

THE MINISTER OF NATIONAL
REVENUE

APPELLANT;

1969

*Feb. 4, 5
Mar. 4

AND

JAMES N. SISSONSRESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Profit on purchase and redemption of debentures of insolvent company in a loss position—Whether profit realized in an “adventure in the nature of trade” and therefore taxable—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 8(1), 137(2), 139(1)(e).

The respondent, a stamp dealer, carried on his business through a private company controlled by him. In 1961, he acquired the debentures and shares of Sonograph and Semco, two related companies in a loss position and on the verge of bankruptcy. For a sum of \$15,000, he acquired \$100,000 debentures of Sonograph in default as to interest and approaching maturity; 2,100 shares of Sonograph at a par value of \$100; \$102,000 debentures of Semco in default as to interest and approaching maturity; and 3,000 common shares of no par value of Semco. It was agreed that the two companies would first make an arrangement with their creditors—but not in respect of a \$112,000 debt owed by Sonograph to Semco. The respondent's private company sold its inventory of stamps to Sonograph and was authorized to buy and sell stamps for the benefit of that company. In 1962 and 1963, Sonograph profits from the stamp business (which profits were exempt from tax by reason of the application of past losses) allowed that company to pay off its indebtedness to Semco of \$112,000. Semco was thus able to redeem its debentures held by the respondent in the amount of \$102,000. The Minister assessed the respondent's profit, \$102,000 less \$15,000, as income. The Exchequer Court allowed an appeal from that assessment. The Court ruled that the profit was not income from a business or adventure in the nature of trade, nor income from a source within the meaning of s. 3, nor a benefit under s. 8(1) or s. 137(2). The Minister appealed to this Court.

Held: The Minister's appeal should be allowed.

The profit was realized in an adventure in the nature of trade and was therefore taxable as income from a business. The acquisition of the debentures was a part of a profit-making scheme. The purpose of the operation was not to earn income from the debentures but to make a profit on prompt realization. The operation had therefore none of the essential characteristics of an investment, it was essentially a speculation.

Revenu—Impôt sur le revenu—Profit sur achat et remboursement d'obligations d'une compagnie insolvable et dont les pertes durant les années précédentes excédaient les revenus—Le profit a été réalisé dans une «affaire d'un caractère commercial» et est imposable—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, art. 3, 4, 8(1), 137(2), 139(1)(e).

*PRESENT: Cartwright C.J. and Abbott, Martland, Spence and Pigeon JJ.

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L'intimé, un commerçant de timbres, exploitait son entreprise par l'intermédiaire d'une compagnie privée dont il avait le contrôle. En 1961, il a acquis les obligations et actions de Sonograph et Semco, deux compagnies liées dont les pertes durant les années précédentes avaient excédé les revenus et qui étaient sur le point de faire faillite. Pour une somme de \$15,000, il a acquis des obligations au montant de \$100,000 de Sonograph en défaut quant à l'intérêt et dont l'échéance approchait; 2,100 actions de Sonograph d'une valeur au pair de \$100; des obligations au montant de \$102,000 de Semco en défaut quant à l'intérêt et dont l'échéance approchait; et 3,000 actions communes de Semco sans valeur nominale. Il fut convenu que les deux compagnies feraient au préalable un arrangement avec leurs créanciers—une dette de \$112,000 due à Semco par Sonograph n'étant pas comprise dans cet arrangement. La compagnie privée de l'intimé a vendu à Sonograph son inventaire de timbres et fut autorisée à acheter et à vendre des timbres pour le bénéfice de cette dernière. En 1962 et 1963, les profits que Sonograph a tirés de l'entreprise (lesquels profits étaient exempts d'impôt en raison de l'application des pertes antérieures) lui ont permis d'acquitter sa dette de \$112,000 envers Semco. Cette dernière a alors pu racheter ses obligations au montant de \$102,000 détenues par l'intimé. Le Ministre a cotisé le profit réalisé par l'intimé, \$102,000 moins \$15,000, comme étant un revenu. La Cour de l'Échiquier a accueilli un appel de cette cotisation et elle a statué que le profit n'était pas un revenu provenant d'une entreprise ou d'une affaire d'un caractère commercial, ni un revenu d'une provenance quelconque dans le sens de l'art. 3, ni un bénéfice en vertu de l'art. 8(1) ou de l'art. 137(2). Le Ministre en appela à cette Cour.

