BETWEEN:

Toronto 1966 June 16

Ottawa Sept. 7

J. HAROLD WOOD .... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Income—Income Tax Act, R S C. 1952, c. 148, ss. 3, 4(a)(b), 139(1)(c)(e) —Nature of capital gain and the relation of these gains to ordinary income—Whether a gain is one of capital or income—"Discounts" received under mortgage contracts—Whether these "discounts" were "interest" within the meaning of s. 6(1)(b) of the Act—Profit from transaction was income, a "source" within the meaning of s. 3 of the Act—Appeal dismissed.

The appellant practised law as a general practitioner and part of his practice consisted of mortgage transactions. From his personal savings he purchased mortgages, and also certain stocks and bonds during the material time. As to mortgages, between 1956 and 1963, he acquired thirteen (13), eleven (11) of which were so-called bonus or discount mortgages, six (6) of which were second mortgages, and seven (7) of which were first mortgages

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The respondent in assessing the appellant's 1962 income, categorized the excess of receipts over outlay realized on a specific first mortgage purchased in 1957 at a discount and paid off at face value in 1962, as income and not a capital gain.

In considering income from a "source" that falls outside the statutory definition of "business", the Court adopted the concept of "income" under the *Income Tax Act* stated by Noël J. in *George H. Steer v. M.N.R.* [1965] 2 Ex. C.R. 458 viz. that "it should be noted that it is '. . . not merely the aggregation of one's incomes from all sources from which there were incomes in the year, but it is made up of the gains from all sources minus the losses from these sources or, expressed otherwise, the net income from all sources of income taken together.' ".

In considering the concept of capital gains the Court noted that capital gains in the main arise from capital assets, and that the most noteworthy and main sources are (1) from increases in land values, (2) from investment in the stock market, and (3) from the creation and expansion of industrial empires; and that an expected rise in the value of an asset is ordinary income and an unexpected rise in value is a capital gain; and that pure capital gains are unforeseen increases in the real value of a man's existing property, not directly attributable to his efforts, intelligence, capital and risk-taking or in other words, windfall additions to his assets.

Held: Adopting in the main, the economist's concept of "money income" as the meaning of "income" under the *Income Tax Act,* namely that it includes three items, (1) pure interest, (2) risk and (3) liquidity, all of which are respectively reflected in yield, and that yield, in a situation of perfect competition, or in other words, no uncertainties, will take into consideration any discount or premium involved in the price of any security;

That since there was no perfect competition in the market in which and when this subject mortgage contract was entered into and sold, which provided for a yield of 11 18%;

That since also there was nothing fortuitous, unsought, uncalculated and unexpected about this gain;

That since also the appellant entered into perfectly normal transactions with one purpose in mind when he purchased this mortgage, the other mortgages, the stocks and the bonds during the relevant period, and "put to work" his excess fees from his earnings from the practice of law, so that he might have what is called a "second income" by various stock brokerage houses and other persons who sell securities in the various financial markets to-day;

That therefore this "second income" from this subject mortgage transaction was identical with and was income as meant in the *Income Tax Act*;

And that (obiter) probably this "discount" was not "interest" within the meaning of s. 6(1)(*b*) of the Act; and that (also obiter)

probably the gain from this mortgage transaction was income from a "business" within the meaning of s. 139(1)(*e*) of the Act;

But that in any event, and as the ratio of the decision in this case, the profit from this transaction was income from a "source" within the meaning of the opening words of s. 3 of the *Income Tax Act* as judicially considered by Noël J. in *George H. Steer v. M.N.R. (supra),* whether or not it was profit from a "business" within the meaning of s. 139(1)(*e*) of the *Income Tax Act,* or "interest" within the meaning of s. 6(1) of the Act, adopting for the purpose of this result the economist's concept of money income;

That the appeal be dismissed with costs.

APPEAL from a decision of the Tax Appeal Board.

