THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

JOSEPH SEDGWICK ..... RESPONDENT.

1963
*Nov. 19
Dec. 16

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income—Partnership—Advances to stock-broker for share of profits—Termination of agreement—Profit in respect of current fiscal year, not yet ended, set at negotiated amount—Whether negotiated amount income or capital receipt—Income Tax Act, R.S.C. 1952, c. 148, ss. 6(1)(c), 15(1), (2).

In 1949, the respondent and four others entered into an agreement with P to advance him funds with which to purchase a seat on the Toronto Stock Exchange and to provide working capital for his stock brokerage business. It was provided that the "lenders" would receive a percentage of the net profits of the business but no interest. The agreement further provided that no partnership should be deemed to be created. However, the trial judge held that a partnership was constituted, and this finding was not challenged before this Court.

As this agreement was in conflict with the rules of the Stock Exchange, it was terminated on February 1, 1956, two months before the end of the then fiscal year. P agreed to pay the lenders a sum of $550,000, made up of (1) the total of all advances, (2) the increase in value of the seat on the Exchange, (3) the share of the lenders in the cash surrender value of an insurance policy, (4) their share in the net profits of the

*PRESENT: Abbott, Martland, Judson, Hall and Spence JJ.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

business for the fiscal year ending two months hence and fixed at $300,000, and (5) a share in the goodwill of the business. The Minister sought to assess as profit from a partnership the respondent's share of the $300,000. The respondent argued that this amount was part of the consideration for the sale of his partnership interest and as such was a capital receipt. The assessment was confirmed by the Tax Appeal Board but was set aside by the Exchequer Court. The Minister appealed to this Court.

Held (Spence J. dissenting): The appeal should be allowed and the assessment restored.

Per Abbott, Martland, Judson and Hall JJ.: Under ss. 6(1)(*c*) and 15(1) and (2) of *The Income Tax Act*, R.S.C. 1952, c. 148, the respondent became liable to tax for the year 1956 in respect of his share of the partnership income (even though not withdrawn) for the fiscal period of the partnership which ended in 1956. That period ended when the partnership was terminated on February 1, but the partnership profits were determined by the agreement up to the end of the normal fiscal period ending March 31. There was no evidence to establish that his share of income was less than that established by the termination agreement. This agreement could not be construed as being one for the sale of interests in a partnership. It was rather an agreement for the winding-up of the partnership, which was necessitated by the rules of the Stock Exchange. In essence, the lenders withdrew from the business the capital value of that which they had provided in the form of capital assets and were paid out the profits which they had acquired out of the operation of the business. The respondent was therefore liable to income tax in respect of his share of the partnership profits.

Per Spence J., *dissenting:* Some of the amounts set out in the termination agreement were merely negotiated or estimated. The respondent never became entitled to receive any income from the operation of the partnership during the fiscal year 1956 because, by the termination agreement, the lenders conveyed to P all their rights to the profits for that year's operation and all the rights they had to any other assets of the partnership. The termination agreement was not a mere dissolution of the partnership but a sale by all the partners of their interests in all the partnership assets. The sale price must therefore be considered as a capital receipt and the same result applied even when the sale price was calculated by including as part thereof an estimate of the already earned but undistributed profits. It follows that no part of the purchase price should have been included in the respondent's income.

APPEAL from a judgment of Ritchie D.J. of the Exchequer Court of Canada[1], setting aside the respondent's assessment for income tax. Appeal allowed, Spence J. dissenting.

E. J. Cross and *P. M. Troop*, for the appellant.

Terence Sheard, Q.C., and *H. Sedgwick*, for the respondent.

The judgment of Abbott, Martland, Judson and Hall JJ. was delivered by

[1] [1962] Ex. C.R. 337, 36 D.L.R. (2d) 97, 62 D.T.C. 1253.

MARTLAND J.:—On March 31, 1949, the respondent, along with four other parties, entered into an agreement with John Edward Purcell, pursuant to which they advanced funds to Purcell to enable him to purchase a seat on the Toronto Stock Exchange and to provide working capital for his stock brokerage business. It is conceded that the respondent's interest under this agreement was held by him on behalf of another person as to one-half of the respondent's interest, so that his actual interest was a one-tenth interest.

