
BETWEEN:

WESTERN LEASEHOLDS LIMITED .....APPELLANT.

1956
Jan. 16 & 17
1958
Jun. 30

AND

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

AND BETWEEN:

WESTERN MINERALS LIMITED .....APPELLANT.

AND

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

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 3(1)—The Income Tax Act, 1948, c. 52, ss. 3, 4, 42 and 50(6)—Statutes of Canada 1949 (2nd Session), c. 25, s. 53—Income—Capital or income—Payments for options to purchase oil rights—Payments when options exercised—Payment for leases—Compensation for cancellation of part of contract—Income in hands of taxpayer and not receipts on account of capital—Disallowance of deductions claimed as exploration expenses and filing fee—Taxpayer not entitled to interest moratorium on unpaid tax—Appeals dismissed.

Appellants are limited companies incorporated in 1944 under the laws of the Province of Alberta and at all relevant times herein were owned and controlled by the same shareholders and directors. The purposes

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

of incorporation included the exploration and development of oil properties. Minerals is the owner of the freehold mineral rights in 496,000 acres and Leaseholds, the operating company, was given the right to lease all or any of these rights on a royalty basis.

In 1946 and in 1947 Leaseholds by arrangement with Minerals, granted Shell Oil an option to purchase the mineral rights in a stated number of acres and was paid $30,000 and for a similar option granted Imperial Oil, it received $250,000. Imperial Oil in 1949 and 1950 exercised its option and paid to Leaseholds about $2,000,000, and in 1949 Leaseholds also received $900,000 under a leasing agreement made with Barnsdall Oil. Leaseholds was assessed for income tax on all these receipts and Minerals was also assessed for income tax on the sum of $234,000 paid it by Leaseholds in 1949 and 1950 as compensation for a change made in the principal leasing agreement entered into between the two companies, providing for a reduction in royalty payable on certain acreage. These receipts were credited on the books of the appellants to capital reserve and appeals from assessments for income tax on the payments of $30,000 and $250,000 respectively to the Income Tax Appeal Board were dismissed. A further appeal was taken to this Court from such dismissals. Other matters in issue in these appeals were brought directly to this Court which also considered the disallowance of certain deductions from income claimed by appellants and disallowed by the respondent.

Held: That the payments received by Leaseholds in 1946 and 1947 constituted income from a business and therefore within the definition of income in s. 3(1) of the *Income War Tax Act*. The receipts in 1949 and 1950 were receipts from a business or property and therefore within the provision of s. 3 of the *Income Tax Act* 1948, as amended.

2. That whilst Leaseholds' ultimate purpose may have been to develop and explore its oil properties, as stated in evidence, a statement of the intention with which a transaction was entered into is not of itself the only nor most important test to be applied; the acquisition and disposal of mineral rights was clearly within the objects and power of Leaseholds as shown by its Memorandum of Association and any profit derived from such transactions would be income derived from a business, and since the company lacked the necessary capital to carry on exploration and development of its properties, the only way such could be acquired was by disposing of a substantial portion of its rights by sublease or sale, and in engaging in such subleasing or selling Leaseholds was carrying on a business for profit and any money received thereby is income and subject to income tax.

3. That certain payments made to lease brokers by Leaseholds on behalf of a wholly-owned subsidiary company for the purpose of the latter acquiring and taking title to gas and oil leases in the Provinces of Saskatchewan and Manitoba were loans from Leaseholds to the subsidiary and as such not deductible from income within the provision of s. 53 of c. 25, Statutes of Canada, 1949, nor were they "annual payments" within the terms of the Statute since they were made to the lease brokers once and for all.

4. That the sum of $750 paid by Leaseholds to the Province of Alberta as a filing fee on these reservations is not deductible within s. 53 above since it is not an annual payment.

5. That the sum of $234,000 received by Minerals in 1949 and 1950 pursuant to the agreement entered into with Leaseholds providing for cancellation of a portion of the original agreement between the two companies is income and taxable as income from its business, since the original contract was an ordinary commercial contract made in the course of carrying on trade or business, namely, the disposal of Minerals' products; Minerals never intended to go into production on its own account and could make a profit only by the disposal in one form or another of such minerals as it owned.

6. That Minerals was not entitled to benefit from the interest moratorium provided by s. 50(6) of the *Income Tax Act*, c. 52, Statutes of Canada, 1948. *Provincial Paper Ltd.* v. *The Minister of National Revenue* [1955] Ex. C.R. 33 followed.

APPEALS under *The Income War Tax Act* and *The Income Tax Act*.

The appeals were heard before the Honourable Mr. Justice Cameron at Ottawa.

H. H. Stikeman, Q.C., N. D. McDermid, Q.C. and *G. McCarthy* for appellants.

D. W. Mundell, Q.C. and *K. E. Eaton* for respondents.

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

CAMERON J. now (June 30, 1958) delivered the following judgment:

At the request of the parties, these appeals were heard together. As the two appellant corporations were at all relevant times owned and controlled by the same shareholders and directors and as many of the issues in appeal arose out of transactions in which both appellants participated, it will be convenient to dispose of all the issues in one opinion. For the sake of brevity, I shall hereinafter refer to Western Leaseholds Ltd. and Western Minerals Ltd. as "Leaseholds" and "Minerals" respectively.

In 1943, Mr. Eric L. Harvie of Calgary, Alberta, a barrister and the senior partner in the firm of Harvie and Arnold, acquired the freehold mineral rights in some 496,000 acres in the province of Alberta from the receivers of British Dominions Land Settlement Corporation and Anglo-Western Oils Ltd., the former company being the registered owner of the mineral rights therein and the latter company holding a 999-year lease of such minerals. While he had made the agreement to purchase in his own name, Mr. Harvie was minded to turn it over to what was

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

called "the Harvie Group", consisting of Mr. Harvie, his three children, his two law partners, Messrs. Arnold and Crawford, Miss Connor, who was Mr. Harvie's secretary, and a geologist, Mr. W. G. Dekoch. Both in the Group and in the companies later formed, Mr. Harvie had at all times the controlling interest.

In order to eliminate the difficulties which might be met by disagreement among or the death of any of the members of the Group, it was decided to incorporate two companies, one of which would own the freehold rights in the minerals (Minerals) and the other of which would be the operator (Leaseholds). Accordingly, under the *Alberta Companies Act,* Minerals and Leaseholds were incorporated in April, 1944. From Exhibits 2, 3, 4 and 5, it appears that the Memorandum of Association and the Articles of Association of each company were in identical terms. In each case, the company was authorized to issue 50,000 Class A common shares and 50,000 Class B common shares, without nominal or par value. Later herein it will be necessary to refer in more detail to the objects and powers set out in the Memorandum of Association.

By agreement dated July 7, 1944 (Exhibit 8), Mr. Harvie agreed to sell to Minerals all his interest in said minerals. Thereby, Minerals (as purchaser) agreed to convey to Harvie (as vendor), or his nominees, the 100,000 shares representing all its authorized capital. Harvie agreed to pay all unearned increment taxes and fees payable on the preparation and registration of the documents and all municipal and mineral taxes to the end of 1944. Minerals agreed to assume and carry out all obligations agreed to be assumed or carried out by Harvie under the provisions of his agreement to purchase and to indemnify him in respect thereof. Clause 3(c) thereof provided as follows:

> 3. As consideration herefor the Purchaser shall:
>
> (c) Grant to the Vendor, or at his request, to his nominee an option in the form and on the terms set forth in Agreement for Leases of even date hereto, between the Purchaser herein as "Owner" and Western Leaseholds Ltd. (the nominee of the Vendor herein) as "Operator", a copy of which Option Agreement has been approved by the parties thereto and the Vendor herein and signed by them for identification. The purchaser doth hereby release and forever discharge the Vendor of all claims and demands hereunder which are assumed by Western Leaseholds Ltd. under the said Agreement for Leases.

