

1964
June 25
Nov. 12

BETWEEN:

J. & R. WEIR LIMITED APPELLANT;

AND

THE MINISTER OF NATIONAL }
REVENUE } RESPONDENT.

Revenue—Income—Income tax—Profit-making scheme—Purchase and resale of Government of Canada bonds—Ownership of bonds—Intent of taxpayer—Investment of surplus capital—Income Tax Act, R.S.C. 1952, c. 148, ss. 6(1)(b) and 139(1)(e).

This is an appeal from the reassessment of the appellant's income for the taxation years 1956, 1957, 1958 and 1959, under which the respondent added to the appellant's income the amount received by the appellant in addition to interest on certain short term transactions in which the appellant claims it invested its surplus capital in the purchase and subsequent resale of Government of Canada bonds.

The evidence established that although the usual contract between the appellant and its broker purported to provide for the purchase by the appellant from the broker of short term Government of Canada bonds, and for the resale of the said bonds to the broker, effective thirty days after the purchase, the appellant, as purchaser, acquired no right to cut off the interest coupons during the thirty-day period it held the bonds, such right being an essential characteristic of ownership.

Held: That the buying and reselling of the bonds are simultaneous to such a degree that, in fact and in law, none of the contracts ever took place, and the transactions under review were merely a thinly disguised form of short term loan between the appellant and the broker

- 2. That the investing intent, in its customary connotation, is lacking in the transactions in question, which exhibit all the ear-marks pertaining to pursuits of profit-making schemes within the scope of s 139(1)(e) of the *Income Tax Act*.
- 3. That the appeal is dismissed.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard by the Honourable Mr. Justice Dumoulin at Quebec.

René Amyot for appellant.

Paul Boivin, Q.C. and *Paul Coderre* for respondent.

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

DUMOULIN J. now (November 12, 1964) delivered the following judgment:

J. & R. Weir Limited, an important Montreal concern, dealing in marine and industrial works, appeals from the

Tax Appeal Board's decision, dated April 29, 1963¹, which affirmed re-assessments by the Minister of National Revenue of appellant's taxable income for taxation years 1956, 1957, 1958 and 1959.

1964
J. & R. WEIR
LTD.

v.
MINISTER OF
NATIONAL
REVENUE

Dumoulin J.

The supplementary dues levied in connection with the four years' period amount to \$5,207.62 and were imposed, so the respondent contends in para. 10 of his Reply, on the assumption that "the appellant's dealings in government bonds were a venture in the nature of trade within the meaning of section 139(1)(e) of the *Income Tax Act*."

Previously, in the Notice of Appeal, the Company had summed up its viewpoint in three concise paragraphs, 5, 6 and 7, hereunder reproduced:

5. The Appellant was a manufacturing company which, over the years 1956 to 1959, carried on a program of investing whatever surplus capital it had, from time to time, in short term Government bonds.

6. On these bonds, the Appellant received interest, which was, of course, duly returned as income and made also a small gain which it contended was a capital gain.

7. The Appellant bought these short term Government of Canada bonds from investment dealers, and on the same day and in the same contract, resold the bonds to him (sic) for delivery thirty (30) days later at an agreed price.

Fifteen such transactions annually in Government of Canada bonds were made by the appellant and a few more by its subsidiary associate, Welding Engineers Limited, also of Montreal, whose similar appeal, number A-1615 of this Court's 1963 records, proceeded jointly with the instant one.

It may seem a commonplace to say the issue consists in unravelling the nature of these dealings within the purview of the oft recurring section 139 (1) (e) of the *Income Tax Act*.

In the record of the case an explanatory brief, labelled "Schedule", is filed and signed by Mr. John W. Robinson, Vice-President and Secretary of J. & R. Weir Ltd., as also of Welding Engineers Ltd.

This executive officer outlines in the document aforesaid his company's explanation of these moot ventures. The undergoing excerpts are taken from pages 2 and 3:

Page 2:

Ever since the inception of the money market in Canada some six years ago, it has been considered acceptable practice for members of the Investment Dealers' Association of Canada to offer their clients the

¹ (1963) 32 Tax A.B.C. 33.

