
Toronto 1968 Apr. 9-11, 17

BETWEEN:

SETTLER OILS LIMITED .....APPELLANT;

AND

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

Income tax—Company formed to acquire mineral rights of dormant company—Oil leases for lump sum payments and royalties on production—Whether lump sums taxable—Whether revenue from a business—Relevance of incorporator's object to liquidate property—Whether price of properties deductible in computing income from leases.

Appellant company, its primary object being to deal in mineral properties, was incorporated in 1952 at the instance of *C* and her children who held all the shares therein. Appellant purchased at an appraised value of $17,500 certain mineral rights in western Canadian lands which were the sole remaining assets of *S* Co., which had been originally incorporated in 1882 to deal in land, and 85% of whose capital stock was held by *C*. This course was decided on by *C* because of the uncertain value of the mineral rights, the problem of succession duties on her death, and because the minority shareholders in *S* Co. were dead or untraceable. Between 1954 and 1963 appellant company granted a number of oil leases to oil companies from which it received lump sum "bonus payments" as well as production royalties. Appellant was assessed to income tax in respect of bonus payments of $16,000 received in 1961, $32,000 in 1962 and

$183,984 in 1963, and appealed contending that such payments were not taxable because the company's sole purpose in acquiring the mineral rights was to dispose of or liquidate them.

Held, notwithstanding that such may have been appellant's intention the lump sum payments were revenue from a business and therefore taxable. *Hudson's Bay Co. v. Stevens* 5 T.C. 424; *C. H. Rand v. Alberni Land Co.* (1920) 7 T.C. 629; *Com'r of Taxes v. British Australian Wool Realization Assoc. Ltd.* [1931] A.C. 224; *Glasgow Heritable Trust Ltd. v. C.I.R.* (1954) 35 T.C. 196, distinguished. *Balstone Farms Ltd. v. M.N.R.* [1968] S.C.R. 205; [1968] C.T.C. 38; *Western Leaseholds Ltd. v. M.N.R.* [1960] S.C.R. 10, applied.

Held also, no part of the $17,500 paid for the mineral rights was deductible from the lump sums received in 1962, 1963 and 1964 under the leasing contracts. This was not a case of a sale of stock-in-trade. *Berkheiser v. Berkheiser et al* [1967] S.C.R. 387, applied.

INCOME TAX APPEAL.

D. J. Wright, Q.C. and *Warren S. Seyffert* for appellant.

D. G. H. Bowman and *F. P. Dioguardi* for respondent.

JACKETT P. (orally):—This is an appeal from the appellant's assessments under Part I of the *Income Tax Act* for the taxation years 1961, 1962 and 1963. The sole ground of appeal is that the assessments are excessive by reason of the inclusion in the computation of the appellant's incomes for the years in question of certain amounts that, according to the appellant, should not have been so included. The amounts that the appellant says were wrongly included in computing its incomes are $16,000 for 1961, $32,000 for 1962, and $183,984 for 1963.

The facts upon which the assessments were based are not really in issue and can be summarized briefly. The appellant was incorporated on June 13, 1952, and the primary object set out in its charter reads as follows:

> (a) to purchase or otherwise acquire, sell, lease, dispose of and otherwise deal with oil, coal and natural gas claims, lands and mineral rights and properties supposed to contain oil, coal and natural gas and undertakings connected therewith;

On September 16, 1952, the appellant acquired, by purchase from a company known as Saskatchewan Land and Homestead Company Limited (hereinafter referred to as "Saskatchewan"), for a consideration of $17,500, the fee simple title to the mineral rights in a substantial acreage of land in Western Canada. During the period from 1954 to 1963, the appellant entered into a number of agreements

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(commonly referred to as oil leases or options to lease) with oil companies who wished to explore for oil in the areas in question. Under each of such agreements, the appellant conferred on the oil company the right, during a special period, to search for oil, and the right to remove any oil found, on terms that certain lump sums (called "bonus payments") would be paid by the oil company to the appellant upon the execution of the agreements (and that certain annual payments, called "delay rentals", would be made during any part of the specified period before the oil company commenced to drill for oil) and that the oil company would be entitled to retain out of any oil so removed 87½ per cent for itself, and would hold 12½ per cent for the appellant. It is common ground that, at the time that the appellant acquired the mineral rights from Saskatchewan, it was the intention that it would enter into transactions of that character, if and when it became possible for it to do so. The amounts in dispute are lump sum amounts received in the years in question under such contracts.