On the same date, Harvie entered into an agreement with Leaseholds (Exhibit 7) by which he assigned to it all the rights acquired by him under his agreement with Minerals, except the 100,000 shares allotted to him. In consideration therefor, Leaseholds agreed to allot to him or his nominees all its authorized capital; to issue to him Perpetual Redeemable Participating Income Debentures of a face value of $250,000; and to perform all the obligations it, as Operator, had entered into in the Agreement for Leases next referred to.

Exhibit 10 is the Agreement for Leases dated July 7, 1944, between Minerals (therein called the "Owner") and Leaseholds (therein called the "Operator"). It related to all the minerals in respect of which the Owner became the registered owner under the transfers. *Inter alia* it provided:

2. The owner hereby grants the Operator up to and including the 31st day of December A.D. 2940, the sole and exclusive right to acquire a lease and/or leases of the said minerals in the form and upon the terms and conditions included in the draft lease attached hereto as Schedule "B", and subject to the terms and conditions hereinafter set forth.

3. The Owner will grant the Operator a lease or leases covering any or all of the said minerals in respect to any or all of the said lands as may be from time to time requested by the Operator. Each lease shall be for such term as specified by the Operator and the Owner agrees to renew any such lease, cancel same, or grant a new lease or leases in respect to the said minerals, as from time to time requested by the Operator; PROVIDED that the term of any lease so granted shall not extend beyond the 31st of December, A.D. 2940.

4. IT IS UNDERSTOOD AND AGREED that the Operator shall be entitled to operate under the said leases on its own behalf or may at its sole election grant subleases in respect to any or all of the said minerals, which subleases may be on such terms and conditions specified by the Operator, provided the terms and provisions of the leases between the parties hereto are given effect to, the Owner agrees to consent and approve of any such sublease if requested by the Operator.

By clause 5, the Operator agreed to pay the Owner during the term of the agreement (a) all municipal and mineral taxes assessed against or payable by the Owner in respect of the said minerals; (b) a minimum annual sum of $1,000 exclusive of taxes but inclusive of any royalties payable; and (c) costs of preparation and registration of documents.

Then s. 6 provided that, when not in default, the Operator could from time to time surrender its right to acquire lease or leases on fulfilling certain conditions. Schedule B thereto is a draft lease which *inter alia* provides that the

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

Operator shall pay the Owner (Minerals) a royalty in cash of 10 per cent. of the current market value of all leased substances produced, saved and sold from the said leased lands.

In January 1945, the Receivers of the former corporate owners and lessees conveyed the mineral rights direct to Minerals. Exhibit 6 is a sample of the duplicate certificate of title showing Minerals to be the owner of an estate in fee simple in "all mines and minerals other than gold and silver which may be found to exist within, upon or under" the lands therein described. In a few of the other titles there were other specific reservations of certain minerals such as coal.

As a result of these transactions, Minerals became the registered owner of the mineral rights so registered in its name, subject to the right of Leaseholds to lease such part or parts thereof as it desired until the year 2940 on the terms mentioned. Exclusive of taxes and the minimum annual payment of $1,000, Minerals' sole prospect of benefiting from the ownership of the minerals was to be derived from the royalties of 10 per cent. reserved to it in any lease it might grant to Leaseholds, unless, of course, Minerals and Leaseholds later agreed to a modification of the agreement. Leaseholds, on the other hand, had nothing except the right to call upon Minerals for such lease or leases as it might require. Harvie and his nominees—presumably the members of the "Harvie Group"—had received all the authorized stock in both companies and $250,000 in debentures of Leaseholds.

Exhibit 16 is an agreement dated May 15, 1946, between Minerals and Leaseholds. Therein it is recited that Leaseholds had received from the Shell Oil Company of Canada an offer to acquire an option to *purchase* the petroleum, natural gas and related hydrocarbons (other than coal) in approximately 300,000 acres of the lands referred to in the Agreement for Leases dated July 7, 1944 between Minerals and Leaseholds (Exhibit 10); that Shell, under the provisions of its offer, would be acquiring the interest of both companies in such products in the said lands and had requested that both companies enter into the agreement; and that it was in the interest of both companies to accept the said offer. The agreement provided that both

companies would sign the proposed Shell agreement; that in the event of Shell purchasing any mineral rights thereunder, Minerals would be entitled to receive out of the purchase price $2 per acre in settlement of its interest in the mineral rights so purchased and Leaseholds should be entitled to the balance of the fixed price.

On the same date, the agreement (Exhibit 15) was signed with Shell, the vendors of the first part being Minerals and Leaseholds. Thereby, Shell agreed to pay $30,000 as payment for the option to purchase said products in the said acreage. The option granted was for the calendar year 1946, with provisions for extensions on certain terms. If Shell took up the option in 1946 or 1947, it was to pay $20 per acre for the first 10,000 acres; $15 per acre for the second 10,000 acres; $10 per acre for the third 10,000 acres; and $5 per acre for additional acreage. If it purchased in 1948, 1949 and 1950, these rates were increased by $5 per acre. Shell was under no obligation to drill for or produce any petroleum it might so purchase, but it was obligated to pay "royalty shares" of all petroleum produced, sold or removed at the rate of $2\frac{1}{2}$ per cent. on acreage purchased in 1946; that rate increased by 1 per cent. per annum, according to the year of purchase, to a maximum of $6\frac{1}{2}$ per cent. if purchased in 1950—the last year to which the option could be extended. Shell paid the sum of $30,000 for the option which expired on December 31, 1946, without being exercised. That amount was entered in the accounts of Leaseholds as "capital reserve".

By letter dated February 4, 1947 (Exhibit 18) Minerals and Leaseholds confirmed to Imperial Oil Ltd. the terms of an option granted that day to the latter. The option was to *purchase* the petroleum, natural gas and related hydrocarbons (other than coal) in approximately 193,000 acres, until December 31, 1951. The purchase price was to be at the rate of $25 per acre for the first 10,000 acres; $20 and $15 per acre respectively for each of the next two additional 10,000 acres; and $10 per acre for any additional acreage. There was to be no drilling commitment on the part of Imperial, but royalties were reserved as follows—on acreage purchased in the first year, 3 per cent.; but increasing by 1 per cent. for acreage purchased in each of

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

the succeeding years to a maximum of 7 per cent. on acreage purchased in the fifth year. The option payments were fixed at $50,000 annually, payable in advance "with the privilege to us of requiring prepayment of all the annual option payments, provided that you are notified of our election to acquire prepayment, on or before the 1st day of June, 1947". Pursuant to that provision, Imperial was required to pay and did pay $250,000 in full of "the option payments" in 1947. The full sum of $250,000 was carried by Leaseholds to "capital reserve". The agreement further provided that all option payments could be applied on account of the purchase price up to the extent of one-half of the purchase price. As shown by Exhibit 18, the full sum of $250,000 was later applied on account of the "purchase price".

In assessing Leaseholds for the taxation years 1946 and 1947, the respondent added to its declared income the two sums of $30,000 and $250,000 received from Shell and Imperial for their options to purchase. An appeal was taken to the Income Tax Appeal Board and, by a majority, the appeals were disallowed. An appeal is now taken by Leaseholds to this Court.

All other matters now in issue in these appeals were brought directly to this Court.

Pursuant to the agreement of February 4, 1947, Imperial Oil on February 2, 1949, exercised its option in respect of 2,208.50 acres at the purchase price of $25 per acre—a total of $55,212.50 (Exhibit 18). It elected to pay one-half of the purchase price out of the pre-paid option payments of $250,000—as provided for in the option—and forwarded its cheque for the sum of $27,606.25. That amount was placed by Leaseholds in its capital reserve.

