

<p>SUTTON LUMBER AND TRADING }          COMPANY LIMITED ..... }</p>	<p>APPELLANT;</p>	<p>1953          *May 15,          18, 19          *June 26</p>
AND		
<p>THE MINISTER OF NATIONAL }          REVENUE ..... }</p>	<p>RESPONDENT.</p>	

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

*Taxation—Income—Excess profits—Sale of timber land by lumber company—Whether profits assessable—Whether in the course of carrying on the business of dealing in timber limits—Was the sale part of the business carried on—Excess Profits Tax Act, 1940.*

The appellant was incorporated in 1893 by memorandum of association under the British Columbia Companies Act 1890, and re-incorporated in 1902 under the Companies Act, 1897. The declared objects of the company included the acquisition of timber lands, leases of such lands and licences to cut timber and turning the same to account, and of saw mills and other mills and factories for the manufacturing of lumber and lumber products, and of water rights for such purposes. The portion of the memorandum in which the objects were defined included the power to sell or otherwise dispose of the properties of the company. The company acquired extensive areas of timber lands

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\*PRESENT: Taschereau, Estey, Locke, Cartwright and Fauteux JJ.

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in the Clayoquot and Nootka Districts on the West Coast of Vancouver Island, some of which were Crown granted and some held under timber leases from the Crown. In the year 1906 a lumber mill was built in the Clayoquot District and manufacturing commenced but, proving unprofitable, the operation was closed down at the end of 1907. Thereafter the lumber mill was kept in repair, surveys were made for the purpose of ascertaining the most profitable means of turning to account the timber upon the company's holdings, water rights were acquired and the preliminary work done for the construction of a dam for the purpose of utilizing such rights. In the year 1942 the mill had been dismantled on the order of the Machinery Controller of Canada and the machinery sold. According to the evidence, it had been the intention of those controlling the company since the year 1902 to utilize the timber limits for the manufacture of cedar lumber in a location in the Clayoquot District. In 1946 the company sold the greater part of its holdings in the Nootka area and was assessed under the *Excess Profits Tax Act 1940* for the profit made upon the sale.

*Held:* The evidence disclosed that the business carried on and intended to be carried on by the company had not at any time been that of purchasing and selling timber lands or interests in such lands but that of manufacturing cedar lumber from the properties in a mill to be operated in the Clayoquot District: that the sale was of a capital asset which was not required and did not fit in to the company's plans for the operation of its main properties and the profit resulting from the sale was not assessable to Excess Profits Tax under the *Act*.

*Anderson Logging Co. v. The King* [1925] S.C.R. 45 distinguished. *Commissioner of Taxes v. The Melbourne Trust Ltd.* [1914] A.C. 1001 and *California Copper Syndicate v. Harris* (1904) 5 T.C. 159 referred to.

APPEAL from the judgment of the Exchequer Court of Canada, Archibald J. (1), upholding the Minister's assessment.

*C. K. Guild Q.C. and O. F. Lundell* for the appellant.

*D. W. Mundell Q.C., J. D. C. Boland and K. E. Eaton* for the respondent.

The judgment of the Court was delivered by

LOCKE, J.:—This is an appeal from a judgment of Archibald J. (1) dismissing the appeal of the present appellant from an assessment made under the *Excess Profits Tax Act 1940* for the taxation year 1946.

The assessment in question was made in respect of a profit of \$95,102.90 made by the appellant upon the sale in the year 1946 of a parcel of Crown granted land described as Section 1, Nootka District, British Columbia, and its interest in seven renewable timber leases made between the

Crown in right of the Province and the appellant in respect of lands in the said district. The appellant gave notice of appeal to the Minister of National Revenue under the provisions of section 14 of the *Excess Profits Tax Act* on the ground that the profit was not income, within the meaning of the *Act*, and the latter affirmed the assessment. Archibald, J. (1) in dismissing the appeal, apparently considered that the question to be determined was governed by the judgment of this Court in *Anderson Logging Co. v. The King* (2).

