J. Bert Macdonald & Sons Ltd (*Appellant*) *v.* **Minister of National Revenue** (*Respondent*)

Thurlow J.—Halifax, November 5, 1969; Ottawa, January 15, 1970.

Income tax—Trading profit, computation of—Family farm conveyed to family company below value—Subsequent sale to developers—Trading account of family company —What figure to be shown as cost of farm—Whether farm acquired outside course of trade.

M owned a farm near Halifax on which he lived and worked with his two sons. In 1959 *M*, desiring his sons to develop the land for residential purposes, conveyed 6.5 acres to appellant, a company wholly owned by himself and his two sons, which carried on a roofing business and operated a trailer court. The sons, after trying without success to develop the land joined with two land developers in forming a development company. In 1964 *M* re-conveyed to appellant the 6.5 acres previously conveyed and an additional 19.919 acres (26.419 acres in all), the price being entered on appellant's books at $1,000 an acre. Three months later appellant sold the 26.419 acres to the development company at $3,000 an acre, the price being secured by a mortgage and payable in five years without interest. In its trading account filed with its income tax return for 1964 appellant put the cost of the 19.919 acres at $3,000 per acre, i.e. its value at the time it acquired the acreage, but the Minister, in assessing appellant, put its cost at $1,000 an acre. The court found the fair market value of the 19.919 acres to be $2,200 an acre at the time appellant acquired the acreage.

Held, appellant acquired the 19.919 acres outside the course of its business and the cost thereof should therefore be entered in appellant's trading account for 1964 at $2,200 per acre.

Where a trader acquires property by a transaction not in the course of his business and subsequently takes it into his business and sells it in the course of that business, in computing the profit from that business the cost of that property is its value at the time it was taken into the inventory of the business.

Where there is an element of bounty in a transaction by which a person acquires property the question whether that transaction was in the course of his business is to be determined by the same principles which determine whether a profit realized on the sale of property is a profit from a business within the definition of "business" in s. 139(1)(*e*) of the *Income Tax Act.*

Here the acquisition of the land from *M* was not in the course of its business. The transaction by which it was acquired was not of the same kind nor carried out in the same way as transactions characteristic of ordinary trading in land. The land was acquired outside the course of appellant's trade for the purpose of effecting a division of its worth among *M* and his sons.

Oxford Motors Ltd v. M.N.R. [1959] S.C.R. 548; *Julius Bendit Ltd v. I.R.C.*, 27 T.C. 44, distinguished; *Ridge Securities Ltd v. I.R.C.* [1964] 1 All E.R. 275, *Jacgilden (Weston Hall) Ltd v. Castle* [1969] 3 All E.R. 1110, *Petrotim Securities Ltd v. Ayers,* 41 T.C. 389 discussed.

APPEAL from Tax Appeal Board.

W. Strug for appellant.

G. W. Ainslie, Q.C. and *C. D. MacKinnon* for respondent.

THURLOW J.—The question to be determined in this appeal is that of the amount to be entered in the appellant's trading account as the cost of 19.919 acres of land at Fairview in Halifax County, Nova Scotia, which the appellant disposed of in 1964 in what was admittedly a trading transaction. The Minister's position is that the cost to the appellant of the land in question was $19,919 and the assessments under appeal are made on that basis. The appellant's case, on the other hand, is that it received from J. Bert Macdonald a gift of a part of the value of the land and agreed to pay him only the balance, equal to $1,000 per acre, and that in these circumstances, in computing profit from the sale of the land, its value at the time of acquisition, which the appellant contends was $3,000 per acre, is the amount which should be brought into the company's trading account as the cost of the property so sold.

The nature of the transaction in which the appellant acquired the property in question is also in dispute. The reasons for judgment of the Tax Appeal Board indicate that in the proceedings before the Board the making of a gift by J. Bert Macdonald to the appellant of a portion of the value of the land was admitted. The Minister's reply to the notice of appeal to this court, however, makes no such admission and puts the matter in issue. Nor was the "Partial Agreement As To Facts" referred to in the reasons of the Board offered in evidence by either party at the trial of the appeal to this court. In the course of argument, however, counsel for the Minister, while contending that the transaction was one of purchase in the course of the appellant's business, conceded that what he referred to as "an element of bounty", the extent of which in his view was small and in any event immaterial, was involved in the transaction.

The appellant company was incorporated in 1952. At the times material to this appeal its issued share capital belonged to J. Bert Macdonald and his two sons, Gordon Macdonald and Aubrey Macdonald, the father holding fifty-seven shares and the two sons fifty-seven and forty-nine shares respectively. The same three persons were also the company's directors and managed its affairs. The company was engaged in business as a roofing contractor and in operating a trailer court.

J. Bert Macdonald owned a farm at Fairview, near the City of Halifax, which he had occupied as his home for many years and on which he and his sons had worked to gain a living. By 1959 this farm, or part of it, was becoming ripe for suburban residential development and Macdonald had been approached on at least two occasions by persons seeking to acquire it for that purpose. He declined these overtures because he wanted his sons to undertake the development of the land.