Again, in 1950, Imperial Oil exercised its option to purchase all these products in specified acreages, the balance of the optioned lands being taken up in full on December 29, 1950 (Exhibit 18). The total payments made by Imperial in 1950, after allowing for the balance of the option payments of $250,000, amounted to $1,953,771.65. That amount was retained by Leaseholds and added to its capital reserve. In assessing Leaseholds, the respondent added to its declared income the sum of $27,606.25 in 1949, and the sum of $1,754,227.10 (being the payments of

$1,953,771.65 received from Imperial Oil less certain deductions of $199,544.55) for the taxation year 1950; Leaseholds now appeals from these assessments.

On January 1, 1949, Minerals entered into an agreement (Exhibit 20) with Barnsdall Oil Company and three other corporations—collectively called therein the "Operator" and referred to hereinafter as "the Barnsdall Group"—by which Minerals

> hereby grants, leases, lets and demises unto the Operator the sole and exclusive right and privilege to explore for by geological, geophysical and other means (whether now known or hereafter discovered or adapted to petroleum exploration), drill for, mine, produce, store and thereafter remove from the Operator's Lands and dispose of the Petroleum Substances the property of the Owner, which may be found to exist within, upon or under the Operator's Lands, in each separate Operator's Unit.

As shown by Exhibit 21, a letter dated February 22, 1949, from Leaseholds to Minerals, that agreement with the Barnsdall Group was negotiated by Leaseholds and was entered into by Minerals at the request and direction of Leaseholds pursuant to the latter's right to call for leases by the agreement of July 7, 1944 (Exhibit 10). The agreement covered about 146,000 acres. As shown by Exhibit 21, the consideration received by Minerals for the agreement, namely, $914,243.75 in cash, and the reservation of a royalty of $12\frac{1}{2}$ per cent. of petroleum substances taken from the land, was to belong to Leaseholds except for the overriding royalty of 10 per cent. reserved to Minerals by the agreement with Leaseholds of July 7, 1944. In 1949, Leaseholds received the cash payment of $914,243.75 and carried it to its capital reserves. In assessing Leaseholds, however, this amount (less certain deductions) was added to the declared income and from that assessment Leaseholds now appeals.

Leaseholds also appeals from assessments made upon it for the years 1949 and 1950, such appeals relating to certain deductions claimed, but disallowed in the assessments. I shall postpone consideration of these matters and of the appeals of Minerals Ltd. until I have disposed of the issues to which I have referred.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

These matters are as follows:

(a) The receipt of $30,000 from Shell Oil and of $250,000 from Imperial Oil for their respective options in 1946 and 1947. As I have said, the Income Tax Appeal Board dismissed the appeals in reference to these two matters.

(b) The receipt of $27,606.25 from Imperial Oil and of $914,243.75 from the Barnsdall Group in 1949.

(c) The receipt of $1,754,227.10 from Imperial Oil in 1950.

What, then, is the true nature of these receipts? The assessments as to the receipts in 1946 and 1947 were made on the basis that they constituted income from a business and were therefore within the definition of income in s. 3(1) of the *Income War Tax Act*. As to the receipts in 1949 and 1950, the assessments were made on the basis that they were income from a business or property and therefore within the provisions of s. 3 of *The Income Tax Act*, 1948, as amended.

For Leaseholds, it is submitted that its business is and always has been that of exploring for and developing oil properties; that it had never been the intention to deal in options and leases as a business and that, in fact, it had not carried on such business; that the transactions which resulted in these receipts were all transactions of a capital nature and that the receipts were merely the realization of part of its capital assets, that capital asset, it is said, being the right to call for mineral leases from Minerals under the agreement of July 7, 1944.

Counsel for Leaseholds attached great importance to the evidence of Mr. Harvie as to his intentions regarding that company at the time he had it incorporated. For many years, he had been interested in the natural resources of the province and his policy had generally been to acquire rights, to hold and develop them himself, and if unable to do so, to abandon them. His personal wish was "to develop these minerals, find out what we have and proceed to develop them ourselves". He said that if he had not brought in partners, he might well have carried out that intention. His associates, Arnold and Dekoch, having other ideas, he acceded to their suggestions to take another approach. By "another approach", I assume that he meant

the disposal of at least some of the minerals either by leases or by options to purchase instead of having the development and production carried out by the company itself.

A statement of the intention with which a transaction is entered into is not of itself the only, nor the most important test to be applied. As stated by the President of this Court in *Cragg v. M. N. R.*[1]

> Nor can it rest on statements of intention on the part of the taxpayer. The question in each case is what is the proper deduction to be drawn from the taxpayer's whole course of conduct viewed in the light of all the circumstances. The conclusion in each case must be one of fact.

As I have stated above, Leaseholds was incorporated in April, 1944. Its objects as disclosed by the Memorandum of Association (Exhibit 3) are very wide and include the following:

> (*a*) To acquire by purchase, lease, concession, license, exchange or other legal title, mineral properties, mines, mining lands, real estate, leases, easements, permits, reservations, concessions or any interest therein, minerals and ores and mining claims, options, powers, privileges, water and other rights, patent right, letters patent of invention, processes, and mechanical or other contrivances, and either absolutely or conditionally and either solely or jointly with others and as principals, agents, contractors, or otherwise, and to lease, place under license, sell, dispose of, and otherwise deal with the same or any part thereof, or any interest therein.
>
> (*c*) To prospect for, open, explore, develop, work, improve, maintain and manage gold, silver, copper, nickel, coal, iron, petroleum, natural gas, and other mines, quarries, mineral and other deposits and properties, and to dig for, raise, crush, wash, smelt, assay, analyze, reduce, amalgamate, and otherwise treat ores, metals, and minerals, whether belonging to the company or not, and to render the same merchantable, and to sell and otherwise dispose of the same or any part thereof, or any interest therein.
>
> (*n*) To make, acquire, manage, produce, hold, operate, use, dispose of, import and export, and otherwise deal in and with the said substances and products, rights to and interests in lands and other properties from which they may be derived; drilling, pumping, mining, milling, reducing, refining, smelting, and other plants, equipment or apparatus for producing, manufacturing, or otherwise working such substances and products; pipe lines, pumping stations, tank cars, tank ships, boats, barges, towboats and other conveyances; tanks, terminals, docks, and any other rights and properties, real personal or mixed, which may be necessary or convenient to the conduct of any of the said businesses.

The acquisition and disposal of mineral rights was therefore clearly within the objects and powers of Leaseholds, as shown by its Memorandum of Association. *Prima facie,* therefore, any profit realized from such transactions would be income derived from its business.

[1] [1952] Ex. C.R. 40 at 46.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

In *Anderson Logging Co. v. The King*[1], Duff J. (later C. J. C.), in delivering the judgment of the Court, said:

> The sole raison d'etre of a public company is to have a business and to carry it on. If the transaction in question belongs to a class of profit-making operations contemplated by the Memorandum of Association, *prima facie*, at all events, the profits derived from it is a profit derived from the business of the company.

In a later case, *Sutton Lumber & Trading Co. Ltd. v. M. N. R.*[2], Locke J., in delivering the judgment of the Court, said:

> The question as to whether or not the present appellant was engaged in the business of buying timber limits or acquiring timber leases with a view to dealing in them for the purpose of profit is a question of fact which must be determined upon the evidence. It may be noted that the memorandum of the appellant, while including the power to sell or dispose of timber properties, *to deal in* timber licenses is not one of the objects stated as it was in the *Anderson* case. Had it in fact included such an object, the evidence in this case demonstrated that the company at no time carried on or intended to carry on any such business. Unlike that case, in the present matter all the available evidence as to the activities carried on or intended to be carried on by the company in the fifty years prior to the time of the trial of this section was given or tendered by the appellant. The decision in that case does not, in my opinion, affect this matter.

In the instant case, counsel for Leaseholds submits that upon the whole of the evidence it should be found as a fact that the company was not engaged in the business of acquiring mineral rights with a view to dealing in them for the purpose of profit.