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The Sutton Lumber and Trading Company Limited was first incorporated by a memorandum of association under the provisions of the Companies Act 1890 of the Province of British Columbia in the year 1893. In the year 1897 that Act was repealed and the various statutes dealing with the incorporation of companies consolidated in the Companies Act 1897. By s. 5 of that statute it was provided that a company theretofore incorporated by memorandum of association, upon compliance with prescribed formalities, might deliver to the Registrar of Companies a copy of its charter and regulations and its certificate of incorporation and receive a certificate of what was called the "reincorporation" and registration of the company as a company under the new Act. The appellant company, taking advantage of this provision, was reincorporated under the Act of 1897 on November 17, 1902. The authorized capital was \$100,000, divided into 1,000 shares of \$100 each, at which figure it has remained to the present day.

The British Columbia legislation providing for the incorporation of companies by memorandum of association followed the plan provided in England by the Companies Act of 1862. Companies so incorporated, as was decided in the House of Lords in *Ashbury Carriage Company v. Riche* (3), and in *Attorney-General v. The Directors of the Great Eastern Railway Company* (4), have no inherent common law rights and are accordingly restricted in their activities to carrying out the objects and exercising such powers as are described in the memorandum, including those which are fairly incidental to those things which the Legislature has authorized. No doubt, it was for this reason

(1) [1952] Ex. C.R. 498.

(3) (1875) L.R. 7 H.L. 653.

(2) [1925] S.C.R. 45.

(4) (1880) 5 App. Cas. 473.

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that until the passing of the Companies Act of 1929, which by s. 22 gave to all companies, thereafter incorporated by memorandum, extensive powers for the purpose of carrying out their declared objects without the necessity of enumerating them in the memorandum, the memoranda of association of many companies incorporated in the province included far reaching powers to carry on activities, many of which were far removed from the real purpose of the incorporation of the company.

The memorandum of association, in so far as its terms affect the present matter, reads as follows:—

2. The objects for which the Company is established are:—

- (1) To purchase, take on lease, or otherwise acquire and hold any lands, timber lands or leases, timber claims, licenses to cut timber, rights of way, water rights and privileges, foreshore rights, wharves, saw mills, factories, buildings, machinery, plant, stock-in-trade, or other real and personal property, and equip, operate and turn the same to account, and to sell, lease, sublet or otherwise dispose of the same, or any part thereof, or any interest therein.
- (2) To purchase, lease, hire, build, and operate saw mills and other mills and factories for the manufacturing of lumber and sale of lumber, shingles, boxes, blinds, sash and furniture, and any other articles of which wood shall form a component part.
- (3) To carry on the business of saw mill proprietors and merchants and manufacturers of and dealers in timber and lumber of all kinds.
- (4) To construct dams and improve rivers, streams and lakes, and to divert the whole or part of the water of such streams and rivers as the purposes of the Company may require.
- (5) To catch, purchase, preserve, sell and deal in seals, and seal skins, and all kinds of fish, and the products thereof, respectively; to acquire, erect and operate fish canneries; and to purchase, sell and trade in general merchandise.
- (6) To carry on all or any of the businesses of dealers in furs, skins and fish, exporters and importers, carriers by land and water, warehousemen, wharfingers and general traders and merchants.
- (7) To construct, carry out, acquire by purchase or otherwise maintain, improve, manage, work, control and superintend any trails, roads, railways, tramways, bridges, reservoirs, watercourse aqueducts, wharves, saw mills, electrical works, telephones, factories, warehouses, ships, vessels, fishing and other boats, and other works and conveniences which the Company may think directly or indirectly conducive to any of these objects, and to contribute or otherwise assist or take part in the construction, maintenance, development, working, control and management thereof.
- (8) Generally to purchase, take on lease, hire, or otherwise acquire any real and personal property, and any rights and privileges which the Company may think necessary or convenient for the purposes of its business.

