1958

*May 19
Jun. 26

MINERALS LIMITED ..... APPELLANT;

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Dominion income tax—Sale of petroleum and natural gas leases —Whether proceeds taxable income or capital gain—The Income Tax Act, 1948 (Can.), c. 52, ss. 3, 4, 127(1)(e).

R, a promoter, organized a company, F.M. Co., to manage mineral rights on behalf of farmers in Saskatchewan. The scheme of operation was that a farmer who had given a petroleum and natural gas lease to a third person could transfer his mineral rights and assign his lessor's interest under the lease to the company, in return for stock and other benefits. R decided that no farmer who had not given such a lease should become a member of F.M. Co., but adopted a practice of personally leasing those rights under a form containing a one-year drilling commitment by the lessee which might be postponed from year to year by payment of 10¢ per acre "delay rental". The company appointed R its agent and promoter for 5 years. In 1950 R caused the appellant company to be incorporated and it became his "alter ego". R sold to the appellant his business as promoter of F.M. Co. and assigned to the appellant all the leases taken by him in his own name. The appellant continued the practice of taking leases in similar circumstances. R's evidence was that when these leases were taken "they did not know what they would do with them". In the spring of 1951 another company approached R with a view to acquiring the appellant's interest in some of the leases held by it. R refused this proposal but offered to sell the appellant's interest in all the leases held by it at a flat price of $2 an acre. This offer was accepted and, with a few minor exceptions, all the appellant's leases were assigned to the other company, at a substantial profit over the original cost.

Held: This profit was taxable income rather than a capital gain from realizing an investment. The test to be applied was that laid down in *Californian Copper Syndicate (Limited and Reduced) v. Harris* (1904), 5 Tax Cas. 159 at 165-6.

*PRESENT: Kerwin C.J. and Locke, Fauteux, Martland and Judson JJ.

The fact that the appellant's objects, as set forth in its memorandum of association, included the acquiring and selling of mineral claims and trading and dealing in leases was not of itself conclusive. *Sutton Lumber and Trading Company Limited v. The Minister of National Revenue*, [1953] 2 S.C.R. 77 at 83; *Salisbury House Estate, Ltd. v. Fry* (1930), 15 Tax Cas. 287 at 316, quoted and applied. On the facts, however, it must be held that the acquisition and sale by the appellant of the leases in question was part of the carrying on or carrying out of its business. *Glasgow Heritable Trust Company, Ltd. v. Commissioners of Inland Revenue* (1954), 35 Tax Cas. 196, distinguished.

The fact that the transaction was an isolated one and that the leases were sold as a group rather than individually did not in itself prevent the profit from being taxable. *Edwards v. Bairstow et al.*, [1956] A.C. 14; *McIntosh v. The Minister of National Revenue*, [1958] S.C.R. 119, applied. Having acquired the leases as a part of its business, the appellant never intended to retain them, either for purposes of development or as an investment, but did intend to sell them if and when a suitable price could be obtained. Consequently, the profit realized on their sale was not in the nature of a capital gain but was a profit made in the operation of the appellant's business.

APPEAL from a judgment of Thurlow J. of the Exchequer Court of Canada[1], dismissing an appeal from a decision of the Income Tax Appeal Board[2], which affirmed an assessment for income tax. Appeal dismissed.

R. A. MacKimmie, Q.C., for the appellant.

J. L. McDougall, Q.C., and A. L. DeWolf, for the respondent.

The judgment of the Court was delivered by

MARTLAND J.:—This is an appeal from a judgment of Thurlow J. in the Exchequer Court[1], dismissing the appellant's appeal from the Income Tax Appeal Board[2], which had dismissed an appeal from the income tax assessment of the appellant for the year 1951. The only question in issue was as to the inclusion by the respondent, as part of the appellant's income for that year, of an amount of $140,084.89 realized by it on the sale of certain petroleum and natural gas leases.