Arrêt: L'appel du Ministre doit être accueilli.

Le profit a été réalisé dans une affaire d'un caractère commercial et était en conséquence imposable comme revenu provenant d'une entreprise. L'acquisition des obligations faisait partie d'un projet dont le but était de réaliser un profit. Le but de l'opération n'était pas de tirer un un revenu des obligations mais de faire un profit sur prompt réalisation. L'opération n'avait en conséquence aucune des caractéristiques essentielles d'un placement, elle était essentiellement une spéculation.

APPEL d'un jugement du Juge Gibson de la Cour de l'Échiquier du Canada¹, en matière d'impôt sur le revenu. Appel accueilli.

APPEAL from a judgment of Gibson J. of the Exchequer Court of Canada¹, in an income tax matter. Appeal allowed.

G. W. Ainslie, Q.C., and D. G. H. Bowman, for the appellant.

Terence Sheard, Q. C., and C. R. Archibald, Q.C., for the respondent.

¹ [1968] C.T.C. 363, 68 D.T.C. 5236.

The judgment of the Court was delivered by

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PIGEON J.:—The respondent is a successful stamp dealer. He caused to be incorporated J. N. Sissons Limited, a private company controlled by him and to which he transferred, after the incorporation, his inventory of stamps. In 1961, he sought to obtain financial advantages through the acquisition of securities of two companies in a loss position: Sonograph Limited ("Sonograph") and Sonograph Engineering & Manufacturing Company Limited ("Semco"). In that view, he successfully negotiated a transaction whereby for a total sum of \$15,000 he acquired:

- (i) \$100,000 6% first debentures of Sonograph, due October 31st, 1961 in default as to interest, but in respect of which all interest had been waived until maturity,
- (ii) 2,100 5% non-cumulative preference shares of \$100 par value of Sonograph,
- (iii) \$102,000 6% first debentures of Semco issued in two series, \$72,000 due October 15, 1962 and \$30,000 due November 1, 1963, both series being in default as to interest, but in respect of which all interest had been waived until maturity, and
- (iv) 3,000 common shares of no par value of Semco.

Sonograph and Semco were related companies on the verge of bankruptcy. It was a condition of respondent's bargain that an arrangement with the creditors would be completed under the *Bankruptcy Act* before the acquisition of the securities would be completed. Respondent undertook to place the companies in a position to make the necessary cash payments for such purpose in the amount of \$20,000 and he postponed his rights as debenture holder of Sonograph to those of the Royal Bank as holder of new debentures in the amount of \$50,000 in order that needed funds could be obtained from that Bank.

To enable Sonograph to earn profits respondent, as part of the operation, caused Sissons Limited to sell to Sonograph its inventory of stamps for \$150,000, this being apparently a fair market price for such a bulk sale. Sissons Limited retained physical possession of the inventory and was authorized to sell it for the account of Sonograph. It was also authorized to make new acquisitions of stamps so

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as to keep the stamp business active for the benefit of Sonograph. The latter's past losses being applicable against its profits from the stamp business, these became exempt from corporate income tax and were available to pay off an indebtedness to Semco in the amount of \$112,000 which had been thoughtfully excluded from the arrangement with the creditors. The scheme was so successful that after only one year, in October 1962, Semco was able to redeem \$72,000 of its debentures and the balance, namely \$30,000, a year later shortly before they matured.

Respondent was assessed for income tax on the amounts thus received by him less his cost of \$15,000 that was deducted in full from the first payment. The issue is whether his profit of \$57,000 in 1962 and of \$30,000 in 1963 is income or a capital gain.

In the Exchequer Court¹ Gibson J., after reciting the facts, made the following finding that was not challenged before us:

... it is apparent, and the appellant admits it, that the said second transaction out of which the redemption of these debentures arose, the subject matter of this appeal, would not have been entered into unless the said first transaction was also entered into, and vice-versa. As a consequence, this was not a simple purchase of debentures which were realized upon at maturity; it was something more than that, namely, the purchase was a part of a whole transaction involving several parts, and the cause of the redemption was due to many factors, as the above brief summary of the facts shows.