- (9) To use water, steam, electricity, or any other power now, or hereafter to become known as a motive power or in any other ways for the uses and purposes of the Company.
- (10) To acquire, operate, and carry on the business of a power company under Part IV of the Water Clauses Consolidation Act, 1897.
- (11) To acquire and carry on all or any part of the business or property, and to undertake any liabilities of any person, firm or association, or Company, possessed of property suitable for the purposes of this Company, or carrying on any business which this Company is authorised to carry on, or which can be conveniently carried on in connection with the same, or may seem to the Company calculated directly or indirectly to benefit the Company, and as the consideration for the same to pay cash or to issue any shares, stocks or obligations of this Company.
- (12) To enter into partnership or into any arrangement for sharing profits, union of interests, co-operation, joint adventure, reciprocal concessions, or otherwise, with any person or company carrying on, or engaged in, or about to carry on or engage in, any business or transaction which this Company is authorised to carry on or engage in, or any business or transaction capable of being conducted so as directly or indirectly to benefit this Company; and to lend money to, guarantee the contracts of, or otherwise assist any such person or Company, and to take or otherwise acquire shares and securities of any such Company, and to sell, hold, re-issue, with or without guarantee, or otherwise deal with the same.
- (13) To sell or dispose of the undertaking of the Company, or any part thereof, for such consideration as the Company may think fit, and in particular, for shares, debentures, or securities of any other Company having objects altogether, or in part, similar to those of this Company.
- (14) To promote any Company or Companies for the purpose of acquiring all or any of the property and liabilities of this Company, or for any other purpose which may seem directly or indirectly calculated to benefit this Company.
- (15) To borrow or raise money for any purpose of the Company, and for the purpose of securing the same and interest, or for any other purpose, to mortgage or charge the undertaking, or all or any part of the property of the Company, present or after acquired or its uncalled capital, and to create, issue, make, draw, accept and negotiate perpetual or redeemable debentures or debenture stock, promissory notes, bills of exchange, bills of lading, warrants, obligations and other negotiable and transferable instruments.
- (16) To take or otherwise acquire, and hold shares in any other Company having objects altogether or in part similar to those of this Company, or carrying on any business capable of being conducted so as directly or indirectly to benefit this Company.
- (17) To distribute any of the property of the Company among the members in specie.

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(18) To sell, improve, manage, develop, exchange, lease, mortgage, dispose of, turn to account, or otherwise deal with the undertaking, or all or any part of the property, and rights of the Company, with power to accept as the consideration any shares, stocks or obligations of any other Company.

(19) To do all such other things as are incidental or conducive to the attainment of the above objects, or any of them.

It will be noted that, while the foregoing subparagraphs 1 to 18 are referred to in the opening words of the paragraph as objects, objects and powers are mingled. It is, in my opinion, a matter of some difficulty to sever what were intended as objects from those which were merely powers, but it seems to me to be clear that to operate and turn to account saw mills, factories, water rights and timber lands or leases in subparagraph 1 and the activities referred to in subparagraphs 2, 3, 5, 6 and 10 were clearly intended as objects, while the remainder of the subparagraphs were intended to define the powers taken for the purpose of carrying out such objects. When, for the purpose of obviating the necessity of defining the powers taken in such detail, the Legislature enacted s. 22 of the Companies Act 1919, the powers which were given to all companies thereafter incorporated as ancillary and incidental to the objects set forth in the memorandum included practically all of those enumerated in subparagraphs 1, 7, 8, 9 and 11 to 19, both inclusive, in addition to others. The powers so vested in every company incorporated under the terms of the Act of 1919 and in any company which might under the provisions of s. 51 of the Act, by ordinary resolution, alter its memorandum of association so as to include any or all of the powers referred to in s. 22, include, it is to be noted, the right:—

- (a) To purchase, take on lease or in exchange, hire, or otherwise acquire and hold any real and personal property and any rights or privileges which the Company may think necessary or convenient for the purposes of its business; . . .
- (l) To sell or dispose of the undertaking of the company or any part thereof for such consideration as the company may think fit . . .

AND

- (q) To sell, improve, manage, develop, exchange, lease, dispose of, turn to account, or otherwise deal with all or any part of the property and rights of the company.

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.