The facts are not in dispute. William Harrison Riddle, an American citizen and a promoter with considerable experience in the oil industry, in 1949 organized a scheme whereby farmers in Saskatchewan, owning mines and minerals in their lands subject to lease to other parties, could pool their interests in their mineral rights and under

[1] [1957] Ex. C.R. 43, [1957] C.T.C. 64, 57 D.T.C. 1063.

[2] 13 Tax A.B.C. 365, 55 D.T.C. 492.

1958

MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Martland J.

such leases. For this purpose he caused to be incorporated, under *The Companies Act* of Saskatchewan, on December 1, 1949, Farmers Mutual Petroleums Ltd. (hereinafter referred to as "Farmers Mutual"), with an authorized capital of 1,000,000 shares without nominal or par value.

The scheme of operation of Farmers Mutual was that a farmer wishing to become a member would transfer his mineral rights and assign his lessor's interest under his petroleum and natural gas leases to Farmers Mutual. That company would issue, in return, one share of its capital stock for each acre of mineral rights transferred to it and would agree to hold in trust for such member an undivided one-fifth interest in those mineral rights transferred to it by him.

By an agreement dated December 13, 1949, Farmers Mutual appointed Riddle as its promoter and organizer for a period of 5 years. He had the sole and exclusive right to solicit memberships in that company and to sell and promote the sale of its shares. He agreed to pay all expenses incurred in connection with the incorporation of the company and the sale of its shares and also agreed to pay for such clerical, bookkeeping and office facilities as it might require for its ordinary business. Farmers Mutual agreed to compensate Riddle by giving him an undivided one-fifth interest in all mineral rights acquired by Farmers Mutual and in all rents, profits and advantages accrued or to accrue therefrom, including rental payments under existing gas and oil leases held by Farmers Mutual.

Riddle employed a number of agents to solicit memberships in Farmers Mutual. He had initially assumed that all the farmers solicited would already have made leases of their petroleum and natural gas rights. He discovered that this was not always the case. While there was no legal impediment to preclude a farmer who had not leased his petroleum and natural gas rights from becoming a member of Farmers Mutual, Riddle adopted a policy of not admitting to its membership anyone who had not made such a lease. However, in the case of persons who had not so leased their petroleum and natural gas rights, he notified his agents that he, personally, was agreeable to leasing those rights. A form of petroleum and natural gas lease was used by his agents for this purpose, which provided for a 10-year

lease with a cash payment of 10¢ per acre of land leased, with a 1-year drilling commitment by the lessee, which commitment might be postponed from year to year by a payment of 10¢ per acre in each year. Such leases, when obtained, were assigned to Farmers Mutual in the same way as were members' leases to other lessees.

On May 30, 1950, Riddle caused to be incorporated, under *The Companies Act* of Saskatchewan, Minerals Ltd., the present appellant, with an authorized capital of $20,000, divided into 20,000 shares of a par value of $1 each. At the outset, all the issued shares in the appellant company were owned by Riddle and his wife. The appellant became his "alter ego". Accordingly, by agreement dated June 1, 1950, and made between Riddle and the appellant, Riddle sold to the appellant his business as promoter and organizer of Farmers Mutual, including his rights under the agreement of December 13, 1949, made between himself and Farmers Mutual. The consideration paid to Riddle was $10,000.

Another agreement was also made on June 1, 1950, by Riddle, the appellant and Farmers Mutual, whereby Riddle assigned to the appellant all his rights under the agreement of December 13, 1949. The appellant agreed to carry out all Riddle's obligations under that agreement and Farmers Mutual accepted the assignment.

Following the making of these agreements, the operation of Farmers Mutual was carried on by the appellant. Agents of the appellant solicited memberships in Farmers Mutual and continued the practice of taking leases of petroleum and natural gas rights from farmers in its own name in cases where they had not already made leases of their petroleum and natural gas rights. The appellant used a printed form of lease bearing its own name as lessee, similar in terms to the leases which Riddle had taken in his own name. The leases previously taken by him were assigned, in respect of his lessee's interest, to the appellant. Commissions were paid by the appellant to its agents in connection with the obtaining of these leases in the same way as they were paid for the obtaining of memberships in Farmers Mutual.