However, he held that respondent's profit was not income from a "business" within the meaning of 139(1)(e) of the *Income Tax Act* nor income from a source within the meaning of s. 3. He also said that the sums received by the respondent were not benefits conferred on him within the meaning of either s. 8(1) or s. 137(2). Accordingly the appeal from the assessment was allowed.

The first question to be considered is obviously whether respondent's profit is income from a "business" bearing in mind that by virtue of the statutory definition this includes "an adventure in the nature of trade". The reasons and conclusions of the trial judge on this point are as follows:

... upon a full review and consideration of the facts in this case, since these debentures (a) came into existence for a full consideration in a

¹ [1968] C.T.C. 363, 68 D.T.C. 5236.

market over which the appellant had no control, (b) the discounts arose unfortuitously by a capital loss to the original owners thereof, and (c) were purchased by the appellant in an arm's length transaction, the purchase price thereby representing the then market value; and since the gain, being the amount of these said discounts, to the appellant, from the redemption of these debentures arose, in part, from the indirect efforts of the appellant through J. N. Sissons Limited, which company in turn earned income working for Sonograph in selling its inventory of stamps and merchandising new inventory and, in part, fortuitously, both in a substantial way, I am of opinion that the purchasing of these debentures and the holding of them to maturity by the appellant was not a 'business' . . .

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With respect, I am unable to agree for the following reasons.

- (a) That the debentures came into existence for a full consideration in a market over which the appellant (respondent in this Court) had no control is irrelevant to the issue which is the character of the operation whereby he subsequently acquired them. It is also inconclusive, when an investment dealer underwrites a bond issue such is usually the situation, it is nonetheless a business operation.
- (b) The loss to the original owners is equally immaterial and inconclusive. If a man in difficult financial circumstances sells a prized possession, say an old painting, to an art dealer for a fraction of what it is worth, the dealer's profit on the resale is clearly income although the former owner has suffered a capital loss when disposing of it.
- (c) That the acquisition was in an arm's length transaction at market value is also irrelevant and inconclusive. Even if a stock promoter obtains shares in a new mining company at full market price, a profit he makes on the resale, if the promotion is successful, is undoubtedly from a "business".
- (d) As to the fact that the gain arose at least in part from respondent's efforts, this clearly tends to show not that it is a capital gain but profit from a "business". One of the characteristics of income from such a source is that it is essentially the result of the businessman's efforts.
- (e) Finally, respondent's gain cannot properly be considered as having arisen fortuitously. On the contrary, uncontradicted evidence shows that it is

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the result of a carefully considered plan executed as conceived. It is true that there is some evidence that the profits from the stamp business carried on for the benefit of Sonograph were greater and quicker than anticipated. This does not make them fortuitous in the legal sense.

For the respondent to escape taxation on his gain from the operation he has to show that it is to be characterized as an investment. Otherwise, the conclusion is inescapable that it is an adventure in the nature of trade. In support of the judgment in the Court below, counsel for the respondent relied essentially on the decision of this Court in *Irrigation Industries Ltd. v. Minister of National Revenue*². In that case, an otherwise inactive company had purchased from a mining company 4,000 treasury shares of an initial issue of 500,000 shares. The majority held that this was an investment and that the gain obtained by selling the shares at a profit a few weeks later was not income. Martland J. said (at p. 351):

In my opinion, a person who puts money into a business enterprise by the purchase of the shares of a company on an isolated occasion, and not as a part of his regular business, cannot be said to have engaged in an adventure in the nature of trade merely because the purchase was speculative in that, at that time, he did not intend to hold the shares indefinitely, but intended, if possible, to sell them at a profit as soon as he reasonably could. I think that there must be clearer indications of "trade" than this before it can be said that there has been an adventure in the nature of trade.

