BETWEEN:

HERSCH FOGEL ..... APPELLANT;

AND

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

1958
June 24
1959
May 26

Revenue—Income—Income tax—Income Tax Act, R.S.C. 1952, c. 148, c. 139(1)(e)—Income or capital gains—Appellant member of a partnership engaged in the business of buying lots, erecting buildings

1959

FOGEL
v.
MINISTER OF NATIONAL REVENUE

thereon and selling same or selling the vacant lots—Profits from sale of lots not built on due to certain conditions are income—Appeal dismissed.

Appellant was a member of a partnership the business of which was to purchase land suitable for building, build on it for sale if that were possible, and sell the land with the building on it, and if for any reason the building could not be built, sell the vacant land at a profit if possible. If there were good reasons for disposing of land at a loss the course was to sell it and in such cases the loss became a deduction against revenue. The appeal is from an assessment for income tax on the sale of some lots at a profit. These lots had been acquired by the partnership along with others some of which had been built upon and sold and others of which had been sold as vacant lots. Appellant gave evidence that these particular lots had been acquired to erect apartment buildings on with a view to making profit through renting them to tenants, rather than by selling them. Due to certain by-law requirements which came into effect after the land was acquired apartment buildings of the kind desired could not be erected by the partnership and the lots were thereupon sold at a profit.

Held: That the lots in question were never at any time solely a capital investment as distinct from a revenue asset; the intention at the time of purchase and the course to be followed were precisely the same as applied in the case of any other parcels of land which the partnership had, namely, to turn them to account for profit by building on them for sale or by sale of the vacant land itself, as might appear expedient, if for any reason the proposed building could not be built; they were not an investment at the time they were acquired nor did they acquire that character from anything that occurred thereafter, any expenditures of money or effort made to carry out that purpose were quite insufficient to give them such a character to the exclusion of any other.

2. That the partnership business included dealing in building lots, that the two properties were bought generally for the purpose of that business and were sold at a profit in the course of carrying it on and as an incident of it, and the profits were from that business and properly assessed for income tax.

APPEAL under the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Thurlow at Toronto.

P. N. Thorsteinsson for appellant.

W. R. Latimer and *G. W. Ainslie* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

THURLOW J. now (May 26, 1959) delivered the following judgment:

This is an appeal from the judgment of the Income Tax Appeal Board[1] dismissing an appeal by the appellant from income tax reassessments for the years 1953 and 1954. The matter in issue is whether sums of $19,662.46 and $12,907.48, respectively realized on the sale of two parcels of land by a partnership of which the appellant was a member, were income for the purposes of the *Income Tax Act*, R.S.C. 1952, c. 148, or capital gains.

Under ss. 3 and 4 of the *Income Tax Act*, the sums in question are to be regarded as income if they are profit for a taxation year from a business, and the term "business" is defined by s. 139(1)(*e*) as including a profession, calling, trade, manufacture, or undertaking of any kind whatsoever and an adventure or concern in the nature of trade. The question to be determined is one of fact, the onus being on the appellant to satisfy the Court that the sums in question were not profits from a business as so defined.

The partnership was known as Enterprising Developments. It was formed in February, 1951 and continued to the end of 1954, its partners being the appellant, a young man who had been educated as a chemical engineer, and Dr. Allan Sharp, a physician. There was no written partnership agreement setting forth its objects, but these were described by the appellant as "basically building and *perhaps* acquiring apartment buildings for investment purposes." The activities carried on in partnership are summarized as follows in paragraph 3 of the notice of appeal, which was admitted in the Minister's reply:

> 3. During the taxation years 1951 to 1954 inclusive, the partnership engaged in the business of buying land suitable for residential housing, building houses and selling the land and houses so purchased and built. Approximately 15 parcels of land or blocks of residential housing lots were purchased by the partnership in that period. A total of 19 houses were built and sold, and on 8 occasions the land purchased in order to build houses was sold without the houses having been built, by reason of the fact that on those occasions the partnership found itself unable to secure the mortgage loans necessary to finance the intended construction. The profits earned on these transactions were included in the income of the partnership for the relevant taxation years and income tax was paid thereon by the Taxpayer and the said Sharp, with the exception of two transactions upon which a loss was incurred and the same was in each case deducted from the otherwise taxable income of the partnership.

[1] 18 Tax A.B.C. 381

1959

FOGEL
v.
MINISTER OF
NATIONAL
REVENUE

Thurlow J.