To this end in 1959 Macdonald conveyed 6.5 acres of the farm to the appellant company and thereafter during the next five years or thereabouts

the two sons endeavoured, but without success, to start a residential development thereon. Their efforts failed because sewer services were not yet available.

No entry whatever appears to have been made at the time in the appellant's books to reflect the acquisition of this 6.5 acre parcel of land. Nor was there any agreement in writing relating to the transaction. There is moreover nothing in the evidence to establish that any express agreement was made at the time providing what, if anything, the appellant was to pay for the land. No issue arises, however, in the appeal as to profit realized from the sale of this particular parcel of land.

Having failed in their own endeavours to develop the property the principals, in 1964, sought outside help. They approached two successful real estate developers, who had their own development firm known as Stevens and Fiske, and with them made a deal for the development of the Macdonald property. How far J. Bert Macdonald was personally involved in the making of these arrangements is not very clear. The evidence leaves me with the impression that he was no longer actively engaged in the appellant's business, that the two sons, Gordon and Aubrey, made the decisions and that J. Bert Macdonald complied with them. His wish was to have the property developed by these two sons and he seems to have been prepared to go along with their plans. To that end on February 15, 1964, he conveyed to the appellant 26.419 acres of the farm, made up of the 6.5 acres which had already been conveyed to the appellant in 1959 and an area of 19.919 acres, the subsequent sale of which to Randall Park Development Limited some three months later, gave rise to the profit which is in question in these proceedings.

Randall Park Development Limited was a company incorporated in pursuance of the deal with Messrs. Stevens and Fiske to develop the property. Its shareholders were Stevens, Fiske, Gordon Macdonald and Aubrey Macdonald, each holding ten shares, and two solicitors each holding one share. J. Bert Macdonald's two sons were thus in a position to share in profits arising from the development of the property by Randall Park Development Limited but Macdonald himself was not. He was, however, still a shareholder of the appellant company and was thus indirectly interested in what that company would receive from Randall Park Development Limited for the land.

In this instance as well there was no written agreement pertaining to the transfer of the land by J. Bert Macdonald to the appellant but at or shortly after the time an entry was made in the appellant's books showing a liability of the company to J. Bert Macdonald of $26,419 in respect of the land conveyed by him to the company.

Speaking of this transaction Aubrey Macdonald, in the course of his evidence, said that it was "a business transaction" between the appellant and J. Bert Macdonald, that they, J. Bert Macdonald and Gordon Macdonald and the witness, had discussed the property and its value to J. Bert Macdonald fully and had decided on the figure to be set up on the company's books as a liability to J. Bert Macdonald, that they felt the property was worth in the area of $3,000 per acre but had recorded the liability at $1,000

per acre because these were homestead lands on which all three had worked and farmed and they (I think at this point he was really referring only to himself and his brother) felt that $1,000 per acre from the appellant to their father was "a fair price" of the land to them considering that J. Bert Macdonald was still president of the appellant and stood to share in any profit the appellant might make from the property.

The consideration for the sale of the property to Randall Park Development Limited some three months later was $79,257 which indeed works out to $3,000 per acre. In the transaction, however, the appellant received no down payment; what it received was a mortgage on the property payable in five years without interest and involving the attendant risk that the development project might not succeed and that the principal itself might never be entirely paid.

In its financial statements for the year ending December 31, 1964, which were prepared in June 1965 and accompanied its income tax return for the year, the appellant showed a loan of $79,000 receivable from Randall Park Development Limited in respect of the transfer of the property to that company, a liability to J. Bert Macdonald of $26,419 in respect of the transfer of the property by him to the appellant and an item of deferred revenue from the sale of the land amounting to $48,844.39. It was stated in evidence that the difference between the total of the last two mentioned amounts and the $79,000 amount represented development costs of $3,736.61 which had been charged in respect of the 6.5 acre parcel.

The development of the 26.419 acres having progressed satisfactorily, on October 25, 1965, J. Bert Macdonald conveyed to the appellant a further 36.37 acres of his property which the appellant early in 1966 conveyed to Randall Park Development Limited at $3,000 per acre by a transaction similar to the earlier one. In this case as well an entry was made in the books of the appellant to record a liability to J. Bert Macdonald of an amount equal to $1,000 per acre of the land conveyed and in an affidavit of value taken by Aubrey Macdonald, which accompanied the deed for the purpose of fixing the amount of the transfer tax, it was stated that to the best of his knowledge and belief the sale price of the property conveyed was $36,670.

In the meantime, however, late in 1965 J. Bert Macdonald had been requested by the Department of National Revenue to file and had filed a gift tax return in respect of an alleged gift of an amount equivalent to $2,000 per acre for the 19.919 acre parcel of land. It was when the gift tax return was demanded that it first came to the attention of the appellant's accountants that there had been a conveyance of the 6.5 acre parcel to the appellant in 1959. In view of the Department having taken the position that such a gift was involved in the acquisition by the appellant of the 19.919 acre parcel the accountants altered the entries in the appellant's books accordingly and prepared a revised financial statement for the year 1964, which was later forwarded to the Department, and by which the amount of $48,844.39 shown in the earlier statement as deferred revenue was decreased to $9,189.39 and an amount of $39,646, denoting the gift, was credited as contributed surplus.

