BETWEEN:

WATSON & McLEOD LTD. ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .. . . RESPONDENT.

Calgary 1966 Jan. 26-28

Ottawa Feb. 14

Income tax—Income or capital—Company in gravel business—Purchase of land in hope of finding sand—Subsequent sale of land—Whether realization of capital asset—Grant of exclusive contract to remove gravel—Whether payment therefor of revenue nature.

Appellant company, which had three equal shareholders, carried on business in Calgary of selling gravel from land which it held under a lease expiring on June 30th 1965.

In January 1958 W, one of appellant's shareholders, made a deal to buy for appellant a 38 4 acre farm near Calgary for $40,000 in the belief (based on an excavation he had made on adjoining property in 1945) that it might contain sand, which appellant's shareholders had been seeking with a view to setting up a concrete operation. The farm was then under lease at $30 a month. The terms of sale provided for payment of $20,000 down and $20,000 on March 1st 1960 with interest at 6% per annum, and that the vendor should retain possession until September 30th 1958 There was no suburban development nor any municipal services near the land, but it was close to rapidly developing Calgary and near a proposed site for a university. Tests conducted shortly afterwards showed that the sand on the land was not commercially useful for mixing concrete, and appellant did nothing with the land until December 1960 when it sold it for $115,200, i.e at a profit of $75,200.

On February 28th 1959 appellant contracted to sell gravel to S Co for the duration of its lease at a fixed price per yard and, in addition, a payment of $60,000 (payable in 6 annual instalments of $10,000) for the exclusive access to the property (subject to appellant's right to remove gravel for development purposes conducted by itself or by another specified company) It was a condition of the contract that appellant should obtain and maintain all necessary permits for S Co, and in connection therewith appellant was obliged to make an engineering survey of the land and undertook to level and seed worked out areas.

Held, appellant was assessable to income tax in respect of both matters

(1) The highly speculative value of the farm and the fact that appellant dealt with it as a speculative dealer would have dealt with it pointed to the conclusion that the $75,200 profit made on the sale of the farm arose from a venture in the nature of trade rather than from the realization of an investment *Irrigation Industries Ltd. v M.N.R.* [1962] S C R 346 at 360, *M N R v Taylor* [1956] C T C. 189, applied.

(2) The contract by which S Co obtained an exclusive right with respect to the removal of gravel was simply a commercial contract made by appellant in the course of carrying on its trade of selling gravel and the $10,000 instalment received therefor in the taxation year was accordingly a revenue and not a capital receipt *Van Den Berghs Ltd.*

1966

WATSON & MCLEOD LTD. v. M.N.R.

v. Clark [1935] A C 431 per Lord Macmillan at p. 440 distinguished and applied.

APPEAL from a decision of the Tax Appeal Board.

R. A. F. Montgomery for appellant.

T. E. Jackson and *S. A. Hynes* for respondent.

THURLOW J.:—This is an appeal from a judgment of the Tax Appeal Board[1] which dismissed the appellant's appeal from a reassessment of income tax for the year 1961. There are two matters in issue. The first is whether a profit of $75,200 which the appellant realized on the sale of a parcel of land is income within the meaning of the statute. The other, which was not raised in the appeal before the Board, is whether an instalment of $10,000 received by the appellant on account of a larger amount of $60,000 payable to it by Standard Gravel and Surfacing of Canada Limited for an exclusive right to remove gravel from certain premises is income within the meaning of the statute. The Minister added to the income declared by the appellant both the $75,200 and the $10,000 and, after allowing a reserve pursuant to s. 85B(1)(*d*) of the Act in respect of the unpaid portion of the $75,200, assessed tax accordingly.

The appellant was incorporated in June 1955 and since then has been owned and controlled by three shareholders each holding a one-third interest. The first of these, Victor Watson, is a farmer and contractor who engages in contracts for road and irrigation work. The second is John C. McLeod, the secretary and a twenty-five per cent shareholder of Spyhill Development and Holding Co. Ltd., a company engaged in land development in the City of Calgary and particularly in the north-western portion thereof where an area known as Spyhill is located. The third is Frank Reid, a farmer, who was one of three owners of a half section of land, known as the Frey property situated near the northern boundary of the City of Calgary not far from the Calgary International Airport. Early in 1955 Watson made a verbal deal with Reid under which Watson obtained the exclusive right for ten years to take gravel and sand from this property at a set price per yard with a minimum payment of $600 per year for the ten year period. Having made the deal Watson invited McLeod to take an