The advances made by the parties to the agreement (who were therein described as "the Lenders" and who will, for purposes of convenience, be thus described hereinafter) were described as being "by way of loan", but no interest was payable to them by Purcell. Instead, the agreement provided that each of the Lenders would receive a percentage of the net profits of the business. It was provided that Purcell should receive an annual payment for his services, plus 10 per cent of the net profits of the business. He agreed not to engage in any other business and to devote his whole time and attention to the business. He also agreed to obey all lawful directions of the Lenders in writing. He undertook to hold the Stock Exchange seat, and any other assets acquired by reason of the operation of the business, in trust for the Lenders.

By letter, dated March 31, 1953, to Purcell, the respondent agreed that the provisions with respect to the giving of directions to Purcell by the Lenders and the holding of his Stock Exchange seat in trust be deleted. Similar letters were written by the other Lenders. The reason for the deletion of these provisions was that they conflicted with the policy of the Toronto Stock Exchange.

One clause of the agreement provided that nothing in the agreement should be deemed to constitute the Lenders as partners in the brokerage business. However, the learned trial judge[1] has held that, notwithstanding this provision, a partnership was constituted by virtue of the provisions of the agreement and this finding was not challenged on the appeal to this Court. The appeal was argued on the basis that a partnership was created.

The business prospered and profits were earned in each year from 1950 to 1955 inclusive. In 1955, however, the

[1] [1962] Ex. C.R. 337, 36 D.L.R. (2d) 97, 62 D.T.C. 1253.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

Martland J.

Board of Governors of the Toronto Stock Exchange ruled that, as the Lenders were not actively engaged in the business, they could not take a share of the net profits of the business and the profit-sharing arrangement was required to be terminated by the end of that year.

In consequence of this, on February 1, 1956, a second agreement was made between Purcell and the Lenders or their successors in interest, referred to in this agreement as "the Creditors". It recited the ruling of the Board of Governors of the Toronto Stock Exchange and further, notwithstanding the letters regarding the deletions from the first agreement, recited that the Stock Exchange seat was held in trust for the Lenders. The agreement then went on to provide:

> 1. It is mutually agreed:
>
> (*a*) That to date the advances of money to Purcell by the Creditors amount to $112,500.
>
> (*b*) That the increase in the market value of the said seat on the Toronto Stock Exchange is fixed at $63,000.
>
> (*c*) That the share of the Creditors in the cash surrender value of the insurance policy is hereby fixed at $4,850.
>
> (*d*) That the share of the Creditors in the net profits of the business for the fiscal year ending March 31st, 1956, is hereby fixed at $300,000.
>
> (*e*) That the share to which the Creditors are entitled in the good will of the business is hereby fixed at $69,650.
>
> Total $550,000.

The agreement stated that the original agreement should be terminated by mutual consent, that the Creditors would no longer be entitled to share in the net profits of the business and that, as consideration for the termination of the original agreement, the giving up of their interest in the Stock Exchange seat and in the physical assets of the business and their right to share in the profits of the business, Purcell would pay to the Creditors a total amount of $550,000. Provision was then made for the terms of payment of this sum of $550,000. $150,000 was to be paid by Purcell by April 15, 1956. The balance of $400,000, until paid, was to carry interest at the rate of 10 per cent per annum, payable quarterly, the first such payment falling due on the last day of June 1956.

The respondent was assessed for income tax for the year 1956 in respect of the amount of $30,000, being his one-

tenth interest in the $300,000 referred to in para. (*d*) of cl. 1 of the agreement recited above.

The assessment was confirmed by the Tax Appeal Board but, on appeal, the Exchequer Court[1] held that, although the relationship between Purcell and the Lenders was that of partners, the real effect of the second agreement was that Purcell had agreed to purchase from the Lenders their interest in the partnership for a total consideration of $550,000. It was further held that this consideration must be regarded as a whole and that the recipients thereof would be in receipt of a capital payment. It was held that the fact that the consideration included an item associated with profits did not affect its character or quality.