At or about the same time, and no doubt as a result of the position taken by the Department in demanding a gift tax return in respect of the earlier transaction, the appellant caused an appraisal to be made of the recently acquired 36.37 acre parcel and on receiving an appraisal at $2,500 per acre revised the entry in its books of its liability to J. Bert Macdonald in respect thereof to $72,740 that is to say the equivalent of $2,000 per acre. Aubrey Macdonald in giving evidence, said that this was done having regard to the fact that work had been done on the first parcel transferred to Randall Park Development Limited while in this case there was little or nothing to be done by the appellant in connection with the land other than to transfer it to Randall Park Development Limited and that after discussion the three, i.e., the father and the two sons, felt the amount should be $2,000 per acre. It is also in evidence that J. Bert Macdonald thereupon filed a gift tax return in respect of a supposed gift of the amount of the difference between that and the $2,500 per acre at which the property had been appraised.

A similar problem exists as to the amount to be entered in the appellant's accounts as the cost of this 36.37 acre parcel of land but as no part of the purchase price was received by the appellant in its 1966 taxation year and as an amount equal to the whole of the profit alleged to arise from the sale was allowed as a reserve under section 85B(1)(d) no portion of the taxation under appeal is referable to the transaction and no issue with respect thereto arises for determination in this appeal.

On the evidence the realizable value of the 19.919 acre parcel, which is the parcel involved in the appeal, when acquired by the appellant, was not $3,000 per acre but, as I see it, was about $2,200 per acre. That was what Mr. Fiske referred to as the base price from which he negotiated with the Macdonalds for the purchase of it by Randall Park Development Limited and to my mind it gives as close an indication of the fair market value as anything in the evidence. Mr. Ainslie argued very persuasively that if one takes as a starting point the $3,000 figure at which the property was sold to Randall Park Development Limited and makes appropriate discounts for the lack of a down payment, for the fact that payment was deferred for five years without interest with no expectation of partial payments in the meantime for some considerable part of the five year period, for the high interest rates which prevailed and for the risks involved, the value indicated would not be much in excess of $1,000 per acre, but I am inclined to regard the $3,000 figure as being itself on the low side having regard to the features mentioned and as representing a favourable deal negotiated by Stevens and Fiske with the Macdonalds who, in my view, were not as well versed as Messrs. Stevens and Fiske in the intricacies or the niceties of the land development business. I therefore conclude that the fair market value of the 19.919 acres, when acquired by the appellant from J. Bert Macdonald, was $2,200 per acre.

I should add at this point that while I regarded Aubrey Macdonald as an honest witness I attribute little significance to any implications which might flow from his choice of expressions such as "business transaction", "price" and "gift" and which might thus tend to characterize the events he

was endeavouring to describe. My conclusions as to the nature of these events for present purposes are derived as implications from his descriptions of the events themselves.

A considerable portion of the argument on both sides was devoted to the characterization of the transaction by which the 19.919 acres of land was acquired. Mr. Strug for the appellant contended that the transaction was in part a sale and in part a gift, that there had in fact been a gift to the appellant of an amount equal to $2,000 per acre of the 19.919 acres of land because, in his submission, J. Bert Macdonald had intended to make such a gift, which, in the circumstances, was all that was necessary to constitute a gift, and that the Minister having demanded a gift tax return and accepted tax in respect of such a gift had admitted the fact and was in no position to contend otherwise.

Mr. Ainslie on the other hand maintained that there had been no gift. His position was that save in cases where there is no consideration at all and cases in which such consideration as is provided for is fictitious or illusory a transaction by which property is acquired for some consideration, however inadequate, amounts in law to a purchase and since here the amount agreed to be paid was substantial, and indeed, in his submission, not far below the fair market value of the land, the transaction must be regarded as a simple purchase of the land by the appellant for the amount settled upon. He did, however, concede that there was "an element of bounty" in the transaction.

While in my opinion, as will appear, the critical issue in the appeal is not whether the transaction was a gift or partly a purchase and partly a gift or a simple purchase, and while it is not necessary to find any such category in which to place the transaction, it may be useful to state at this stage the view I take as to what was involved in it. In form the transaction appears little more like a purchase than like a gift. There was no written or oral contract to purchase but merely a conveyance—which was not put in evidence—and a discussion either before or after the conveyance or both before and after it which resulted in an agreement on an amount to be entered in the books of the appellant as a liability to J. Bert Macdonald. The persons concerned in this discussion, and thus the appellant as well, were all aware that the amount to be paid was far less than the value of the land, indeed they thought the difference was even greater than it was in fact. They were also aware that the amount to be paid was, in that sense, but a partial recompense for the land and they appear to have understood that for the rest the conveyance was being made for family reasons. I do not think that any of the persons involved in the transaction ever considered at that stage that a gift, in the legal sense of the term, was being made and I am inclined to think that the attempt to characterize the transaction as a gift or partly a gift first arose when the department demanded a gift tax return. Nevertheless the evidence satisfies me that the "family reasons" were as much a feature of the transaction as was the conveyance of the property and were also as much if not more of an inducement to J. Bert Macdonald to make the conveyance as was the amount which the appellant entered in its books

as a liability and subsequently paid to him. If I thought that this element in the transaction amounted to a gift, in a legal sense, I would not shrink from so characterizing it, but I doubt that it does amount to a gift and as in my view it is not necessary for the purposes of this appeal to put a label on it or on the transaction as a whole I prefer to deal with the matter by reference to the transaction as described rather than upon the basis of it having been one of any well known or common type.