If there were no facts other than the ones that I have just summarized, there would not appear to be any real doubt that the amounts in question were properly included in computing the appellant's incomes for 1961, 1962 and 1963, respectively, as being revenues from a "business" within the extended meaning of that word as defined by section 139(1)(*e*) of the *Income Tax Act*. Compare *Minerals Ltd. v. M.N.R.*,[1] *Western Minerals Ltd. v. M.N.R.*,[2] and *Western Leaseholds Ltd. v. M.N.R.*[3] Having regard to the conclusion that I have reached, I will not deal with the alternative arguments that, even if there was no "business", these payments would have an income character as being profits from property,[4] or by virtue of section 6(1)(*j*) of the *Income Tax Act*.

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[1] [1958] S.C.R. 490. [2] [1960] S.C.R. 24.

[3] [1960] S.C.R. 10.

[4] I am unable to distinguish the leases involved here from the "lease" that was the subject matter of the decision in *Berkheiser v. Berkheiser et al.*, [1957] S.C.R. 387. As I understand that decision, while such a lease is, from one point of view, a sale of property—that is, a sale of the minerals when removed—it is not a conveyance of the minerals *in situ*, title to which remains in the lessor, and both the rents and royalties are "profits" and "like rent from a leasehold" are embraced

The facts upon which the appellant relies for its contention that the amounts in question were not, properly considered, revenues from a business within the meaning of that word as used in the *Income Tax Act* were developed in some detail commencing with the time when Saskatchewan was incorporated in 1882. Those facts, in so far as I appreciate their significance for the purpose of the appellant's contention, may be summarized as follows:

(a) Saskatchewan, during its early years, acquired land in Western Canada for resale under agreements of sale to settlers. (In fact, apparently, much of the land was resold, either by Saskatchewan or the mortgage company, under agreements that reserved the mineral rights to Saskatchewan.)

(b) In the early part of this century, there were internal troubles in the administration of Saskatchewan that resulted in protracted litigation, and such litigation effectively brought an end to Saskatchewan's land disposition business.

(c) By the time the litigation came to an end, the "moving force" in the company was a lawyer by the name of A. B. Cunningham who had been acting for the company in this litigation and who had put a great deal of effort and money into carrying on the litigation. He had also become a substantial shareholder in Saskatchewan.

(d) The litigation also left Saskatchewan with debts substantially in excess of what could be readily realized from its assets.

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in a devise of the title to the land. See the judgment of Rand J. and Cartwright J. (as he then was) at pages 394-5. Even though there is no conveyance of legal title to the land, but only a sale of something to be taken from the land, the appellant's operations may nevertheless constitute the carrying on of a "business" within the meaning of the words as used in the *Income Tax Act*. Compare *Orlando v. Minister of National Revenue*, [1962] S.C.R. 261. While I am unable, as I see the matter, without more mature consideration, to escape the conclusion that the payments in dispute are, in any event, income of the appellant from property, in which event the appellant's contention based on the "liquidation" and "disposition" cases would have no application, I have chosen to deal with the matter on the basis of the respondent's principal contention, which was that the appellant's operations constitute the carrying on of a business.

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(e) During the 1920's and 1930's, as a result of a depression in the western provinces, Saskatchewan went into default under a mortgage on its lands and in respect of its liability to a bank.

(f) The mortgage company thereupon took over the management of the winding-up of Saskatchewan's affairs; and the shares of Cunningham and others in Saskatchewan were assigned to the mortgage company and the bank.

(g) A. B. Cunningham died in 1932 leaving a widow and eight children. His estate was left to his widow, who was executrix of his will, but the estate did not appear to be sufficient to warrant the expense of probate.

