BETWEEN:

HENRY J. FREUD ....APPELLANT;

Windsor
1966
Oct. 5

AND

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

Income tax—Loss sustained by individual in promoting car marketing scheme—Loan to corporation formed for promotion of scheme—Failure of scheme—Loss of money loaned—Whether deductible in computing net income—Income Tax Act, s 3—"Source" of income—Meaning.

Appellant, a Detroit attorney residing in Windsor, conceived the idea of developing a market for a small personal sports car and of interesting a manufacturer in its production. In furtherance of this scheme, in 1958 he and two other men promoted a corporation in Michigan (later taking in additional stockholders) which produced prototypes of the car, but attempts to sell the idea to various manufacturers proved unsuccessful. In 1930 appellant loaned $13,840 to the corporation which it used to pay for labour, materials and the cost of driving a prototype of the sports car to New York in an effort to interest a New York manufacturer in its production, but the project came to nought and the corporation accordingly went out of business without realizable assets In his income tax return for 1960 appellant sought to deduct the $13,840 which he loaned to the corporation from his other income for 1960.

Held, allowing his appeal, had appellant's scheme been successful the profit he made would be income from a source within the meaning of the word "source" in the opening words of s. 3 of the *Income Tax Act,* and the money spent by him in 1960 was spent for the purpose of obtaining income from that source; and accordingly the loss he thereby sustained was deductible by him in computing his 1960 income because it is net income only that is taxable.

[*George H Steer v. M N R.* [1965] 2 Ex. C R 458, and *Wood v. M N R.* (unreported) referred to.]

APPEAL from income tax assessment.

Keith Laird, Q.C. for appellant.

A. Garon for respondent.

GIBSON J.:—The issue in this appeal is whether the sum of $13,840.47 advanced by the appellant to a United States company known as Detroit-National Automobile Company is deductible from the appellant's income for the taxation year 1960.

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The appellant for the years 1958 to 1960, which are the material years in this matter, was a resident of Windsor, Ontario, and he practised law in Detroit, Michigan.

In 1958, in conjunction with one Meredith Kettlewell of Orchard Lake, Michigan, a tool and die maker who sold certain components to the "Big Three" automobile manufacturers, he conceived the idea that there was a market for a small personal sports car. This idea in subsequent years and to-day has proved to be a sound one as is evidenced by the success of the Chevrolet Corvette Sting Ray, the Ford Mustang, and this year the Chevrolet Camaro, and the Mercury Cougar. The idea was to market a limited number of these small personal sports car in the belief that purchasers in the market wished to have a motor vehicle unique and distinct from their neighbours. The scheme of marketing the idea was to interest manufacturers, other than the "Big Three" motor car manufacturers, to produce these small personal sports cars without going to the expense of making the metal dies which all motor car manufacturers such as the "Big Three" incur and which runs into millions of dollars. The kind of manufacturer that the appellant had in mind in interesting in manufacturing such a sports car was Seagraves Corporation, whose head office is in New York City, and plant in Columbus, Ohio, a long time manufacturer of fire engines.

The appellant and Kettlewell and a retired mechanical engineer by the name of Charles S. Porritt in 1958 first embarked on this project and a prototype of their sports car was made in that year.

The moneys put up in carrying on this project by the appellant and Mr. Kettlewell at this time were advanced to a corporation which was incorporated in Michigan under the name of Floridian Motors Corporation.

Then when the appellant and Mr. Kettlewell became convinced that much more substantial sums of money were necessary to advance their project they caused this company to have its name changed to Detroit-National Automobile Company and to have increased its share capital. Then certain shares were sold to other third parties and some greater sums of money were obtained in order to permit this company to further advance this project.

Further prototypes of this small sports car were made and contacts were had with various corporations in an attempt to sell the idea to one of them.

It was never the intention of the appellant and his associates to get into the manufacturing business. Instead the idea was to sell the concept to a third party corporation, which latter was to do the actual manufacturing.

Up until 1960 no success was met in selling this idea to any manufacturer and in the year 1960 all of the other shareholders declined to put up any further moneys.

Up to that time the moneys put up by the appellant had been exchanged by Detroit-National Automobile Company for shares in that company.

In 1960, however, the appellant advanced moneys by cheques from his own bank account in the sum of $13,-840.47. Some of these were put through the bank account of the Detroit-National Automobile Company, some of these were issued directly to certain labour employed by that company, and some directly to material men who supplied the materials to this company, and the balance was spent directly by the appellant in taking him, a prototype model of the company's sports car, and the driver to New York City to display and to attempt to sell to the Seagrave Corporation this concept of a sports car.

The prototype which was taken to New York was drivable. It had a continental motor. And for some months in 1960, the Seagrave Corporation expressed interest in it, but finally did not make any offer to buy the concept and project of Detroit-National Automobile Company. The appellant at this hearing said that in retrospect he now realizes that what was required was more than a prototype model which in essence was hand made without engineering plans. What was necessary, he said, was the complete engineering design and plans for such a sports car so that any potential purchaser of the concept would be able immediately to go into manufacturing production.

Having failed to sell the concept to Seagraves Corporation, the appellant ceased to advance any further moneys and the Detroit-National Automobile Company went out of business in 1960, and there was no salvage value in any of its assets.

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Gibson J.

The issue on this appeal is whether these moneys in the sum of $13,840.47 paid out by the appellant to Detroit-National Automobile Company or on its behalf in 1960, can be utilized as a deduction from his other income in that year, for the purpose of computing his taxable income.

The appellant claims that these moneys paid out in 1960 were an outlay for the purpose of earning income from a "business", and the respondent contends that such moneys paid out are not deductible because they do not qualify under section 12(1)(*a*), or alternatively that they are advances of capital within the meaning of section 12(1)(*b*) of the Act.

As the evidence discloses and which is not disputed, the appellant did not at any time intend that Detroit-National Automobile Company would produce this small personal sports car the concept of which the appellant and Mr. Kettlewell had. Instead they intended to sell the idea and obtain the gain through such sale.

In my view, if the appellant had been successful and realized a profit therefrom, this gain clearly would be income from a source outside the sources specified in section 3 but within the meaning of "sources" in the opening words of the section. In other words, it would not have been a windfall gain and so not a capital gain.

In my view also, the moneys paid out in 1960 by the appellant were moneys spent by him for the purpose of obtaining an income from a source within the meaning of the opening words of section 3 of the Act.

The appellant therefore in computing his income for the taxation year 1960 was entitled to deduct the loss from such potential source because it is his net income only in this sense that is taxable. (cf. *George H. Steer v. M.N.R.*[1]; and *Wood v. M.N.R.*[2])

The appeal is therefore allowed with costs.

[1] [1965] 2 Ex C.R. 458 [2] (September 7, 1966, Unreported).