The evidence further indicates that no dwelling houses were constructed after July, 1953, though some parcels of land suitable for dwellings were acquired and sold at a profit after that time. In July, 1953, the partners undertook the construction of a 47-suite apartment building which they completed in March, 1954. When it was completed, the partners had a one-third interest in it, which they held until the end of 1954, when they transferred their interest to Enterprising Developments Limited, a company incorporated to assume the undertaking of the partnership. The shares of this company are held by the appellant and Dr. Sharp. The remaining two-thirds of the apartment building were owned by David Hecht and Sam Rosen. In March, 1954, the partners commenced construction of another large apartment building, this one having 51 suites. The building was completed in September, 1954 and was held by the partners until transferred by them to Enterprising Developments Limited. The cost of these buildings was approximately $380,000 each, most of which was financed on mortgages, the equity capital being remarkably small. In each case, the builder was the partnership, and after completion the partnership obtained rental revenue from the property.

In January, 1951, prior to or at the time of the formation of the partnership, Dr. Sharp had entered into an agreement to purchase for $40,000 four parcels of land in the Township of North York containing a total of 25 building lots, as shown on a subdivision plan. One of these parcels contained five lots numbered 6 to 10 inclusive, and another similar parcel contained five lots numbered 84 to 88 inclusive. In the contract of sale, the vendor had warranted to Dr. Sharp that building permits would be issued for the erection of apartment buildings on these ten lots and for the erection of dwelling houses on the others, and it was further provided that the vendor should refund the purchase moneys paid in respect of any of the lots for which such building permits could not be obtained. The 25 lots so acquired by Dr. Sharp apparently became or were assets of the partnership and were subsequently sold by it, and no question arises as to the proceeds of sale of any of them (other than 6 to 10 and 84 to 88) having been receipts of

a revenue nature. Lots 84 to 88 were held until December 4, 1953, when they were sold to a single purchaser at a profit of $19,662.46, this being one of the sums in issue in the appeal. On November 4, 1953, prior to that sale, the partners had sold an undivided two-thirds interest in lots 6 to 10 to David Hecht and Sam Rosen for a sum in excess of the cost of the lots, and on or about December 23, 1953, they accepted an offer and sold these lots, including their remaining interest in them, to another purchaser. This sale was completed in February, 1954, and in it they realized a further profit. The total profit realized by the partners from these lots was $12,907.48, and this is the other sum in issue in the appeal.

On these facts, it seems clear that the business of the partnership was not limited to that of constructing buildings for sale but included, as well, at least as an incident of that process, dealing in vacant land suitable for buildings. *Prima facie,* therefore, it would seem that the profits from the sales of lots 6 to 10 and 84 to 88 were profits of the partnership's business and liable to be taxed accordingly. The appellant, however, maintains that lots 6 to 10 and lots 84 to 88 were acquired with the sole intention of constructing on them apartment buildings to be held by the partnership as investments, that the sales in question were made simply to realize the partnership investment in those lots, the intention with which they were acquired having been frustrated by the passage of a by-law which rendered impossible the construction thereon of apartment buildings of the kind desired, and that the profits realized therefrom were accordingly capital and not income.

In support of this contention, evidence given by the appellant before the Income Tax Appeal Board was read by consent on the trial of the appeal to this Court. In it, the appellant stated that the sole purpose for which the lots in question were purchased was to erect apartment buildings thereon for investment and to derive rental income therefrom, and that in April, 1952, an architect was employed to prepare plans for them. Blueprints of several drawings made by the architect, some dated 3/4/52 and others dated 3/6/52, were put in evidence. The buildings so planned did not, however, comply with By-law 7625 of

1959

FOGEL
v.
MINISTER OF
NATIONAL
REVENUE

Thurlow J.

the Township of North York, which required that there be provision for certain minimum parking space and certain minimum garage space on the premises and that the building be situate at least 25 feet from the curb. This by-law had been read a first and second time on January 30, 1952 and finally passed on June 25, 1952 after the plans had been completed. The partners had known as early as January, 1951 that it was likely that certain restrictions as to minimum parking space and distance of the buildings from the curb line would be imposed but not that there would be a minimum garage space requirement as well. They became aware at some stage that the proposed construction would not comply with the by-law as finally passed but, even after that, they proceeded for a time with their scheme in the hope and expectation that the by-law would be waived in their favour. During the summer of 1953, they approached a number of financial institutions with a view to borrowing the funds necessary to put up the building or buildings but were turned down. It was said that the reason for selling the two-third interest in lots 6 to 10 to Messrs. Hecht and Rosen was to enlist their financial resources in the project and that the sale to them was made below the market price in order to get them interested in it. On December 2, 1953, however, a public meeting of the Committee of Adjustments of the Township of North York was held, when some thirty citizens appeared to oppose any waiver of the by-law, and it then became apparent that the scheme to build the particular buildings as planned could not succeed. Both parcels of land were accordingly sold, the sale of one of them being made two days later and the sale of the other three weeks after the meeting.

It may be noted in passing that permits for one or more larger apartment buildings might have been obtained, but in that case fireproofing would have been required and would have substantially increased the cost of the buildings. Permits might also have been obtained for smaller apartment buildings, but the partners did not regard the probable return from such buildings as satisfactory.