What remains to be considered is the treatment to be accorded the transaction described in computing income for tax purposes.[1] By sections 3 and 4 of the *Income Tax Act* the income of a taxpayer for a taxation year is declared to include income from all businesses and the income from a business is declared to be, subject to the other provisions of Part I of the Act, the profit therefrom for the year. To my mind the initial question which section 4 thus poses, whenever the income of a taxpayer from a business is under consideration, is: What was the profit from the business for the year?, and this question is answered by consideration of what results were achieved by the trading or business transactions carried out by the taxpayer in the course of the trade or business.

In this context it is well settled that the profit from a business is considered to be the difference between what the taxpayer has realized from the trading or business transactions of his business and the amounts which he has expended to earn such revenues, including the cost to him of stock-in-trade which he has acquired and sold in the course of the business. In ordinary situations no great problem arises in determining the amount of either the revenues or the costs of inventory to be taken into account in determining profit. Problems, however, do arise in determining revenues when stock-in-trade is disposed of otherwise than by transactions in the course of trade. Of this, cases such as *Doughty v. Commissioner of Income Tax*[2], *Sharkey v. Werhner*[3] and *Petrotim Securities c. Ayers*[4] are examples. Problems also arise in determining the amount to be brought into the accounts as the cost of stock-in-trade when it is acquired otherwise than by a transaction in the course of trade. Examples of such problems are found in *J. M. Craig (Kilmarnock) Ltd. v. Inland Revenue*[5] and *Osborne v. Steel Barrel Co. Ltd.*[6]. A somewhat different kind of problem is involved where the question on which the case turns is whether the transaction by which the stock-in-trade was acquired was a transaction in the course of trade. As I see it the present is a case of this sort.

[1] It is perhaps desirable to state that no issue arises in this appeal as to whether or not liability for a gift tax was actually incurred in respect of the transaction, whether by J. Bert Macdonald as giver or by the appellant as receiver, nor has the basis of any assessment of gift tax that may have been made disclosed by the evidence.

[2] [1927] A.C. 327.

[3] [1956] A.C. 58.

[4] [1964] 1 All. E.R. 269, 41 T.C. 389.

[5] [1914] S.C. 338, 13 T.C. 627.

[6] [1942] 1 All E.R. 634.

The position taken by Mr. Ainslie on behalf of the Minister was put in three propositions. First, in his submission, the issue for determination is whether in computing profit one is entitled to disregard the actual cost of goods purchased and sold and to use another figure in those cases where there is an element of bounty in the transaction whereby the inventory was acquired. To this he suggested as the answer (*a*) that in computing profit inventory must always be brought into the computation at the lower of cost or market value; (*b*) that when an actual price paid is ascertainable it must be ascertained; and (*c*) that the presence of an element of bounty, which is not sufficient to enable one to say that the acquisition was gratuitous, does not permit one to disregard the actual price, and that accordingly, except in a case where the amount paid can properly be treated as a fictitious or illusory consideration it must—no matter how much below value it may be—be taken as the cost of the goods to the trader. Second, in his contention, the question as to how one computes profit in those cases where inventory has been acquired by way of a voluntary transaction and not by way of purchase does not arise for determination in the present case. His third contention was that no question arises in this case as to how one computes profit when a non-trading asset, which has been acquired for value, at a subsequent time becomes part of the trader's inventory.

In my opinion the rule that one values inventory on hand at the end of a fiscal period at the lower of cost or market has no relevance in the present situation where the problem is entirely one of the amount to be entered in the computation of profit as the cost to the trader of such inventory. Moreover, while it may be possible to say, in relation to inventory acquired in the course of trade that when an actual price paid is ascertainable such price must be ascertained and entered as the cost of the inventory to the trader, to my mind, the same conclusion does not necessarily follow when the transaction, by which property subsequently dealt with as inventory is acquired, is not itself a transaction in the course of trade. It may be that at times a transaction not within the ordinary course of trade can for this purpose be regarded as equivalent in effect to a transaction in the course of trade, particularly when the price paid in it is identifiable and not unrealistic in amount and where it is arrived at on the basis of ordinary trading considerations. *Craddock v. Zevo Finance Company Limited*[7] and *Tuxedo Holdings Limited v. M. N. R.*[8] appear to me to be examples of this class of case. This leaves unresolved, however, what is to be done in other situations when the transaction in which the property is acquired is not one in the course of trade. Finally, it seems to me that while Mr. Ainslie's proposition that the presence of an element of bounty in the transaction, not sufficient to give the transaction the character of a completely gratuitous acquisition, does not permit one to disregard the actual price, may be acceptable as a statement of an applicable principle where stock-in-trade is

[7] 27 T.C. 267.
[8] [1959] Ex.C.R. 390.

acquired in the course of trade, there is, so far as I am aware, no such general rule applicable where the property is acquired otherwise than in the course of trade.