1964
 J. & R. WEBER
 LTD.
 v.

MINISTER OF
 NATIONAL
 REVENUE

Dumoulin J.

advantages contained in the Canada Money Market. This has been achieved by the purchase by various corporations of Government of Canada Securities (and or Government of Canada guaranteed issues) and their resale at a later date.

. . . To implement this investment, dealers offered to various corporate clients who have temporary unemployed funds, short term government and government guaranteed securities.

There has also come into existence a type of transaction which would involve *lending* (italics added throughout) of certain amounts of money to the investment dealer, who, in turn, would pay a certain rate of interest on the funds so *borrowed*. To secure the *loan*, the dealer would lodge Government of Canada Securities with the client, *and in some instances obligate himself to have this loan outstanding for a given period of time* (usually 30, 60, or 90 days). In other instances, a so-called *loan would be entered into between the client and the dealer . . .*

Bonds were sold to various corporate clients who had excess funds, at the current market, flat coupon interest, with a day to day money market interest rate allowed on the amount of money involved. This rate of interest so allowed since funds might be required on anything from 1, 30 or 60 days, the bonds being then sold at the current market, thus involving gain or loss by the holder of the bonds.

Page 3:

Bonds as placed with our Company with respect to loans remain the property of our Company throughout the period of the arrangement . . .

Especially noticeable are the frequent recurrences of the expressions "loan", "borrowed", and that of "arrangement".

The opening in Canada, a matter of common knowledge, of a so-called money market, naturally intensified this simple enough trading of excess funds against short term Government securities, on a monthly basis, and deriving therefrom a dual source of profit, day to day interest and the par value appreciation as the term of maturity drew nearer. A six to ten cents "natural increment" (cf. Notice of Appeal, para. 8), on a one hundred dollar bond is meaningless, but if multiplied, as in this case, 250,000 times, it brings in \$150, bolstering up by so much the current interest "*agreed upon*" as we shall see. (cf. ex. A-2). At all events, it affords a better yield than would accrue, here, from the snail like pace of bank interest, were any allowed. In brokerage parlance this practice is called "buy-backs".

In his testimony before the Tax Appeal Board, Mr. John W. Robinson indicated the motivating incentive that prompted the appellants to initiate these deals. Some quotations, out of the transcript filed, are in order; the witness is examined by the companies' counsel:

At page 7:

Q. How did you happen to start making investments in Government J. & R. WEIR
of Canada short term securities? 1964
}

A. As I said previously, *we first went to the bank and we found no* v.
MINISTER OF
NATIONAL
REVENUE
satisfactory situation there, so we went to the brokers, and from
discussions with the brokers it was presented to us to engage in
this sort of business.

Dumoulin J.

From this point on, there arises more than a strong suspicion that the objective sought had little in common with a real investment of surplus funds, for which banks are unfrequent agents, and bears a striking resemblance to a quest for the highest interest yield.

Nothing in the following excerpts tends to modify this opinion.

At page 12:

Q. You knew at the beginning that the value of the bonds would increase day by day approaching their maturity.

A. Yes, that's right.

Mr. Robinson now is cross-examined. At page 18:

Q. These bonds were the property of your company as soon as they were acquired for the period stated in the contract?

A. For the period of thirty (30) days.

Q. How come, if you were the owners of these bonds, your company was not to receive the full amount of the interest (3%) stated on the bonds?

A. Because we were only getting them for thirty (30) days.

Q. But the bonds were paying three per cent interest, and your company received only one and a quarter per cent?

A. The reason for that is that the bond was three per cent, and that's three per cent per annum; but we held the bonds for only thirty (30) days.

From page 21:

Q. *When you sold back your bonds, were you always selling them to the same dealers who sold them to you, Mr. Robinson?*

A. *Yes.*

The witness admits these particular operations were not transacted on the open market but through private contracts.

About these contracts, Mr. Harry W. Andrews, who, in 1956, negotiated them with J. & R. Weir Ltd., and for Welding Engineers, in his then capacity of senior sales representative for Royal Securities, vouchsafes some additional information to Mr. Chagnon, counsel for respondent, who proceeds to cross-examine him.

