were, in fact, sold until 1940, and by that time the decision to abandon all ideas and plans for a manufacturing operation in British Columbia had been made. The company was then in the process of disposing of its British Columbia holdings as rapidly as possible, consistently with disposing of them at a profit, and in concentrating its resources for an expansion of its eastern operations. Moreover, until this decision had been made, that is to say, prior to 1939, cutting under these licences under pay as cut contracts had been done on only five of the 41 limits and the returns indicate that it was not very extensive. They are:

1919	$ 211.87
1921	87.50
1929	653.68
1933	1,905.40
1934	575.26
1935	1,191.07
1936	1,680.53
1937	3,589.54
1938	1,814.37
	$10,709.22

This, with certain very small sums for trespasses, was all the company recovered in twenty years from an investment of $200,000, and it would not approach the amount of expenses incurred in connection with holding the licences.

The attitude of the company towards these licences in the meantime is shown in several minutes of the directors in 1928, 1929, 1936, and 1937 and in a letter to Mr. P. L. Lyford dated February 15, 1933. The minutes are:

December 11, 1928—

Regarding B.C. limits.

. . . Nothing definite from J. D. Lacey & Company. It looks as if immediate prospects of sale was only on the stumpage basis which has serious drawbacks.

January 14, 1929—

B.C. Limits discussed.

The President stated nothing further to report as to possibility of selling them to advantage. The only enquiries to date for the Drury Inlet limits being on a pay as you cut basis which as stated at previous meetings carried serious disadvantages with it . . . though on the other hand if successfully and amicably operated on such basis greater returns could be obtained than on a cash basis . . .

December 15, 1936—

Some offers to cut some limits in Drury Inlet on pay as cut basis had been received but not considered as our experience in this method of selling timber was not satisfactory.

February 8, 1937—

Clark and Lyford has two prospects for buying cedar timber on Drury Inlet on pay as cut basis, no deposit, or guaranty of quantity to be taken out. As our experience in this type of timber sale was far from satisfactory, it was decided not to consider offers of this kind for Drury timber.

The letter of February 15, 1933 (Ex. 25), the first three paragraphs of which refer to the Clark and Lyford licences, is as follows:

Dear Sir:

Re: Profit Sharing Limits.

We have your letter of the 4th inst. suggesting a fee or commission of 5% net to you for sales of timber on these limits including general over-sight of these profit-sharing limits, negotiating of sales and administration of the contracts and collection of stumpage, and we are agreeable to this.

We have already written you that our experience with selling timber on a pay as cut basis has not been satisfactory and suggesting improved methods of accounting to which you refer in your letter.

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We would prefer to sell these *limits* on a lump sum basis and this would be to your advantage also as you would get the same return and we would both be saved the difficulties of collecting on logs as cut.

It may not be possible to sell in this way at the present time but under present conditions and price we will let the Drury Inlet timber stand rather than accept the prices you mention, where there is no guarantee as to the quantity the buyer would take off the limit. Eventually we feel that stumpage will return to a more or less profitable basis, particularly if B.C. can improve their export trade in the future as much as they have been doing this year.

We feel that in spite of Mr. Bennett's stand that the Canadian Exchange is likely to get nearer in line with Sterling and further away from the United States in view of the deficit both in the Dominion, Provincial and Municipal budgets, and that in view of these deficits it will be difficult to keep our exchange in line with the United States and this will make it still easier for B.C. export trade both in Britain and Asia.

Unless you can get something worth while on the Drury Inlet timber, either on a lump sum or with a worth while deposit held so that it cannot be manipulated like the McNaughton one, we will let this timber stand hoping that prices will pick up in a reasonable period.

Yours truly,

GILLIES BROS. Limited,
J. S. Gillies.

It is, of course, possible to sell timber on a lump sum basis, as well as to sell licences on that basis, and it is also possible to sell licences on terms of payment extended over the period of cutting. But I think that the references in the minutes and letter to lump sum sales at least include lump sum sales of licences, if indeed they do not mean such sales alone, rather than lump sum sales of timber. The third paragraph of the letter states that the company prefers to sell the *limits*. And, as far as the evidence discloses, any lump sum sales made were lump sum sales of licences, rather than of timber, except in one case (Ex. 40) where the sale purported to be one of timber but the contract also provided for transfer of the licence to the purchaser upon payment of the purchase price.