What does appear to me to be well settled is (1) that, when a trader sells inventory that he has acquired in the course of his trade for re-sale, he can, for the purpose of computing his profit, deduct from his sale price, as cost of inventory, what he paid for that inventory; and (2) that, when a trader acquires something by some means or transaction unrelated to his business (e.g., by inheritance or gift, by purchase for personal use or even by purchase as a capital asset of some other undertaking) and then, having subsequently taken it into his business, sells it in the course of that business, it is only the profit from his business that is taxable and, to arrive at that profit, what must be deducted from the sale price in respect of the cost of inventory is the value of the thing sold at the time it was taken into the inventory of that business (because that is the cost to him of putting that thing into the business).

It seems to me, therefore, that the initial problem that must be determined, in cases where an element of bounty is involved in the transaction by which goods later disposed of as inventory are acquired, is whether the transaction by which the property came into the trader's possession can be classed or treated as a transaction in the course of his trade or business and to my mind in determining this question the same principles apply as are applicable when the question for determination is whether a profit realized on the sale of property is a profit from a business within the meaning of the definition of business in section 139(1)(*e*) of the *Income Tax Act*. For if the gain arises from a transaction which cannot be treated as a transaction in the course of the trade, as I see it, such gain is not profit from the trade or business and is not taxable as such.

For the purpose of determining whether property has been acquired in the course of trade the presence or absence of an element of bounty in the transaction by itself does not appear to me to be the critical fact. Rather to my mind the significance of the presence of such an element lies in what it tends to show, in the particular situation, as to whether the property in question was acquired by a transaction in the course of the trader's trade. I should not have thought, for example, that it would have any effect in a situation where a trader obtains stock-in-trade at an exceptionally low price through the business generosity of a supplier. *Oxford Motors Limited v. M.N.R.*[9] can, I think, be regarded as a case of this kind. The case of *Julius Bendit Ltd. v. Inland Revenue Commissioners*[10] which is referred to later in these reasons is, I think, another case of the same sort. On the other hand the element of bounty, in a transaction by which a father transfers to his son for a nominal or partial consideration property which the son subsequently disposes of in the course of his trade, might well turn out to be the decisive fact in determining the question whether the acquisition of the property by the son was a transaction in the course of his trade.

[9] [1959] S.C.R. 548.
[10] 27 T.C. 44.

The cases which to my mind illustrate best what appears to me to be the principle applicable in the present situation are *Ridge Securities Ltd. v. Inland Revenue Commissioners*[11] and the recent case of *Jacgilden (Weston Hall) Ltd. v. Castle*[12], in the earlier of which the inventory was brought into the accounts at value, though a much lower price had been paid for it, and in the later of which the inventory was brought into the accounts at the price actually paid, though the value of the inventory when acquired was much higher.

In *Ridge Securities v. Inland Revenue Commissioners* the taxpayer had acquired securities from a subsidiary company, which was about to be wound up, for a price grossly below their market value in a transaction which, though ostensibly within the trading activities of both companies, was carried out for the purpose of incurring a loss in the trading operations of the vendor company. When the result of these transactions from the point of view of the vendor company was under consideration in *Petrotim Securities Ltd. v. Ayers*[13], the court upheld the finding of the Commissioners that these were not trading transactions.

Ungoed-Thomas J. discussed the point thus at page 398:

> Mr. Foster, however, relied upon Lord Guest's speech, at page 924, which indicated that the test of whether the transaction is a trading transaction is an objective test. Here, there is no evidence of subjective intention and the only test that can be applied is objective, namely, whether the transaction is in its nature a trading transaction. Lord Guest quotes with approval the test which appears from Lord President Clyde's words in *Commissioners of Inland Revenue v. Livingstone*, 11 T.C. 538, at page 542:
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> > whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.
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> That is far removed from the submission which Mr. Foster was constrained to make in this case with a view to excluding consideration of surrounding circumstances: namely that a sale between traders of stock-in-trade at an undervalue must always be in the course of trade. In developing this submission he rightly conceded that a gift by a trader of stock-in-trade—whether or not to a trader—need not be in the course of trade. This necessary concession invites the obvious question: "Why, in that case, should a transfer at a nominal or derisory consideration, although the payment was genuinely made, be the less a transaction not in the course of trade?" Mr. Foster conceded further that a sale at an undervalue of stock-in-trade by a trader to a non-trader need not be in the course of trade. From this it follows that the undervalue is not decisive of the nature of the transaction but that the character of the recipient must also be considered. If, however, this has to be considered, there is no reason for excluding from consideration any other relevant circumstance. This conclusion seems to me to be in keeping with Lord President Clyde's words quoted by Lord Guest.
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> The Commissioners in their decision stated:
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> The profit-seeking motive, which is normally important, was absent, and in its place there appears to have been an intention to make a loss for a reason which was not explained. It therefore seems a fair inference to draw that in relation

[11] [1964] 1 All E.R. 275.
[12] [1969] 3 All E.R. 1110.
[13] 41 T.C. 389.