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The company was incorporated under the Act of 1890 at the instance of W. J. Sutton, J. E. Sutton and their associates and acquired from one of the Suttons a lease granted by the Provincial Government of ten sections in the Clayquot District on the West Coast of Vancouver Island. By the terms of the Lands Act of 1888, the Lieutenant-Governor in Council were authorized to grant renewable leases for terms not to exceed thirty years, containing provisions binding the lessee to erect in some part of the Province a lumber mill capable of cutting not less than 1,000 ft. of lumber per day for every 400 acres of land included in the lease. The company, while controlled by the Suttons, had built and operated what was referred to as a small lumber mill. The extent of the holdings of the company during this time was apparently some 2,500 acres.

In November 1902, W. H. and A. F. McEwan of Seattle, the principals in the Seattle Cedar Lumber Manufacturing Company, which was engaged in the production of cedar lumber in the State of Washington, acquired the share interest of the members of the Sutton family. As shown by the Minute Book of the company, the McEwans and one of their solicitors at Victoria were appointed the first directors of the company following its reincorporation and a resolution was passed that the registered office be at No. 2 Broughton Street in Victoria.

In November 1903, B. W. Arnold, a lumberman carrying on business in Ontario and the Eastern United States, became a shareholder and was elected a director and thereafter agreed to advance to the company the funds necessary for the construction of what was referred to as a mill and logging plant at Clayquot. Between the years 1902 and 1905, renewable leases of large areas of timber in the Clayquot area were obtained by the company from the Provincial Government and some Crown granted lands were purchased. In addition, during this time certain leases and some Crown granted lands were obtained in the Nootka District lying to the north of the Clayquot District.

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The English Lumber Company, a Washington corporation, acquired shares in the company at a date which is not disclosed in the evidence. Whether the shares were held in the name of the company or that of Edward English, the directing head of the company, is not shown. No further leases or Crown grants of timber were acquired between 1905 and the time of the sale made in 1946 which gave rise to the present litigation.

In 1946, Mr. A. F. McEwan alone survived of those who had been the principals in the direction of the affairs of the appellant company in 1915 and he died before the present dispute arose. W. H. McEwan, Arnold and Edward English had all died long prior to that time. There was, however, in the employ of the Seattle Lumber Company Wm. C. Schultheis who, since the year 1898, had been employed by that company as a log and timber buyer and looked after the outside interests of the McEwans and was intimately familiar with the activities of the appellant company between the year 1902, when the McEwans first acquired their interest, up, until the present time. In 1923, on the death of W. H. McEwan, Schultheis had succeeded him as a director and had been elected Vice-President of the appellant company.

Schultheis said that, at the time the McEwans acquired control of the appellant company, there was only a cursory examination made by cruisers of the limits in the Clayoquot area. There was only a limited time to take up the options his employers had taken upon the Suttons shares and the cruisers found enough timber to justify the purchase. Cedar predominated throughout the area. The Suttons apparently had not any cruise of the timber. It was apparently prior to 1905 that certain leases had been obtained in the Nootka District, which lay in a different water shed than Clayoquot. In either of the years 1904 or 1905 the company purchased three Crown granted claims from a Captain Townsend, which were suitable for a mill site and booming grounds. In the year 1905 the company started clearing the land for the erection of a mill in Mosquito Harbour in the Clayoquot District and obtained fore shore leases at that place and booming ground rights near the mouth of the Kennedy River. In the same year, it applied for and obtained a water licence enabling it to divert water from



Sutton Creek, a tributary of Mosquito Harbour, for the purpose of milling operations. In the year 1906 the mill was built, designed for the manufacture of cedar lumber and shingles. It was not designed to handle fir logs. The mill operated with logs cut from the adjoining limits of the company during the year 1907. The financial statement of the company as of January 1, 1908, showed an investment in buildings, machinery, machine shops, etc. in excess of \$153,000. Other buildings including dwellings had accounted for an expenditure in excess of \$14,000. Something more than \$24,000 had been spent on dock construction in the harbour and for donkey engines and other equipment for use in logging, something more than \$15,000 had been expended. The capital stock of the company remained at \$100,000 and the company was indebted to its stockholders for loans of money, apparently for the acquisition of the timber limits, the payment of rentals and the construction and equipment of the mill in an amount approximating \$460,000.