My estimate of what the minutes and letter above quoted show is that in this period, with its vision of a milling operation of its own fading, the company was left with *en bloc* sales of licences and stumpage sales of timber as its remaining methods of realizing profits from the licences. Because of its unsatisfactory experience with

pay as cut contracts, the company favoured *en bloc* sales of the licences and would hold the licences for disposal on a lump sum basis except when a substantial deposit could be obtained from one wishing to contract on a pay as cut basis. In any event, I think it is obvious that at this stage these licences were for sale if a profit could be made and the company preferred that course to using the licences in pay as cut arrangements. Preference for one type of contract over another was, however, based only on the desire to secure the best possible return, rather than on any desire to retain the subject matter, that is, the licences, for future use. The intent, as far as the licences were concerned, was thus to turn them to account for profit in the best way that might present itself.

From 1939 onward prices for all types of lumber improved, and commencing in that year and continuing through 1940, 1941, 1942, and 1943 the company entered into pay as cut contracts on 20 of the Drury Inlet limits and derived substantial sums from them. By the end of 1943, 14 of them had been allowed to lapse, some without anything being recovered from the investment, and some after all merchantable timber had been removed. Two had been sold in a single transaction in 1940. The remainder, some twenty-five of them, were transferred to the appellant, but of those transferred about twelve were under pay as cut contracts. The appellant also entered into pay as cut contracts in respect of four or more of the licences. Most of the licences under pay as cut contracts were ultimately allowed to lapse, but some were sold. In all, the appellant sold 13 of this group of licences, five in a single transaction in 1947, five more in a single transaction in 1948, one in another transaction in 1948, and two in separate transactions in 1950.

Besides the Clark and Lyford, Seabird, and Drury Inlet licences, the company in 1921 purchased eight licences on Seymour Inlet. These were situate only twelve

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miles or thereabouts to the northward of Drury Inlet, but the timber on them was commercially more inaccessible in that it would have to be sawn in the inlet, which involved setting up a mill there, or the logs would have to be towed in open waters of the Pacific Ocean to take them to other mills, and this involved greater risks and higher towing charges than towing from Drury Inlet. The timber on these limits, when cruised, fell far short of the rough estimate on which the company had made the purchase, and in a letter to Clark and Lyford dated January 24, 1922 (Ex. H), adverting to this the company, among other things, said:

> This timber, owing to its inaccessibility was bought only as a long term speculation and at a nominal price, and the matter of four or five year's carrying charges is a serious item.
>
> We note your suggestion to take over limit #8810 at an additional cost of $1,182.34, say 20¢ per M, but before putting any more money into this lot we should be glad to hear from you as to what would be the prospect of selling the timber on some of the lighter timbered berths such as 6608 and 6642 containing say 14,000,000 feet and what price could be obtained for these two licenses for immediate cutting. If the Cedar market is now in shape these could be sold to advantage at say $1.50 per M or over, to be cut now, it would reduce the investment and enable us to hold the more desirable licenses.

Two of these licences, 6608 and 6609, were in fact sold in 1922 at a small profit and 6610 was acquired in the same year. The remaining seven were disposed of under pay as cut contracts in 1940 and 1942, and no question as to the proceeds of them arises on this appeal.

One other purchase in British Columbia made by Gillies Brothers Ltd. should be mentioned, that of the Tyee Crown grant in 1924. As to this, it is obvious from the correspondence in evidence that, whether or not it may have also figured in the contemplated manufacturing operation as a source of supply, it was purchased as a speculation and in the hope of realizing profit by selling it or the timber on it in a short time. In a lettter to Clark and Lyford, dated June 13, 1924, the company quoted the following wire it had sent the previous day:

> Your wire twelfth. Trade quiet. No sales. Money tight and directors averse to new commitments. But willing to take on if price named is lowest price obtainable. Willing to give you ten per cent commission on any reduction from purchase price. Purchase contingent on resale com-

mission of ten per cent applying only on profit or difference between cost including carrying charge to date of resale, and the resale price as conceivably on a long hold the commission might equal the profit. Wire amount needed and when.

