GENERAL CONSTRUCTION COMPANY LIMITED ..... APPELLANT;

1959
May 12
*Jun. 25

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Sale of interest to co-venturer when venture substantially completed—Whether taxable income or capital receipt—The Income Tax Act, 1948 (Can.), c. 52, ss. 3, 4.

The appellant company entered into an agreement in December, 1949, described as a "joint venture agreement", by which it advanced a percentage of the working capital required by a contractor to perform a pipe line construction contract. At the completion of the work, the funds advanced were to be refunded plus 15 per cent. of the profits. When the work was practically completed, the appellant sold its interest to the contractor and was paid the sum it had advanced plus $90,000. The Minister treated the $90,000 as income. The assessment was affirmed by the Income Tax Appeal Board and by the Exchequer Court of Canada.

Held: The $90,000 represented taxable income in the hands of the appellant. It was "a gain made in an operation of business in carrying out a scheme for profit-making". *Ducker v. Rees Roturbo Development Syndicate,* [1928] A.C. 132, applied.

It was clear that the appellant made a business of entering into joint ventures with a view to profit. It entered the joint venture agreement in question with the intention of investing moneys in the joint venture and of recouping the same, plus a profit, at the conclusion of the venture.

The agreement by which the appellant disposed of its interest in the joint venture was not made with the intention of disposing of a capital asset in a going concern. It was made with the intention of providing for a return of the appellant's invested capital plus a sum representing an estimate of the profit to which the appellant would become entitled upon the winding up of the joint venture.

APPEAL from a judgment of Dumoulin J. of the Exchequer Court of Canada[1], affirming a decision of the Income Tax Appeal Board. Appeal dismissed.

W. Murphy, Q.C., for the appellant.

W. R. Jackett, Q.C., F. J. Cross and *G. W. Ainslie,* for the respondent.

*PRESENT: Locke, Cartwright, Fauteux, Abbott and Martland JJ.

[1] [1958] Ex. C.R. 222, C.T.C. 148, 58 D.T.C. 1089.

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The judgment of the Court was delivered by

MARTLAND J.:—The appellant was incorporated in the year 1923 and has carried on the business of constructing buildings, roads and dams and generally projects involving earth moving. In the course of its business it has entered into joint ventures with other contractors, sometimes as the sponsor of the venture and sometimes as a contributor of funds. In the period between 1949 and 1953 it was a party to some sixteen of such ventures. It had entered into similar ventures prior to 1949.

On November 12, 1949, an agreement was made by Interprovincial Pipe Line Company with Canadian Bechtel Limited, Bechtel International Corporation and Fred Mannix & Company Limited (hereinafter referred to as "Mannix") with respect to the construction for Interprovincial Pipe Line Company by the other three parties of a section of an oil pipe line comprising approximately 441 miles of twenty-inch pipe in the Provinces of Alberta and Saskatchewan.

On November 23, 1949, Canadian Bechtel Limited, Bechtel International Corporation and Mannix made an agreement, described as a "joint venture agreement", whereby it was agreed that the relative participation of the three companies in the construction agreement would be Canadian Bechtel Limited 40 per cent, Mannix 40 per cent, and Bechtel International Corporation 20 per cent. The initial working capital of the venture was to be $50,000 contributed by the parties in those proportions and further capital was to be provided, as and when needed, in the same proportions. Canadian Bechtel Limited was designated as sponsor of the joint venture and authorized to act for and bind the members in all matters relating to the joint venture and its affairs.

It was agreed that, upon receipt of final payment for the contract work, the assets and liabilities of the joint venture would be liquidated, the capital contributions of the joint venturers returned and the profits distributed to the joint venturers in the same proportions.

On December 19, 1949, Mannix entered into an agreement, also described as a "joint venture agreement", with Standard Gravel & Surfacing Co. Ltd. (hereinafter referred

to as "Standard") and the appellant, which referred to the fact that Mannix had entered into the joint venture agreement above mentioned dated November 23, 1949, as well as an operating agreement of the same date (together referred to as the "prime agreements") and that Mannix had a 40 per cent undivided interest in these prime agreements. It then went on to recite:

AND WHEREAS for the better procurement of the monies required for the performance of the said work the parties hereto have agreed to enter into this joint venture agreement.

This agreement contained, among others, the following provisions:

II

As between themselves and to the extent of the following percentages, respectively to wit:

FRED MANNIX & COMPANY LIMITED ..... 70 percent
STANDARD GRAVEL & SURFACING COMPANY LIMITED ..... 15 percent
GENERAL CONSTRUCTION COMPANY LIMITED ..... 15 percent

the joint venturers shall have and own an undivided interest in the Mannix interest, and in each and every asset thereof, including the profits which may be realized by the Mannix interest by virtue of the prime agreements; and likewise and to the same percentages, the said joint venturers shall assume and bear all of the obligations and liabilities arising from or out of the Mannix interest under the prime agreements, including losses, if any, which may be sustained by the Mannix interest under the prime agreements.