J. W. Goodchild for appellant.

B. Verchere and *S. A. Hynes* for respondent.

GIBSON J.:—This is an appeal from the decision of the Tax Appeal Board as to the appellant's 1962 income tax assessment wherein the excess of receipts over outlay realized on a first mortgage purchased in 1957 and redeemed and paid off in 1962 was found to be income and not a capital gain.

The appellant in his formal Notice of Appeal puts his grounds for appeal in this way:

A. STATEMENT OF FACTS

In the month of July, 1957, the taxpayer in association with a client bought through another solicitor a first mortgage on the property known as 90 Campbell Avenue, Toronto, Ontario. The amount then owing on the mortgage was Eight thousand five hundred dollars ($8,500 00) for principal with interest at the rate of six and one-half per cent (6½%) per annum from the 5th July, 1957. The taxpayer and his client paid the sum of Seven thousand one hundred dollars ($7,100 00) with each of them putting up one-half of the purchase price. The source of the taxpayer's share of the funds used for the purpose of acquiring the mortgage was his personal savings. The mortgage was paid off in full in July, 1962.

B. REASONS THAT THE TAXPAYER INTENDS TO SUBMIT:

Any and all profits (apart from the interest provided for in the mortgage) which were received by the taxpayer during the year 1962 from the investment made by him in this mortgage were not profits from a business carried on by the taxpayer during the said year within the meaning of Sections 3, 4, and 139(1)(*e*) of the Income Tax Act, were not in satisfaction of interest within the meaning of Section 6(1)(*b*) of the Act, and were not income from property within the meaning of Sections 3

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and 4 of the Act, but were the realization by the taxpayer of a capital accretion on a mortgage investment made by him.[1]

. . .

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.

. . .

6 (1) Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

. . .

(*b*) amounts received in the year or receivable in the year (depending upon the method regularly followed by the taxpayer in computing his profit) as interest or on account or in lieu of payment of, or in satisfaction of interest;

. . .

139 (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 respondent submits that the difference[2] between the amount advanced by the appellant on the security of the said mortgage and the amount received by him upon its subsequent redemption during the appellant's 1962 tax year is a profit from a "business" carried on by the appellant during the said year and is income within the meaning of ss. 3, 4, and para. (*e*) of s-s. (1) of s. 139 of the *Income Tax Act*; or, in the alternative, that this amount was an amount received by the appellant during his 1962 taxation year as interest or on account or in lieu of payment of or in

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[1] *Income Tax Act.*

[2] (Speaking generally, considering this type of gain as income all in one year and not as accruing over the term of the mortgage contract is unfair to the taxpayer and not in accord with reality. It may not be administratively simple or even practicable to apply an accrued scheme of taxation; but instead of lumping the gain into a single tax period, some system of averaging after over the period during which the gain accrued would eliminate some of the inequity in the taxation of this type of gain)

satisfaction of interest and, therefore, is income from property within the meaning of ss. 3, 4 and para. (*b*) of s-s. (1) of s. 6 of the *Income Tax Act*.

The relevant facts in this matter briefly are as follows:—

The Appellant between 1956 and 1963 acquired thirteen (13) mortgages, eleven (11) of which were so-called bonus or discount mortgages, six (6) of which were second mortgages, and seven (7) of which were first mortgages.

The appellant's law office, in which there were two other partners, as part of its solicitor practice at the time of the hearing, managed the collection for clients of mortgages which had an aggregate principal value of over four and a half million dollars. In 1957 it was not that much but still the aggregate principal value of the mortgages then managed was substantial.

The appellant acquired these mortgages for his personal account during the period when he was carrying on his practice and all of them came to his attention by reason of the fact that he was practicing law as a general practitioner and the fact that part of his practice consisted of mortgage transactions.

The mortgages acquired for his personal account are not large in number; and the evidence is that the appellant also purchased some stocks and bonds for his personal account during this same period of time.

The purchase of these mortgages and the stocks and bonds were made from savings of the appellant and such purchases in total were not substantial.