[1] (1963-64) 34 Tax A.B.C 426.

interest in the contract and the appellant company was then formed with broadly expressed objects including investing in, developing and improving land, and constructing buildings thereon, buying, selling and dealing in, *inter alia*, gravel and sand and acquiring, holding or otherwise dealing in real and personal property and rights. The three persons mentioned became the shareholders and directors of the company and the company proceeded to engage in and work up a business of supplying gravel to the public in general but more particularly to persons engaged in land development including the Spyhill Development & Holding Co. Ltd. As the digging, crushing, loading and hauling were done either by the purchasers or by a contractor the appellant required no employees and maintained no business office.

In January 1956 the agreement with the owners of the land was reduced to writing by a letter addressed by them to the appellant and acknowledged by the latter. It provided for payment for gravel at the rate of $7\frac{1}{2}¢$ per yard and for sand at the rate of $20¢$ per yard with, as previously mentioned, a minimum annual payment of $600 and fixed June 30th, 1965 as the date of termination of the right thereby granted. The property contained an estimated $2\frac{1}{4}$ million yards of gravel but little or no sand in commercial quantity.

In the following year the three shareholders of the appellant company began looking for a practical and economical source of sand for the purpose of supplying materials for a pre-mix concrete operation which several small contractors had suggested could be set up and operated from the Frey property if a supply of suitable sand could be obtained. For this purpose tests were made on a number of prospective sites during the summer of 1957 but these either were not available or the sand was not of satisfactory quality.

On or about February 12th, 1958 Mr. Watson contacted a man named Johnson and on behalf of the appellant offered him $800 an acre for a property consisting of some 38.4 acres of agricultural land with a small house and some other buildings thereon. Johnson was interested but required a week to think the matter over at the end of which time he put a firm price of $40,000 on his property. Watson agreed to buy at that price and thereupon paid a deposit of

1966

WATSON & McLEOD LTD. v. M.N.R.

Thurlow J.

$5,000 to bind the bargain. Subsequently on February 28th, 1958 an agreement of sale of the property was executed by Johnson and the appellant providing for payment of $40,000 for the property by payment of $20,000 on execution and a further payment of $20,000 on March 1st, 1960 with interest at six per cent thereon payable yearly. The property was at that time let to a tenant who paid some $30 a month rent and the agreement provided that the vendor should retain all benefits under the lease until September 30th, 1958 from which date the appellant should have the right to possession and should be responsible for the outgoings.

At the time of the purchase there was no suburban development of the city within half a mile of the property, most of the property was higher than the existing water supply installation could serve and there were no sewers or other municipal services immediately available or likely to be available to serve a development of the property for several years. On the other hand the land was in a highly speculative area. The development of the City of Calgary was proceeding at a fast pace, and there had been publicity respecting proposed development of land half a mile to the southward as a site for a university. The land also adjoined the western boundary of land belonging to and held by the Spyhill Development & Holding Co. Ltd. for the purpose of developing it. The speculative character of the property also appears both from comparison of the price paid with the rental revenue obtainable, and from the conduct of the parties in negotiating the price.

According to Mr. Watson his purpose in buying the Johnson property was to acquire a sand pit and he had no other purpose. In 1945 in the course of making an excavation on an adjoining property he had cut through twelve to fifteen feet of sand which suggested to him that there would be sand on this property as well. He did not want the vendor to know that he hoped to find usable sand on the property and he therefore bought it for the appellant and paid the deposit without making tests to ascertain the quantity or the quality of sand that might be present in the property. He did so as well without consulting either of his associates with respect either to their knowledge of the presence of sand on the property or their views as to the price to be paid.

1966

WATSON & MCLEOD LTD. v. M.N.R.

Thurlow J.

In April or May of the same year tests were conducted on the property and it was found that while sand was present it was not useful for making concrete without processing to remove clay therefrom. As this would not have been economical the appellant had no use for the property in its business and but for some small amounts of rental received from a tenant, who seems to have been put in possession by the appellant largely as a caretaker, derived no revenue therefrom during the time it was held. According to Mr. Watson most of the time land in the area was selling for $500 an acre and the shareholders were hoping to get their $1,000 or thereabout an acre back. Just when the purchase was ultimately completed does not appear but presumably it was completed on or about March 1st, 1960.