An effort was made at the trial to minimize the importance of these stated objects in the Memorandum of Association. Mr. Arnold, who was Mr. Harvie's junior partner, prepared the original Memorandum of Association in what is called the Short Form, intending to rely to a substantial extent on statutory powers conferred on all companies by *The Companies Act of Alberta*. Mr. Harvie, however, was accustomed to using the longer form and on his insistence the objects were set out in full. They were therefore included deliberately and not by chance as was suggested.

Then it will be noted that by clause 4 (*supra*) of the basic agreement of July 7, 1944 (Exhibit 10) between Minerals and Leaseholds, the parties clearly contemplated the possibility of Leaseholds granting subleases, in respect

[1] [1925] S.C.R. 45 at 56.

[2] [1953] 2 S.C.R. 77 at 93.

to all or any of the minerals on such conditions as it might determine and suitable provision was made therefor. In this connection, it may be noted that while the royalty reserved to Minerals was 10 per cent. of production, the customary royalty in such matters was 12½ per cent.

On the evidence, I have no hesitation in finding that one of the purposes in the minds of the officers of Leaseholds was that of ultimately going into production on its own account. But from the outset, it was also apparent that they could not do so without disposing of substantial portions of their minerals by sublease or sale. Mr. Arnold made the position quite clear when he stated that there were tremendous areas involved and "we could not possibly do it ourselves. We had to have help, and we had to have help from major companies who could afford to speculate in a very cold area which they had abandoned before".

In explaining why the agreement with Shell Oil was entered into, he said, "Well as I said before, our primary interest in any negotiation there was two-fold. We were extremely anxious to interest the major companies in going back into that area and exploring for oil and if they spent money there—it was either a question of us going in and doing it ourselves. We did not have the money to do it and we were anxious that someone go in there and explore."

Lacking the necessary capital to satisfactorily explore the lands and drill wells, they were obliged to resort to other steps to obtain their objectives. What they actually wanted was to enter into agreements with others, including some of the major oil and gas companies, by which the latter would undertake to explore and do the drilling, a very costly operation and at that time considered to be also a very risky operation. These companies, however, were unwilling to undertake the obligation of drilling and in the result, Leaseholds finally consented to modify their original requests and consented to the options to purchase (as in the case of Shell and Imperial Oil) and to the Leases to the Barnsdall Group. It was hoped by Leaseholds that the very substantial down payments for these options to purchase and for the lease, coupled with the rentals and increasing royalties in succeeding years would spur the other parties to complete their exploration and drill wells at an early date. If that were done, the company would

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

benefit not only by the rentals and royalties received, but by the benefit that would accrue to the lands still held, if gas or oil were discovered by the purchasers or lessees.

When one takes into consideration the number of such transactions, the acreages involved, the rapidity with which Leaseholds disposed of its rights after they were actually acquired, it is apparent that such transactions were not characteristic of a company which merely wishes to hold an investment. On the contrary, they indicate the carrying out of a policy which was followed continuously from almost the inception of the company to dispose of the mineral rights at a profit by selling or leasing them. I do not suggest that they at any time abandoned the other plan they had in mind, namely, to go into production themselves when they were in a position to do so. The fact is that at least until the end of 1947 they did no drilling or development on their own account, their field activities being confined to certain surveys and mapping of the land. In later years Leaseholds went into production on a very large scale, and at the date of the trial was said to be the second largest producer in the field. The financing of this part of its operations was made possible by the funds derived from its sales or subleases of mineral rights.

In all, Leaseholds entered into some nine agreements to sublet or sell their mineral rights. In addition to the Shell, Imperial Oil and Barnsdall agreements already mentioned, there were the following:

A reservation—i.e., a right to explore with an option to purchase—was granted to A. E. Verner by letter dated October 4, 1944, over some 2,300 acres in consideration of the payment of $1,146.35 (Exhibit 34). That reservation (called P.R.3) also refers to an earlier petroleum reservation No. 2 granted to Verner on June 1, 1944, the rights in which were cancelled by P.R.3. A further reservation was granted for about 20,000 acres to Rusylvia. In both of these cases, while there were no legal obligations on Leaseholds to grant these reservations, it is said there was a moral obligation to continue them due to verbal promises made by the original owners. Then by letter dated October 10, 1945 (Exhibit 12) a similar reservation was granted to one Cameron over some 5,000 acres, the consideration being $682.30. A reservation was also granted to one Evans, the

particulars of which are not clear. Again on November 1, 1946, Minerals granted a lease to Leaseholds over three-quarter sections in the Leduc area (Exhibit 29), and on the same date Leaseholds issued a sublease (Exhibit 17) on the same property to Imperial Oil for a period of ten years or so as long as gas and oil could be found thereon. The rental was one dollar per acre and the royalty reserved 12½ per cent. of the market value of production.

It is important also to note the magnitude of the acreages leased or sold. As I have said, the original acreage acquired by Minerals and which Leaseholds had the right to lease, was 496,000. The Shell option to purchase related to some 300,000 acres and after it expired, the new option to purchase to Imperial Oil covered 193,000 acres. The later agreement with Barnsdall, entered into while the Imperial Oil option was in effect, covered 146,000 acres. These facts seem to indicate clearly that Leaseholds had adopted a definite plan to turn its rights to account by leasing or selling them at a profit. It may be noted here that the main Imperial Oil option was for the *purchase in fee* of the minerals and their options were taken up in succeeding years on that basis. In the final result, however, Imperial requested that it be given a 979 years' lease of the hydrocarbons instead of a conveyance and by the agreement Exhibit E, Minerals, with the concurrence of Leaseholds, granted such a lease dated December 30, 1950, the royalty reserved being 9 per cent. The evidence indicates that Imperial requested the lease instead of the conveyence due to difficulties experienced in the Land Titles Office in the registration of titles in fee with royalties reserved.

Finally, by agreement dated December 30, 1950 (Exhibit E), Minerals signed an Agreement of Settlements and Adjustments and, subject to the adjustments and agreements, the Agreement for Leases dated July 7, 1944, was terminated. *Inter alia,* the new lease to Imperial Oil was to remain in effect. All monies payable for the purchase price by Imperial Oil were to be the property of Leaseholds excepting for $234,394.68, being the amount paid by Leaseholds to Minerals as consideration for reducing the royalty payable under the Agreement for Leases (10 per cent.) to 9 per cent., which was the royalty reserved to Minerals by the new agreement with Imperial Oil. This latter item

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

will be referred to later in connection with Minerals' appeals. Minerals also granted a petroleum and natural gas lease to Leaseholds for 996 years over 293,568 acres (including the land covered in the Barnsdall lease). The royalty reserved to Minerals by the new lease was 10 per cent. of production.

It is of particular interest to note, also, that Leaseholds had actually negotiated the Shell Oil option before it entered into the agreement with Minerals, by which both Minerals and Leaseholds would enter into the agreement with Shell. Similarly, the main agreement with Imperial Oil was signed by both Minerals and Leaseholds on the same day (Exhibit 18). The Leduc lease to Imperial Oil was sublet by Leaseholds on the same day it took up the lease from Minerals. In the same way, Leaseholds negotiated the Barnsdall Agreement, authorized Minerals to enter into the agreement directly with Barnsdall without having itself actually acquired the mineral leases. There is, therefore, the clearest indication that as to these very substantial acreages, Leaseholds had no intention of retaining any rights therein (except for rents and royalties reserved) or of drilling for and producing oil or gas therefrom. It had prevented itself from doing so unless, of course, the options to purchase leases were surrendered.

In my view, no distinction can be drawn between the five items of profit now under consideration. They are all gains which fall within the test laid down in *Californian Copper Syndicate v. Harris*[1], namely, whether the amount in dispute is "a gain made in an operation of business in carrying out a scheme for profit-making". That principle was approved in a judgment of the Privy Council in *Commissioner of Taxes v. Melbourne Trust*[2], and in *Ducker v. Rees Roturbo Development Syndicate*[3]; it has been followed in a great many Canadian cases.