Assuming that the lots in question were purchased with the possible erection and holding of apartment buildings thereon in mind, the evidence leaves me far from satisfied that that ever was the partners' sole intention with respect to them. This land was but part, though no doubt a part with its own characteristics, of the whole group of lots purchased at or before the commencement of the partnership. Some lots of this same group were sold as vacant land, and some may have been used as sites for dwellings and then sold. There is no reason to doubt that the returns from such other lots were revenue receipts, just as were the receipts from other lands subsequently acquired, which were dealt with in the same way. The pattern of the partnership's business was to purchase land suitable for building, build on it for sale if that was feasible, and sell the land with the building on it; and if, for any reason, the building could not be built, sell the vacant land at a profit, if possible. When there were good reasons for disposing of land, even though at a loss, the course was to sell it, and in such cases the loss became a deduction against revenue. Here the only difference from the other lands acquired by the partnership was one of a conditional intention; that is, that if the proposed buildings could be built they were to be held with a view to making profit through renting them to tenants, rather than by selling them. But if the proposed buildings could not be built, whether for lack of funds or for failure to obtain permits for the buildings desired, a contingency of which the partners must have been aware, the intention, as I see it, and the course to be followed were precisely the same as applied in the case of any other parcels of land which the partnership had, namely, to turn them to account for profit by building on them for sale or by sale of the vacant land itself, as might appear expedient.

On the evidence, I do not think that the lots in question were at any time solely a capital investment in the sense urged by the appellant, as distinct from a revenue asset. When purchased, they were not producing rental revenue and, while the partners held them, they never produced revenue of that kind. Moreover, while the appellant says

1959

FOGEL
v.
MINISTER OF
NATIONAL
REVENUE

Thurlow J.

that they were acquired for a particular purpose, that purpose was conditional on the partners' obtaining both building permits and money and was hemmed in, as well, by limitations imposed by the partners as to the kind of buildings to be built on them. In my view, the utmost that can be said in favour of the appellant's position is that these lots were acquired generally for the purposes of the partnership business, with an intention to turn them into an income-producing investment if that could be done in the way the partners desired, and otherwise to deal with them in the same way as other lands acquired in the same and other transactions were to be dealt with in the course of the partnership business. In this view, they were not an investment in the sense urged at the time they were acquired, nor did they acquire that character from anything that occurred thereafter, for such expenditures of money and effort as were made in seeking to carry out that purpose were, in my opinion, quite insufficient to give them such a character to the exclusion of any other, and it was always open to the partners to carry out the alternative plan for obtaining profit from these properties by selling them in the course of their business. Even if the buildings had been erected by the partnership, let for a time, and subsequently sold, I should have regarded it as unlikely, so long as the business was being carried on and no unequivocal event had occurred to deprive the properties of their revenue character, that they could be treated as having been solely investments in the sense urged or that any gain made on the sale of them should be treated otherwise than as income from the partnership business.

The test applicable in a matter of this kind is that stated as follows by the Lord Justice Clerk in *Californian Copper Syndicate v. Harris*[1] at p. 165:

> It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of

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

a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for Income Tax.

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

In *Ducker v. Rees Roturbo Development Syndicate*[1] Lord Buckmaster, at p. 141, after referring to the test stated in *Californian Copper Syndicate v. Harris (supra)*, applied it to the case then before the House as follows:

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

In the present case, it may well be that the partners preferred, as the course by which profit should be made from these particular lots, to carry out their scheme for building apartments on them and that, with this in mind, they held them, preferring not to sell them even at a profit so long as any hope for the success of that scheme remained. But that is far from saying that the erection of apartment buildings to be held as income-producing investments was the sole purpose for which the lots in question were acquired. Sale of the other lots included in the same purchase, as well as of lands acquired in other transactions, whether such lands had been built on or not, was, from the commencement of the partnership, one of the means by which profits from their business were to be realized, and, since the scheme for apartments on the lots in question was

[1] [1928] A.C 132.

1959

FOGEL
v.
MINISTER OF
NATIONAL
REVENUE

Thurlow J.

both contingent and limited, I see no reason to think that sale of these lots, as well, was not also contemplated as one of the alternative ways in which they would be turned to account for profit if the scheme for building apartments thereon should fail. In my opinion, it makes no difference for the present purpose that, if the apartment buildings had been built as planned, profit might have been obtained from them in the form of rentals. The material facts are simply that the partnership business included dealing in building lots and that two properties, bought generally for the purposes of that business, were sold at a profit in the course of carrying it on and as an incident of it. The profits in question, in my opinion, were accordingly profits from that business and were properly assessed.

The appeal will be dismissed with costs.

Judgment accordingly.