Toronto
1966
Nov. 28-29

BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

FIRESTONE MANAGEMENT LIMITED ..... RESPONDENT.

Income tax—Aquisition of company shares as investment—Conversion of company to public company and issue of shares to public through underwriters—Whether profit made a trading profit.

In late 1960 F and C, each of whom owned a half interest in a sales company, reached a deadlock and in accordance with their pre-incorporation agreement respecting that eventuality F bought all of C's shares in the sales company for $425,000. As part of the arrangement for financing the purchase the shares so bought from C and, in

addition, F's own shares in the sales company were sold for $850,000 to respondent, a company controlled by F. Early in 1961 respondent, as a result of advice to F in January and with the assistance of experts, converted the sales company to a public company, reorganized its capital structure, made the necessary arrangements with the Securities and Exchange Commission of the U.S.A. and with the authorities of individual States in the U.S.A., and sold half its shares in the sales company for $1,451,400 to a group of United States underwriters who intended to offer them for sale to the U.S. public. Respondent made a net profit of $921,725 in the transaction. It was assessed to income tax on this sum as being income from trading in shares or from a venture in the nature of trade.

Held, affirming the decision of the Tax Appeal Board, the profit in question was not chargeable. The evidence indicated that respondent did not acquire the shares of the sales company with the intention of turning them to account at a profit by offering them for sale to the public, as it subsequently did. Neither did respondent's activities following its acquisition of the shares in the sales company as an investment, *viz* in converting it to a public company, reorganizing its capital structure, employing expert assistance, arranging for necessary registration with United States securities authorities, amount to the carrying on of a business: it merely did what its advisers advised it to do in order to realize most advantageously a portion of an investment which as a matter of good judgment called for some diversification.

[*Moluch v. Minister of National Revenue* distinguished.]

Semble. The operations of a company or of the holder of a large block of shares in a company for the acquisition of new capital by issuing stock or in selling stock it already owns to the public can never, without more, amount to the carrying on of a business.

APPEAL from decision of Tax Appeal Board.

Pierre Genest and *L. R. Olsson* for appellant.

H. Heward Stikeman, Q.C. and *Maurice A. Regnier* for respondent.

JACKETT P.: (Delivered orally from the Bench at Toronto, November 29, 1966)—This is an appeal from a decision of the Tax Appeal Board whereby a re-assessment of the respondent for the 1961 taxation year was vacated.

With certain exceptions, which do not affect the conclusions that I have reached, the facts as found by the Tax Appeal Board are substantially the same as those that have been established by the evidence adduced before me. It is not, therefore, necessary for me to re-state the facts in detail.

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There are, however, two matters that I have to consider that do not appear to have been before the Tax Appeal Board. To state my conclusions with regard thereto, it is sufficient for me to summarize the facts very briefly and in quite general terms.

There are three main persons involved:

(*a*) Joseph H. Firestone (hereinafter called "Firestone"),

(*b*) the respondent company (hereinafter called "the respondent") which was at all material times controlled by Joseph H. Firestone, and

(*c*) Fireco Sales Limited (hereinafter called the "Sales Company"), an Ontario company carrying on business in Canada.

Until 1960, Firestone had a 50 per cent interest in the Sales Company, the other 50 per cent being held by one Covent. The Sales Company had been incorporated pursuant to an agreement between Firestone and Covent under which Covent could require Firestone, in the event of deadlock between them, either to acquire all Covent's shares in the company or to sell to Covent all his shares in the company. In 1960, Covent invoked the clause of the agreement that gave him this right and Firestone elected to acquire Covent's shares at a price of $425,000.

As part of the scheme arranged to finance this acquisition, the shares acquired from Covent and the shares previously owned by Firestone, being substantially all the shares in the Sales Company, were sold to the respondent at a total cost to the respondent of $850,000. This all happened in the last half of 1960.

The next stage in the story is that, during the first part of 1961, the respondent sold one-half of the shares held by it in the Sales Company to a group of underwriters in the United States who acquired them with the intention of re-selling them to the general public in the United States. The respondent received $1,451,400 from the underwriters for the shares so sold to them.

After deducting certain expenses, the respondent had a profit from the purchase and re-sale of one-half of the shares in the Sales Company of $921,725.21. That profit

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was assessed by the appellant as income. The respondent appealed. The Tax Appeal Board allowed the appeal and the appellant is now asking this Court to restore the assessment as far as that profit is concerned.