Generally speaking, a business is operated for the purpose of making a profit and the pursuit of profits may be carried on in a variety of ways and by different operations. In the instant case, it seems to me that the business of Leaseholds was carried out in two stages and involved two different operations. While the purpose of ultimately

[1] 5 T.C. 159. [2] [1914] A.C. 1001.
[3] [1928] A.C. 132.

developing its own resources may have been kept in mind throughout, the first operation necessarily consisted of the acquisition and disposition of mineral rights so as to acquire funds with which to enter into the second stage, namely, the drilling for and operation of oil and gas wells on its own account. The possibility of disposition of the mineral rights had been contemplated since the company was formed. In dealing with its mineral rights in this fashion, it did not do so accidentally but as part of its business operations, and although possibly that line of business was not of necessity the line which it hoped ultimately to pursue, it was one which it was prepared to undertake, and, by its charter, had power to undertake.

Reference may usefully be made to the case of *Ducker v. Rees Roturbo Development Syndicate, Ltd.*, cited above. The facts and findings are set out in the headnote as follows:

The respondent company was formed primarily for the purpose of acquiring the benefit of an invention relating to centrifugal pumps, and it acquired from the inventor his existing patent and two-thirds of any foreign patent rights in respect of the invention, the inventor reserving to himself the remaining one-third. In the course of its business the company acquired further English and foreign patents in connection with the invention. The main business of the company was the granting of manufacturing licences under its patents, but it always contemplated the possibility of a sale of its interest in the foreign patents. The respondent company and the inventor granted to an American company a licence to manufacture under a United States patent with an option to purchase, which was exercised.

Upon an appeal by the respondent company against assessments to income tax and excess profits duty upon a sum representing the company's share of the proceeds of the sale of the United States patent, the company claimed that the sum in question was a capital asset and not a profit of its circulating capital. The Special Commissioners decided that profits on the sale of patents arose in the course of the company's business and were chargeable to tax and duty:—

Held, that the Special Commissioners had not wrongly directed themselves, and that there was ample evidence to support their conclusion of fact.

The test laid down by the Lord Justice-Clerk (Macdonald) in *Californian Copper Syndicate v. Harris* (1904) 6 F. 894; 5 Tax Cas. 159 approved.

Lord Buckmaster in delivering the judgment in the House of Lords (all the other judges concurring) said at p. 141:

Turning to the findings of the Commissioners, I find that they set out in detail the circumstances connected with the working of this company, and, in particular, the reports, which begin in 1907 and continue down to

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

1918. 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.

My Lords, I find myself unable to see that in this case the Commissioners have wrongly directed themselves, and if they have not wrongly directed themselves, there appears to me to be abundant evidence upon which their conclusion of fact could be supported. It is for this reason that I think this appeal should be allowed.

In my opinion, the profits here in question were gains made in the carrying on or carrying out of a business and in the scheme for profit-making. Those relating to the years 1946 and 1947 are therefore within the definition of income as found in s. 3(1) of the *Income War Tax Act;* as a result, the appeals from the Income Tax Appeal Board in respect of these years will be dismissed with costs, and the assessments made upon Leaseholds affirmed. Those profits relating to the years 1949 and 1950 fall within the provisions of ss. 3 and 4 of *The Income Tax Act* 1948 and are therefore taxable profits. The respondent therefore was right in adding these amounts to the declared income of the appellant and the appeals in regard thereto will be dismissed.

I turn now to certain deductions claimed by Leaseholds for the years 1949 and 1950 and disallowed in part by the respondent. In 1949, Leaseholds caused to be incorporated Prairie Leaseholds Limited as a wholly-owned subsidiary for the purpose of acquiring and taking title to gas and oil leases in the provinces of Saskatchewan and Manitoba. In 1949, Leaseholds for and on behalf of Prairie Leaseholds disbursed $63,404 to individual lease brokers in payment for such leases, covering 108,510 acres, all of which were taken in the name of Prairie Leaseholds. In its annual return for that year, Leaseholds claimed as a deduction $10,851 of that amount which represented the amounts which the lease brokers had paid to owners as "lease rentals" and that amount was apparently allowed as a

proper deduction. In addition, Leaseholds claimed a further deduction of the balance of $52,553, that amount having been kept by the lease brokers as their profit on the transaction. This deduction was disallowed in full by the respondent.

Similar transactions took place in 1950, Leaseholds expending $157,225.12 for leases on approximately 240,000 acres. It claimed and was allowed $37,086.52 as "lease rentals", but its claim for the balance of $120,138.60—which was of a like nature as the claim for $52,553 in 1949—was likewise disallowed.

Counsel for the appellant submits that these two items of $52,553 and $120,138.60 are deductible under the provisions of s. 53 of c. 25, Statutes of Canada, 1949 (Second Session) as amended, the relevant portions thereof being as follows:

53. (1) A corporation whose principal business is production, refining or marketing of petroleum, petroleum products or natural gas or exploring or drilling for petroleum or natuarl gas may deduct in computing its income, for the purposes of The Income Tax Act, the lesser of

(*a*) the aggregate of the drilling and exploration costs, including all general geological and geophysical expenses, incurred by it, directly or indirectly, on or in respect of exploring or drilling for oil and natural gas in Canada
  (i) during the taxation year, and
  (ii) during previous taxation years, to the extent that they were not deductible in computing income for a previous taxation year, or

(*b*) of that aggregate an amount equal to its income for the taxation year
  (i) if no deduction were allowed under paragraph (*b*) of subsection one of section eleven of the said Act, and
  (ii) if no deduction were allowed under this subsection,
  minus the deduction allowed by section twenty-seven of the said Act.

(2) (Not relevant)

(2A) In computing a deduction under subsection (1) or (2) no amount shall be included in respect of a payment for or in respect of a right, licence or privilege to explore for, drill for or take petroleum or natural gas other than an annual payment not exceeding $1.00 per acre.

In the appellant's Notice of Objection for 1949 it was stated:

In the year 1949 through its wholly-owned subsidiary, Prairie Leaseholds Limited, the taxpayer acquired certain petroleum and natural gas leases in the province of Saskatchewan and paid the sum of $52,553 to various lease brokers. The said payments were annual payments made in respect of a right, licence or privilege to explore for, drill for or take petroleum or natural gas and did not exceed one dollar per acre.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

A similar statement appears in the Notice of Objection for 1950.

It is unnecessary for me to say anything as to the amounts which were allowed as deductible expenses for these two years. Whether or not those amounts were properly deductible under s. 53 (*supra*), does not now concern me as they were, in fact, allowed by the assessment.

I am fully satisfied, however, that the amounts now in dispute were properly disallowed. In no proper sense can it be said that these payments were annual payments within the meaning of s-s. (2)A of s. 53. In my view, the "annual payment" therein referred to relates to a payment made or to be made by the taxpayer for its right to explore for, drill for or take petroleum or natural gas, *during each year* for which the taxpayer has the right, licence or privilege in question. Here the amounts in question represent the profit of the lease brokers who upon the completion of each transaction dropped out of the matter entirely and were not thereafter entitled to any further payment by the appellant in respect of that transaction.

The real nature of these payments was revealed by the evidence at the trial. It is true that they were made by the appellant to the lease brokers, but in every case the payments were made by Leaseholds for and on behalf of Prairie Leaseholds Limited which was itself without funds to pay for the leases. Exhibit 27 is a copy of an agreement dated January 2, 1950, between Prairie Leaseholds Limited (as owner) and Western Leaseholds Limited (as operator). The recitals therein are as follows:

> WHEREAS the Owner has acquired and is continuing to acquire in the Provinces of Alberta, Sasktachewan and Manitoba mineral rights, including petroleum and natural gas leases and/or other mineral leases, by the purchase of such rights and leases or of interests therein;
>
> AND WHEREAS the owner has applied to the Operator for a loan to finance the purchase of such mineral rights including leases as aforesaid and has agreed to grant leases or subleases thereof, as the case may be, to the Operator on the terms and conditions hereinafter set forth.

