1962
Nov. 29
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Jul. 30

BETWEEN:

GOLDWIN CORLETT ELGIE .....APPELLANT;

AND

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

Revenue—Income tax—Income Tax Act R.S.C. 1952, c. 148, ss. 3, 4, 139(1)(e)—Profits capital gain or income—Mortgages purchased at a discount or acquired with a bonus—Investment—Mortgages held until maturity or prior payment—Circumstances negative indicia normally characterizing an investment—Appeal dismissed.

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Appellant, a solicitor, a small part of whose practice consisted of real estate conveyancing, acquired, over a period of years, a number of mortgages at a discount or with a bonus and held them to maturity. All were acquired by appellant alone, without advertising or solicitation, but were handled for him by his office staff. The mortgagors in the transactions were not able to obtain loans from lending institutions and the mortgages had been peddled in the market with the result that appellant was approached because he gave a better deal, and even then the bonuses and discounts were quite substantial, never below 25 per cent and in some instances as high as 50 per cent. The appellant assumed the entire risk himself and the greatest part of his income was obtained from such transactions.

The Minister assessed these profits for income tax, adding them to the appellant's income and from that assessment he appealed to this Court.

Held: That the appeal be dismissed.

2 That the profits or gains realized by the appellant from bonuses or discounts were taxable income.

3. That the transactions were not ordinary investments and as securities they were risky and of a second class nature and the appellant therefore expected a greater return to compensate him for the greater risk.

4. That the multiplicity of the transactions, considered together with the surrounding circumstances, the second class nature of the mortgages, the short term in which the bonuses and discounts were realized, all are indicative of determining that the transactions were business transactions carried out for a scheme of profit-making and not those which characterize an investment.

APPEAL under the *Income Tax Act.*

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

W. D. Goodman for appellant.

Donald Guthrie, Q.C. and *M. Barkin* for respondent.

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

CATTANACH J. now (July 30, 1963) delivered the following judgment:

This is an appeal from the appellant's income tax assessments for the taxation years 1956, 1957, 1958 and 1959.

The Minister in reassessing the appellant for the years 1956 to 1959 inclusive added the sums of $2,582, $7,360, $9,035 and $2,380 to the amounts of taxable income reported by him in his income tax returns for these four respective years, which sums represented the total of the difference

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between the amounts advanced by the appellant on the security of mortgages or to purchase existing mortgages at a discount or with a bonus and the amounts received by the appellant on the maturity of the mortgages in the years in question.

The issue in the appeal is, therefore, whether the profits realized by the appellant from the transactions into which he had entered were capital accretions from investments, as claimed by him, and, therefore, not subject to income tax as profits from a business or an adventure in the nature of trade as claimed by the Minister, and, therefore, taxable income within the meaning of sections 3 and 4 and section 139(1)(*e*) of the *Income Tax Act*, R.S.C. 1952, c. 148.

By section 3 of the Act the income of a taxpayer for the purposes of Part 1 of the Act is declared to be his income from all sources inside and outside Canada and to include income for the year from *inter alia* all businesses. By section 4 of the Act income from a business is declared to be the profit therefrom for the year and by section 139(1)(*e*) business is defined as including a profession, calling, trade, manufacture or undertaking of any kind whatsoever and as including an adventure or concern in the nature of trade but not an office or employment.

The distinction between profits that are subject to income tax as income from a trade and those that are not, was stated in the well known case of *Californian Copper Syndicate (Limited and Reduced) v. Harris*[1] and the test for resolving such an issue was outlined by the Lord Justice Clerk at page 166 as follows:

> 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 realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

In *M.N.R. v. Spencer*[2] the President of this Court referred at page 115 to many cases in which the test so laid down had been approved, and, at page 125 to numerous cases in which the principle that each case must be considered according to its facts has been stated by the Supreme Court of Canada.

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

[2] [1961] C.T.C. 109.

It is essential to ascertain the facts respecting the appellant's transactions in mortgages and the circumstances surrounding them to ascertain their true nature and determine whether the profits arising from them were taxable income or not.

There is no dispute about the facts which were given in considerable detail by the appellant himself, nor about the accuracy of the figures outlined above, but the dispute lies in the inference to be drawn from these facts.