(h) In 1944, the mortgage company, having realized almost enough to pay off its claim, the bank and Saskatchewan agreed that the bank would take over Saskatchewan's remaining lands in full satisfaction of its claim. The shares in Saskatchewan were then returned to the estate of A. B. Cunningham. As a result, Saskatchewan was left with nothing except the mineral rights that had been reserved to it, which were understood at the time to be of no value.

(i) Saskatchewan remained, after the 1944 arrangement, for all practical purposes, dormant, until 1948, when it became aware, as a result of an offer made to it by an oil company, that its mineral rights had some value. Its corporate affairs were then put in order and Mrs. Cunningham and two of her sons were elected as its officers, and took over its active administration.

(j) In June 1948, Saskatchewan granted an option to lease all of its mineral rights of which its management was then aware to an oil company, and received, under the option contract, in 1948 and 1949, payments totalling $43,085.95. Eventually, the oil company took a lease under that option.

(k) While the Department of National Revenue originally took the position that the 1948-49 payments were income, eventually it conceded that they were not taxable under the *Income Tax Act*.

(l) In or about 1951, Saskatchewan discovered that it owned mineral rights of which it had not previously

been aware, and that it therefore still had assets of value to be disposed of although there was not then much activity in the area where those mineral rights were.

(m) At that time (i.e. after the discovery of the existence of additional mineral rights), as the Cunningham family saw it, there was a potential succession duty problem by reason of the fact that Mrs. Cunningham was almost eighty years of age and owned about 85 per cent of Saskatchewan's shares, and the fact that it was impossible to make an accurate determination of the value of the mineral rights. Her family, moreover, were anxious that she should receive some of the proceeds from realization during her lifetime. The situation from their point of view was "further complicated by the fact that the remaining 15 per cent of Saskatchewan's outstanding shares were registered in the names of shareholders, most of whom were deceased or untraceable". For those reasons, it was decided by Mrs. Cunningham and her children to incorporate a new company, all the shares of which would be owned by the Cunningham family to acquire Saskatchewan's mineral rights, which were Saskatchewan's only assets other than cash and bonds at the time, "for a cash consideration based upon appraisal". They also decided that Saskatchewan should then be wound up and that the interests of the unknown or untraceable shareholders should be paid to the Public Trustee. Before proceeding with this plan, a ruling was obtained from the Department of National Revenue that the shareholders in Saskatchewan would not be taxable on the distribution on its winding up.

(n) The appellant was incorporated by the Cunningham family on June 13, 1952, pursuant to this plan and, as already indicated, purchased Saskatchewan's mineral rights (including the mineral rights which had already been leased to an oil company by Saskatchewan) for $17,500. Saskatchewan thereupon distributed its assets to its shareholders and surrendered its charter. Mrs. Cunningham subscribed for preferred shares in the appellant in the amount of $17,500, which amount was

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used by the appellant to pay for the mineral rights purchased from Saskatchewan. Ordinary shares were issued at $1 per share as follows:

(a) Mrs. Cunningham	16 shares
(b) Each of the eight children, 8 shares or	64 "
TOTAL:	80 "

Certain other facts were also established. In 1954, the appellant agreed to lease to the oil company with whom Saskatchewan did business in 1948 and 1949 the mineral rights that came to its attention in 1951 and received as a result amounts of $36,274.60 and $15,361.09, which the Department of National Revenue decided not to include in its income for the purpose of the *Income Tax Act*. Eventually, that oil company abandoned all its rights in respect of its leases from the appellant except in respect of lands where oil had been discovered "and the full mineral rights in respect thereof automatically reverted again to the appellant". The discovery of a new field in 1956 resulted in the appellant being able to grant further options and leases in respect of the "reverted mineral rights" which resulted in the lump sum payments now in question. All told, in addition to the lump sum payments to which I have referred, the appellant has received royalty payments (i.e. under its right to 12½ per cent of production) amounting to about $1,500,000, and it has received a depletion allowance under the *Income Tax Act* of 25 per cent in respect of such payments.