The governing provisions of the *Income Tax Act*, R.S.C. 1952, c. 148, are the following:

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

* * *

(*c*) the taxpayer's income from a partnership or syndicate for the year whether or not he has withdrawn it during the year;

15. (1) Where a person is a partner or an individual is a proprietor of a business, his income from the partnership or business for a taxation year shall be deemed to be his income from the partnership or business for the fiscal period or periods that ended in the year.

(2) Where an individual was a member of a partnership the affairs of which were wound up during a fiscal period of the partnership by reason of the death or withdrawal of a partner or by reason of a new member being taken into the partnership, for the purpose of subsection (1), the fiscal period may, if the taxpayer so elects, be deemed to have ended at the time it would have ended if the affairs of the partnership had not been so wound up.

Their effect is that income from a partnership must be included in a taxpayer's income for a taxation year, whether or not he has withdrawn it during that year. Such income in a taxation year is his share of the partnership income for the fiscal period ending in that year. If a partnership is wound up during a fiscal period by reason of the death or withdrawal of a partner, the taxpayer may elect to have the fiscal period of the partnership deemed to end at the time it would have ended if the partnership affairs had not been wound up.

Applying these provisions to the present case, the respondent would become liable to tax for the year 1956 in respect of his share of the partnership income (even though

[1] [1962] Ex. C.R. 337, 36 D.L.R. (2d) 97, 62 D.T.C. 1253.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

Martland J.

not withdrawn by him) for the fiscal period of the partnership which ended in 1956. That period ended when the partnership was wound up on the date of the second agreement, February 1, 1956, but the partnership profits were determined by the agreement itself up to the end of the normal fiscal period ending March 31, 1956. If the respondent were entitled to invoke subs. (2) of s. 15, that is the date at which the profits would be ascertained.

Unless he were able to establish that his income from the partnership was less than that established by the agreement, it would appear that he is liable for income tax in respect of it (*Johnston v. Minister of National Revenue*[1]). No evidence was led to establish that his share of income was less.

Counsel for the respondent contended that these profits were not taxable in the respondent's hands, but in the hands of Purcell, because the respondent, by the agreement, sold his interest in the partnership business to Purcell and the whole of the payment to which the respondent became entitled would be a receipt of capital. He submitted that the fact that the price was determined, in part, by the share of the Lenders in the partnership profits for the fiscal year ending March 31, 1956, does not alter the quality of the payment to be made to them by Purcell. He cited the statement of Lord Macmillan in *Van Den Berghs, Limited v. Clark*[2]:

> But even if a payment is measured by annual receipts, it is not necessarily itself an item of income. As Lord Buckmaster pointed out in the case of *Glenboig Union Fireclay Co. v. Commissioners of Inland Revenue* ((1922) S.C. (H.L.) 112): "There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the test."

In my opinion this argument fails and I am unable, with respect, to agree with the conclusions reached by the learned trial judge because I cannot construe the agreement of February 1, 1956, as being one for the sale of interests in a partnership. It is rather an agreement for the winding-up of the partnership, which had been necessitated by the decision of the Board of Governors of the Toronto Stock Exchange. As a result of that decision, the Lenders were thereafter precluded from sharing in the profits of the business. That right they gave up in the agreement because they had been compelled to do so.

[1] [1948] S.C.R. 486, 4 D.L.R. 321, C.T.C. 195, 3 D.T.C. 1182.
[2] [1935] A.C. 431 at 442.

The agreement determined the amount of the advances by the Lenders to Purcell (out of which the seat on the Toronto Stock Exchange had been purchased), the increase in value of that seat, the cash surrender value of a certain insurance policy, the value of the goodwill of the business and the amount of the Lenders' share in the profits of the business for the year ending March 31, 1956. Purcell agreed to pay to the Lenders the total of those various amounts, and the $400,000 balance remaining after the payment of $150,000 is referred to in the agreement as a "loan", which bore interest as in the agreement provided. Essentially, therefore, the Lenders were withdrawing from the business the capital value of that which they had provided to it in the form of capital assets and were to be paid out the profits which they had acquired out of the operation of the business. The character of each of the items described in cl. 1 was not altered by the fact that they were totalled at the end of the clause.