The specific mortgage, the gain on which is the subject of this appeal, was on the premises known as 90 Campbell Avenue, Toronto. The circumstances surrounding its acquisition were as follows: One Williams, who was described as a speculator, purchased 90 Campbell Avenue, Toronto, on June 11, 1957 for $10,000. In July 1957 he sold these premises to one Lawrence for $13,700. Lawrence paid Williams $2,200 cash and gave him back a first mortgage and second mortgage in the respective sums of $8,500 and $3,000. These mortgages were drawn obviously for the purpose of immediate resale. The first mortgage of $8,500 was then

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purchased by the appellant and a client in July 1957 for $7,100 (and therefore at a discount of $1,400 from its face value). This mortgage bore interest at 6½% per annum on its face value of $8,500 and was paid off in 1962.

This subject mortgage, and all of the mortgages acquired by the appellant according to his evidence were purchased by the appellant after he had inspected each proposed mortgaged premises and had made a decision that each purchase was a safe investment for him.

It is the gain of the appellant resulting from the acquisition of this mortgage at a discount and the holding of it until it was paid off at face value that is the subject matter of this appeal.

As a perusal of the cases shows, it is often difficult to determine the exact nature of a receipt, whether income or capital gain. This is especially true when a distinction is sometimes made between the gain realized from the acquisition and holding to maturity of a discount mortgage, such as the subject mortgage in this case, and the gain realized from the acquisition of and holding to maturity of so-called "discount bonds".

To assist in the determination of whether a gain is one of capital or income in my view, it is helpful to consider the economist's conception of the nature of capital gains and the relation of these gains to ordinary income.

Before mentioning such economist's concepts, as I understand them, however, it should be noted that the nature of the gain from "discounts", that is the face value less the amount advanced or paid, received under mortgage contracts have been the subject of many judicial decisions. In *James Frederick Scott v. M.N.R.*[1] Judson J. reviewed the two kinds of results of such cases in which the issue in each was resolved by deciding whether or not the taxpayer was in a "business" within the meaning of s. 139(1)(*e*) of the Act, and said at p. 225:

This diversity of opinion is understandable when the decision must depend upon a full review of the facts in each case for the purpose of determining whether the discounts can be classified as income from a business Even on the same facts, there is room for disagreement among

[1] [1963] S.C.R. 223.

judges on the conclusions that should be drawn from these activities of a taxpayer, for the Act nowhere specifically deals with these discounts, as it does, for example, in s. 105(*a*) with shares redeemed or acquired by a corporation at a premium. It is possible to deal expressly with the problem and the Act has not done so.

and concluded in that case (p. 228) that the taxpayer was in

. . . the highly speculative business of purchasing these obligations at a discount and holding them to maturity in order to realize the maximum amount of profit out of the transactions, and that the profits are taxable income and not a capital gain.

And it should also be noted that such "discounts" received under mortgage contracts have been also the subject of consideration in many cases as to whether they were "interest" within the meaning of s. 6(1)(*b*) of the Act.

As to the latter, it may be that the Parliament of Canada when it referred to "interest" in s. 6(1)(*b*) of the *Income Tax Act* had in mind the same meaning of the word as in the *Interest Act*[1]. If that is so, there may be serious doubt that such "discounts" are "interest" within the meaning of s. 6(1)(*b*) because of the decision of the Supreme Court of Canada in *Attorney-General for Ontario v. Barfried Enterprises Limited*[2]. In my view the Court when it referred in that case to "discounts" as synonymous with "interest" under the *Interest Act* was referring to the gain from the type of discounts arising in Canadian financial markets from such sources as (1) Canada Treasury Bills sold by the Government of Canada every Thursday at a discount and maturing at par; (2) the loans made by way of the purchase of non-interest bearing post-dated Bankers' Acceptances of Canadian Chartered Banks[3]; and (3) the mechanical application by Canadian Chartered Banks of their "call loan" or collateral security loan business.

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[1] R.S.C. 1952, c. 156.