This was apparently the first time that a cedar mill had been operated on the West Coast of Vancouver Island and the results were not profitable. A cargo of lumber was shipped to the New York market which arrived there at the time of the financial panic of 1907 and a heavy loss resulted. The loss in the operations for the year 1907 approximated \$150,000 and the mill was closed down. In so far as the market in the United States was concerned, Schultheis said it was decided to wait until the Panama Canal was completed. The location of the timber was such that during this period it was not possible to sell logs on the West Coast market at a profit. Owing to the necessity of rafts being towed for long distances in the open sea, such an operation was not possible and Davis rafts which might have made this feasible were not then known.

The financial statement of the company for the year 1909, during which neither the lumber nor shingle mills were operated, shows the investment of the company in the mill site before depreciation at \$153,427.14, for outside buildings and dwellings \$14,010.39, for the fresh water system \$6,857.66, for dock construction \$24,325.76, for woods plant comprising logging, donkeys, equipment, etc. \$15,713.83, for the Tug Clayoquot \$5,041.03, for the cook

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house and camp buildings \$2,366.90, in addition to the amounts invested in boom chains and other miscellaneous equipment. The advances by shareholders to the company as at the end of the year totalled \$462,000. A caretaker was employed at the mill and no logging operations were carried on.

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According to Schultheis, it was either in the year 1910 or 1911 that a timber cruiser was sent to make an examination of the Nootka limits and he reported that they were predominantly fir. These limits constituted only about one-seventh of the company's holdings and it was not practical to operate a fir mill in the Nootka District and a cedar mill in Clayoquot. On October 10, 1911, at the annual meeting of the shareholders held at Victoria, the directors were authorised to sell for such consideration as they thought fit the three Crown granted lots in the Nootka District and the company's leasehold holdings in that area. Other than the Crown granted lots, these were the properties which were sold thirty-five years later, the sale resulting in the profit sought to be taxed in these proceedings.

In the year 1922 the company had all of the limits completely cruised. In the Nootka District the area of the Crown granted and leased lands was 10,195 acres, upon which there was an estimated 335,701,000 ft. B.M. of timber, the greater part of which was fir, hemlock and balsam; in the Clayoquot District, where there was comparatively little fir and cedar greatly predominated, the area of the limits was 63,665 acres, containing an estimated 1,955,616,000 ft. B.M. The evidence of the witness Schultheis, together with that of Mr. Aird Flavelle, a manufacturer of cedar lumber of very long experience on the West Coast and who had an intimate knowledge of the cedar market during the past forty years, show conclusively that, from the time of the acquisition of the limits until after the conclusion of the Second World War, the manufacture of cedar lumber on the properties or the sale of cedar logs from the limits was not economically possible. The company, however, maintained the lumber and shingle mill and the appurtenant properties in a state of repair, looking forward to the day when operations might become possible. In 1924, concrete foundations were placed under

the mill replacing the timber posts originally installed. A caretaker was maintained continuously until it was dismantled in the year 1942.

In 1926, the company employed W. C. Morse, a hydraulic engineer, to advise as to the best means of bringing logs from Kennedy Lake, which lay in a southeasterly direction from the mill in Mosquito Harbour, down the Kennedy River to salt water, and after an extensive survey received his opinion as to the most feasible method and the probable cost. The engineer was further instructed to examine the area and report as to the possibilities of developing hydro-electric power in the Kennedy Lake area and as to suitable locations for a ground wood paper mill in the area, and two written reports made by him respectively in July and August 1926 were put in evidence. Mr. Morse advised that a suitable power site was available at the Kennedy River Rapids where there was an excellent dam site. He advised that a very large amount of timber would have to be cut and bucked before the lake level could be raised and advised as to its disposition. As to a site for such a mill, he said that there was a suitable location at the mouth of the Kennedy River with a wharf facing on deep navigable waters in Tofino Inlet and advised as to the cost of installations for the production of 9,550 and 18,500 horse power respectively. The engineer considered that the ideal combination to develop the timber in the Clayoquot District would be a cedar mill, a hemlock mill and a pulp and paper mill and, as between the existing location of the company's mill at Mosquito Harbour where the mill was, in his opinion, worth around \$150,000, advised as to the suitability of a second site at the mouth of the Kennedy River and a third site at Mud Bay, giving figures as to the cost that would be involved in further construction at Mosquito Harbour if operations were to be continued there and if mills were constructed at the alternative sites. As an alternative to construction on the West Coast of Vancouver Island, the engineer considered and advised as to the cost of delivering logs to Alberni at the head of the Alberni Canal, assuming the company should decide to build a cedar mill at that point rather than in the vicinity of its Clayoquot holdings.