The appellant contends that one of the possibilities that the respondent had in mind in acquiring the shares in the Sales Company was that it might turn them to account by causing the Sales Company to "go public", that is, by doing what it in fact did, namely, causing the Sales Company to be converted from a private company to a public company, suitably revising the capital structure of that company, qualifying the shares for distribution by underwriters in the various states of the United States and then selling some of them to underwriters at a profit. The Tax Appeal Board rejected this contention on the evidence before it and, in so far as the same evidence was before me, I adopt the reasons of the Board. There was, however, a very important difference between the evidence before the Board and the evidence that was before me. Before the Board it was pleaded that Firestone was first made aware of the corporate advantages of offering the shares of the Sales Company to the public "in January 1961". Firestone apparently gave evidence that he had not considered such a possibility until that month. Before me, Firestone gave evidence that he had, in connection with the evidence in this case before the Board and in this Court, completely forgotten, until just before the trial in this Court, an earlier occasion when he, his chief associate and his accountant had visited an investment dealer to discuss in an exploratory way whether the Sales Company was the sort of company that might "go public". He was quite definite, however, that he never seriously considered going public as a possibility for the Sales Company until January 1961. I accept his evidence and I regard it as corroborated by the evidence of the witnesses called by the appellant in connection with the same occasion in so far as that evidence sheds any light on the matter.

On the whole of the evidence, I am satisfied that Firestone's decision to acquire Covent's shares in the Sales Company was motivated exclusively by his desire to be the

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owner of all the shares in the Sales Company so that he might continue to run the affairs of that company in place of the alternative with which he was faced, of selling his shares in the Sales Company to Covent and thus lose his position in and in relation to that company. I am further satisfied that Firestone's intention, which must also be regarded as being the intention of the respondent, in arranging to have all the shares in the Sales Company sold to the respondent, was to enable the carrying out of a convenient scheme of financing the purchase from Covent, which involved the respondent playing the role of an investment company for Firestone.

The appellant's further contention is that, even if the respondent acquired the shares in the Sales Company as an investment, what it did, commencing in January 1961, constituted the carrying on of a business (within the ordinary meaning of that word) and that the profit in question, or, alternatively, the difference between the selling price to the underwriters and the value of the shares when they were dedicated to the business, constituted a profit from the business that must be included in the respondent's income for the 1961 taxation year. The things that the appellant contends so constitute the carrying on of a business are set out in subparagraph (*a*) of paragraph 2A of the Amended Notice of Appeal, which reads as follows:

> Alternatively, the Appellant says that shortly after purchase of the said shares by the Respondent for the sum of $425,000.00, commencing in or about January 1961, the Respondent retained a "finder" to effect a sale of the said shares or part thereof to a syndicate of underwriters in the United States of America, caused Fireco Sales Limited to be re-organized into a public company and to have its shares re-classified and subdivided, caused the said shares to be qualified for sale to the public by registration with the Securities and Exchange Commission of the United States of America and with numerous state authorities of that country, and assisted the underwriters who were to purchase the said shares in their re-sale to the public by furnishing the said underwriters with a list of purchasers of the said shares, all with a view to re-sale of the said shares at a profit. In June, 1961 the said shares were sold by the Respondent to a syndicate of underwriters for the sum of $1,451,400.00 for re-sale by the underwriters to the public.

The appellant relies on the recent unreported decision of my brother Cattanach in *Moluch v. Minister of National Revenue,* in which it was decided that the appellant had

acquired land as a *capital asset* of a farming business and, after he ceased carrying on that business, used that land as the *inventory* of a new business in which the raw land was converted into building lots and made the subject matter of an operation of selling lots to individual builders. I entirely agree with that decision and I also agree with Mr. Justice Cattanach that, in any particular case, "the matter is one of degree depending upon the business-like enterprise and activity displayed". I also agree that an "element of trade" would be introduced if a purchaser were, by himself or his own employees, or by a contractor, through an expenditure of effort and monies, to change the character of the property. Whether such "element of trade" is such as to constitute the particular operations the carrying on of a business remains, as Mr. Justice Cattanach says, a question of degree "depending upon the business-like enterprise and activity displayed".

In this case I cannot find that the respondent embarked on a business. It merely did what its advisers advised it to do in order to realize most advantageously a portion of an investment which, as a matter of good judgment, called for some "diversification". Neither the respondent nor Firestone, who constituted its management, exercised any initiative or active role in the matter. What was done does not really differ in kind from the normal operations of a company that is desirous of raising new capital and decides to go into the market with a new stock issue. I doubt whether such an operation by an issuing company or the holder of a large block of shares, without more, can ever be the carrying on of a business. In any event, I find that it is not the carrying on of a business in the circumstances of this case.

The appeal is dismissed with costs.