The appellant is a barrister-at-law and Queen's Counsel and has been practising his profession in the City of Toronto since January 20, 1920. He has conducted, what in common parlance might be termed a one man office, that is, at no time did he have a partner although he usually employed two and sometimes three lawyers as well as a student-at-law. The stenographic staff consisted of two girls, one of whom had been with the appellant for a number of years and as is almost always the case, she became very valuable to him being, in effect, the office manager.

The appellant's practice was a general one, but he tended to specialize in litigation which in later years was predominately motor vehicle accident cases. Real estate work and conveyancing comprised a very low percentage of his practice which the appellant estimated at 2 percent over twenty years and in the years in which real property was moving extensively he estimated that percentage may have risen to six. The appellant said that about one real estate deal a month went through the office and that he never handled such work personally, but left it to the solicitors he employed.

However, the circumstance that the appellant's law office did not act extensively on behalf of clients in real estate matters, does not preclude the appellant from personally entering into mortgage transactions.

Counsel for the Minister filed in evidence as Exhibit "B" a schedule of mortgages held by the appellant during the period 1956 to 1960. There were 71 mortgages listed in Exhibit "B" which were held by the appellant in the period covered thereby which extends one year beyond the taxation years now under review.

The appellant quite frankly admitted that he began to acquire mortgages in all years from 1950 on, a number of

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which had matured prior to the year 1956, the assessment for which year is the first of the four presently under appeal. The appellant explained that prior to the depression years he had held mortgages, as well as a number of properties on some of which he had suffered a loss in the depression, but a number of properties he had been able to retain through these years. He sold those houses at a profit, although not as great a profit as he might have realized had he sold them later. These sales gave the appellant some money and mortgages were taken back by the appellant for the balance of the unpaid purchase price. In 1950 the appellant suffered an illness which prompted him to sell his own home and move to a smaller house which he owned. The sale of his home put the appellant in further funds. The implication I take from this testimony of the appellant is that these sales of real property constituted the source of the funds with which he entered into mortgage transactions.

A general summary of the discounted mortgages or those acquired with a bonus held by the appellant which matured and were paid during the years 1956 to 1959, both inclusive, was filed by his counsel as Exhibit 1.

It shows for each year in question the date of purchase of the mortgage, which is identified by the street address, the amount paid therefor, the amount of the discount or bonus, the term of the mortgage, how the mortgages were financed, when each mortgage was paid off, the face value and the name of the mortgagor.

In the year 1956 four mortgages were paid. The first listed mortgage was acquired on November 30, 1951 with a term of five years. It was paid on December 19, 1956, that is very shortly after due date. The face value was $2,700, the price paid was $1,890, the discount realized was $810 or 30 per cent. The information on Exhibit 1 and on Exhibit "B" does not disclose whether the mortgage was a first or second one. The interest rate was 6 per cent. The appellant stated it was a second mortgage. The appellant explained that a young man known to him since the young man's birth wanted to buy a business. He had sold a house at a profit but had been obliged to take back a second mortgage for $2,700. Being in immediate need of more money he sold the second mortgage to the appellant for the consideration of $1,890.

The second listed mortgage was acquired on May 14, 1953 with a term of 6 months and was eventually paid on May 16, 1956, that is two years and 6 months after due date. The face value was $1,800 and an amount of $1,228.53 was advanced by the appellant resulting in a bonus of $572 or approximately 33⅓ percent. This was a third mortgage. There were peculiar circumstances surrounding the acquisition of this mortgage. The appellant's law office was acting for the mortgagor who was being dispossessed by the holder of the second mortgage. The appellant was unaware of the proceedings and apparently the lawyer employed by him who had charge of the matter neglected to take any action on behalf of the client. The appellant, therefore, felt morally obliged to advance the client $1,228.53 on the security of a third mortgage to permit the client to retain possession of the premises. The interest rate was 6 percent. The record of payments on this mortgage was particularly bad. The appellant received nothing for two years, but cheques on accounts without sufficient funds. Eventually the mortgagor raised a further mortgage the funds from which were used to pay off the appellant.

The third listed mortgage was acquired on March 5, 1953 for a term of 5 years and was paid on May 16, 1956 well before due date. The face value was $4,000 and it was acquired for $3,200, a bonus of $800 or 25 percent. Exhibit "B" discloses this was a second mortgage bearing interest at 6 percent, but the appellant testified it was a first mortgage acquired as security for funds advanced by him to the mortgagor at a bonus.

