BETWEEN:

NICHOLAS DETORO ..... APPELLANT;

AND

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

1965
June 16, 17
July 19

Revenue—Income tax—Capital gain or income—Adventure or concern in nature of trade—Acquisition of land for construction of apartment building—Transfer of property to company—Sale of company shares—Whether sale contemplated when property acquired.

Appellant, a speculative builder, joined with an employee of a mortgage brokerage firm in purchasing a city lot which they transferred to a company formed for that purpose, and an apartment building was then erected on the lot. They then acquired additional lots, some of which they sold and upon others of which they later constructed another apartment building. Before construction of the second building was begun the first building was sold at a profit of $40,000, the transaction being put through at the purchasers' request by a transfer of the shares in the company which owned the building. Appellant was assessed to income tax on his profit from the sale, and appealed.

Held, dismissing the appeal, the gain made was profit from an adventure or concern in the nature of trade and so taxable. The evidence indicated that it was not the exclusive intention of the two men at the time they acquired the property to derive rental income from a building to be constructed thereon but that they also contemplated the possibility of its sale. It was immaterial that the profit was made on the sale of shares in the company which owned the building rather than from the sale of the real property.

APPEAL from assessment under the *Income Tax Act*.

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

Colin S. Bergh for appellant.

G. W. Ainslie and *Alban Garon* for respondent.

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

CATTANACH J. now (July 19, 1965) delivered the following judgment:

This is an appeal from assessment to income tax levied by the Minister on the appellant for the 1961 taxation year.

The appellant began his working life as a construction worker specializing, at first, as a tile setter, but subsequently engaged in the building of single family dwellings in and about the City of Toronto. While the appellant could and did build the odd home pursuant to contract, nevertheless the greater number of homes which were built by him were built on a speculative basis, that is with no specific purchaser in view.

In 1958, because of competition from developers and builders on a large scale, the appellant's business was no longer profitable so he abandoned it and cast about for another means of livelihood.

During the appellant's career as a speculative builder, he had become well acquainted with Stanley W. Carr, who is also an appellant from assessment to income tax for his 1961 taxation year arising from the same transaction as gives rise to the present appeal. Mr. Carr had been the employee of a firm of financial agents and as such had been engaged in placing mortgage monies on behalf of his employer. In this capacity, Mr. Carr first became acquainted with the appellant and their business relationship ripened into a personal friendship.

In the fall of 1958 it came to the appellant's attention that a parcel of land in the City of Toronto, municipally known as 151 St. George Street, was for sale at a price of $73,000. This particular parcel had a frontage of 57 feet, 5 inches and the parcel immediately adjacent to the north had a frontage of 56 feet, 7 inches, while the property immediately adjacent to the south had a frontage of 57 feet. The remainder of the block was taken up by two apartment buildings.

The municipal by-law in effect at that time and to which the property was subject permitted the construction of an apartment building with a floor area three and one-half times the lot area with side yards of no less than 10 feet.

Such by-law would permit of the erection of an apartment building containing 48 suites. The owners of the site, upon which there was an old house of substantial size, had made an application for and had been granted a building permit for such a building by the Municipal authority.

It became known to the appellant that no further building permits of this nature were available from the City of Toronto with respect to the immediate area because of the prospective enactment of a further zoning by-law prohibiting the erection of any building on a lot having a front lot line of less than 90 feet, any part of which would be within 15 feet of the side lot lines and further that the floor area should not exceed two times the lot area. A by-law to this effect, being by-law No. 20623 was in fact given first reading by the City of Toronto on April 13, 1959 and was subsequently approved by the Ontario Municipal Board on June 29, 1959 thereby coming into force.

The appellant also ascertained that the building permit obtained by the then owners of the site prior to the end of the 1958 calendar year would be available to a purchaser, as would other permits which might have been similarly obtained with respect to other sites in the area. The appellant investigated further and found that no applications for building permits had been made with respect to the lots immediately adjacent to 151 St. George Street to the north and south, which for purposes of convenience will hereinafter be referred to as 149 and 153 St. George Street. The appellant therefore concluded that an apartment could be erected on 151 St. George Street and that the likelihood of competitive buildings being erected on 149 and 153 St. George Street was remote because the restrictive terms of by-law No. 20623 would render such projects economically unfeasible.

The appellant thereupon telephoned his friend Stanley Carr, who was likewise impressed with the prospect of an apartment building on 151 St. George Street and readily agreed to the suggestion of the appellant that they should purchase the site and build an apartment house thereon. The arrangement between them was that the appellant, because of his building experience, should undertake the detailed supervision of the acquisition of the site, the erection of the building and subsequent to its completion

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the management and operation thereof. Carr, for his part, would supply the necessary funds from his personal resources and arrange mortgage financing and the like since that was where his experience lay. However, because of the possible implication of Carr entering into competition with clients of the firm of financial agents by whom he was employed, it was arranged that he should otherwise be inactive in the matter and that the appellant should assume the active and dominant role in all negotiations.