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In advance of incurring the expense of these surveys by Mr. Morse, a reservation of the water power in the area was made and the official findings of the engineer were filed with the Water Board at Victoria. A contract was made to drill the foundations for a dam at Kennedy Rapids and this work was done. The company also undertook negotiations with the Crown Zellerbach Corporation for the establishment of a pulp mill which continued over an extended period. The company had purchased a suitable property as a site for a pulp mill and town site at Mud Bay at a cost of \$5,000, having accepted the recommendation of the engineer as to this. However, construction was not proceeded with and the depression commencing at the end of the year 1929 rendered impossible the profitable operation of the properties.

Other than the logging and lumbering activities which were carried on in the years 1906 and 1907, no such operations were carried on until the year 1937 when the company, by a contract dated August 3, sold to Gibson Brothers Limited the merchantable timber on section 2, which was Crown granted, in the Nootka District and upon the lands covered by the timber lease of Lot 656 in that area. Upon these areas there was, as shown by the cruise, 50,809,000 ft. of fir and 651,000 ft. of cedar. The contract price was a stumpage rate of \$3 per thousand of timber cut from the Crown granted lands and \$2 per thousand for timber cut from the lease, and in addition 50 per cent of the net proceeds received from the purchaser from the sale of the logs, after the deduction of logging and marketing costs specified by the agreement. By the agreement, the purchasers agreed to log and raft not less than 10,000,000 ft. B.M. during each twelve month period and, on the demand of the vendor, to sell to it all cedar logs cut from the property from time to time at the then market price. By a further agreement dated August 17, 1938, the company agreed to sell to Gibson Brothers Limited all the merchantable timber on its timber lease on Lot 34 in the Nootka District on the same terms. The purchaser found the logging operations unprofitable and did not complete the logging of the said limits and, by an agreement dated March 31, 1943, the two agreements were terminated and Gibson Brothers Limited was released from further liability.

On March 31, 1945, the company entered into an agreement to sell the merchantable timber upon part of its holdings in the Clayoquot District to the North Coast Timber Company Limited at an agreed stumpage rate and, in addition, in consideration of 60% of the net proceeds which the purchaser should receive from the sale of all logs cut off the said lands, the purchaser agreeing to log and raft not less than 20,000,000 ft. and not more than 35,000,000 ft. in each period of twelve months throughout the term of the contract. Much of the timber so sold was upon limits that, according to Morse's survey, would be flooded by the construction of a hydro-electric plant on Kennedy River. The North Coast Company sold its interest in the contract to Kennedy Lake Logging Co. Ltd. and active logging operations were commenced and were being carried on at the time of the trial of this action. The logs cut were taken to mills at Port Alberni and this was apparently the first time that, following the termination of the Second World War in 1945, the market was such as to permit logging the cedar timber at a profit. The financial statement of the company for the year 1946 showed receipts from stumpage and profit sharing under the North Coast agreement amounting to \$49,754.68.

Other than such amounts as had been received from the logging operations of Gibson Brothers Limited, the company had had no income between the year 1907 and the year 1946. The moneys to provide for the payment of rentals, for the timber leases and for the other expenditures of the company were provided accordingly by loans made to the company by the shareholders which totalled as of December 31, 1946, \$1,081,588.52.

During the year 1946 the company sold to British Columbia Forest Products Ltd. section 1 and all of its interest in its timber leases in the Nootka District, realizing, according to its financial statement, a profit of \$95,261.10, which was carried to capital surplus in the balance sheet.