The fourth mortgage listed on Exhibit 1 and which was paid in 1956, was acquired on October 1, 1955, the term was not given but the mortgage was paid on March 5, 1956. The face value was $1,000 for which $599.60 was paid by the appellant who thereby realized a discount of $400 or 40 percent. The interest rate was 8 percent but no information was given as to the type of mortgage.

Three of the mortgages were acquired by the appellant with his own available funds, but one such mortgage was acquired when he had an overdraft at his bank.

The total discounts and bonuses realized by the appellant in 1956 was $2,582, the amount added by the Minister to his income for that year. The total face value of the four

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mortgages held was $9,500 for which the appellant paid $6,918 or an average discount or bonus of approximately 30 percent.

In 1957 six mortgages were paid from which the appellant realized by way of bonus or discount the sum of $7,360 which was added to his income for that year by the Minister. The total face value of the six mortgages was $20,875 which were acquired by the appellant for a total outlay of $13,515 or a discount of approximately 36 percent. Each of the six mortgages was paid on or before the due date. Five of the mortgages were for a term of five years and one was for a term of two years. Four of these six mortgages paid in 1957 were second mortgages, one was a first mortgage and there is no information as to the type of the remaining mortgage. The one first mortgage bore interest at 6½ percent, three of the second mortgages bore interest at 6 percent, another second mortgage bore interest at 5½ percent and the remaining unidentified type of mortgage bore interest at 7 percent.

One mortgage was specifically mentioned by the appellant as being taken as security for monies advanced by him with a bonus and which he identified as a first mortgage but which is described in both Exhibits 1 and "B" as a second mortgage.

Another of the six mortgages was an existing mortgage purchased by the appellant at a discount. No information was forthcoming as to whether the remaining four mortgages were existing and purchased by the appellant or were taken as security for monies advanced by him. However, it is certain that on each either a substantial bonus or discount was realized by the appellant. Two of the mortgages were purchased by the appellant when he had a bank overdraft, one when he had no such overdraft and there is no information in this respect as to the remaining three mortgages.

In the year 1958 four mortgages were paid from which the appellant realized the sum of $9,035 by way of bonus or discount which amount was added to his income for that year by the Minister.

The total face value of these four mortgages was $22,215 for which the appellant paid or advanced $12,354. The discrepancy in the difference between the total face value and the total outlay to acquire the mortgages (which is $9,861) and the sum of $9,035 actually realized by the appellant is

accounted for by the fact that the full face value was not paid on discharge.

All four mortgages were for a term of five years. Three of the mortgages were second mortgages and no information was given as to the remaining mortgage. Two bore interest at 6½ percent and two bore interest at the rate of 6 percent.

Each of the four mortgages was paid on or before the due date and all four were acquired by the appellant when he had an overdraft at his bank.

In 1959 only one mortgage was paid from which the appellant realized $2,380 by way of either discount or bonus. This mortgage had a face value of $6,800 and was acquired by the appellant for $4,420. It was a second mortgage bearing interest at 6 percent and was for a term of 5 years but was paid before maturity. This mortgage was acquired when the appellant had an overdraft at his bank.

The appellant testified that during the years 1956 to 1959 he held 51 mortgages of which 20 were first mortgages, 27 were second mortgages, 3 were third mortgages and one which he could not identify in rank. He further stated that the mortgages were normally for terms of five years with minor variations with very few exceptions, two of which he knew to be for a lesser term. He also considered that all mortgages bore reasonable rates of interest, the majority at 6 percent, with one or two at 5½ percent, two he thought at 6½ percent and one at 7 percent.

My own review of the evidence discloses that the appellant's estimate is substantially correct, although in the 15 mortgages which were paid in the years 1956, 1957, 1958 and 1959 I have observed three bearing interest at 6½ percent and one at 8 percent.

The appellant further testified that he never borrowed money for the purpose of lending on mortgages, but that there were occasions when he had a substantial amount of cash on hand and others when there were overdrafts on a general range of credit. He was not obliged to make any special arrangement to purchase or lend on mortgages since the line of credit was available to the appellant if he needed it for this purpose at the branch of the bank in which he kept his personal account. The appellant's office accounts were in a different branch of the same bank.

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The proceeds by way of principal and interest payments on mortgages held by the appellant were deposited in his personal bank account.

Before lending money on the security of a mortgage or purchasing an existing mortgage, the appellant invariably made an inspection of the premises and also placed reliance of the mortgagors whose plans he made it a policy to discuss with them to ascertain if they were persons who would maintain the premises in good repair and intended to remain there.