Accordingly on September 17, 1958 an agreement for the purchase of the land was entered into, in trust for a company to be formed, at a price of $73,000 which funds were provided jointly on behalf of the proposed company by the appellant from the proceeds of the sale of his construction business and by Carr from his personal savings.

By Letters Patent dated December 23, 1958 a company was incorporated under the name of 151 St. George Street Limited and in accordance with the terms of purchase the land was registered in the name of the company.

All of the issued shares in the capital stock of the company were issued to the appellant and Carr in equal proportions.

On December 23, 1958 a building permit was granted to the company to excavate and build foundations. On May 3, 1959 a further building permit was issued to the company to erect a 48 suite apartment building on that site. The appellant in his testimony, described these permits as renewals of the previously issued permits although on their faces they are originals.

Demolition of the previously existing building on the site was begun on December 1, 1958. The apartment building was completed in December 1959 but had been fully leased and occupied in September 1959.

Interim financing of the construction of the building was by means of a bank loan of $75,000. A mortgage loan of $315,000 was obtained by the company from London Life Insurance Company out of which the bank loan was repaid and construction costs paid. Prior to this mortgage having been obtained, a mortgage commitment had been received from Investors Syndicate for a sum of $300,000. The total cost of the building and land was $436,396.74. The difference was made up from capital of the company and advances by

the appellant and Carr with Carr putting up the greater amount.

In February or March of 1959, prior to the completion of this apartment at 151 St. George Street, the appellant and Carr became aware, through the architect employed by them, that other clients of that architect were desirous of building apartments at 153 and 149 St. George Street and to do so would make application to amend zoning by-law No. 20623 so as to restore the restriction of 10 foot side yards and a floor area of $3\frac{1}{2}$ times the lot area rather than the restriction of 15 foot side yards and a floor area of two times the lot area as provided in by-law No. 20623.

On learning of the possibility of a change in the zoning by-law affecting 149 and 153 St. George Street the appellant approached the owners of 149 St. George Street forthwith to ascertain if they would be willing to sell, which they were. Accordingly the appellant and Carr, as trustees, on April 20, 1959, executed an offer to purchase (which was accepted) 149 St. George Street for $85,000, paying a deposit of $500, with $28,500 to be paid upon closing and a first mortgage back to the vendors for the balance. The offer contained a provision that an existing building could be demolished and that if a building permit for an apartment was not forthcoming then the appellant and Carr might terminate the contract if they wished.

Similarly the owners of 153 St. George Street were approached and an offer to purchase that property was executed on July 9, 1959 by the appellant and Carr as trustees, which offer was also accepted, also at a price of $85,000 payable by a deposit of $1,000, $10,000 on closing and a first mortgage back to the vendors for the balance of $74,000. This offer was subject to the same conditions respecting the acquisition of a building permit as was the offer to purchase 149 St. George Street.

On July 17, 1959 a document was executed by the appellant and Carr acknowledging that 153 St. George Street was held by them in trust for Samuel Roy, a builder, and that 149 St. George Street was held in trust for a limited company to be formed in which the appellant and Carr were to be the only shareholders.

Subsequently the beneficiary of the trust respecting 149 St. George Street was changed to become the wives of the

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appellant and Carr who purchased the property with their own funds and from the proceeds of a loan arranged for them by Carr. This property was sold subsequently by the wives at a profit upon which income tax was levied and paid.

The appellant and Carr then became the initiators of an active and persistent campaign to have by-law No. 20623 amended as it affected 149 and 153 St. George Street. This campaign was begun by a letter dated December 4, 1959 to the Department of Buildings and Development of the City of Toronto from the architect employed by the appellant and Carr for building permits for two buildings similar to that on 151 St. George Street and with dimensions identical thereto to be erected on 149 and 153 St. George Street.

By a report to the Committee on Buildings and Development, dated February 2, 1960, the Commissioner of Planning recommended against the requested exemption from the residential standards of by-law No. 20623 being granted. A similar recommendation dated February 11, 1960 was made by the City Solicitor and the Commissioner to the Committee.