> to those transactions the Company, at the time of the sales, was no longer acting as a dealer or financier and accordingly the sales were not made in the course of the Company's trade. A *fortiori*, the position is the same with regard to the Y transaction as neither the purchase nor the sale, it seems to us, was made in the course of the Company's trade.... The four transactions in the present case are clearly brought into question and an examination of the circumstances surrounding them leads us, in the absence of rebutting evidence, to the conclusion that they were not made in the course of trade.

It was submitted that the Commissioners based their conclusion in part, at any rate, on a subjective test of intention which they found to be an intention to make a loss, and that this was contrary to the objective test required in accordance with Lord Guest's speech to which I have referred. It seems to me, however, that in the absence of direct evidence of intention, intention could only be deduced from what the Commissioners decided was the nature of the transaction, and this indeed is indicated by the words they used, namely: "there appears to have been an intention to make a loss." If persons are to be credited with intending the natural consequences of their own acts this was an inevitable conclusion; and the Commissioners must have come to a conclusion on the nature of the transaction before they could have made the inference of intention. Their final conclusion on the transactions is based on "an examination of the circumstances surrounding them".

In the Court of Appeal Lord Denning, M.R. said at page 407:

> It seems to me that, when there is a sale at a gross under-value by one associated company to another, the Commissioners are entitled to find that it is not a transaction made in the course of trade. Whoever would suppose that any trader in his right senses would enter into transactions of this kind, that he would sell at a gross under-value, were it not that he had in mind some benefit out of making a loss? It is just on a par with a case where a company gives its money away. You might indeed say here that £630,000 was given away by the Company in the X transactions. It could have realised the securities for £835,000, but it chose to sell them for £205,000. Such a transaction is so outside the ordinary course of business of any trader that the Commissioners were entitled to find that it was not done in the course of trade.

So far what was said applied to the transaction from the point of view of the vendor but later Lord Denning, M.R. proceeded:

> In the course of the argument, Mr. Foster asked: "What about the purchasing company, Ridge Securities? If that is to be assessed for tax, it has got to bring these securities in at the actual price it paid for them—at the very low price. There might be a very large profit." I need not say anything about the tax position of Ridge Securities, because we are only concerned with Petrotim. I would suggest, however, that if it was not in the nature of trade for one of these associated companies to sell at an under-value, it is not in the nature of trade for the other to buy at an (under-value).[14] In each case the sale ought to be brought in at the realisable market value at the time.

Russell L.J. agreed with Lord Denning, M.R. on this point.

It is I think of interest to note the stress put by Lord Denning, M.R. on the fact that Petrotim and Ridge Securities were associated companies and thus were not dealing with one another at arm's length.

[14] The word "over-value" appears in the report in 41 T.C., the word "under-value" in the report in [1964] 1 All E.R. at page 273. The latter appears to agree with the context.

Later when the *Ridge Securities*[15] case itself came before the court, Pennycuick, J. followed the dictum and held (page 284), though the particular matter does not appear to have been contested, that:

> For the purpose of computing the profits of the taxpayer company, the market value of the shares and debentures of Ridge Investments, Limited, and the shares of Petrotim should, in accordance with the decision in Petrotim's own case, be brought into account.

The learned Judge also applied the same principle with reference to the acquisition of War Loan stock by a controlled company at a gross undervalue. At page 289 he said:

> As a matter of company law, Blackheath, having bought the War Loan from Petrotim for £10,000 and sold it for £105,000, had made a profit which admittedly it could legitimately distribute to the taxpayer company in accordance with the resolution creating the preference shares. So, counsel for the taxpayer company contends, this profit will in due course be charged with tax and the dividend is properly payable under deduction of tax: see s. 184(2) of the Income Tax Act, 1952. Counsel for the Crown, in answer, points to the decision in the *Petrotim* case and, in particular, the passages which I have quoted from the judgments of Lord Denning and Russell, L.J., in the Court of Appeal. The proper course, he says, in the computation of the profits of Blackheath is to bring in the War Loan not at £10,000, the purchase price, but at its market value when acquired, i.e., approximately £105,000, and to adjust the profits of Blackheath accordingly. Once this adjustment is made, it will be found that Blackheath at April 3, 1959, had no profit chargeable with tax which would support the payment of the dividend of £90,000 under deduction of tax. It seems to me that this contention is well founded. In the *Petrotim* case, the Court of Appeal, applying the principle laid down by the House of Lords in *Sharkey (Inspector of Taxes) v. Wernher,* held that Petrotim must bring in the market value of securities sold at under-value. Lord Denning, M.R., and Russell, L.J., in the passages which I have cited, indicated, no doubt obiter, that the taxpayer company, the purchaser, should likewise bring in these securities at market value. I was referred to *Julius Bendit, Ltd. v. Inland Revenue Comrs., Julius Bendit, Ltd. v. Dickson (Inspector of Taxes).* I have found it difficult to reconcile what was said in that case with the dicta of the *Petrotim* case, but I think that I should follow the dicta which, if I may respectfully say so, appear to me to be in accordance with sound principle. If a trader starts a business with stock provided gratuitously, it would not be right to charge him with tax on the basis that the value of his opening stock was nil. The decision in the *Julius Bendit* case was of course given before the matter of gratuitous transfers of stock was considered in *Sharkey (Inspector of Taxes) v. Wernher,* There appears to be no other decision directly in point.
>
> Counsel for the taxpayer company went on to contend that in this connexion a distinction should be made between the securities sold by Petrotim and the War Loan. The latter, it will be remembered, was by common consent wholly disregarded in the *Petrotim* case. It seems to me that the same principle must be applicable in each case provided that the sale and purchase of the War Loan is treated as a valid transaction at all. The only alternative would be to disregard this transaction for all purposes on the basis that the transaction was ultra vires Petrotim and a nullity. This alternative would not assist the taxpayer company here.

[15] [1964] 1 All E.R. 275.

The facts in the *Julius Bendit*[16] case referred to by the learned judge appear from the first paragraph of the headnote:

> The Appellant Company, a British company, was formed in 1936 by a Jew carrying on business in Germany as an exporter of textile goods, with a view to avoiding so far as possible the control imposed upon him by the Nazi Government. He owned all the shares in the Company. He supplied goods to the Company at less than normal market prices, so decreasing his profits and increasing those of the Company. The Company contended that for the purposes of Income Tax and Excess Profits Tax its profits should be computed by substituting for the figures of cost brought into its accounts figures representing the market value of the goods supplied. The claim was rejected by the Special Commissioners.

The Commissioners' finding which appears at page 49 of the report was expressed as follows:

> 14. We, the Commissioners who heard the appeal, held on the evidence that the real bargain between the parties was that Mr. Bendit should sell and the Company should purchase the goods in question at the "invoice" prices, which were deliberately fixed at less than the market value of the goods for the purpose of enabling the Company to make a correspondingly larger profit by selling the goods in the course of its trade; this bargain was in fact carried out and the Company paid the "invoice" prices, and no more; these prices represented the true cost to the Company of the goods; the goods were rightly charged at these prices in the Company's books and audited accounts, and there was no justification for the Company's claim to substitute the market value for the invoice prices as the figure at which the goods should be charged for taxation purposes.

The taxpayer's appeal from this finding was dismissed by Macnaghten, J., whose judgment appears from the following paragraph:

> Mr. King, in answer to the question: What is the point of law raised by the Case?, puts forward what is a good point of law, namely, that there was no evidence on which the Special Commissioners could find the facts which they have found in their decision. I have listened with interest and pleasure to Mr. King grappling with the difficulties of that contention, but it seems to me that not only was there ample evidence on which the Commissioners could find the facts as they have found them, but that there was no evidence on which they could have found the facts as Mr. King suggested they should have found them. I do not think I need say more. The result, therefore, is that the appeal must be dismissed with the usual result as to costs.

I do not find much difficulty in distinguishing that situation from the present since the transactions in question were simple sales and purchases in the course of trade of both Julius Bendit and the company and while the prices were set below value for special reasons that were not related to the trade, the intention was nevertheless to set the prices for the purposes of the trade.

In *Jacgilden (Weston Hall) Ltd.*[17] one Rowe caused a vendor, from whom he had, some months earlier, contracted to buy property, to convey it to a newly formed company, of which Rowe and his wife were the share-

[16] 27 T.C. 44.
[17] [1969] 3 All E.R. 1110.

holders, for £72,000. This represented the amount Rowe had agreed to pay for the property but by the time the property was conveyed to the company its value had risen to £150,000. Shortly afterwards the company sold it for £155,000. The company then sought to bring the cost of the property into its accounts for tax purposes at £150,000 on the basis that the difference between that amount and the £72,000 which it agreed to pay and paid to the vendor was a gift.

Plowman, J., said at page 1121:

> There is no question of the contract for the sale and purchase of the hotel at £72,000 having been an illusory or colourable or fraudulent transaction: it was a perfectly straightforward and honest bargain between Mr. Rowe and the vendors. It is, in my judgment, therefore clear that, subject to the question of gift, the proper figure to be debited in respect of the hotel is its cost, £72,000. The Special Commissioners have found that the acquisition was a commercial acquisition and inferentially, if not explicitly, that the transaction was not one of gift. The question which I have to decide therefore comes down simply to this: is that a conclusion which the Special Commissioners were entitled to reach on the evidence? In my judgment, it was. It seems to me that they were entitled to conclude, as a matter of business common sense and notwithstanding any element of gift there may have been, that the transaction with which they were concerned was not a gift or a sale by Mr. Rowe to the taxpayer company at an undervalue, but a purchase by the company of trading stock at a price which had been fairly negotiated between Mr. Rowe and the vendors. The *Sharkey v. Wernher* line of authority has never, so far as I am aware, been applied to a case where the price at which the property passed had been negotiated as a fair and proper price, and because it is an exceptional line of authority I think that the court should be slow to extend it.