The appellant never held himself out publicly as being ready to lend money on mortgages or to purchase them. He never advertised in any way. The appellant had been a member of the City Council and of the legislature for many years and was accordingly extremely well known to people in the district in which he lived so that he was frequently approached by persons for mortgage loans at a bonus or by persons who wished to dispose of mortgages at a discount.

He also explained that he was approached by these people because he gave them a better deal than they could get on the general market for second mortgages.

The appellant never disposed of any mortgages but held them until maturity or prior payment. He also stated that he had diversified investments. He had always owned dividend paying shares in Canadian mining companies and in Canadian, British and foreign industrial companies.

In addition, the appellant had, at one time, rather extensive real estate holdings producing rental income but because of his unfortunate experience during the depression years he explained that he did not wish to become "lopsided" again for which reason he did not accept all mortgages offered him for purchase or every opportunity to lend money on the security of mortgages even if he had funds with which to do so.

However, it is obvious, from the facts recited above, that the appellant held a number of mortgages and in each instance the discount or bonus which he received on each such mortgage was very substantial, ranging from approximately 25 percent to 50 percent.

On cross-examination, when the substantial amounts and percentages of the discounts and bonuses were pointed out to the appellant he replied that they were less than those

prevailing on the market and he acknowledged there was an element of capital risk in second mortgages.

The appellant concluded his testimony by stating he had bought these mortgages as an investment because he was reaching an age when he had to think of retirement without pension and, therefore, had to have an investment with interest. He also stated he had been working less arduously which circumstance was reflected in his professional income as disclosed in his income tax returns.

On referring to the appellant's income tax return for the year 1956 I observe that the appellant received a net income of $2,358.15 from his profession, an investment income of $2,700 from stocks, a rental income of $955 and income from mortgage interest in the sum of $10,691.53 from 40 current mortgages.

In his income tax return for 1957 the appellant disclosed a net professional income of $2,166.89, rental receipts of $2,486 cancelled out by expenses, dividends of approximately $950 and income from mortgage interest in the sum of $10,733.56 from 44 current mortgages.

The appellant's 1958 return reveals similar information. His net professional income disclosed was $4,452.86, dividends of $1,271.94 and interest from 40 mortgages in the amount of $9,285.83.

Therefore, as the appellant indicated in giving evidence, his income from interest on mortgages far exceeded his income from other sources. The prevailing rates of interest on prime first mortgages on Toronto residential properties where the loan did not exceed 60 percent of the valuation were 5½ percent to 6 percent in the year 1951, 6 percent in the years 1952 and 1953, and 6½ percent in 1954 and later years.

The appellant kept a comprehensive record of his mortgage transactions at his law office, being a mortgage ledger and a file with respect to each transaction. These records were maintained by the clerical staff employed by the appellant.

From the foregoing facts it is apparent that the appellant had substantial funds available and as a result of knowing a great number of people from his political connections in the municipal and provincial fields, he was able to acquire, with these funds, a number of mortgages which

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yielded him a substantial interest income thereon and in addition a substantial yield by way of bonus or discount.

I repeat that the issue herein is whether the profits from the mortgage transactions under review were enhancements of the value of investments or profits from a business, including therein transactions that were adventures in the nature of trade and accordingly, income within the meaning of sections 3 and 4 of the Act and the determination of this issue must depend on the totality of the facts and surrounding circumstances of the case because no single criterion has been laid down upon which to decide whether the transactions were investments or adventures in the nature of trade.

On the facts as above outlined I have no hesitation in finding, from what I conceive to be the true nature of the transactions, that the profits or gains realized by the appellant from bonuses or discounts were taxable income.

The transactions were not ordinary investments of the kind referred to in the *Californian Copper case* (*supra*). As securities they were risky and of a second class nature which follows from the fact that the mortgagors were not able to obtain loans from lending institutions and that they had been peddled in the market with the result that the appellant was eventually approached because, as he put it, he gave a better deal. Despite the better deal given by the appellant, the bonus or discounts were substantial, never being below 25 percent and in some instances being as high as 50 percent. These factors, to me, emphasize the element of risk involved.

The appellant never entered into these transactions in concert with others which would have had the effect of minimizing the risk, but on the contrary he assumed the entire risk himself and it is, therefore, natural that he should expect a greater bonus or discount to compensate for the greater risk.