The Committee, after a meeting held on March 2, 1960, at which the architect appeared in support of his application, recommended to City Council that the zoning by-law be amended to permit of the erection of the proposed apartments on 149 and 153 St. George Street. City Council called for a poll of the owners of property in the area which resulted in 24 being in favour, 8 opposed, 12 did not reply and 2 were disinterested. (It is obvious that the appellant and Carr were in favour of the amendment). City Council thereupon enacted by-law No. 20995 on May 24, 1960 amending by-law No. 20623 to permit the erection on 149 and 153 St. George Street of apartment houses having lesser side yards, and greater floor space area than prescribed in by-law No. 20623.

However, the approval of the Ontario Municipal Board was a condition to by-law No. 20995 coming into force.

The appellant and Carr next retained counsel to obtain an early appointment before the Board and to represent them at that hearing. By its decision dated July 25, 1960, the Ontario Municipal Board approved the by-law stating that, in its opinion, the erection of the proposed apartments would not harmfully affect the proper enjoyment of the

adjoining lands for their present uses and that an undue hardship would be inflicted upon the owners of 149 and 153 St. George Street if the by-law were not approved.

By an agreement between Samuel Roy (the beneficiary of the trust respecting 153 St. George Street) and the appellant and Carr entered into on an unspecified day in May 1960, Roy agreed to pay the appellant and Carr $10,000 for their services in keeping the contract for the purchase of 153 St. George Street alive, by arranging numerous extensions, and for obtaining the amendment to the zoning by-law. It was subsequently agreed between Carr and the appellant that the appellant should retain the $10,000 so paid by Roy since the appellant had conducted the bulk of the negotiations.

Immediately upon the completion of the construction of the apartment building on 151 St. George Street, the appellant and Carr began assembling other property on St. George Street for the purpose of erecting a larger apartment building thereon.

On December 28, 1959, the appellant, as trustee for the company to be incorporated, made an offer to purchase property known municipally as 268 St. George Street for $45,000. A deposit of $500 was made, $14,500 was to be paid on closing with a first mortgage back to the vendor for the balance of $30,000. It was also agreed that upon payment of $10,000 on account of principal the existing building on the lot could be demolished. The offer was conditional upon a building permit for the erection of an apartment being obtained. This offer was accepted by the owner.

On January 26, 1960 an offer was also made to purchase numbers 274, 276 and 278 St. George Street for a price of $137,500, which offer was accepted. A deposit of $5,000 was paid, $30,000 was to be paid on closing, an existing mortgage would be assumed and a mortgage for the balance would be given back to the vendor. This offer was also conditional upon the purchaser being able to obtain a building permit to erect an apartment before the closing date.

Extensions to both these offers were from time to time requested by the appellant and Carr and were granted, subject to the terms of payment of additional amounts.

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During the course of the construction of the apartment building at 151 St. George Street, the appellant was approached by a real estate agent with an offer to purchase the building on behalf of Venezuelan interests which offer the appellant, after consultation with Carr, refused.

Early in 1960 a listing was given to a real estate agent named Tasse to sell the apartment at 151 St. George Street. The appellant also advised at least eight real estate agents that the property was for sale and supplied them with an estimate of income and expenditure.

On September 27, 1960, the Company, 151 St. George Street Limited accepted an offer to purchase 151 St. George Street at a price of $440,000 which exceeded the cost of the land and building by a very small amount. It was a condition of the offer that the transaction be closed by October 31, 1960.

On October 14, 1960 the Company, the appellant and Carr received an offer from Judges Landreville and Cooper for the property at 151 St. George Street at a price of $480,000 which represented a profit of approximately $40,000. This offer was accepted on behalf of the Company subject to the condition of the prior offer of September 27, 1960 not being perfected by October 31, 1960. In the opinion of the appellant and Carr the prior offer was not perfected prior to October 31, 1960 and accordingly the offer of October 14, 1960 was accepted without qualification on October 31, 1960.

By an agreement dated October 31, 1960 between Judges Landreville and Cooper of the one part and the Company, the appellant and Carr of the other part, it was provided that rather than the real estate being sold to them, they would purchase all outstanding shares in 151 St. George Street Limited, the beneficial owners of all such shares being the appellant and Carr for the like sum of $480,000.

The offeror of the offer dated September 27, 1960 began litigation which was settled so the actual sale of the shares was delayed until 1961. The profit from this sale of shares is the subject matter of the appellant's assessment to income tax for 1961 from which the present appeal is taken.

Immediately following the sale of the shares in 151 St. George Street Limited the appellant and Carr erected an

apartment building at 268, 274, 276 and 278 St. George Street through the interposition of a joint stock company named 276 St. George Street Limited in which the appellant and Carr were the only shareholders and apartment buildings were erected on 149 and 153 St. George Street by persons other than the appellant and Carr.