This being so, in my opinion the respondent is liable to income tax in respect of his share of the partnership profits, as determined by cl. 1(*d*) of that agreement.

The appeal should be allowed and the assessment restored with costs both here and in the Exchequer Court.

SPENCE J. (*dissenting*):—I have read the reasons of my brother Martland herein and I wish to adopt his outline of the relevant facts.

The learned Exchequer Court Judge[1] found that the arrangement carried on between the Creditors and Mr. Purcell under the agreement of March 31, 1949 (ex. 1) was a partnership and neither party disputed that finding in this Court.

When the respondent was absent in England, his secretary, as was her usual course, made up his income tax return form T.1 General and a photostat copy thereof was filed as ex. A upon the trial before Ritchie D.J. in the Exchequer Court. In the schedule attached to the said income tax return there was shown in the recapitulation of income an item which read "Purcell invest. account, $32,000" and written opposite the words "Purcell investment account" are the words "T.20 in file of Jack Purcell". There was no explanation at the trial as to who endorsed

[1] [1962] Ex. C.R. 337, 36 D.L.R. (2d) 97, 62 D.T.C. 1253.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

Spence J.

the last mentioned memoranda on the form. The Minister of National Revenue issued a re-assessment notice to the respondent under date of March 5, 1958, adding to the tax assessment the sum of $697.57 plus $33 interest, a total of $728.57. The respondent filed notice of objection to that re-assessment under date of March 31, 1958, and in a "Statement of Facts and Statement of Reasons for Objection" attached thereto took the position for the first time that as to $30,000 of the sum of $32,000 referred to, *supra,* the respondent received on his own account only the sum of $15,000 and not $30,000, and that that receipt was a capital receipt and should not be taxed as income. It will be seen that the sum of $15,000 is 10 per cent of the sum of $150,000 which was, by virtue of the agreement of February 1, 1956, to be paid immediately to the "Creditors" and the respondent was entitled to 10 per cent of the amounts payable under that agreement.

The discussions preceding the execution of the agreement of February 1, 1956, are dealt with in the evidence of the respondent at trial. It should be noted that the respondent was the only witness called at the trial and therefore there is no denial of any evidence given by him. At p. 37, line 21, the respondent said:

> The agreement sets it out in detail as to how the $550,000 was reached.
>
> MR. CROSS: Do you remember the figure of $550,000 was reached; was there any audit of the books of Jack Purcell made?
>
> A. I don't remember if there was any audit but I do recall his auditor attended one or more than one meeting and gave some sort of estimate as to how much money would be there but I don't think he would be able to make an audit at the end of December because his year ended in March and no one would know what he would do. It was an indication, not an audit. It couldn't have been an audited figure—$300,000 is obviously an error—.
>
> Q. Had there been a quick audit by the Stock Exchange shortly before that?
>
> A. I don't know, I couldn't tell you. I know they do a sub-audit but I don't know—. I paid no attention to the business. I was in the office twice; once at Christmas time and—.
>
> Q. If the lenders were partners, you say they were not, and if they were, as partners, entitled to profits at the time the agreement of February 1st, 1956, was entered into, you do not dispute the amount of those profits would be $300,000?
>
> A. I don't dispute or deny.

Then, at p. 38, line 21:

> HIS LORDSHIP: And then on this seat, $30,000 profits for period. It does not show what period. I have the fixed impression from the evidence

I have heard that this was an end agreement in consideration of the lenders relinquishing any rights, any further right, for a negotiated settlement.

THE WITNESS: That was the point.

MR. CROSS: I think the $550,000—.

HIS LORDSHIP: The $550,000 made up of the other items I have mentioned, an amount of $112,500 and then the cash surrender value, the increase of the Stock Exchange seat and then those items total $150,000. Is that right?

THE WITNESS: Yes, my lord, you put it perfectly and that is the situation. It was an end agreement and the figure of $300,000 may, for all I know, bear some relation to some profit that had been earned but it was an agreed on figure, it is not an accounting figure.

HIS LORDSHIP: I think it is a negotiated figure.

THE WITNESS: A negotiated figure.