[2] [1963] S.C.R. 570 (In that case there was discussed the meaning of the word "interest" in interpreting s. 6 of the *Interest Act* in relation to a mortgage transaction, relief from which had been granted under *The Unconscionable Transactions Relief Act,* R.S.O. 1960, c. 410).

[3] (See s. 18(1)(*f*) and (*g*) of the *Bank of Canada Act,* R.S.C. 1952, c. 13 as amended by S. of C. 1953-54, Vol. 1, c. 33).

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"Discounts" from such sources not only are all "interest" within the meaning of the *Interest Act* but are also all "income" within the meaning of the *Income Tax Act*, being income from a "source" within the meaning of the opening words of s. 3 of the *Income Tax Act* and also specifically "interest" within the meaning of s. 6(1)(*b*) of the *Income Tax Act*.

Preliminary also to recording the reasons for the decision in this case, I mention that I would have no difficulty in finding that the gain arising out of this discount mortgage transaction was income, being profit from a "business" within the meaning of s. 139(1)(*e*) of the Act but do not choose to do so; and for the reasons just stated, I do not wish to say whether the discount from this particular mortgage was "interest" within the meaning of s. 6(1)(*b*) of the Act.

I prefer instead, to found my decision in this case by resolving the question of whether or not this gain was income from a "source" within the meaning of the opening words of s. 3 of the *Income Tax Act*.

And as far as I know, there is no decision of this Court or of the Supreme Court of Canada in which a question of this kind has been resolved by deciding that such a discount was income from a "source" within the meaning of the opening words of s. 3 of the Act, without deciding whether it was income from any of the particular sources detailed in s. 3 or elsewhere in the Act.

In considering income from a "source" that falls outside the statutory definition of "business" (as was said by Noël J. in *George H. Steer v. M.N.R.*[1]) it should be noted that it is ". . . not merely the aggregation of one's incomes from all sources from which there were incomes in the year but it is made up of the gains from all sources minus the losses from these sources or, expressed otherwise, the *net income* from all sources of income taken together".

In other words, in determining such income for the purpose of the *Income Tax Act* as was held in that case, there must be allowed ". . . the deduction of any outlay or

[1] [1965] 2 Ex. C.R. 458.

expense involved in earning income from a 'source' that falls outside the classes of sources of income specifically named in section 3 (i.e., businesses, property, and offices or employments), ...".

Relating this to the economist's concepts, and beginning the consideration of such concepts as I understand them, relevant to this matter, it should first be noted that when economists speak of "income", they refer to "net income" in the same sense as it is used in that case. All proper charges therefore must first be deducted, which in the case of acquisition of securites would include commissions paid, legal fees and so forth.

Secondly, as I understand the matter, the conceptional distinction made by economists between capital gains and income is as follows.[1]

An economist when he speaks of "money income" is talking about what he refers to as "social income"[2]. And the interest portion of "money income" the economist says includes three items, namely (1) pure interest, (2) risk, and (3) liquidity.

Pure interest is the price paid for waiting. Risk is the cause of the reward which exists because there is a possibility of there being a loss of the capital advanced. Liquidity

[1] Lawrence H. Seltzer, in *The Nature and Tax Treatment of Capital Gains and Losses* (New York, 1951) p. 3, describes this conceptional distinction as follows:—"In both law and common speech, capital gains are generally regarded as the profits realized from increases in the market value of any assets that are not a part of the owner's stock-in-trade or that he does not regularly offer for sale; and capital losses, as the losses realized from declines in the market value of such assets *Ordinary* profits and losses, in contrast, are realized on the sale of goods and services that *are* a part of the seller's stock-in-trade or that he regularly offers for sale. . . ."

[2] ("Social income" is not identical with income as meant in the *Income Tax Act* because income under the *Income Tax Act* also includes what the economists call "transfer payments", that is for example, government pensions, etc , in respect to which the recipient does not render any concurrent services to the government or its citizens in exchange, or in other words, has not provided any labour, land or capital in exchange. Transfer payments, however, are not relevant to the matter in issue in this case.)