The company's mill at Mosquito Harbour had been dismantled in the year 1942 on the order of the Machinery Controller of Canada and the machinery sold. It was impossible to buy machinery during the war years but, after the sale in 1946, the company had been endeavouring to locate a suitable mill site in the vicinity of the Alberni

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Canal and, in the year 1948, purchased a property at Ucluelet in the Clayoquot District which had been used as an airport during the war and upon which there were hangars and numerous other buildings, of which use might be made when establishing a mill, the consideration for the purchase being approximately \$60,000.

Keith Fiskien, the Treasurer of the appellant company, had been a director since 1938 and President from that year until 1950, an officer of the Seattle Cedar Company since 1930 and was the executor of the estate of A. F. McEwan and intimately associated with the affairs of the appellant since being elected to its Board. Since 1938 he said that the directors had attempted on numerous occasions to find a way to operate the property but that every time it appeared that something could be done the cedar market fell. The English Lumber Company, to which the appellant company was indebted as of December 31, 1946, in the sum of \$270,397.55 for advances and which held 25 per cent of the shares, got into difficulty with its creditors and its shares were taken over by them and further advances by that company were not available. In the existing state of the company's finances, the only source from which moneys for the construction of a mill and the developing of the property could be sought was from the shareholders. The company had not built a new mill up to the time of the inception of these proceedings.

In addition to the evidence of the actual activities carried on by the company since 1902, the appellant tendered at the hearing the evidence of Schultheis as to the business which those who controlled the company intended that it should carry on. Schultheis, as I have said, did not become a director of the company until 1923, when he was elected as such upon the death of A. F. McEwan. He was, however closely associated with the McEwans and their associates in the company and had been present at many conferences between them and Arnold prior to 1905 and was clearly in a position to say how the then directors intended to deal with the property. Counsel for the Crown, however, objected to Schultheis giving evidence as to the business which it was intended that the company should carry on and the learned trial Judge ruled that his evidence was inadmissible, apparently on the ground that he was not

then a director of the company. Thus, since all of those who were directors at the time were dead, the intention of those who controlled and directed its activities must be sought by inference from the record of the business actually carried on.

In my opinion, the evidence of Schultheis as to the business which the company proposed to carry on between the years 1902 and 1923 was improperly rejected. The record, however, of the activities of the company during this period is consistent only with the view that the intention was to carry on the business of operating a saw mill for the production of cedar lumber in the Clayoquot District. There had been no real cruise made of the timber in the Nootka area in 1910 or 1911 but the examination which had been made apparently led the directors to believe that the timber was predominantly fir and thus unsuitable for manufacturing into lumber in a cedar mill, whereupon they passed the resolution in October 1911 that these limits be disposed of. In fact, when an accurate cruise was made of all the properties by Gardiner and Baxter in 1922, it was disclosed that there was more cedar than fir upon the Nootka Limits. Taking, however, the hemlock, balsam and other species, the cruise showed the cedar to be only slightly more than one-third of the timber upon the property. The evidence of Schultheis, who was permitted to speak of the activities which the company proposed to carry on from the time in 1923 when he was elected a director, and of Fiske and the record of the heavy expenditures made by the company in Morse's survey, for the upkeep and maintenance of the mill, for the acquisition of a mill site, for a site for a pulp mill which could be operated in conjunction with a lumber mill, for the purchase of the mill and town site at Ucluelet and the acquisition of the water rights on Kennedy River, demonstrated, in my opinion, that those who controlled this company did not depart from their original intention to utilize these extensive limits for the manufacture of cedar lumber in a location in the Clayoquot District. The sales to Gibson Brothers and to the North Coast Timber Company were made in the hope of obtaining some money to assist in carrying the properties, which cost annually for rentals and taxes some \$20,000, and the sale of the Nootka

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limits, which did not fit in to the proposed cedar operations, was to obtain funds to repay part of the long-standing indebtedness of the company to its shareholders.

In the reasons for judgment delivered at the trial, the learned trial Judge, commenting on the evidence of Schultheis, said that the evidence did not satisfy him that the witness had detailed knowledge respecting all the plans of the directors of the appellant company and that he could not accept his evidence as conclusive proof of the intent and purposes of the directors during the early years of its existence, adding that he found his evidence entirely unsatisfactory in that respect. With respect, this comment appears to overlook the fact that the evidence of Schultheis, which had been tendered as to the activities proposed to be carried on by the directors between the period 1902 to 1923, had been rejected. As to the business carried on and intended to be carried on from 1923 onward, the evidence is clear, direct and uncontradicted.