The evidence of Mr. Meech, general manager, and director of Leaseholds, was that this agreement related to all the leases acquired by Prairie Leaseholds whether in 1949, 1950 or later. In cross-examination, Mr. Meech

was referred to certain questions asked him on his examination for discovery and admitted that they were correctly reported. They are as follows:

Q. Did Western Leaseholds lend this money to Prairie Leaseholds or do you remember how the transaction was handled?

A. I believe Western advanced an open account to Prairie Leaseholds but I will have to inform myself.

Q. What do you mean exactly by open account?

A. Loans.

Then as a result of undertakings given at the examination for discovery to produce further information, Mr. Meech on behalf of Leaseholds wrote to his counsel, Mr. Stikeman, a letter dated August 4, 1955, giving certain additional information which was conveyed to counsel for the respondent (Exhibit F). It includes the following questions and answers.

(*c*) Q. Who actually made the payment of $52,533 to the lease brokers?

A. Western Leaseholds Limited on behalf of Prairie Leaseholds Limited.

(*d*) Q. Did Western Leaseholds lend this money to Prairie Leaseholds?

A. Yes.

While these answers relate specifically to the year 1949, there is nothing to indicate that they do not also apply to the year 1950.

From this evidence it is abundantly clear that these amounts, while paid out by Leaseholds directly to the lease brokers were, in fact, considered by both Leaseholds and Prairie Leaseholds to be loans by the former to the latter. There is not a tittle of evidence to suggest that they ever were anything but loans. As such, s. 53 above referred to is of no assistance to the appellant. The appeal as to these amounts for the years 1949 and 1950 will therefore be dismissed.

The Minister also disallowed the claim of Leaseholds to deduct from its income the sum of $750 paid by it in 1949 to the province of Alberta as a filing fee on three reservations in respect of a right, licence or privilege to explore for, drill for or take petroleum and natural gas, which amount is said not to exceed one dollar per acre. Mr. Meech stated that in the provincial regulations under which the fee was payable, it is referred to as a "filing fee" and is payable but once, at the time of making the application. The claim for this deduction is made under the

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

provisions of s. 53, above referred to. There is very little evidence as to the nature of this expenditure, neither the provincial regulations nor the reservations acquired being put in evidence. The only evidence is that it is a filing fee in respect of the acquisition of petroleum and natural gas reservations (which I may assume gave the appellant certain rights of exploration and possibly an option to later acquire a lease) and the fact that it was paid once only. In view of my earlier comments as to the meaning of an "annual payment" as these words are used in s-s. (2)(a) of s. 53, I am unable to find that this payment falls within the provisions of s. 53. It is not suggested that it is deductible under any other provisions of *The Income Tax Act*. Accordingly, the appeal on this item will be disallowed.

In the result, therefore, the appeals of Leaseholds for the years 1949 and 1950 must fail, and will be dismissed with costs. Inasmuch as certain other matters relating to the assessments for these years were (by consent) referred back to the Minister for reconsideration and re-assessment at the trial, the matter which I have now determined will also be referred back to the Minister for the purpose of completing the re-assessment.

There remains for consideration the appeals of Minerals in respect of the assessments made upon it for the years 1949 and 1950. Leaseholds paid Minerals $34,850.13 in 1949 and $199,544.55 in 1950 under the circumstances presently to be mentioned. Minerals considered these receipts to be on capital account and did not include them in its income tax returns, but in assessing Minerals, the respondent added the full amounts thereof to its declared income. Minerals now appeals from such assessments.

It will be recalled that by the terms of the main Agreement for Leases between Minerals and Leaseholds dated July 7, 1944 (Exhibit 10), the latter was required to pay to the former 10 per cent. of the current market value of all leased substances produced, saved and sold from the lands leased by Leaseholds. By the main agreement with Imperial Oil dated February 4, 1947 (Exhibit 18), Imperial was required to pay Leaseholds a royalty of 3 per cent. on acreage purchased in the first year of the option, that royalty increasing, however, by 1 per cent. per year in

each of the succeeding years to a maximum of 7 per cent. By a letter-agreement dated December 31, 1947 (Exhibit 19) between Minerals and Leaseholds, it was agreed that Leaseholds should retain the $250,000 option money paid by Imperial and that in respect of the Imperial agreement, Minerals would grant to Leaseholds an exclusive option to purchase from time to time up to 7 per cent. of its royalty on the following basis:

	Per acre
On the first 10,000 acres	$2.63 for each 1% purchased
" " second " "	2.10 " " " "
" " third " "	1.58 " " " "
" " balance of acreage	1.05 " " " "

The only clear evidence relating to these payments of $34,850.13 and $199,544.55 is found in a paragraph of Exhibit 32—an agreement between Minerals and Leaseholds dated December 30, 1950 and called "An Agreement of Settlement and Adjustments". *Inter alia* that agreement provided:

1. Re Agreement for Leases, dated the 7th day of July, A.D. 1944, hereinafter referred to as the "Agreement for Leases".

It being agreed between the parties hereto that the option rights for leases under the provisions of Agreement for Leases shall be terminated after giving effect to the following, namely:

(*a*) The following presently existing Agreements shall remain in full force and effect:

(3) Petroleum and Natural Gas Lease, dated the 15th of January, A.D. 1951 (to be effective from the 31st of December, A.D. 1950) made between Minerals as "Lessor" and Imperial Oil Limited as "Lessee", hereinafter referred to as "Imperial Oil Lease", covering One Hundred Ninety-three Thousand, One Hundred Thirty-seven and Seventy-nine One Hundredths (193,137.79) acres more or less. It being agreed that Western Leaseholds relinquishes all rights and claims in respect to the said lands or lease, SUBJECT To Leaseholds being entitled to all monies paid by Imperial Oil Limited as the purchase price for the said lease, under the terms of the Option Letter, dated the 4th of February, A.D. 1947, addressed to Imperial Oil Limited, and signed by each of the parties hereto excepting the sum of Two Hundred and Thirty-four Thousand, Three Hundred and Ninety-four Dollars and Sixty-eight Cents ($234,394.68), being the amount paid by Leaseholds to Minerals as consideration for reducing the royalty payable under the Agreement for Leases from Ten Percent (10%) to Nine Percent (9%), which sum was computed on the basis set forth in letter between the parties hereto, dated the 31st day of December, A.D. 1947.

The item of $234,394.68 mentioned therein is made up of the two payments made by Leaseholds to Minerals, namely, $34,850.13 in 1949 and $199,544.55 in 1950.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

By an agreement of the same date between Minerals and Imperial Oil (Exhibit E), Minerals leased to Imperial Oil for nine hundred and seventy-nine (979) years the petroleum and natural gas and all related hydrocarbons other than coal in 193,137.79 acres, Minerals reserving to itself a 9 per cent. cash royalty. There is no evidence as to why Imperial Oil agreed to pay a 9 per cent. royalty when under its original agreement it was required to pay smaller royalties for lands taken up under its option in the years 1949 and 1950.

Counsel for Minerals submits that these amounts were capital receipts and ought not to be regarded as forming part of the profits arising from the carrying on of its trade or business. For the Minister it is contended that they were income from the business carried on by Minerals or, alternatively, that they were income from property and that consequently the profit therefrom is taxable income under ss. 3 and 4 of *The Income Tax Act*.

I must confess that I have found more difficulty in reaching a conclusion on this point than on any of the other matters now under appeal and the opinion which I have finally arrived at, and will now endeavour to state, was reached only after a very complete examination of the facts and after reaching a definite conclusion as to the nature of the receipts in question.

Counsel for Minerals submits that in effect Leaseholds purchased 1 per cent. of the Imperial Oil royalty from Minerals. I do not think that that is quite so. While the amount of the payments may have been computed on the basis of the formula contained in the agreement of December 31, 1947 (Exhibit 19), Leaseholds did not actually acquire 1 per cent. of the Imperial Oil royalty. It is clear that after December 30, 1950, Minerals was entitled to the full royalty of 9 per cent. and Leaseholds was entitled to no part thereof.