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is self-explanatory and includes the range, market and time of availability of potential purchasers for the particular security contract.

The economist considers that pure interest, risk, and liquidity of a security are always respectively reflected in yield; and that in speaking of yield, as opposed to contractual interest rate, he means the net result having regard to such interest rate and the price of the security. Yield, therefore, in his view, takes into consideration any discount or premium involved in the price of any security.

Thirdly, one other qualifying factor the economist says, must be introduced and that is that there must exist a perfect market or, in other words, that there must be no uncertainties. Under such conditions, that is an absolute guarantee of perfect market conditions, the market capitalization of assets according to the economist would equal their present discount value. In other words, anyone could borrow or lend as much as he wished at a single competitive market rate of interest. Every asset would be yielding the same market rate of interest. This equality of yield would result from the way competitors bid up or bid down the market price of any asset—whether it be a bond, a stock, a mortgage, a patent, a going business, a piece of real estate, or any earning stream of other income whatsoever.

Because, however, there is no perfect competition and there are no certainties, the economist recognizes that there do result in certain circumstances capital gains or losses. They are bred by uncertainty and they cannot be predictably expected to occur again and again.

The perfect competition or condition of absolute certainty that the economist speaks of means the situation that would obtain if each seller had absolutely no control over price; in other words, it means that each seller's demand curve is perfectly horizontal and infinitely elastic; it means that no person is able to control any significant fraction of the total of any category of productive resource.

But in the individual case histories of many of these so-called capital gains or losses, among economists there will be wide divergence of opinion as to whether the "gain" or "loss" was an income receipt or loss or a true capital gain or loss.

The origins of substantially all capital gains are not, however, the subject of diversified opinions.

Capital gains in the main arise from capital assets. Buying and selling such income producing rights as corporate securities, real estate, leases and contracts and disposing of these assets at prices higher than the original cost produce gains which are not related to the income flows associated with these assets. Capital gains from increases in land values, from investment in the stock market and from the creation and expansion of industrial empires are the most well known sources of such capital gains.

The unexpected nature of a capital gain is the main thing that most economists stress in expressing the conceptual difference between capital gains and ordinary income.[1] In other words, they say that the expected rise in the value of an asset is ordinary income and an unexpected rise in value is a capital gain.

Therefore, in this view, pure capital gains are windfall additions to one's assets or, as put by Seltzer, "Unforeseen increases in the real value of man's existing property not directly attributable to his efforts, intelligence, capital or risk-taking".[2]

The main kinds of changes which affect the value of assets which give rise to capital gains may be grouped into three general types: Changes in expectations regarding the net receipts to be obtained from a capital asset, unexpected changes in interest rates, and changes in the disposition of investors to face uncertainties.

As previously mentioned, in a situation of perfect competition the present value of a capital asset is based on the discount value of the expected flow of receipts of the asset over its life; and because there is no such thing as perfect competition and there is no such thing as certainty, any potential investor must estimate these receipts and then discount them having regard to the basis of his experience

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[1] Compare A. C. Pigou, *A Study in Public Finance,* Third and Revised Edition, London, 1947, p. 156; and J. M. Keynes, *The General Theory of Employment Interest and Money,* London, 1936, pp. 52-61.

[2] Seltzer, *The Nature and Tax Treatment of Capital Gains and Losses* (*supra*) p. 53; and see also A. C. Pigou on "Windfalls" in *A Study in Public Finance* (*supra*) pp. 56 and 64.

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and knowledge of the present which inevitably yields unstable results.[1]

The investors' estimates of future yields are therefore in practice forever changing for a variety of reasons, many of which are subjective.

As a result, capital gains in a pure sense do arise, according to the economist, from unanticipated changes in the value of capital assets. This is because, putting it in other words, this latter value is obtained by discounting the expected stream of income of an asset over its life, and unexpected changes in the stream or in the discounting factors will affect the capitalized value.

These, as I understand them, are the economic origins of capital gains.

Again they differ from ordinary income only by virtue of their unexpected character.

