JAMES FREDERICK SCOTT .....APPELLANT;

AND

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

1963

*Jan. 28, 29
April 1

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Agreements for sale, lease-option agreements and mortgages purchased at a discount and held to maturity—Whether profits taxable income or capital gain—Income Tax Act, 1948 (Can.), c. 52, ss. 3, 4 and 127(1)(e)—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4 and 139(1)(e).

The appellant, a barrister and solicitor, was found liable for income tax on certain discounts received in the years 1950 to 1955 inclusive. These receipts came from his purchase of agreements for sale of land, lease-

*PRESENT: Taschereau, Fauteux, Judson, Ritchie and Hall JJ.

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option agreements on land and mortgages on land. He purchased at a discount and held the securities to maturity. Most of the agreements covered small house properties in outlying districts where mortgage institutions would not normally do business. The source of funds from which the agreements were purchased was the sale of certain houses and other assets owned by the appellant. As payments were made on the agreements, the appellant used these funds for further purchases. He also operated with a bank loan under which his maximum liability was $100,000. The issue was whether the discounts when received were taxable income or accretions to capital. The Exchequer Court having held that they were taxable income, the appellant appealed to this Court.

Held: The appeal should be dismissed.

For the reasons given by the Exchequer Court the appeal failed. It was true that the appellant purchased the agreements by himself and never in association with anyone else, and that he did not set up any organization for their acquisition. He was not in the business of lending money nor in the business of buying and selling agreements. That there was an element of risk in the transactions was obvious. Nevertheless, the facts established that the appellant was in the highly speculative business of purchasing these agreements at a discount and holding them to maturity in order to realize the maximum amount of profit out of the transactions. The profits were taxable income and not a capital gain.

APPEAL from a judgment of Thorson P. of the Exchequer Court of Canada[1], holding that certain discounts received by the appellant were taxable income. Appeal dismissed.

T. J. Hopwood, for the appellant.

D. S. Maxwell, Q.C., and *G. W. Ainslie,* for the respondent.

The judgment of the Court was delivered by

JUDSON J.:—Both the Tax Appeal Board and the Exchequer Court[1] have found the appellant liable for income tax on certain discounts received in the years 1950 to 1955 inclusive. These receipts came from his purchase of agreements for the sale of land, lease-option agreements on land and mortgages on land. He purchased at a discount and held the securities to maturity. The issue is whether the discounts when received by him were taxable income or accretions to capital. The judgment of the Exchequer Court holds that they were taxable income and, in my respectful opinion, for the reasons given by Thorson P., the appeal fails.

[1] [1961] C.T.C. 451, 61 D.T.C. 1285.

There has been a line of six cases on this problem in the Exchequer Court beginning in 1957 with the case of *Arthur Cohen v. Minister of National Revenue*[1]. There the accretion was held to be capital in the case of a retired businessman who disposed of many of his investments and put his capital into mortgages which he purchased at a discount. In the next five cases including the present one: *Minister of National Revenue v. Louis W. Spencer*[2]; *James F. Scott v. Minister of National Revenue*[3]; *Minister of National Revenue v. Beatrice Minden*[4]; *Minister of National Revenue v. Philip Mandelbaum and Albert Mandelbaum*[5]; *Minister of National Revenue v. Henry S. Rosenberg*[6], the contrary conclusion was reached. The discounts when received were held to be taxable because the securities were acquired not as investments but as a scheme of profit-making and, consequently, taxable as income from a business. However, in the latest case, *Minister of National Revenue v. William Hedley MacInnes*[7], the judge concluded that the taxpayer was engaged in investment and not in a scheme for profit-making.

This diversity of opinion is understandable when the decision must depend upon a full review of the facts in each case for the purpose of determining whether the discounts can be classified as income from a business. Even on the same facts, there is room for disagreement among judges on the conclusions that should be drawn from these activities of a taxpayer, for the Act nowhere specifically deals with these discounts, as it does, for example, in s. 105(*a*) with shares redeemed or acquired by a corporation at a premium. It is possible to deal expressly with the problem and the Act has not done so.

The appellant is a barrister and solicitor practising in the City of Calgary. At the time of the appeal to the Exchequer Court he was 69 years of age and had been practising for 47 years. His income from his practice during the years in

[1] [1957] Ex. C.R. 236, [1957] C.T.C. 251, 57 D.T.C. 1183.
[2] [1961] C.T.C. 109, 61 D.T.C. 1079.
[3] [1961] C.T.C. 451, 61 D.T.C. 1285.
[4] [1962] C.T.C. 79, 62 D.T.C. 1044.
[5] [1962] C.T.C. 165, 62 D.T.C. 1093.
[6] [1962] C.T.C. 372, 62 D.T.C. 1216.
[7] [1962] C.T.C. 350, 62 D.T.C. 1208.