I have come to the conclusion that some of the amounts set out in para. (1) of the agreement of February 1, 1956, which total $550,000 must have been on the basis of negotiation or estimate. Paragraph (*a*), the advances made by the Creditors to Mr. Purcell, $112,500, is a fixed and easily ascertainable item. Paragraph (*b*), the increase in the market value of the seat on the Toronto Stock Exchange, $63,000, can only be an estimate or judgment of what the seat would be worth if it had been sold on the market on that day. Such an estimate might well be based on the last similar sale of such a seat but the estimate might be higher than or lower than the amount of the sale price in the last previous sale depending on the difference in stock market conditions between the date of the last previous sale and February 1, 1956. Paragraph (*c*), the share of the Creditors in the cash surrender value of the insurance policy, ($4,850) is, of course, a figure which could be ascertained exactly. Paragraph (*d*), the one in question in this appeal and which reads "That the share of the Creditors in the net profits of the business for the fiscal year ending March 31, 1956, is hereby fixed at $300,000" must be considered in the light of the evidence given at trial part of which has been set out above. There was no division of profits during the course of a fiscal year in this partnership and there was no audit which would enable anyone to say with any exactness what the profits would be at the end of the fiscal year March 31, 1956. One need only consider the nature of the business of the partnership to understand how inaccurate an estimate might be of the profits for the year when that estimate was made two full months prior to the end of the fiscal year.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

Spence J.

In a stock brokerage business those two final months might have been disastrous so that the profits could have been reduced drastically or they may have been very profitable so that the profits would far exceed the estimate. It would appear, from one question put to the respondent upon the trial, that the profits actually much exceeded the figure of $300,000. The share of the goodwill to which the Creditors were entitled, $69,650, again illustrates the negotiated or estimated character of the various items set out in these paragraphs as no one could put an exact amount to include a $50 item, upon such a nebulous asset as goodwill. It is quite evident that para. (*a*), the advances, and (*c*), the cash surrender value of the insurance policy, were the only fixed amounts in the calculation and that the other three paras. (*b*), (*d*) and (*e*) were all negotiated or estimated figures to reach the total of $550,000. The Minister has assessed the tax upon the item of $30,000 as being profits to which the respondent was entitled for the operation of the business in the fiscal year ending March 31, 1956, and which would eventually have been paid to him apart from the agreement made on February 1, 1956. The Minister relies on s. 6(*c*) of the *Income Tax Act*, R.S.C. 1952, c. 148, and s. 15(1) and (2) of the said statute. Certainly, if the respondent had or was entitled to receive an income from the operation of this partnership in the year 1956, he must pay tax upon that income. The position, however, of the respondent is that he never did become entitled to receive any income from the operation of the partnership during the fiscal year 1956, because on February 1, 1956, by the agreement of that date he and his fellow Creditors conveyed to Mr. Purcell all of their rights to the profits for that year's operations and all the rights they had to any other assets of the partnership.

By para. 2 of the said agreement:

> It is further agreed that the Original Agreement shall be terminated by mutual consent of the Parties hereto for the reasons set out in the third recital hereof, and that the Creditors shall no longer be entitled to share in the net profits of the business. As consideration for the Creditors terminating the Original Agreement and giving up their interest in the Stock Exchange seat, and in the physical assets of the business as aforesaid, Purcell covenants and agrees to pay to each of the Creditors the amount

set opposite his name below, totalling in all $550,000, payable at the times hereinafter set forth:

I am of the opinion that what the Creditors and Mr. Purcell accomplished by the agreement (ex. 3) dated February 1, 1956, was not a mere dissolution of the previously existing partnership but a sale by all of the partners except Purcell of their interests in all of the partnership assets to Purcell. I am of the opinion that a dissolution of a partnership necessarily implies a division of the assets of the partnership, after payment of its creditors, amongst the partners in proportion of their respective shares in the partnership. In the present case, there was no attempt at realization of the partnership assets and no division of the assets either by money or in specie between the former partners who were designated in the said agreement (ex. 3) as Creditors, nor does there seem to have been even an accurate evaluation of those assets. The business of the partnership was carried on exactly as before by Mr. Purcell who had been prior to that date the manager and one of the partners of the partnership business and who thereafter became the sole proprietor subject to the payment of the unpaid portion of the purchase price. It is true that this purchase price was arrived at by taking the actual value of some of the partnership assets and an estimate of the monetary value of other of the partnership assets but this was merely a method of calculating a sale price. I am therefore of the opinion that the recital of the sum of $300,000 as being the fixed share of the Creditors in the net profits of the business for the fiscal year ending on March 31, 1956, is merely a recital of how one of the items used to determine the sale price was arrived at.