In law, however, the meaning of capital gain is not as refined and narrow as the economist's concept.

In law, as the cases indicate, a capital gain is not always completely unanticipated and it is often a mixture of the other types of factor returns—wages, rents, interest and profits.

Relating these concepts to the matter in issue, it should first be noted that a market condition which approaches in some degree perfect competition and approaches absolute certainty, does exist in the sale of certain securities through recognized stock exchanges and other traditional financial markets. The business community recognizes that in respect to securities which are traded on such recognized stock exchanges or in such other traditional financial markets, that there will be from time to time fortuitous gains which the business community categorizes as capital gains and not as income receipts. The business community explains that these gains happen because the market does not

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[1] J. M. Keynes, *The General Theory of Employment Interest and Money* (*supra*) pp 149-50 " . . Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and often negligible If we speak frankly, we have to admit that our basis of knowledge for estimating the yield ten years hence of a railway, a copper mine, a textile factory, the goodwill of a patent medicine, an Atlantic liner, a building in the City of London amounts to little and sometimes to nothing; or even five years hence. . . . "

always reflect the true worth of such securities and therefore such gains are expressed in the form of capital.

It is this type of capital gain that the English Court of Appeal in *Lomax (H. M. Inspector of Taxes) v. Peter Dixon and Son, Limited*[1] discussed.

Its relevance to the Canadian market, as I understand it, briefly is as follows:

In Canada about 1958 there developed a money market for so-called discount bonds. This became especially pronounced after a very substantial market break in the fall of 1959.

The money market for these discount bonds, in the main, was utilized by corporate investors who had idle surplus funds for temporary investment.

The Government of Canada, for example, in March of 1959 sold a $2\frac{1}{4}\%$ issue due in thirteen months at $97.90 to yield 4.6%. This issue, in the main, as stated, was purchased by such corporate investors and such corporate investors treated the gain arising from this discount to maturity or the difference between the buying and selling price if sold prior to maturity as a capital gain or at least non-taxable income and paid corporate tax on the interest or coupon only.

Provincial Governments in Canada, also about this time, began to issue bonds at a discount.

They also looked, in the main, for corporate investors who considered these bonds to afford a high degree of safety of principal and interest and a high degree of liquidity. (Compare the economists' concept of money income above mentioned).

Between early 1958 and December, 1960 the Canadian Provinces and their authorities raised millions of dollars through the sale of discount bonds or notes with terms ranging from six months to two or three years. In the vast majority of cases a 2% coupon was used and the gross yield ranged from 2.40% to 5.65%.

Then finally, in December, 1960 a three million dollar issue was done by a province. This issue was in two parts and each bore a 2% coupon. One part had a ten year term and was priced at $76.28 to yield 5.05%. The other was a fifteen year term and was priced at $66.95 to yield 5.20%.

[1] [1943] 1 K.B. 671.

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This led the Government of Canada to enacting s. 7(2) of the *Income Tax Act*.[1] This section then provided (and now provides) that for any new bonds issued where the coupon rate was less than 5% the gross or total yield on which the bond could be sold could not exceed the coupon by more than $\frac{1}{3}$. If this gross yield exceeded the coupon by more than $\frac{1}{3}$, then the whole of the discount would be deemed to be income in the hands of the first Canadian resident taxable holder of the instrument. This meant, for example, to avoid the income tax implication of s. 7(2) for a bond bearing a fixed or coupon rate of 2% the highest gross rate at which it could now be sold was 2.66%.

The enactment of s. 7(2) of the *Income Tax Act* therefore brought an end to the issuance of these "deep discount" bonds.