Here the clear indication of "trade" is found in the fact that the acquisition of the securities was a part of a profit-making scheme. The purpose of the operation was not to earn income from the securities but to make a profit on prompt realization. The operation has therefore none of the essential characteristics of an investment, it is essentially a speculation.

In *Irrigation Industries* the tests that were applied to decide if the operation was an adventure in the nature of trade were (at p. 352):

(1) Whether the person dealt with the property purchased by him in the same way as a dealer would ordinarily do and (2) whether the nature and quantity of the subject-matter of the transaction may exclude

² [1962] S.C.R. 346, [1962] C.T.C. 215, 62 D.T.C. 1131, 33 D.L.R. (2d) 194.

the possibility that its sale was the realization of an investment, or otherwise of a capital nature, or that it could have been disposed of otherwise than as a trade transaction.

The following was quoted from Viscount Simonds' judgment in *Edwards v. Bairstow*³:

I find 'activities which led to the maturing of the asset to be sold' and the search for opportunities for its sale, and, conspicuously, I find that the nature of the asset lent itself to commercial transactions. And by that I mean, what I think Rowlatt J. meant in *Leeming v. Jones*, (1930) 1 K.B. 279, that a complete spinning plant is an asset which, unlike stocks or shares, by itself produces no income and, unlike a picture, does not serve to adorn the drawing room of its owner. It is a commercial asset and nothing else.

Those observations apply with peculiar force in the instant case where the asset is a lot of debentures at or close to maturity. They could not be considered as acquired for income.

Applying the second test it was observed that the acquisition of corporate shares "is a well recognized method of investing capital in a business enterprise". Such is certainly not the case for debentures coming to maturity. Respecting the quantity, it was said (at p. 353):

Furthermore, the quantity of shares purchased by the appellant in the present case would not, in my opinion, be indicative of an adventure in the nature of trade, as it constituted only 4,000 out of a total issue of 500,000 shares.

Here it is the whole issue of debentures that was acquired. Also, while the acquisition was not made in the way in which an investment dealer would, it was in no way done as an investment is normally made. It was part of a scheme for quickly making a very substantial profit out of the prompt realization of debentures payable immediately or in the near future.

There can be no doubt that the acquisition of mortgages by an individual is of its nature just as much an investment as the acquisition of corporate debentures or of company shares: *Wood v. Minister of National Revenue*⁴. However, it is established by two decisions of this Court that when such acquisition by its frequency and other cir-

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³ [1956] A.C. 14 at 29, [1955] 3 All E.R. 48, 36 T.C. 207.

⁴ [1969] S.C.R. 330, [1969] C.T.C. 57, 69 D.T.C. 5073.

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cumstances takes on the character of a business, it is no longer an investment although all the mortgages are held to maturity: *Scott v. Minister of National Revenue*⁵, *Minister of National Revenue v. MacInnes*⁶. It is equally well established that even a single operation entered into for gain takes a business character when it cannot properly be considered as an investment but is to be characterized as a speculation. In such circumstances, it is an adventure in the nature of trade: *Fraser v. Minister of National Revenue*⁷, *Minister of National Revenue v. Freud*⁸.

Having come to the conclusion that respondent's gain is a profit from an adventure in the nature of trade, it follows that it is income from a "business" and it becomes unnecessary to consider the Minister's alternative submissions. Consequently, no opinion is expressed as to the correctness of the conclusions in the Court below on those points.

The appeal must be allowed with costs and respondent's appeal to the Exchequer Court from his revised assessments for income tax must be dismissed with costs.

Appeal allowed with costs.

Solicitor for the appellant: D. S. Maxwell, Ottawa.

Solicitors for the respondent: Strathy, Archibald, Seagram & Cole, Toronto.

⁵ [1963] S.C.R. 223, [1963] C.T.C. 176, 63 D.T.C. 1121, 38 D.L.R. (2d) 346.

⁶ [1963] S.C.R. 299, [1963] C.T.C. 311, 63 D.T.C. 1203.

⁷ [1964] S.C.R. 657, [1964] C.T.C. 372, 64 D.T.C. 5224, 47 D.L.R. (2d) 98.

⁸ [1969] S.C.R. 75, [1968] C.T.C. 438, 68 D.T.C. 5279.