1964

J. & R. WEIR
LTD.

v.

MINISTER OF
NATIONAL
REVENUE

Dumoulin J.

On pages 38 and 39:

- Q. Mr. Andrews, I show the contracts by which the bonds were acquired by Weir and I ask you to explain to the Court what is meant by the word "flat"?
- A. It means that there is no accrued interest on the transaction because the contractual agreement is not that the coupon belongs to the purchaser as such.
- Q. They belong to whom?
- A. They belonged to the Royal Securities in this instance because the agreement is for thirty days that they can have the bonds. They actually owned the bonds, *but it's our agreement that they will return them to us at the expiration of that time, so the coupon belongs to Royal Securities in these instances.*
- Q. So the bonds were always acquired by the taxpayer or the appellant without any coupons?
- A. Oh, no, the coupons would be on the bond, *but they had no right to cut them off.*
- Q. *And the right to cut them off would be to your company (i.e. Royal Securities Ltd.)?*
- A. *Yes.*

It certainly would require an astounding stretch of the imagination to perceive in such "arrangements" the customary traits of a true and outright purchase. In this occurrence, buying and reselling are simultaneous to such a degree that, in fact and law, none of those contracts ever took place, but merely a thinly disguised form of short term loan between the appellant and Royal Securities. An essential characteristic of ownership resides in the entitlement to all accruing benefits, in this instance the interest coupons, which, as seen above, the so-called purchaser "had no right to cut".

Exhibits A-2 and A-3, *inter alia*, each composed of statements of sale slips to J. & R. Weir Ltd., and statements of purchase from the latter by Royal Securities Corporation, same dates in both cases, and, in each instance again, two letters identically dated, one referring to the would-be sale to J. & R. Weir, the other to the supposed repurchase from it, leave no room for doubt as to the true nature of these transactions.

The appellant company and the investment dealers concerned never had the intention of entering into a valid sale nor a genuine investment.

To all appearances, the appellant pursued the thrifty purpose of putting its abundant spare cash to the best use possible, in other words, the highest rate of interest, and

insofar its endeavours are encompassed by s. 6 (1) (b) of the Act:

6. (1) Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

* * *

(b) amounts received in the year or receivable in the year . . . as interest or on account or in lieu of payment of, or in satisfaction of interest.

1964
J. & R. WEIR
LTD.
v.
MINISTER OF
NATIONAL
REVENUE
Dumoulin J.

Out of duty, I reviewed the taxpayer's entire plea when, truly, the legal fallacy in para. 8 of the Appeal might have warranted a shorter shrift.

Apart from a split interest return, the residue retained by Royal Securities, it is alleged that J. & R. Weir (and also Welding Engineers Ltd.) "has considered that the natural increment in price of a bond over that period (exactly 30 days) was from six (.06) to ten (.10) cents or more per month, as the bond was coming closer to maturity, and this normal increment was considered as a capital gain by the appellant . . .", (cf. Notice of Appeal, para. 8).

So far, so good, but, then, whose bonds attracted that "natural increment"? Surely not the taxpayer's since oral and literal evidence, for instance, exhibits A-2, A-3 and R-2, repetitiously assert resales of the bonds to Royal Securities the very moment they purported to have been bought by the appellant. Indeed, both transactions are so inextricably interwoven that resale seems to precede purchase. It does not come as a surprise, therefore, that the real owners of those bonds, Royal Securities Corporation, were alone empowered to cut off the interest coupons (H. W. Andrews *dixit*). Consequently, capital appreciation benefited the investment dealers who, by anticipation, apparently added this "increment" to the pre-determined interest.

At all events, the investing intent, in its customary connotation, is lacking. Irrespective of any other description, these deals exhibit all the ear-marks pertaining to pursuits of profit-making schemes, within the scope of s. 139 (1) (e) of the Statute.

This was a smart attempt to escape the long reach of the tax-gatherer, and insomuch no blame attaches, . . . income tax only.

For the above reasons, the decision of the Tax Appeal Board is affirmed and the appeal dismissed. The respondent will be entitled to recover his costs after taxation.

Judgment accordingly.