It seems to me that the only reasonable interpretation to be put upon that part of the Agreement of Settlements and Adjustments, which I have cited above, is that Minerals and Leaseholds thereby agreed to cancel that part of their contract of July 7, 1944 (Exhibit 10) by the terms of which Leaseholds was bound to pay Minerals 1 per cent. more royalty than Imperial Oil by the terms of

the new agreement of December 30, 1950 would thereafter pay Minerals, namely, 9 per cent. The consideration for the cancellation of that part of the contract was the total of the several amounts paid in 1949 and 1950.

Mr. Stikeman submitted that compensation paid for the cancellation of the contract under these circumstances was a capital receipt. He relied on certain statements in the *Van Den Berghs Ltd. v. Clark*[1] case—a decision of the House of Lords. In that case Van Den Berghs, which carried on the business of manufacturing and selling margarine and other products, entered into a profit sharing and non-competition agreement in 1908 with a Dutch company. Due to difficulties occasioned by the First World War, the companies were unable to compute their several share of the profits and it was therefore subsequently agreed that the agreements would be cancelled for the future upon the payment to Van Den Berghs of the sum of £450,000. In the House of Lords it was held that such payment was for the cancellation of the Van Den Berghs' future rights under the agreements which constituted a capital asset and that the money so received was therefore a capital receipt. At p. 431 Lord MacMillan stated:

> Now what were the Appellants giving up? They gave up their whole rights under the agreements for thirteen years ahead. These agreements are called in the Stated Case "pooling agreements", but that is a very inadequate description of them, for they did much more than merely embody a system of pooling and sharing profits. If the Appellants were merely receiving in one sum down the aggregate of profits which they would otherwise have received over a series of years, the lump sum might be regarded as of the same nature as the ingredients of which it was composed. But even if a payment is measured by annual receipts, it is not necessarily in itself an item of income. As Lord Buckmaster pointed out in the case of the *Glenboig Union Fireclay Co., Ltd. v. Commissioners of Inland Revenue*, 12 T.C. 427 at p. 464: "There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of that test".

That case, however, is clearly distinguishable on its facts. Lord MacMillan was careful to point out the special nature of the "pooling agreements" that were there cancelled and to distinguish the cancellation of such agreements from

[1] 19 T.C. 390.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

the cancellation of ordinary commercial contracts made in the course of carrying on trade. In the paragraph immediately following that cited, he said:

> The three agreements which the Appellants consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their trading profits when earned should be distributed as between the contracting parties. On the contrary, the cancelled agreements related to the whole structure of the Appellants' profit-making apparatus. They regulated the Appellants' activities, defined what they might and what they might not do, and affected the whole conduct of their business. I have difficulty in seeing how money laid out to secure, or money received for the cancellation of, so fundamental an organisation of a trader's activities can be regarded as an income disbursement or an income receipt. Mr. Hills very properly warned your Lordships against being misled as to the legal character of the payment by its magnitude, for magnitude is a relative term and we are dealing with companies which think in millions. But the magnitude of a transaction is not an entirely irrelevant consideration. The legal distinction between a repair and a renewal may be influenced by the expense involved. In the present case, however, it is not the largeness of the sum that is important but the nature of the asset that was surrendered. In my opinion that asset, the congeries of rights which the Appellants enjoyed under the agreements and which for a price they surrendered, was a capital asset.

In my opinion, the contract cancelled in the instant case was an ordinary commercial contract made in the course of carrying on trade or business, namely, the disposal of Minerals' products. The evidence is clear that Minerals never intended to go into production on its own account. It could make a profit only by the disposal in one form or another of such minerals as it owned. By the Agreement for Leases with Leaseholds, it obligated itself to dispose of all its minerals to the latter company (or its assigns)—an ordinary commercial transaction made in the course of what was undoubtedly its business, and entered into for the sole purpose of profit making, as evidenced by its reservation of a 10 per cent. royalty. It had virtually no business operation other than complying with the requirements of Leaseholds (or its assigns) from time to time and the supervision of such contracts as it entered into pursuant thereto.

In my opinion, the principle to be followed is that stated in *Short Brothers Ltd. v. Commissioners of Inland Revenue*[1]. The facts appear in the headnote as follows:

(1) The Appellant Company in the first case contracted in February and March, 1920, to build two steamers, but in November of that year agreed to the cancellation of the contracts in consideration of the payment of the sum of £100,000, which was paid to it on 26th November, 1920. The Commissioners of Inland Revenue took the view that this sum should be included in the computation of the profits of the Company for the accounting period of twelve months ending on 30th June, 1921 (the final accounting period of the Company for the purposes of Excess Profits Duty).

The Company contended that the said sum was a capital receipt, and alternatively that, if it was a revenue receipt, it should be apportioned over the periods during which the work under the contracts would have been performed and should not be regarded as a profit wholly attributable to the accounting period in question.

Held, in the Court of Appeal, that the said sum was chargeable to Excess Profits Duty as a receipt in the ordinary course of the Company's trade, and must be included in the profits for the accounting period ending on 30th June, 1921, in which it became payable and was in fact paid.

At p. 972 Lord Hanworth, M. R., said:

It is not denied that Messrs. Short Brothers, Limited, carry on a business of building ships, and in the course of carrying on their business they must enter into a great number of contracts—contracts, some of which are fulfilled, possibly, some of which are broken, some of which, possibly, are terminated; but in all such matetrs it is not argued that Messrs. Short Brothers, Limited, have less power than other business firms to determine whether or not they will bring to an end, upon terms which they are disposed to agree, contracts which they have entered into, contracts which, for one reason or another, are to be terminated in the interests of one party or the other to the contract. Once one sees that a contract may be determined in the course of business, it appears to me that we have the answer to the problem which is put before us.

Reference may also be made to *The Commissioners of Inland Revenue v. The Northfleet Coal and Ballast Co. Ltd.*[2] and to *Burmah Steam Ship Co. Ltd. v. Commissioners of Inland Revenue*[3].

For these reasons, I am of the opinion that the compensation moneys so received for the cancellation of a portion of the contract—the only portion thereof in which Leaseholds had any interest—was taxable income of Minerals in the years 1949 and 1950. The appeals on this point must therefore be dismissed.

Western Minerals also appeals in respect of an interest charge made upon it by the respondent, dated September 22, 1953, for its taxation year ending December 31,

[1] 12 T.C. 955. [2] 12 T.C. 1102.
[3] 16 T.C. 67.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

1950. It filed its return for that year within six months of the end of its fiscal year, namely, on June 30, 1951. On July 31, 1951, the respondent forwarded to the appellant a Notice of Assessment which for the sake of clarity I shall refer to as the first Notice of Assessment. That notice showed a tax levied of $23,789.79, with an equal amount paid on account and no unpaid balance. Under date of September 9, 1953, the Minister, acting under the provisions of s. 42 of *The Income Tax Act*, forwarded a Notice of Reassessment indicating a tax levied of $215,049.32; after crediting the payments on account of $23,789.79, there was added an interest charge of $25,300.17, showing a balance unpaid of $216,559.70. This notice refers to the Notice of Assessment of July 31, 1951, as the "original assessment". Again, for the sake of clarity, I shall refer to this notice of September 9, 1953, as the second Notice of Assessment.

Subsequently, on September 22, 1953, the respondent forwarded to the appellant a further Notice of Re-assessment called "Revised Assessment Replacing Assessment Issued September 9, 1953". This final notice was apparently issued to correct a mathematical error in the computation of interest drawn to the attention of the tax officials by the appellant and resulted in the reduction of the interest charges by about $355. While the appeal is taken from the revised assessment dated September 22, 1953, the appellant's counsel does not contend that this third notice has any bearing on the particular "interest" point now in issue.