Throughout the evidence put forward on behalf of the appellant, it has been contended that the intention of those who have constituted the management of Saskatchewan and the appellant since the discovery of value in the mineral rights in 1948 has been to dispose of or liquidate the assets of the respective companies. In this connection, it has been testified that the only practical way of *disposing* of oil rights in Western Canada during the period in question was to grant leases or options of the kind that I have already described. I accept it that the only sensible way whereby the legal owner of mineral rights having a value by reason of the possible presence of oil could have turned them to advantage, if he were not in

a position to explore and develop himself, was to enter into such arrangements. This would appear to have been the only businesslike course of action for any person owning such rights and desiring to turn them to advantage. I have difficulty, however, in regarding such contracts as being dispositions of the mineral rights themselves although I recognize that, in the case of a wasting asset such as oil, once the lessee has exercised his rights by removing all the oil, the mineral rights will have little more than a theoretical value unless and until some other mineral is discovered.

The contention that the intention of the appellant was exclusively that of disposing or liquidating the mineral rights was put forward on the apparent assumption that there is a doctrine or principle established by the so-called "disposition" or "liquidation" cases that, where a company's sole purpose in acquiring property is to dispose of it or to liquidate it, it is not taxable under the *Income Tax Act* on any profit that it may make in the course of such disposition or liquidation. The cases relied upon by the appellant in this connection are *Hudson's Bay Co. v. Stevens*[5], *C. H. Rand v. Alberni Land Co.*[6], *Com'r of Taxes v. British Australian Wool Realization Assoc. Ltd.*[7], *Glasgow Heritable Trust Ltd. v. C.I.R.*[8]

In my view, none of these cases have any application to the facts of this case which, as I understand them from this point of view, do not differ in principle from the facts under consideration in *Balstone Farms Ltd. v. M.N.R.*[9]

The only principle involved in the problem that I have to decide, as I understand it, is that, by virtue of the *Income Tax Act*, a taxpayer is taxable on any profit for a year from a business. The so-called disposition or liquidation cases do not establish any different principle. They are merely cases where it was found as a fact that the taxpayer was not carrying on a business. The problem I have to solve is therefore merely a question as to whether the amounts in question are revenues from a business.

As I have said, what was decided in each of the cases on which the appellant relies is that the company three

[5] 5 T.C. 424.
[6] (1920) 7 T.C. 629.
[7] [1931] A.C. 224.
[8] (1954) 35 T.C. 196.
[9] [1968] S.C.R. 205; [1968] C.T.C. 38.

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involved did not receive the amounts in dispute as profits from a business. In the *Hudson's Bay Co.* case, a great exploration company was held not to be carrying on a business when it was disposing of the lands it had received in place of those received by it by way of a grant from the Crown as an incentive to its exploration of unknown lands. In the *Rand* case, a company was employed as "machinery" by private landowners to properly realize the capital of their property "under the peculiar circumstances of their divided title". In the *British Australian Wool* case, the company received the property in question under a scheme pursuant to which it was to dispose of the property and distribute the proceeds to specified parties. In the *Glasgow Heritable Trust* case, real property acquired by a partnership for resale in the course of a business became unmarketable by reason of new legislation so that the business came to an end and there was no alternative but to hold the property and salvage as much as possible by disposing of it as and when that became possible.[10] The company in question was incorporated in that case as machinery for this long-run salvage operation. As pointed out by Judson J. in *Balstone Farms Ltd. v. M.N.R.*[11]: "In none of these realization cases was there an out and out transfer by former owners for a cash consideration." On the one hand, in the *Hudson's Bay Co.* case, there was a mere realization by the owner of property and there was not "a sale in execution of a profit-making enterprise, either 'adventure', or 'trade', or 'business'".[12] On the other hand, in the other cases, the property was put into the hands of the company in question for the benefit of the former owners or persons nominated by them.

The appellant's acquisition is not at all similar to any of such cases. The appellant bought the property in question for a price based on an appraised value which, for present purposes, I must assume was a fair price because one purpose of the transaction was to bring to an end the very real interest that the 15 per cent minority shareholders in Saskatchewan had in the possible increase in the value

[10] Compare *Minerals Ltd. v. M.N.R.*, [1958] S.C.R. 490, per Martland J. at p. 497.