Farmers Mutual, through the efforts of Riddle and of the appellant, acquired mineral rights in approximately 750,000 acres of land in Saskatchewan. Petroleum and natural gas

1958

MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Martland J.

leases made to Riddle as lessee (and assigned by him to the appellant) and to the appellant as lessee totalled some 81,000 acres.

Funds were advanced from time to time to the appellant equally by Central Leduc Oils Limited and Del Rio Producers Ltd., two oil companies which were under the direction of Neil McQueen and Arthur Mewburn. In consideration of these advances, and in partial payment of them, one-half of the capital stock of the appellant was issued to these two companies in November 1950.

In his evidence Riddle, when asked as to the intention of the appellant regarding the petroleum and natural gas leases taken by it from farmers, stated that they did not know what they would do with them. He said that he tried to get McQueen and Mewburn to take them and that they did not want them.

He, himself, was approached at one time by a representative of British American Oil Company Limited, who suggested that Riddle should work as a broker for that company in obtaining leases for it and that that company would, as part of the arrangement, take over the leases held by the appellant. This offer was not accepted.

In the spring of 1951 Amigo Petroleums Ltd. approached Riddle, with a view to acquiring the interest of the appellant in some of the leases held by it. Riddle refused this proposal, but offered to sell the appellant's interest in all the leases which it held at a flat price of $2 per acre. This offer was accepted and a letter agreement was made between the appellant and Amigo Petroleums Ltd., dated May 5, 1951, respecting this sale, subject to the right of the Amigo company to refuse any lands in respect of which it was not satisfied as to title. All of the appellant's leases were assigned, pursuant to this agreement, to Amigo Petroleums Ltd., save only those relating to a small portion of the lands in respect of which there was some question as to title. The profit realized by the appellant upon this sale was $140,084.89.

The sole question in issue is as to whether this sum represents taxable income of the appellant or is a capital gain.

The relevant sections of the *Income Tax Act*, 1948 (Can.), c. 52, applicable in respect of this question are as follows:

3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

127. (1) In this Act, . . .

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment.

For the appellant it was contended that the sale of the petroleum and natural gas leases was an isolated transaction, whereby the appellant disposed of all its leases at a uniform price, and constituted the sale of a capital asset. The respondent took the position that the sale of the leases was a gain from a trade or business carried on by the appellant.

The test to be applied in resolving this issue is the frequently-cited statement of the Lord Justice Clerk in *Californian Copper Syndicate (Limited and Reduced) v. Harris*[1]:

It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for Income Tax.

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts;

[1] (1904), 5 Tax Cas. 159 at 165-6.

1958

MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Martland J.

the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

The respondent has made reference to the objects of the appellant as set forth in its memorandum of association, which include the acquiring and selling of mineral claims and trading and dealing in leases. The existence of these objects and powers, however, does not determine the question in issue here. Locke J., delivering the judgment of this Court in *Sutton Lumber and Trading Company Limited v. The Minister of National Revenue*[1], states:

> The question to be decided is not as to what business or trade the company might have carried on under its memorandum, but rather what was in truth the business it did engage in. To determine this, it is necessary to examine the facts with care.

Similarly, Lord Warrington of Clyffe, in *Salisbury House Estate, Ltd. v. Fry*[2], says:

> But the Crown contends that the fact that the taxpayer is a limited company may distinguish its operations from those of an individual. Assuming the Memorandum of Association allows it, and in this case it unquestionably does, a Company is just as capable as an individual of being a landowner, and as such deriving rents and profits from its land, without thereby becoming a trader, and in my opinion it is the nature of its operations, and not its own capacity, which must determine whether it is carrying on a trade or not. Nor do I see any reason why, as in the present case, some of its operations under the wide powers conferred by the Memorandum should not be operations of trade, whereas others are not.