This portion of the appeal is based on s-s. (6) of s. 50 of the Act.

> 50. (6) No interest under this section upon the amount by which the unpaid taxes exceed the amount estimated under section 41 is payable in respect of the period beginning 12 months after the day fixed by this Act for filing the return of the taxpayer's income upon which the taxes are payable or 12 months after the return was actually filed, whichever was later, and ending 30 days from the day of mailing of the notice of the original assessment for the taxation year.

In its Notice of Appeal, the appellant submitted that the first "genuine assessment" was that mailed to it on September 22, 1953, but at the trial his argument was that the second notice of September 9, 1953, was in the circumstances to be mentioned, the first or original Notice of

Assessment. If that be so, then he submits that under s-s. (6), the appellant is relieved from duty for the period June 30, 1952 (being twelve months after the date fixed for filing the return) to October 9, 1953 (being thirty days from the date of mailing of the notice on September 9, 1953) which the appellant says was the notice of the original assessment.

For the Minister, it is submitted that the original assessment was that contained in the first notice of July 31, 1951, and that consequently, on a proper interpretation of s-s. (6) of s. 50, the appellant is not relieved from payment of any interest payable under the other provisions of s. 50.

To support his submission, Mr. Stikeman relied on the evidence of A. O. Ellis, taken on examination for discovery on October 25, 1955. Mr. Ellis at all relevant times was director of taxation at the Calgary office of the Department of National Revenue (Income Tax) where the returns were filed and the assessments made and the Notices of Assessment forwarded. He personally had no part in the processing of the return or in the assessment, but had informed himself as to the procedure followed. From his evidence, it appears that the T2 return was received by the mailing unit on June 30, 1951, accompanied by a cheque for $23,789.79, the full amount of the tax payable as computed by the appellant. Then the cashier issued a receipt for the remittance which was mailed to the taxpayer and the cashier initialled the return showing that the amount said to have been remitted was received. The return was then sent to "assessing control"; a check was made in the ledger accounts as to any credits claimed or paid. It was then sent to the "assessment section"; then the assessor examined the return and the net profit shown therein; he reviewed the company's figures, reconciling the profits shown in the attached statements with the profits shown on the T2 return, and thereby reached a basis for computing the tax as estimated by the taxpayer. He accepted the company's reconciliation and accepted the figures as stated in the T2 return, indicating on the T2 return that he had assessed the return. Then the assessor computed the tax on the income as shown in the return. Having verified that the tax as computed by the appellant corresponded with his own computation of assessment and

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

having verified the amount of payments as received by the accounting department, he completed Form T-6-7-L containing the information from which Form T-6-7-A—the Notice of Assessment—was prepared by a typist. Then the return and the computation so made were sent to the checking unit where a check was made as to the work of the assessor and the typed Notice of Assessment to ensure that there were no typographical errors. This last step was a mere mathematical computation and the assessor's computation of the income was not there questioned. One copy of the Notice of Assessment was sent to the taxpayer and others were retained for internal use. The procedure which I have outlined was apparently followed in the case of the first Notice of Assessment dated July 31, 1951.

At some stage, the T2 return was segregated for further investigation, but whether this was done before or after the first Notice of Assessment was mailed is not shown. That investigation by the assessing section took place at some time between the date of issue of the first and second Notices of Assessment. The assessor who reviewed the return had left the department, but Mr. Ellis outlined what steps were probably taken. He would review the financial statements in detail, and they are lengthy and involve a great many claims for deductions of various sorts. He would consider all the items of a contentious nature bearing on the assessment, and after preparing a summary of his requirements to complete the review, would secure the necessary information either from correspondence with the company or by consultation with its officials or by reference to its books and records. Having secured the required information and computed the tax payable, the appellant was re-assessed and was sent the second Notice of Assessment dated September 9, 1953.

As I have noted above, the contention is that the second assessment dated September 9, 1953, is in fact the "original assessment" referred to in s. 50(6). The submission is that the first assessment was invalid and incomplete, that the Minister did not comply with the provisions of s. 42(1), namely, with all despatch to examine each return of income and assess the tax for the taxation year—and,

more particularly, it is alleged, as the examination of the return is incomplete and as it was at some stage marked "for further review".

In my opinion, the matter is concluded by the judgment of the learned President in *Provincial Paper Ltd. v. M.N.R.*[1]—a judgment with which I respectfully agree. In that case, the Minister by his assessor had accepted the taxpayer's return as correct and had assessed it accordingly. Subsequently, the return was reviewed and the taxpayer was re-assessed. There, as here, the taxpayer contended that the first assessment was not the original assessment and claimed the benefit of s-s. (6) of s. 50. In that case it was held:

Held: That it is not for the Court or anyone else to prescribe what the intensity of the examination of a taxpayer's return in any given case should be. That is exclusively a matter for the Minister, acting through his appropriate officers, to decide.

2. That there is no standard in the Act or elsewhere, either express or implied, fixing the essential requirements of an assessment. It is exclusively for the Minister to decide how he should, in any given case, ascertain and fix the liability of a taxpayer. The extent of the investigation he should make, if any, is for him to decide.

3. That the Minister may properly decide to accept a taxpayer's income tax return as a correct statement of his taxable income and merely check the computations of tax in it and without any further examination or investigation fix his tax liability accordingly. If he does so it cannot be said that he has not made an assessment.

On p. 39 the President stated:

But the basic fallacy in the contention lies in the assumption that the Minister is precluded from ascertaining and fixing a taxpayer's liability on the basis of the assumed correctness of his income tax return but must do something else and that if he does not do so he has not made an assessment. While the Minister is not bound by the taxpayer's return, as was emphasized in the *Dezura* case ([1948] Ex. C.R. 10 at 15), there is nothing in the Act to prevent him from accepting it as correct and fixing the taxpayer's liability accordingly. In *Davidson v. The King,* [1945] Ex. C.R. 160 at 170, I made the statement that the taxpayer's own return of his income, while not binding upon the Minister, may be the basis of the assessment made by him and I pointed out that it was reasonable that this should be so, since the taxpayer knew better than anyone else what his income was.

The Minister may, therefore, properly decide to accept a taxpayer's income tax return as a correct statement of his taxable income and merely check the computations of tax in it and without any further examination or investigation fix his tax liability accordingly. If he does so it cannot be said that he has not made an assessment.

[1] [1955] Ex. C.R. 33.

1958

WESTERN LEASEHOLDS LTD. AND WESTERN MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Cameron J.

Counsel for the appellant in thise case submitted that this case should be distinguished from the *Provincial Paper* case mainly on the grounds that at some stage the taxpayer's return was "in some fashion identified as being segregated for further investigation". It is urged that if it was marked for further investigation before the initial assessment was made, such assessment was incomplete and invalid in that the Minister had failed adequately to comply with the provisions of s. 42(1), his examination of the return being incomplete.

While the return was at some stage set aside for further review—a review which led to the reassessment of September 9, 1953—there is no evidence to establish when it was so set aside. I am therefore quite unable to distinguish the facts in this case from those in the *Provincial Paper* case in any essential matter. It follows, therefore, that the Notice of Assessment dated July 31, 1951, was the notice of the original assessment referred to in s-s. (6) of s. 50 and that the appellant is not entiteld to the benefits of that subsection. The appeal on this point will therefore be dismissed.

In the result, therefore, all the appeals of Leaseholds and Minerals which were not disposed of at the trial with the consent of the parties will be dismissed with costs.

The assessments made upon Leaseholds for the years 1946 and 1947 will be affirmed.

Inasmuch as certain other matters in the appeals of both Leaseholds and Minerals for the years 1949 and 1950 were referred back to the Minister for reconsideration and re-assessment at the trial, I think it inadvisable to affirm the assessments made for those years and these matters will be referred back to the Minister for the purpose of enabling him to make such further re-assessments as may be necessary.

Judgment accordingly.