[11] [1968] S.C.R. at p. 212; [1968] C.T.C. at p. 41.

[12] See *Anderson Logging Co. v. The King*, [1925] S.C.R. 45, per Duff J., at p. 58.

of what Saskatchewan sold to the appellant. It is quite clear that the appellant was not to dispose of, or liquidate, the property for the benefit of Saskatchewan, which was to be wound up, or for the benefit of Saskatchewan's shareholders, 15 per cent of whom were to have no interest in the proceeds of the disposition of the property by the appellant, but were to accept their share of the $17,500 in lieu of what their interest in the disposition of the property might have been if Saskatchewan had retained it.

Indeed, the appellant acquired the property in question, as every trader acquires his stock in trade, in the hope that it might realize from it more than it paid for it, but knowing that the proceeds of realization might possibly be less than that amount. Any amount it might realize in excess of what it paid was to go, in the ordinary course of corporate operations—by way of dividends or on winding up—to its shareholders—that is, the members of the Cunningham family—and would not benefit any other person, and in particular would not benefit any of the 15 per cent minority shareholders in Saskatchewan. I cannot distinguish the acquisition of the property in question by the appellant and its subsequent turning of that property to its advantage from what happened in *Minerals Ltd. v. M.N.R.*, *Western Minerals Ltd. v. M.N.R.*, and *Western Leaseholds Ltd. v. M.N.R.*, to which cases I have already referred. I refer to the judgment of the Supreme Court of Canada in *Western Leaseholds Ltd. v. M.N.R.*, per Locke J. at pages 21-2, where he used language that applies equally to this case when he said:

> In *Anderson Logging Company v. The King*, Duff J., as he then was, said that if the transaction in question belongs to a class of profit-making operations contemplated by the Memorandum of Association, *prima facie* at all events the profit derived from it is a profit derived from the business of the company. That presumption may, of course, be negatived by the evidence as was done in the case of *Sutton Lumber & Trading Company v. The Minister of National Revenue*. In the present case, however, the evidence, far from negativing the presumption, appears to me to support it.

I have come to a conclusion against the appellant on the main branch of the appeal.

In the alternative, the appellant contended that, if the amounts in dispute were properly included in the computation of its income for the years in question, it was entitled to a deduction in the same years of some part of the price

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of $17,500 that it paid for the mineral rights. No suggestion was made as to what part of that price should be allowed as a deduction for any particular year or as to what principle should be applied in determining the amount of each deduction. This is not a case of buying stock-in-trade and selling it. The principles applicable to such a case are well settled. See *Minister of National Revenue v. Irwin.*[13] In this case, the appellant at no time sold what it purchased. If it had, it would have been entitled to deduct the cost to it of what it sold even though it were difficult to work out the actual allowance. Compare *British South Africa Co. v. Com'r of Income Tax.*[14] However, this is not such a case. What the appellant did in this case was grant certain "leases" of its mineral rights that did not differ in character from the mineral lease under consideration in *Berkheiser v. Berkheiser.*[15] It never parted with title to its mineral rights. Nothing is deductible in such a case. Compare *Alianza Co. v. Bell.*[16] Just as nothing is deductible from ordinary rentals of real property in respect of the cost of the simple title to the property that has been leased, so nothing is deductible here from the payments (that are of the same character as ordinary rental payments according to the *Berkheiser* decision) in respect of the cost of the fee simple title to the mineral rights. It is because there is no deduction for cost in such a case that a depletion allowance is granted in respect of the oil actually removed from the land. In this case, the appellant has been allowed such a depletion allowance equal to 25 per cent of over a million and one-half dollars in royalties, being the 12½ per cent of production received by it.

The appeal is dismissed with costs.

[13] [1964] S.C.R. 662.
[14] [1946] A.C. 62.
[15] [1957] S.C.R. 387.
[16] [1906] A.C. 18.