The appellant's case is set out in his Notice of Appeal as follows:

At no relevant time has the appellant purchased and sold real estate for the purpose of earning income and at no time has the Appellant dealt or traded in shares of the capital stock of corporations as a business.

The relevant facts indicate that the sale of the shares of 151 St. George Street Ltd. by the Appellant did not constitute a sale of inventory but rather a forced realization of a capital investment in order that it might be preserved intact and so that the proceeds of sale could thereupon be reinvested in like security in 276 St. George Street Ltd. from which company the Appellant receives and enjoys investment income properly subject to income tax.

The Minister has accordingly erred in assessing the Appellant to tax on the fortuitous gain received by him in 1961 on the sale of shares of 151 St. George Street Ltd. within the meaning of Sections 3, 4, and 139(1)(*e*) of the Income Tax Act.

In answer to the foregoing the Minister contends:

That the acquisition by the Appellant and the said Stanley Carr of a certain parcel of real property known as 151 St. George Street, in the City of Toronto, and its realization in the form of shares of capital stock of a company known as 151 St. George Street Ltd, together with a further realization of the shares of such company at a profit to the Appellant of $18,440.73 is income from a business within the meaning of the word as defined in the Income Tax Act.

The question for determination is whether the profit realized on the sale of the shares of 151 St. George Street Limited constituted a profit realized from a venture that commenced with the acquisition of the real property known as 151 St. George Street and was, therefore, a profit from a business within the meaning of sections 3 and 4 of the *Income Tax Act* and the extended meaning of "business" as defined by section 139(1)(*e*) to include an adventure or concern in the nature of trade or, as contended by the appellant, the land was acquired and the apartment house built thereon exclusively as an investment for the purpose of receiving rental income therefrom and that the disposition thereof, through the sale of shares constituted the realization of a capital asset.

In my view, the fact that the profit was made by the appellant and Carr from the sale of the shares in the

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Company and not from the sale of the real property, is immaterial. The original offer from Judges Landreville and Cooper, which the appellant and Carr conditionally accepted, as the only shareholders and officers of the company, was for the acquisition of the real property from the Company. The offerors subsequently suggested that the shares of the Company be purchased rather than the real property to obviate the necessity of the incorporation of a further company to hold the property to be purchased, to which arrangement the appellant and Carr readily agreed. They had decided that the real property should be sold by the Company. Without it, the Company was of no further use to them. While they were not the initiators of the proposal they concurred in it so this was, therefore, merely an alternative method that the appellant and Carr adopted to complete the venture commencing with the acquisition of the real property. See *R. K. Fraser v. M.N.R.*[1] per Cameron J. at page 345 *et seq.* and in the Supreme Court of Canada[2] at page 376.

On behalf of the appellant it was stressed that the site at 151 St. George Street was possessed of such unique attributes as would ensure the success of the project. However, the owners of 149 and 153 St. George Street were both willing to sell prior to December 1958, the deadline date after which building permits for apartments would not be granted. While it is true that the then owners had not applied for building permits, either for themselves nor on account of any other persons, there was a three month period during which building permits might have been granted with respect to numbers 149 and 153 if they had been applied for. Therefore, the unique characteristic of 151 St. George Street, upon which the appellant and Carr rely as indicative of their intention to retain that site with an apartment constructed thereon as an income producing capital asset, did not exist on September 17, 1958, the date of their acquisition of the property and did not arise until December 31, 1958. The construction of the apartment had been begun prior to the date when this unique quality became a certainty.

[1] [1963] Ex. C.R. 334. [2] [1964] C.T.C. 372.

Further this unique quality did not persist for any length of time. In February 1959, two months after it was a certainty that permits would not be issued for buildings on the adjoining lots, the appellant and Carr learned that there was a possibility of a change in zoning regulations to permit of the construction of apartments on 149 and 153 St. George Street. The appellant and Carr testified that such apartments, twenty feet from their building, would depress the rents that they could demand and thereby lessen their estimated returns.

However, it should be borne in mind that in the block there were already two apartments on the other sides respectively of 149 and 153 St. George Street. It was represented to the Ontario Municipal Board, on behalf of the appellant and Carr, that the continued existence of the old houses on 149 and 153 St. George Street, one of which was operated as a rooming house, constituted an eyesore and that their removal would improve the area. The Board, upon the evidence adduced before them, concluded that the erection of apartments on 149 and 153 St. George Street would not harmfully affect the proper enjoyment of adjoining lands for their present uses, that is to say, that the apartment on 151 St. George Street would not be harmfully affected. Therefore, it is difficult to conclude that the appellant and Carr seriously felt that the erection of apartments in close proximity on both sides of their apartment would effectively destroy it as a source of investment income, or so drastically reduce that income as to render its immediate disposal a necessity.