It would appear from three cases that such a device for the calculation of a purchase price cannot change the fact that the actual price calculated and paid was a capital receipt and not receipt of income. In *Glenboig Union Fire Clay Co. v. The Commissioners of Inland Revenue*[1], the House of Lords was dealing with a transaction whereby a railway company paid to the taxpayer the sum of £15,316 as compensation for their foregoing the right to remove clay from certain of their lands adjacent to the line of the railway company. It was said and not disputed that that amount was assessed by considering that the fire clay to

[1] [1922] S.C. (H.L.) 112.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

Spence J.

which it related could be worked only for some two and a half years before it would be exhausted and that the amount represented the actual profit for two and a half years had the fire clay been worked, which was, under the agreement, received in one lump sum, and that therefore the amount should be treated as profits. Lord Buckmaster said, at p. 115:

> It is unsound to consider the fact that the measure adopted for the purpose of seeing what the amount should be was based on considering what were the profits that would have been earned. That no doubt is a perfectly exact and accurate way of determining the compensation, for it is now well settled that the compensation payable in such circumstances is the full value of the minerals that are to be left unworked, less the cost of working, and that is of course the profit that would be obtained were they in fact worked. But there is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the test. I am unable to regard this sum of money as anything but capital money, and I think therefore it was erroneously entered in the balance-sheet ending 31st August 1913 as a profit on the part of the Fireclay Company.

It is true that decision dealt with the foregoing of profits which were to be earned in the future by a lump sum payment while the present case deals with forgoing profits which were payable in the future although jointly earned in the past. But again I stress that on February 1, 1956, neither the respondent nor any of his fellow Creditors were entitled to any profits and that the $300,000 was only an estimate of what had been earned during the past 10 months and would have been earned during the following two months.

Rutherford v. Commissioners of Inland Revenue[1] dealt with the situation where on October 31, 1921, one partner who had been entitled to 18/64ths of the profits of a partnership retired and on December 7, 1921, by agreement it was provided that the retiring partner should receive £1,500 "in full settlement of his whole share and interest in the profits of the firm for the year ending the 31st of December 1921" and further decreasing amounts in subsequent years. The remaining partner who up to October 31, 1921, was entitled to 36/64ths of the profits attempted to take the sum of £1,500 which was payable to the retiring person from the

[1] (1926), 10 Tax Cas. 683.

firm's profits before his own share was calculated for taxation. The learned President, Clyde, said at p. 692:

> The sum of £1,500 was made payable to the retiring partner independently of what might turn out to be the profits actually made in the current year, either as a whole, or during that part of it which preceded the date of dissolution. It was nothing but the consideration in respect of which the retiring partner gave up any right he might have had in the profits made in that part of the year; and it would have remained a debt due to him by the remaining partners, personally, even if no profits at all had been shown on a balance struck by the remaining partners—whether at the date of dissolution or at the end of the current year.

And at p. 693:

> (2) The sum of £1,500 was not a share of those profits but the price or consideration paid by the remaining partners for a discharge of any claims on the part of the retiring partner to participate in them.

Lord Blackburn said at p. 697:

> The fair construction of the agreement does not appear to me to provide any justification for treating this sum as a charge upon the profits. In my opinion, it must be regarded as a price paid to the retiring partner for his share in the profits and a sum for which the remaining partners remained liable irrespective altogether of what the profits of the firm for the year might prove to amount to.