In the meantime on February 28th, 1959 the appellant had entered into an agreement with Standard Gravel and Surfacing of Canada Limited with respect to the gravel on the Frey property. Standard was a customer who had bought gravel from the appellant and at that time was interested in bidding for two contracts for works at the airport which would require a large quantity of gravel. That company accordingly bargained with the appellant both for a set price for gravel which they might require and for a right which would enable it to deny its competitors the opportunity to count on purchasing gravel from the property. The agreement, after reciting the exclusive right of the appellant to remove sand and gravel from the land until June 30th, 1965, provided that Standard might take gravel from the property during the remainder of the appellant's term at ten cents per ton, and sand at twenty cents per ton, and that Standard might set up such plant and other installations as its operation might require. In turn it undertook to remove the same upon termination of the agreement and to leave the parts of the property on which it had worked clear of debris and in a neat and tidy condition. The agreement further provided that Standard should have "the exclusive right of access and egress to and from and of occupation of the land for the purpose of any and all of its operations" in respect to removing gravel from the land, provided however, that the appellant should have the right to remove gravel required for subdivision development work conducted by the appellant itself or by

1966

WATSON & MCLEOD LTD. v. M.N.R.

Thurlow J.

Spyhill Development and Holding Co. Ltd. The appellant's existing stockpile of crushed gravel was also excepted from the terms of the agreement. In consideration of the exclusive rights so granted to it Standard agreed to pay, in addition to the price already mentioned for sand or gravel removed by it, the sum of $60,000 in six annual payments of $10,000 each commencing on March 1st, 1959. The appellant undertook to make efforts at its own expense to obtain and maintain such permits as might be necessary to entitle Standard to carry on its activities on the land and it was provided that if the permit for Standard to commence its activities was not obtained the initial $10,000 payment should be returned and that if any permit expiring during the term should not be renewed immediately the agreement should become void and a proportionate part of the $10,000 paid in respect of the year in which the agreement terminated should be repaid to Standard. The obtaining of these permits involved the making of an engineering study as to the contours of the land before and after the operation and an undertaking by the appellant to level and seed worked out areas.

Standard obtained the airport construction contracts in which it was interested and in the years 1960 to 1964 inclusive paid the appellant sums totaling $123,415.76 for gravel removed from the property. That these sums were revenue receipts in the appellant's hands is not in dispute. But in the 1961 taxation year to which this appeal relates the appellant also received one of the $10,000 payments under the contract which, as previously mentioned, the Minister included in his computation of the appellant's income for the year.

In the latter part of 1960 the appellant accepted an offer from the Spyhill Development and Holding Co. Ltd. for the Johnson property and by an agreement dated December 1st, 1960 sold it for $115,200. By that time, water service had become available to part of the property, contracts had been let for the construction of buildings on the university property half a mile to the southward and the city had revised its plans for providing services in the area and in particular had advanced its plans for a water system to supply the area. A water supply in fact became available for the whole of the property in the following year. The appellant thus realized a profit of $75,200 on the sale of the

1966

WATSON & MCLEOD LTD. v. M.N.R.

Thurlow J.

property and the nature of this profit for the purposes of the *Income Tax Act* is the other matter in issue in the appeal.

It will be convenient to deal with this issue first. The question to be determined is whether the $75,200 profit realized on the sale of the property was profit from a business within the meaning of that term which, as defined in s. 139(1)(*e*) of the *Income Tax Act*, includes a "venture or concern in the nature of trade". The Minister's position is that the profit in question was profit realized by the appellant in the course of carrying on its business or alternatively was profit from a venture in the nature of trade. The appellant's position is that the profit arose neither from its business nor from a venture in the nature of trade but from a mere realization of a capital asset.

The case is perhaps a close one, with some features tending to support the appellant's submission and others pointing to the opposite result but on balance I have come to the conclusion that the profit in question arose from a venture in the nature of trade. I observed nothing in the demeanour of Mr. Watson which would cause me to discredit his evidence that his purpose in purchasing the property was to acquire a source of sand but the determination of cases of this kind depends on the particular facts[1] and there are features of the present situation which appear to me to stand out above the others and to point to the conclusion which I have reached.