Later in the letter, the following paragraph appears:

We note your suggestion to make the resale price a minimum of $80,000 and for prompt sale we would be agreeable to this. You of course to get as much higher a price as can be had. Prices should advance with the time the timber is held.

Another letter, dated October 27, 1925 (Ex. K) shows the same intention both with respect to the Tyee Crown grant and one of the Clark and Lyford licences. When asked if the correspondence did not indicate that Gillies Brothers Ltd. had in mind a quick re-sale of the Tyee Crown grant, Mr. Gillies replied:

A. It wasn't too quick. They were already held a good many years. Cutter Creek was purchased in 1913. The Cutter Creek was one of the 14 licences. I know that. I cruised and traveled that myself.

Q. 2. Could we leave Cutter Creek out of this discussion?

A. If you wish to reduce it to the one with Tyee Crown grant probably you might say that it was with a possible sale. We hope and continue to hope that we are traders and if you can get a big and quick profit on anything you buy you are foolish not to accept it. That is my idea of doing business. Then as far as timber goes you could sell it tomorrow and get a profit and go out of it after and buy an additional quantity probably at a lower price for a hold.

The surface rights in the Tyee grant were sold for a small sum in 1927, and the timber was disposed of to a number of loggers over the period from 1933-1943. The receipts from it are not involved in these appeals.

To sum up, the acquisitions by the company in British Columbia from 1913 to the end of 1943 consisted of six purchases between 1913 and 1925 and the transfer to the company in 1933 of the Clark and Lyford interest in the first group of licences. Its sales of licences consisted of one transaction in 1916, one in 1917, one in 1922, none in the next eighteen years, one in 1940, one in 1941, and one in 1943. The remainder of its transactions consisted of sales not of licences but of timber under pay as cut contracts, and these, too, were of only minor importance and extent until 1939. From 1939 onward, extensive sales of timber from these licensed tracts were made.

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To make the sales, the company had an agent in British Columbia whose remuneration was a commission based on the selling price, whether it was the selling price of timber or the selling price of the licence. The agent's work included the promotion of sales, and for this purpose advertisements were also published from time to time.

In my opinion, the Clark and Lyford group of licences was purchased to be sold at a profit and, while other intentions as to their use may have arisen under the pressure of economic circumstances, the scheme to make profit from them by selling them was never lost or abandoned.

The Drury Inlet group was purchased to hold for the purposes of the contemplated mill, this being the favoured purpose, but with the secondary purpose (and this whether the possible mill materialized or not) of deriving profit in any way in which they might be turned to account at a profit, including sale of them. The Seymour Inlet group was purchased with the same purposes in mind as applied to the Drury Inlet licences, but with the knowledge that there was less possibility of using them in the contemplated milling operation. The Tyee Crown grant was purchased to be turned to account for profit by sale of the grant or the timber on it. These original purposes were substantially frustrated by the moribund condition of the timber market in the late 20's and 30's and the general economic depression, and when the markets revived the company's plans for a mill in British Columbia were given up in favour of expansion in eastern Canada. At that stage the residual purpose was to sell either the timber or the licences as expeditiously as this could be done at a profit, and this is what was, in fact, being done with them when the appellant took over the assets and undertaking of the company.

Pausing here, I am of the opinion, notwithstanding the very small number of sales of licences, six in all, made over the years from 1913 to 1943, that at the time when

it ceased operations and transferred its assets and undertaking to the appellant at or about the end of 1943 the business of the company included that of trading or dealing in British Columbia timber licences. It had acquired licences in considerable volume with a view to turning them to account by methods which included sale of them, it had sold some of them, it had an agent engaged to seek purchasers and arrange sales on a commission based on the selling price of either timber or licence, and it advertised for purchasers. No doubt sales of licences were infrequent, but when they occurred I think they were part of the trade rather than mere realizations of investments.