There is no doubt from the information in the income tax returns filed by the appellant that the greatest source of his income was from interest on mortgages held by him and his income from other sources such as real estate holdings, dividend bearing stocks, bonds and from the practice of his profession, was small in comparison. This disparity negatives the appellant's avowed intention of preventing his

investments from becoming "lop-sided" for to me that is precisely the position in which the appellant has placed himself.

While an attraction to the appellant of these transactions was, as he stated, the income by way of interest, it is logical to infer that an equal, if not greater attraction, was the prospect of profit that would result when the bonuses or discounts were realized.

In every instance the mortgages were held until maturity or until paid prior thereto. Therefore, the appellant received exactly the amounts he expected when the mortgages were acquired. The holding of the mortgages to maturity might well be a feature of an operation of a business because such a policy would result in greater profits to the appellant than if he sold them prior to maturity with the obligation of giving the purchaser a discount. The appellant stressed the necessity of providing himself with a source of income in contemplation of his gradual and eventual complete retirement. To me it, therefore, follows that it would be most advantageous to the appellant to amass as much as possible in his remaining active years and it is logical to assume that this is the course he had adopted. The comparatively short terms of the mortgages enabled him to realize the maximum profit quickly which profits would be available to finance still further transactions.

The multiplicity of the transactions confirm my conclusion that this was the course of conduct designedly embarked upon by the appellant. The multiplicity of transactions, in addition to confirming the foregoing conclusion is also a very strong factor, when considered together with other surrounding circumstances, in determining they were operations of business in carrying out a scheme of profit-making.

In my view the cumulative effect of the circumstances under which all transactions were entered into by the appellant negative any *indicia* that normally characterize an investment, but rather, the multiplicity of the transactions, the second class nature of the mortgages and the comparatively short time within which bonuses and discounts were realized are indications that the transactions in question were business transactions.

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There is support for this view in *Noak v. Minister of National Revenue*[1] in which case Kerwin J. as he then was, said at p. 137:

> The number of transactions entered into by the appellant and, in some cases, the proximity of the purchase to the sale of the property indicates that she was carrying on a business and not merely realizing or changing investments.

While this was a decision on whether the appellant in that case was carrying on a "business" within the meaning of the term used in the *Excess Profits Tax Act,* nevertheless the statement is applicable to the facts of the present case.

I think it can be reasonably inferred from the appellant's course of conduct that he was not looking for investments that would yield a moderate and safe return on his money, but rather he sought to realize a maximum amount in as short a time as possible. If his object had been to secure investments he would have invested in first mortgages that earned the same rate of interest without the attendant risk attaching to more speculative mortgages carrying bonuses or discounts.

I do not overlook the appellant's statement he was making provision for his retirement. I think he was postponing his investment in safer but less rewarding securities to a later time when he would have the greater funds which would be required to ensure an equivalent return.

It was not necessary for the appellant to set up an organization for the mortgage transactions. He was already equipped for that purpose. In fact his business premises and the time of the clerical staff must have been more devoted to these transactions than to the legal practice of the appellant. Furthermore, a line of general credit had been established by the appellant with his bank which could be and was utilized by him for the purpose of the mortgage transactions.

The fact that the appellant did not seek out the mortgages or advertise that he was in the market for them does not make the appellant an investor in them. He did not have to do so. The prospective borrowers or vendors of existing mortgages sought the appellant out and he was in a position to select those he considered most advantageous.

[1] [1953] 2 S.C.R. 136.

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I am also of the opinion, that even on the facts, it is impossible to distinguish those of this case from those in *Scott v. Minister of National Revenue*[1] in which the decision of the President of this Court was unanimously confirmed by the Supreme Court of Canada, or from the facts in *Minister of National Revenue v. MacInnes*[2] in which case the Supreme Court of Canada in a unanimous decision reversed the decision of the Exchequer Court, and wherein the Supreme Court of Canada decided that the appellant and respondent in those respective cases were in the highly speculative business of purchasing obligations of this nature at a discount and holding them to maturity in order to realize the maximum profit out of the transactions.

I, therefore, find that the discounts and bonuses realized by the appellant in the taxation years in question were taxable income since they were profits or gains from a trade or business within the meaning of sections 3 and 4 of the *Income Tax Act* aforesaid.

The Minister was, therefore, right in assessing the appellant as he did for the taxation years 1956 to 1959 inclusive with the result that the appeal herein is dismissed.

The Minister is also entitled to costs to be taxed in the usual way.

Judgment accordingly.