But the issuance and sale of securities to taxable corporations for investing of surplus funds has continued. All these

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[1] (2) Where, in the case of a bond, debenture, bill, note, mortgage, hypothec or similar obligation issued after December 20, 1960 by a person exempt from tax under section 62, a non-resident person not carrying on business in Canada, or a government, municipality or municipal or other public body performing a function of government,

(*a*) the obligation was issued for an amount that is less than the principal amount thereof;

(*b*) the interest stipulated to be payable on the obligation, expressed in terms of an annual rate on

(i) the principal amount thereof, if no amount is payable on account of the principal amount before the maturity of the obligation, or

(ii) the amount outstanding from time to time as or on account of the principal amount thereof, in any other case,

is less than 5%; and

(*c*) the yield from the obligation, expressed in terms of an annual rate on the amount for which the obligation was issued (which annual rate shall, if the terms of the obligation or any agreement relating thereto conferred upon the holder thereof a right to demand payment of the principal amount of the obligation or the amount outstanding as or on the account of the principal amount thereof, as the case may be, before the maturity of the obligation, be calculated on the basis of the yield that produces the highest such annual rate obtainable conditional upon the exercise of any such right) exceeds the annual rate determined under paragraph (*b*) by more than $\frac{1}{3}$ thereof; the amount by which the principal amount of the obligation exceeds the amount for which the obligation was issued shall be included in computing the income of the first owner of the obligation who is a resident of Canada and is not a person exempt from tax under section 62 or a government, for the taxation year of the owner of the obligation in which he became the owner thereof.

new issues have been and are now tailored to comply with the "coupon plus $\frac{1}{3}$" requirements of s. 7(2) of the *Income Tax Act,* that is they provide an effective yield to maturity or to the earliest call date that does not exceed the contractual rate by more than one third. Corporate investors who buy these securities and hold them, apparently treat the gain arising as a capital gain on the basis that they are investing temporary surplus funds and are not in a "business" within the meaning of s. 139(1)(*e*) of the Act.[1]

So much for the discussion of discount bonds.

Reverting now to the subject matter in this case, it is clear that no such similar market situation obtains in the case of the mortgage in this action.

As stated, this was a first mortgage purchased at a discount and it did not come into existence in a market which in any way approached a situation of perfect competition. Instead, this mortgage was tailor-made by the parties and no free forces of the market obtained which caused this discount to arise. (There may be cases in respect of mortgage discounts where the concept of the decision in the *Lomax* (*supra*) case may apply but these would be exceptions in my view, especially in the light of the knowledge of how the usual type of mortgage contract is entered into in this country.)

The yield to the appellant on this mortgage amounted to 11.18%.

The gain on this particular mortgage, I am of the opinion that no economist would categorize as a capital gain. Every economist would say that there was not perfect competition in the market when this mortgage contract was entered into and sold, that there was substantial control over the market by the persons concerned, that there was nothing fortuitous, unsought, uncalculated and unexpected about this gain, and that therefore the receipt was all income.

In my view the appellant entered into perfectly normal transactions with one purpose in mind when he purchased this mortgage, the other mortgages, and the stocks and

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[1] (The Department of National Revenue apparently recognizes these gains as similar to gains discussed in the *Lomax* (*supra*) case. Whatever the reason, there would be a loud cry in the business community if this type of gain was taxed as income receipts.)

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bonds during the relevant period. "He put to work" his excess fees from his earnings from the practice of law so that he might have what is called a "second income" by various stock brokerage houses and other persons who sell securities in the various financial markets to-day. This "second income" from this subject mortgage transaction was identical with and was income as meant in the *Income Tax Act*.

In the result, therefore, I am of opinion and found my decision on the grounds that the profit from this transaction was income from a "source" within the meaning of the opening words of s. 3 of the *Income Tax Act* as judicially considered by Noël J. in *George H. Steer v. M.N.R.* (*supra*), whether or not it was profit from a "business" within the meaning of s. 139(1)(*e*) of the *Income Tax Act*, or "interest" within the meaning of s. 6(1)(*b*) of the *Income Tax Act*. In doing so, I am adopting for this purpose the economist's concept of income as described above.

Accordingly, the appeal is dismissed with costs, and the matter is referred back for reassessment, not inconsistent with these reasons, for the purpose of deducting all proper charges and thereby correctly computing the net income received by the appellant from his mortgage transaction.