This, then, was the situation when the appellant assumed the undertaking and acquired the remaining British Columbia licences. In my opinion, the appellant acquired them for the purpose of making profit from them either by selling the timber or by selling the licences, and it carried out this purpose using the same methods as the company had used until it had disposed of all of them in one or the other of these ways. In so doing, I think it too engaged in the business of trading or dealing in British Columbia timber licences as part of its scheme for turning the licences to account for profit in either of the two ways which it, in fact, used. When the appellant acquired the licences, there was no thought of using them in connection with a milling operation of its own. No doubt, having abandoned the vision of a mill in British Columbia and having made definite plans for an expansion of the Ontario and Quebec operations, the directors intended from the outset of the appellant's activities to wind up the British Columbia part of the undertaking. There was need for capital to finance the expansion. But the disposals of the British Columbia timber and licences were carried out through the same British Columbia agent, in the same way, on the same commission arrangement, and with the same oversight and direction from the directors as had been followed by the company in earlier years. And they were not all disposed of at once or all

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in the same way but at such times and by such methods as for one reason or another appeared to the directors to be advantageous. I can see nothing in the evidence which would classify such disposals as other than the final sales in what was in fact the carrying on of a trade with a view to making profit therefrom.

A passage in the judgment of the Privy Council in *Commissioners of Inland Revenue v. Melbourne Trust* (1) at p. 1010 seems not inappropriate to express the situation. There the question was whether or not the company was a trading company, and Lord Dunedin, after stating and approving the test expressed in *Californian Copper Syndicate v. Harris* (*supra*) said:

> In the present case the whole object of the company was to hold and nurse the securities it held and to sell them at a profit when convenient occasion presented itself.
>
> Their Lordships therefore come to the conclusion that there is ample evidence here that the company is a trading company and that the surplus realized by it by selling the assets at enhanced prices is a surplus which is taxable as a profit.

As I interpret this quotation, the company referred to was held to be a trading company because what it was doing as set out in the first quoted paragraph was trading. Paraphrasing the paragraph for the present case, it might read:

> In the present case, the whole object of the appellant with respect to its British Columbia timber licences was to hold and nurse them and to sell them or the timber from them at a profit whenever convenient occasion presented itself.

In this view, the appellant's business included the process of trading in British Columbia timber licences and the profits in question, insofar as they arose from sales of licences made by the appellant, were profits arising from such trading. With respect to them, the basis of the assessments has thus not been demolished. This feature distinguishes the case, so far as the profits from such sales are concerned, from *Sutton Lumber and Trad-*

(1) [1914] A.C. 1001.

ing Company v. Minister of National Revenue (1), where at p. 94 Locke J., in delivering the judgment of the Court, said:

> In the present case, the Nootka limits which were sold in 1946 were assets in which the company had invested with a view to cutting the merchantable timber into lumber in a mill to be erected by it in the Clayoquot District and the sale merely a realization upon one of its capital assets which was not required and did not fit in to the company's plans for the operation of its main property and one which was not made in the course of carrying on the business of buying, selling or dealing in timber limits or leases.

I find that the profits realized from the *en bloc* sales of licences made by the appellant were profits from a trade or other business within the meaning of s. 3 of the *Income War Tax Act* and within the definition of business contained in s. 127(1)(*e*) of *The Income Tax Act*. Such profits were accordingly income and were properly assessed.

On the other hand, I do not think the same can be said of contracts of sale made by the company prior to the incorporation of the appellant and later transferred to the appellant as such sales were not made in the course of the trading or business of the appellant. Nor do I think that receipts by the appellant of the moneys payable under such contracts were receipts from its trading or profit-earning operations. What the appellant acquired from the company in these cases was a debt plus a licence to hold as security until the debt was paid. Sums received by the appellant in payment of such debts were, in my opinion, mere realizations of what was assigned to the appellant by the company, and if profit was realized by the appellant therefrom it was not income but a capital gain. Two of such contracts (Exs. 40 and 46) were put in evidence as being involved in the appeals, and one or both of them may have affected the assessments for 1944 and 1945. However, the extent of such affection, if any, is not clear on the evidence. If the parties cannot agree on this, I will hear them as to it on the application

(1) [1953] 2 S.C.R. 77.

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of either party, and in the meantime final disposition of the appeals from the 1944 and 1945 reassessments will be reserved.

The appeal from the reassessment for the year 1951, so far as it is based on profits realized on sale of the McConnell and Mackelcan timber limits, will be allowed with costs up to the time of the amendment above mentioned, and the reassessment will be referred back to the Minister for revision accordingly. The appeals from the reassessments in respect of the years 1949, 1950, and 1952 will be dismissed with costs.

Judgment accordingly.