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question was approximately $12,000 a year. In 1945, he purchased a ranch and was operating it in a fairly substantial way at the time of the appeal. Nothing in this appeal turns on his activities as a rancher.

The appellant began to purchase these agreements in 1947 and continued until 1955. His explanation for his withdrawal from this activity is that he was getting older and wished to leave a more liquid estate to face estate tax liabilities. From 1947 to 1954 he purchased 149 agreements, particulars of which are as follows:

In 1947	.....	28 agreements
In 1948	.....	17 agreements
In 1949	.....	20 agreements
In 1950	.....	28 agreements
In 1951	.....	20 agreements
In 1952	.....	20 agreements
In 1953	.....	15 agreements
In 1954	.....	1 agreement
Total	.....	149 agreements

Of the 84 agreements purchased in the period 1950 to 1954, there were 70 lease-option agreements, 12 agreements for sale and 2 first mortgages.

Most of the agreements covered small house properties in undeveloped districts on the outskirts of Calgary where mortgage institutions would not normally do business. The properties had been sold with small down payments averaging from 10 to 15 per cent of the full purchase price with 8 to 11 years in which to pay the balance. The appellant only purchased agreements where a discount was offered and these discounts varied from 20 per cent to 40 per cent of the balance of the purchase price. Most of the agreements carried interest at 6 per cent. The going rates of interest at the time on *National Housing Act* mortgages were, first, $4\frac{1}{2}$ per cent and later, 5 per cent, and on other mortgages 5 per cent and later $5\frac{1}{2}$ per cent, but these rates were on loans not exceeding 50 per cent or 60 per cent of the appraised value made by mortgage companies on first class properties. I mention these interest rates because there appears to be no connection between the size of the discount and an unduly low interest rate.

When the appellant purchased an agreement, he obtained a transfer of title from the vendor and an assignment of the agreement and thus became the registered owner of the property, subject only to such caveat as the purchaser or lessee under the agreement might have filed against the title.

The source of funds from which the appellant purchased these agreements was first of all the sale of 25 small houses which he owned before the war and which he sold after the war. He had, in addition, $54,000 in stocks and bonds. As payments were made on the agreements, he used these funds for further purchases. He also operated with a bank loan under which his maximum liability was $100,000.

The appellant purchased these agreements by himself and never in association with anyone else. He did not set up any organization for their acquisition, never employed anyone to purchase agreements for him, never advertised for them and never offered to buy them, nor did he bargain with vendors about the price he would pay. The appellant was approached by building contractors or real estate agents who stated how much they wanted for the agreements and he decided whether he would accept their offer or not. In some cases, the building contractors or real estate agents were clients. Some of the agreements were drawn by his law firm and many were not. The building contractors concerned often had small financial means and when they had sold a house, they had to realize cash on the agreement under which they had sold in order to build another one. The appellant explained that it became known that he was a potential purchaser of such agreements in the first place because of the agreements held by him on the 25 houses originally owned by him and which he had sold.

Sometimes he purchased an agreement from a builder immediately after the builder had sold the house but he never dealt with a builder before the property was sold.

The appellant did not sell any of the agreements purchased by him but kept them all until maturity or until paid off prior to maturity except for some 25 agreements transferred to his ranching company, incorporated under the name of Baha Tinda Stock Farm Ltd., for preference stock equivalent to the balance owing on the agreements transferred.

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The appellant was clearly not in the business of lending money. He did not lend money at any time. He purchased for less than their face value existing obligations which arose from a sale by a builder to a purchaser. These obligations given back by the purchaser carried a normal rate of interest which was slightly above the rate of interest charged under the *National Housing Act* at the times in question.

There was an obvious element of risk in these transactions. The down payments were small and mortgage companies and other lending institutions were not interested in them. Furthermore, provincial legislation which restricted the owner of the security to reliance upon the security and not upon the personal covenant made it even more risky. The discount is, therefore, explained by the nature of the risk and the needs of the builder who had to sell these obligations to finance further building.

The appellant was not in the business of buying and selling. He bought long-term obligations with small down payments and, with the exception of the transfer of 25 of these obligations to the ranch when it became incorporated in return for preferred shares in the ranch, the appellant never sold any of them. He held them all to maturity with the exception of one or two, on which he had to realize by way of foreclosure or sale.

I have stated the facts with all the emphasis given to them by counsel for the appellant. Nevertheless, I remain in agreement with the judgment of Thorson P. that these facts establish that the appellant was in the highly speculative business of purchasing these obligations at a discount and holding them to maturity in order to realize the maximum amount of profit out of the transactions, and that the profits are taxable income and not a capital gain.

I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Scott, Gregg, Hopwood & Scott, Calgary.

Solicitor for the respondent: A. A. McGrory, Ottawa.