It may be noted that that decision dealt only with payment for an agreement to forgo a share of profits to which the taxpayer would become entitled in the future, such profits having been earned in the past, while in the present case, the sum of $550,000 payable to the Creditors was for the discharge of not only the Creditors' rights to the profits which would, on March 31, 1956, be determined as having been earned in the fiscal year at that time, but to release all of the Creditors' other claims to partnership assets, and the $300,000 (item (*d*)) was merely one of the items included in the calculation to arrive at the said sum of $550,000. I am of the opinion, therefore, that the facts in the present case are more favourable to the contention of the respondent than were those in *Rutherford v. Commissioners of Inland Revenue.*

In *Van Den Berghs, Ltd. v. Clark*[1], the House of Lords considered a payment of £450,000 by a Dutch company to an English company made in the year 1927, to settle the claim of the English company, the appellant for a share in the profits of the Dutch company during the First War and

[1] [1935] A.C. 431.

1963

MINISTER OF NATIONAL REVENUE v. SEDGWICK

Spence J.

for the release of their right to a share in the profits which might be earned by the Dutch company in the years following and up to 1940. The English company had been entitled to those shares of profits up to the year 1940 under a series of agreements between the two companies. The appellant had, in calculating the amount it should claim in the arbitration to fix the amount due between the companies, worked out a sum of £449,042 which it alleged the Dutch company owed them already. The special commissioners held that the £450,000 was paid in respect of the pooling agreements and must be brought in for the purpose of arriving at the balance of the profits and gains of the appellant for the year ending December 31, 1927. Lord Macmillan said, at p. 442:

> But even if payment is measured by annual receipts, it is not necessarily itself an item of income. As Lord Buckmaster pointed out in the case of the *Glenboig Union Fireclay Co. v. Commissioners of Inland Revenue*, 1922 S.C. (H.L.) 112, 115, "There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the test."

If the arrangement arrived at by virtue of the agreement of February 1, 1956, (ex. 3) is, as I have found it to be, a sale of partnership assets by the various partners to the continuing partner and included in those assets the right of the retiring partners to share in any profits of the partnership, either those which were earned before the agreement or those which would be earned thereafter, then I am of the opinion that the authorities quoted require the sale price to be considered as a capital receipt, and I am of the opinion that if, when the sale price was calculated by including as part thereof an estimate of the already earned but undistributed profits, the same result applies. Counsel for the Minister cited in reply the *Commissioner of Taxation v. Melrose*[1], a decision of the Supreme Court of Western Australia. That was an appeal from the decision of a magistrate of the Court of Review. Melrose was the owner of 4/7ths shares in a partnership operating a very large agricultural enterprise. The partnership agreement provided for the division of profits on June 30 annually. On June 24, 1920, Melrose delivered $\frac{1}{4}$th of his interest to each of three members of his family and then attempted to resist the claim of the Commissioner of Taxation for tax on the profits which

[1] (1923), 26 W.A.L.R. 22.

would be payable upon those 3/7ths interest. McMillan C.J. said, at p. 25:

> It seems to me that it is a very clear case. During the year in question considerable profits accrued, to which, when they had been ascertained, the present respondent would have been entitled. Those were the profits which he would have got from the business. But a few days before the time for taking the accounts he handed over portion of his share of the partnership profits to different members of his family. It seems to me that if profits have once accrued, as they did in this case, although the actual amount of them had not been ascertained, there is taxable income upon which the Commissioner is entitled to require the usual amount to be paid.

The decision of the Court does not cite any authority nor is any authority mentioned in the notes of the argument. The transfer of the shares to members of his family was evidently gratuitous. I am unwilling to accept this decision in view of the decision of the House of Lords in *Rutherford v. Commissioners of Inland Revenue,* and *Van Den Berghs Ltd. v. Clark, supra.* In my view, Mr. Purcell and the Creditors, i.e., his former partners, made an agreement whereby Purcell for a price, bought the physical assets of the partnership, and any rights which his partners might have in the future, whether that future be near or far, to obtain profits from the operation of the partnership business. The purchase price was a capital receipt and no part of it should have been included in the respondent's income. I would dismiss the appeal with costs.

Appeal allowed with costs, SPENCE J. *dissenting.*

Solicitor for the appellant: E. S. MacLatchy, Ottawa.

Solicitors for the respondent: Johnston, Sheard, Johnston & Heighington, Toronto.