It is, therefore, necessary to determine from other evidence whether in fact the acquisition and sale by the appellant of the leases in question were merely the realization of an ordinary investment or were a part of the carrying on or carrying out of the appellant's business.

The principal business of the appellant was the sale and the promotion of the sale of shares in Farmers Mutual and the organization of that company. As previously pointed out, Riddle, and, in turn, the appellant, decided, as a matter of policy, that they would take petroleum and natural gas leases from farmers who had not previously leased those rights, so as to make it possible for them to become members of Farmers Mutual. This was not a matter of legal

[1] [1953] 2 S.C.R. 77 at 83, [1953] C.T.C. 237, [1953] D.T.C. 1158, [1953] 4 D.L.R. 801.

[2] (1930), 15 Tax Cas. 287 at 316.

necessity to enable such farmers to become members of Farmers Mutual. It was not incumbent on the appellant to take such leases. It did so as a matter of business judgment and as a part of its business in relation to the sale of shares of Farmers Mutual.

Having acquired those leases, what disposition was to be made of them by the appellant? The leases involved drilling commitments or, alternatively, payments for postponement of those drilling obligations. It has already been mentioned that in his evidence Riddle said, respecting his intention in connection with these leases, that they did not know what they would do with them, that he had tried to get McQueen and Mewburn to take them, but that they did not want them. He said that they talked about the leases several times and that they knew they would have to pay (*i.e.*, the delay rentals) if they kept them long enough. In the end a sale of the leases was made less than a year after their acquisition.

The appellant argued that the leases had been acquired unwillingly and not as a part of the appellant's business. It was contended that the situation was analogous to that in *Glasgow Heritable Trust, Ltd. v. Commissioners of Inland Revenue*[1].

In that case the appellant company was formed to acquire tenement properties previously owned by a partnership of builders. The shares of the company were mainly held by the former partners, or members of their families. Sales of flats took place from time to time either to sitting tenants or when flats were vacated by tenants. The evidence established that the operation of the appellant company was in the nature of a salvage proposition. It was pointed out in the judgment of the Lord President at p. 215 that:

> The purpose which informed the Company was to salve something from the wreck of a type of trading enterprise which when the Company was formed was not "dormant" but dead, by selling the separate flats in the only possible fashion for the benefit of the firm's creditors and of the beneficiaries on the estates of the deceased partners.

The circumstances of that case are not at all similar to those in the present one. In this case the leases were deliberately acquired by the appellant as a part of its business in operating Farmers Mutual. There is no evidence

[1] (1954), 35 Tax Cas. 196.

1958

MINERALS LTD. v. MINISTER OF NATIONAL REVENUE

Martland J.

whatever of any intention either to work them or to retain them as an investment. The appellant was aware of the payments which would be required if they were retained and the leased lands were not drilled. It elected to sell them.

The fact that the leases were sold as a group rather than individually or in separate portions does not affect the result. The appellant contended that this was an isolated transaction, but that does not, in itself, prevent the profit from being taxable, as is pointed out in *Edwards v. Bairstow et al.*[1], and in *McIntosh v. The Minister of National Revenue*[2].

In my view, having acquired the leases as a part of its business, the appellant never intended to retain them, either for purposes of development or as an investment, but did intend to sell them if and when a suitable price could be obtained. Consequently the profit realized on their sale is not in the nature of a capital gain, but is a profit made in the operation of the appellant's business.

I would, therefore, dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Allen, MacKimmie, Matthews & Wood, Calgary.

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

---

[1] [1956] A.C. 14, [1955] 3 All E.R. 48.

[2] [1958] S.C.R. 119, [1958] C.T.C. 18, [1958] D.T.C. 1021, 12 D.L.R. (2d) 219.