First the property at and from the time of its purchase by the appellant was a highly speculative one. Land may, of course, be useful for a great variety of purposes and have value accordingly depending on its location and other characteristics. But at the price of $40,000, which Mr. Johnson put upon it, this property plainly had value in excess of what it was worth for the agricultural purposes for which it was let at $360 or thereabouts per year. It might also have had value to the appellant for the sand on it, had there been any there, but that was undetermined and the possibility was not made known to the vendor. Yet he held out for $40,000. He did so in my opinion because he knew the property had value arising from its location not far from

[1] *Vide* Cartwright J. in *Irrigation Industries Ltd. v. M.N.R.* [1962] S.C.R. 346 at 360 where the principles expounded by Thorson P. in *M.N.R. v. Taylor* [1956] C.T.C. 189 are summarized.

1966

WATSON & McLEOD LTD. v. M.N R.

Thurlow J.

the suburban residential development of a rapidly growing city. The property was also no mere building lot but a substantial area of land which could be expected to become ripe for subdivision and development within the space of a few years. The nature and quantity of this land, the subject matter of this venture, thus, while not necessarily such as to "exclude the possibility that its subsequent sale by the appellant was the realization of an investment, or otherwise of a capital nature, or that it could have been disposed of otherwise than as a trade transaction"[1] is, I think, at least strongly suggestive that its sale was not the realization of an investment but a disposal as a trade transaction.

Secondly, the property appears to me to have been dealt with as a speculative dealer in land might have been expected to deal with it. It was bought for $40,000 with a down payment of half the amount and with completion of the transaction deferred for two years. Despite the interest which would accrue from the time of the making of the agreement possession was not to be assumed for seven months. These were spring and summer months. Yet so far as appears the appellant obtained no right to remove sand from the property in the meantime, and apart from the making of some tests for sand, the property from the time of its purchase was simply held until it was ripe for disposal to a development company at a substantial profit and thereupon disposed of accordingly. And this occurred within a year after the final payment fell due.

On both of the two positive tests propounded by Thorson P. in *M.N.R. v. Taylor*[2] the balance thus favours the conclusion that this was a venture in the nature of trade.

Nor do I see in the evidence, when read as a whole, anything which outweighs these considerations. The evidence of Mr. Watson's intention indicates that he hoped and thought, perhaps optimistically, that usable sand would be found on the property and that had usable sand been found it would have been turned to account by using the sand in the appellant's business. This, however, was only a possibility. Apart from it he had no intention or

[1] *Vide Irrigation Industries Limited v. M.N.R.* [1962] S.C.R. 346 where at 352 Martland J. treated the land involved in *Regal Heights Ltd. v. M.N.R.* [1960] S.C.R. 902 as a subject matter to which this principle applied.

[2] [1956] C.T.C. 189.

purpose for the property and in the circumstances disclosed by the evidence I do not think it can be said either that his intention was exclusively to acquire the property as an item of capital or that the purchase itself was exclusively an acquisition of the property for use as a capital asset in the business or to hold as an income yielding investment.

Accordingly I am of the opinion that the profit in question was properly taken into account in computing the appellant's income for tax purposes and the appeal on this issue therefore fails.

This brings me to the other issue in the appeal, that is to say, whether the payment of $10,000 received from Standard on account of the $60,000 payable in respect of the exclusive right granted to it was of a revenue nature and thus properly included in the computation of the appellant's income.

In considering this problem the distinction to be applied in my opinion is that stated in *Van Den Berghs, Limited v. Clark*[1] where after referring to *British Insulated and Helsby Cables, Ltd. v. Atherton*[2] and citing the principle there stated by Viscount Cave, Lord Macmillan said at page 440:

> My Lords, if the numerous decisions are examined and classified, they will be found to exhibit a satisfactory measure of consistency with Lord Cave's principle of discrimination. Certain of them relate to excess profits duty and not to income tax, but for the present purpose this distinction is immaterial. A sum provided to establish a pension fund for employees, as has already been seen, is a capital disbursement: *British Insulated and Helsby Cables, Ld. v Atherton* [1926] A C 205; so is a sum paid by a coal merchant for the acquisition of the right to a number of current contracts to supply coal: *John Smith & Son v. Moore* [1921] 2 A C 13; so is a payment by a colliery company as the price of being allowed to surrender unprofitable seams included in its leasehold: *Mallett v. Staveley Coal & Iron Co.* [1928] 2 K B 405 Similarly a sum received by a fireclay company as compensation for leaving unworked the fireclay under a railway was held to be a capital receipt: *Glenboig Union Fireclay Co. v. Commissioners of Inland Revenue* [1922] S C (H L) 112
>
> On the other hand, a sum awarded by the War Compensation Court to a company carrying on the business of brewers and wine and spirit merchants in respect of the compulsory taking over of its stock of rum by the Admiralty was held to be a trade or income receipt: *Commissioners of Inland Revenue v Newcastle Breweries, Ld.* (1927) 12 Tax Cas. 927: so was a sum paid to a shipbuilding company for the cancellation of a contract to build a ship: *Short Brothers, Ld. v. Commissioners of Inland Revenue* (1927) 12 Tax Cas 955; so was a lump sum payment received by a quarry company in lieu of four

[1] [1935] A C. 431 [2] [1926] A.C. 205.

1966
McLEOD LTD.
v.
WATSON & M.N.R.
Thurlow J.

annual payments in consideration of which the company had relieved a customer of his contract to purchase a quantity of chalk yearly for ten years and build a wharf at which it could be loaded: *Commissioners of Inland Revenue v. Northfleet Coal and Ballast Co.* (1927) 12 Tax Cas. 1102; so was a sum recovered from insurers by a timber company in respect of the destruction by fire of their stock of timber: *J. Gluksten & Son v. Green* [1929] A.C 381. Conversely, where a company paid a sum as the price of getting rid of a life director, whose presence on the board was regarded as detrimental to the profitable conduct of the company's business, the payment was held to be an income disbursement: *Mitchell v. R. W. Noble, Ld.* [1927] 1 K.B. 719; so was the payment made in the case of the *Anglo-Persian Oil Co. v. Dale* [1932] 1 K B. 124 in order to disembarrass the company of an onerous agency agreement. There are further instances in the reports, but I have quoted enough for the purposes of illustration.

Lord Macmillan then discussed the facts of the case before the House and in doing so said at page 441:

> It is important to bear in mind at the outset that the trade of the appellants is to manufacture and deal in margarine, for the nature of a receipt may vary according to the nature of the trade in connection with which it arises. The price of the sale of a factory is ordinarily a capital receipt, but it may be an income receipt in the case of a person whose business it is to buy and sell factories.

and at page 442:

> 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 organization 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 the present case the trade or business of the appellant was to deal in gravel, of which a large quantity, consisting

1966

WATSON & MCLEOD LTD. v. M.N.R.

Thurlow J.

of the whole of the gravel on the Frey property, was available to it at a fixed price per yard. Standard was not a competitor but was the appellant's customer and was interested in obtaining a set price for the gravel it might require and a right to acquire the bulk of the gravel which the appellant had the right to sell. Standard and the appellant accordingly for commercial reasons concluded what appears to me to be simply a commercial contract made by the appellant in the course of carrying on its trade, a contract respecting the disposal to Standard of gravel which the appellant had for sale. In these respects therefore the situation was the opposite of that in the *Van Den Berghs* case. Moreover while the $60,000 was a single amount payable in respect of the whole of the remainder of the appellant's term it was payable only in proportion to such part of the term as the municipal permits to be obtained by the appellant might cover and there was thus something to be done by the appellant in the course of its business activities from time to time during the term to perfect its right to the amount. Since the digging, crushing, loading and removing of gravel from the property in the course of the appellant's operation was normally done by others, including customers, one of whom was Standard itself, there was nothing unusual to the appellant's mode of operation in the appellant giving Standard the right to enter the property and to dig, crush, load and remove gravel and in the circumstances, despite the fact that the appellant, by giving Standard (subject to some exceptions) an exclusive right to do so, restricted and committed itself to dealing with a single customer in respect of a large portion of its business the transaction appears to me to have been entered into in the course of its trading activities and to have been but a particular mode of earning profit from the right which the appellant had to purchase gravel from the owners of the property at a favourable price. In my opinion the amount was accordingly part of the revenue of the appellant's business and was properly taken into the computation of its income for tax purposes.

The appeal will be dismissed with costs.