III

THE initial working capital of the joint venture shall be contributed in cash by the joint venturers upon the execution of this joint venture agreement, in the percentages set opposite their respective names in paragraph II above. It is agreed that additional working capital of the joint venture, as and when needed, shall be contributed by the joint venturers in the same percentages as set forth above.

* * *

VI

ADEQUATE books of account of the joint venture and its operations shall be kept by it and may be examined by any of the joint venturers at any time. Reports of the financial condition of the joint venture and the progress of the work shall be made to each joint venturer periodically or upon demand.

VII

UPON receipt of final payment for the contract work, the assets and liabilities of the joint venture shall be liquidated and the capital contributions of the joint venturers shall be returned and profits of the joint

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venture shall be distributed to the joint venturers in proportion to their interests in the joint venture as specified in paragraph II hereinabove. By mutual agreement distribution of a portion of the profits of the joint venture may be made before receipt of final payment for the contract work.

VIII

IT is specifically understood and agreed by the parties hereto that this joint venture agreement extends only to the Mannix interest in the prime agreements. In no event shall this agreement extend to or cover any other or different work, and upon a final accounting and settlement of the parties hereto this agreement shall terminate.

IX

NONE of the parties hereto shall sell, assign or in any manner transfer its interest or any part thereof in this joint venture without first obtaining the written consent of the other parties hereto.

* * *

XI

FRED MANNIX & COMPANY LIMITED is hereby designated as the sponsor of this joint venture and, as such, is hereby authorized and empowered to act for and bind this joint venture and the members thereof in all matters relating to this joint venture and its affairs.

XII

THE joint venture shall purchase the equipment set out in Schedule "A" attached hereto at the then present day price and such other equipment as may be mutually agreed upon between the parties hereto from time to time. Such equipment shall be rented to BECHTEL-MANNIX under the terms of the prime agreements.

XIII

IT is understood and agreed that on the completion of the work contemplated under the prime agreements certain equipment will be acquired under the terms thereof. The choice of such equipment shall be made on consultation between the parties hereto; the final decision, however, remaining with the sponsor of the joint venture.

XIV

ON the conclusion of the operations of the joint venture the equipment acquired under paragraphs XII and XIII hereof and any other equipment the property of the joint venture, shall be disposed of in the following manner.

Each of the joint venturers shall have the right or option to acquire from the joint venture, at prices ascertained as hereinafter provided such portion thereof the option prices of which bear the same percentage to the aggregate prices thereof as their respective interests in the joint venture bear to the whole thereof. If the joint venturers cannot mutually agree as to the specific item or items to be acquired by each joint venturer,

determination shall be made by drawing lots as to each classification of items, or, if none of them desires to exercise its option, the joint venture may sell such item or items to third parties for the best price obtainable.

* * *

XVI

NOTHING in this agreement contained shall be read or construed as limiting FRED MANNIX & COMPANY LIMITED from fully performing all the terms and conditions of the prime agreement and making any and all decisions necessary to the performance of the work contemplated thereunder and such decisions shall be binding on the parties hereto.

The effect of the two joint venture agreements, so far as the appellant is concerned, was that Mannix had a 40 percent interest in the prime agreements of which Canadian Bechtel Limited was sponsor and that to assist in financing Mannix's share in those agreements the appellant would contribute 15 per cent of the working capital to be provided by Mannix and was to receive 15 per cent of Mannix's 40 per cent interest in the prime agreements.

The construction of the Interprovincial pipe line proceeded in the year 1950 and, by September of that year, the portion to be constructed by Canadian Bechtel Limited, Mannix and Bechtel International Corporation had been substantially completed. Early in that month Mannix advised the appellant that it would not be long before the work would be completed and that a decision would have to be made as to the disposal of the machinery and equipment which had been rented by Mannix to the Bechtel-Mannix joint venture. As a result, officials of Mannix, Standard and the appellant met in Calgary about the 25th or 26th of September, 1950. It was then suggested that, as the appellant was not engaged in and did not intend to enter the pipe line business, whereas Mannix was active in that business, Mannix would be the logical party to acquire the machinery and equipment.