The case for the Minister is apparently based upon the fact that in subparagraph 1 of paragraph 2 of the memorandum the power "to sell, lease, sublet or otherwise dispose of" timber lands and leases was taken. It was apparently considered by the draftsmen of the memorandum that this power should be expressly taken. Had the Companies Act of 1897 included a section similar to s. 22 of the Act of 1929, the power to sell the limits would have been implied. The existence of this power does not afford evidence that the company was, in truth, carrying on the business of buying timber lands or acquiring leases and selling them with a view to profit. The evidence submitted by the appellant in the present case demonstrates the contrary. In *Anderson Logging Company v. The King*, above referred to, the appellant company was incorporated under the British Columbia Companies Act of 1907. The objects declared in the memorandum included the following:—

To stake, lease, record, purchase, sell and *deal in* timber licenses, timber leases and timber lands and to cut and buy and sell timber of all sorts and to carry on a general business as logger and dealer in logs and timber of all sorts in British Columbia and elsewhere.

The company had purchased certain timber limits and these were sold at a substantial advance over their cost and the question was as to whether this profit was income, within



the meaning of the *Income and Personal Property Taxation Act (B.C.) 1921*. While the company had carried on business for several years, no evidence was given as to the nature of the business actually carried on from the time of its inception until the year 1916, a fact commented on by Duff, J. who delivered the judgment of the Court upholding the assessment. After pointing out that there was only evidence of one transaction, the purchase of the limits in question, the following further comment was made:—  
(p. 51).

It is not unimportant to remark that neither of the principal partners of the company, who could have given a history of the company's affairs from its inception, was called as a witness, nor, as has already been mentioned, was any but the most meagre evidence adduced as to the character of the company's operations before 1916.

In the absence of the evidence of any one having any knowledge of what was referred to as the *design* of the directors of the company in purchasing the limits and as one of the substantive objects of the company, as declared by the memorandum, was to acquire timber lands and timber rights with a view to dealing in them and turning them to account for the profit of the company, it was held that the appellant had failed to show that the assessment was one which ought not to have been made.

The question as to whether or not the present appellant was engaged in the business of buying timber limits or acquiring timber leases with a view to dealing in them for the purpose of profit is a question of fact which must be determined upon the evidence. It may be noted that the memorandum of the appellant, while including the power to sell or dispose of timber properties, *to deal in* timber licenses is not one of the objects stated as it was in the *Anderson* case. Had it in fact included such an object, the evidence in this case demonstrated that the company at no time carried on or intended to carry on any such business. Unlike that case, in the present matter all the available evidence as to the activities carried on or intended to be carried on by the company in the fifty years prior to the time of the trial of this action was given or tendered by the appellant. The decision in that case does not, in my opinion, affect this matter.

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In *Commissioner of Taxes v. The Melbourne Trust Limited* (1), Lord Dunedin, in delivering the judgment of the Judicial Committee, quoted with approval the following passage from the judgment in *California Copper Syndicate v. Harris* (2):

It is quite a well settled principle in dealing with questions of income tax that where the owner of an ordinary investment chooses to realize 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 realization or conversion of securities may be so assessable where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business.

In the present case, the Nootka limits which were sold in 1946 were assets in which the company had invested with a view to cutting the merchantable timber into lumber in a mill to be erected by it in the Clayoquot District and the sale merely a realization upon one of its capital assets which was not required and did not fit in to the company's plans for the operation of its main property and one which was not made in the course of carrying on the business of buying, selling or dealing in timber limits or leases.

The appeal should be allowed with costs throughout and the judgment of the Exchequer Court and the assessments made set aside.

*Appeal allowed with costs.*

Solicitor for the appellant: *O. F. Lundell.*

Solicitor for the respondent: *J. D. C. Boland.*

(1) [1914] A.C. 1001 at 1010.

(2) (1904) 5 T.C. 159.