On learning of the possible amendment of the zoning regulations the appellant and Carr testified that they were faced with the following decisions:

(1) to oppose the by-law;

(2) to acquire 149 and 153 St. George Street and retain those lots as vacant land; or

(3) to acquire effective control of the adjoining lots, press for the amendment of the zoning by-law to permit the erection of apartments thereon and before any such

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apartments were erected thereon, dispose of 151 St. George Street.

The appellant and Carr adopted the third course.

Since they did not embark upon the first course, I can only conclude that they must have felt that there was small chance of its success. On the other hand, if they felt there was a prospect of the by-law being successfully opposed, their failure to follow that course rebuts the allegation that 151 St. George Street was possessed of an unique characteristic.

The second course was never seriously considered by them because it was beyond their financial means to do so and in any event the additional expenditure of $170,000 would make the project economically unsound.

In pursuance of the third course, the appellant and Carr made offers to purchase 149 and 153 St. George Street. While they never became the beneficial owners, nevertheless they realized a profit of $10,000 for their efforts on behalf of the beneficiary, Roy, a builder, by keeping the contract alive and pressing for the amendment of the by-law. With respect to 149 St. George Street they afforded their wives the opportunity of making a profit on the sale of that property.

The appellant and Carr both testified that if the by-law were not amended they would have retained 151 St. George Street. This I do not follow. When they committed themselves to their third course of action, by offering to purchase the adjoining properties from which purchases profits were eventually realized, they were irretrievably committed to the sale of 151 St. George Street.

Neither do I follow the suggestion of the appellant and Carr that by controlling 149 and 153 St. George Street, after the amendment of the zoning by-law, and thereby preventing the building of apartments thereon, which could otherwise be built, before the sale of 151 St. George Street would result in a higher price therefor. A prudent purchaser would carefully investigate the surrounding circumstances before buying and the means of such an investigation would be as readily available to any purchaser as originally to the appellant.

Furthermore at this time, they also had made offers to purchase the lands at 268 to 278 St. George Street. They had made substantial commitments of their resources and 151 St. George Street had to be sacrificed to the larger and better apartment project at 268 to 278 St. George Street.

The first offer accepted relieved the appellant and Carr from their undertaking at 151 St. George Street without loss, but with no substantial gain, with which they were content, but they were much more content to accept the second offer whereby a greater profit was realized.

Added to this is the fact that the construction cost of the apartment at 151 St. George Street exceeded their estimate. The appellant and Carr testified that the excess cost was incurred by reason of the use of superior materials. This factor was put forward as indicating their intention to retain the apartment as an investment. However, Carr testified that the excess cost resulted from the use of materials to enhance the external appearance of the building. During construction a dispute arose over the design of the structural steel. The engineer who drafted the original plans had over-designed the structural steel, in the opinion of the appellant and Carr and another engineer whom they consulted. This increased the cost. A compromise was arrived at whereby the cost of the steel was reduced. The concentration of the additional cost on external appearances is more consistent, to me, with an intention to sell the building, than its retention.

I am, therefore, convinced that the moment the appellant and Carr decided to campaign for a change in the amending by-law, they had resolved to sell the building, that is to say, in April 1959 about four months after the building was completed.

But this does not resolve the issue.

The narrow question is whether, when the appellant and Carr acquired 151 St. George Street on September 17, 1958, it was their exclusive purpose to construct an apartment house to derive rental income therefrom, or whether that was not their exclusive purpose at the time when the

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enterprise was begun, but that they also entertained as one of their possible purposes the sale of the building.

If the first alternative were the case, then the profit from the eventual sale would not be taxable, but if the second alternative were the case, then the resultant profit is clearly taxable.

The onus of disproving the Minister's assumption that the latter was the case when assessing the appellant as he did, falls on the appellant.

The question of fact as to what was the purpose of the appellant and Carr in acquiring this property is one that must be decided after considering all the evidence. The appellant's statement at the trial, which was reiterated by Carr, that their intention was to construct and operate an apartment building for the rental income therefrom, is only part of the evidence and while it may have been given in all sincerity it still may not reflect the true purpose at the time of acquisition.

The appellant was experienced in the field of speculative building and Carr had abundant experience in a closely allied field. Therefore they could not have been oblivious to the eventualities which did in fact happen and, in my view, it must be inferred that they foresaw and planned for the alternative course of selling 151 St. George Street from the outset.

After having given careful consideration to all the evidence I am not satisfied that it can be said the Minister was not warranted in assessing the appellant as he did.

The appeal is, therefore, dismissed with costs.