Following discussions as to the amount to be paid, it was finally agreed that Mannix would acquire the interest of the appellant in the joint venture agreement of December 19, 1949, thereby taking over the appellant's interest in the machinery and equipment, and that Mannix would pay to the appellant the appellant's total capital contributions to the joint venture, less those sums which it had

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already received back, plus an additional sum of $90,000. This agreement was reduced to writing on September 27, 1950, and provided as follows:

WHEREAS the parties hereto entered into a joint venture agreement dated the 19th day of December, A.D. 1949, relative to the construction of approximately 441 miles of pipe line in the Provinces of Alberta and Saskatchewan;

AND WHEREAS General is desirous of assigning to Mannix all its right, title and interest in the said joint venture agreement;

NOW THEREFORE THIS INDENTURE WITNESSETH:

1. MANNIX agrees that it will assume all liabilities of the joint venture and shall pay and discharge same, and General hereby assigns to Mannix absolutely all its interest in and to the joint venture and in consideration thereof Mannix shall pay to General all monies advanced by General to the joint venture less all monies paid by the joint venture to General, plus the sum of Ninety-Thousands ($90,000.00) Dollars;

2. IN CONSIDERATION of the premises Mannix and General do hereby release the other, their and each of their heirs, executors, administrators and assigns, and their and each of their estates and effects, from all sums of money, debts, duties, contracts, agreements, covenants, bonds, actions, proceedings, claims and demands whatsoever, which Mannix or General now hath or have against the other, for or by reason or in respect of the said joint venture agreement dated the 19th day of December, A.D. 1949, save and except the provisions of paragraph one (1) hereof.

The appellant had contributed $117,021.93 to the joint venture and had been repaid $68,772.19. This left a balance of $48,249.74, which amount, plus $90,000 was paid by Mannix to the appellant on November 3, 1950.

The question in issue in this appeal is as to whether or not the sum of $90,000 represents taxable income in the hands of the appellant, or whether it was a capital payment. Both the Income Tax Appeal Board and the Exchequer Court[1] have decided that it was taxable income.

Counsel for the appellant submits that the joint venture agreement of December 19, 1949, was a partnership agreement; that the agreement of September 27, 1950, between the appellant and Mannix was a sale by the appellant to Mannix of the appellant's interest in the partnership and that such a sale of a partnership interest is the sale of a capital item.

He cited a number of cases dealing with the sale of partnership interests in which it had been held that the proceeds of the sales were to be considered as capital and

[1] [1958] Ex. C.R. 222, [1958] C.T.C. 148, 58 D.T.C. 1089.

not as income. Some of these are cases in which a partnership has sold all its assets to a company incorporated to take over and to carry on the existing partnership business. Other decisions cited deal with cases in which a partner has disposed of his interest in a continuing business to others. However, in none of them were the circumstances similar to those in the present case.

I think the test which is to be applied to the facts of the present case is that which was stated by Lord Buckmaster, who delivered the judgment of the Court in *Ducker v. Rees Roturbo Development Syndicate*[1]:

> My Lords, I think it is undesirable in these cases to attempt to repeat in different words a rule or principle which has already been found applicable and has received judicial approval, and I find that in the case of the *Californian Copper Syndicate v. Harris,* 5 Tax Cas. 159, it is declared that in considering a matter similar to the present the test to be applied is whether the amount in dispute was "a gain made in an operation of business in carrying out a scheme for profit-making." That principle was approved in a judgment of the Privy Council in the case of *Commissioner of Taxes v. Melbourne Trust,* 1914 A.C. 1001, and it is, I think, the right principle to apply.

In this case it is clear that the appellant made a business of entering into joint ventures with a view to profit. It did so both before and after the making of the agreement of December 19, 1949. The appellant entered the agreement in question with the intention of investing moneys in the joint venture and of recouping the same, plus a profit, at the conclusion of the venture.

The joint venture in question here was practically completed and the time had arrived to consider the distribution to be made, on its completion, of the machinery and equipment which had been acquired for use in the performance by Mannix of its portion of the prime agreements. The agreement of September 27, 1950, was made for that purpose. It was not the intention of the appellant to sell, or of Mannix to buy, an interest in a going concern. Mannix did not intend to make a capital investment to acquire a capital asset, but did intend to make a payment in furtherance of the ultimate winding up of the joint venture. It was intended that an arrangement be effected whereby Mannix

[1] [1928] A.C. 132 at 140.

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could acquire the machinery and equipment which otherwise the appellant would have acquired on the distribution to be effected on the completion of the joint venture.

That agreement spells out what represents a return of invested capital and what represents the appellant's profit in the enterprise. This is not the case of a total consideration being paid to acquire a partnership interest in a going concern. It provides specifically for a repayment of the balance of the appellant's capital interest, plus a further sum of $90,000, which, in my view, represented an estimate of the profit to which the appellant would become entitled upon the winding up of the joint venture.

It seems to me that in these circumstances the $90,000 is clearly "a gain made in an operation of business in carrying out a scheme for profit-making", under the test above mentioned, and that it represents taxable income in the hands of the appellant.

In my opinion the appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Campney, Owen, Murphy & Owen, Vancouver.

Solicitors for the respondent: J. A. MacDonald and F. J. Cross, Ottawa.