Then, on which side of the line does the present case fall?

The appellant obtained property for which it made a pecuniary payment of $1,000 per acre, when it was worth $2,200 per acre, and resold it in the course of a transaction of a trading character as a result of which it made a profit that is, admittedly, taxable. The question to be decided is whether the cost that may be set off against the sale price in computing such profit is the amount so paid or is the value of the land, and this turns on whether the appellant purchased the 19.919 acres of land from J. Bert Macdonald in the course of its trading or whether it acquired that land by a transaction which was outside the course of its trade and then, forthwith, took it into the business.

On this issue it was for the appellant to show, if it could, that the land was not acquired in the course of its trade. This onus was not made any easier to discharge by the fact that the appellant, who had control of its own transactions and bookkeeping, set up the transaction in question and its bookkeeping in such a way as to support the *prima facie* implication that the acquisition of the land was in the course of its trading operations and, at the time made no entry or record indicating in any way that it was anything else. Nor was the appellant's case advanced by Aubrey Macdonald's choice of words when he said it was a "business" transaction and that he and his father and brother had discussed the property and had arrived at a figure which, for the reasons he gave, they thought was a fair "price" for the land to them.

On the other hand, notwithstanding the obstacles in the appellant's path, due weight must, in my view, be given to the evidence which, as I have indicated, I accept, that J. Bert Macdonald and these two sons owned all the shares in the appellant company, that the land in question was part of a farm property, used as a family residence, on which all three had worked and farmed, that the father for the reasons given and, I assume, the usual family reasons, wished to put the land under the control of his sons for development purposes, that it was in furtherance of that purpose that he conveyed the land to the appellant and that by agreement among the father and the two sons, the appellant credited to the father what the three thought would be a "fair price" considering that the father was still president of the company and a substantial shareholder in the appellant, and stood to share in any profit the appellant might make on the property. These, in the circumstances, and particularly having regard to the wide difference in the amount to be credited and what the three considered the land to be worth, are all facts that militate against a conclusion that the transfer was the result of a purchase by the apellant from the father in the course of trade. They appear to me to indicate that the transaction was not of the same kind, and that it was not carried out in the same way, as transactions that are characteristic of ordinary trading in land; and that on the contrary it should be regarded as an unusual transaction in which property was acquired by the appellant otherwise than in the course of its trade. While the question is not an easy one to resolve, I have come to the conclusion that the balance of probability on all the evidence is that this is the correct way to view the transaction and that it was not a purchase from J. Bert Macdonald by the appellant in the course of its trade but was an arrangement whereby J. Bert Macdonald put property into a company held by himself and two sons for the purpose of effecting a division of its worth among himself and his sons.

Having concluded that the appellant acquired the property under such a family property settlement arrangement, it follows that, when the appellant took the property into its trading operations, it should have charged up as a cost of inventory the value of the property at that time, which, as I have already found, was $2,200 per acre.

I should add that I find this view of the transactions more attractive than the alternative view on reflecting that the appellant's concern with making profit from the property really consisted in the sale which it made of the property to Randall Park Development Limited. The acquisition transaction on the other hand, not having been one between parties dealing at arm's length and having been carried out in the manner and for the reasons described, scarcely suggests, let alone persuades one, that a trading profit could arise therefrom as well. Yet this would be the result if the Minister's position were to be upheld and the property were to be brought into account at the $19,919 figure rather than at the value it had when conveyed to the appellant. I think, therefore, that the profit attributable to the appellant's trading is more accurately reflected by entering as the cost the value of the land at the time of its acquisition.

I am also somewhat strengthened in my view that this is the right conclusion in this particular case by the fact that the land in question was land which, prior to the transfer in question, had been part of a capital asset

of J. Bert Macdonald used as a homestead and in a farming operation carried on by him with the aid of his two sons, so that if the sale to Randall Park Development Limited which gave rise to the taxable profit in question had been made by the father (instead of by the appellant whose shares belonged to the father and the two sons) the profit would not have been taxable and the father could have divided the proceeds among himself and his sons as he saw fit. Just as the court will not lightly characterize an ambiguous transaction carried out through closely held companies in such a manner as to avoid taxes that would otherwise be payable so I am inclined to think that the court should not be astute to characterize a transaction so carried out in such a manner as to give rise to taxes that would not otherwise be payable.

I find, therefore, that the amount to be brought into account, in computing income for income tax purposes, as the cost to the appellant of the 19.919 acres of land here in question is its value at the time of its acquisition, that is to say, $43,821.80. The appeal will be allowed to that extent, with costs, and the reassessments will be referred back to the Minister for reconsideration and reassessment accordingly.