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HIGHWOOD-SARCEE OILS LIMITED....APPELLANT;

AND

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

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Income Tax—Income War Tax Act (Dom.)—Computing amount to be assessed—Deductions claimed for losses—Nature of business carried on—Capital losses—Whether investments were of fixed or circulating capital.

Appellant claimed that in computing the amount of its assessment for income tax under the Dominion *Income War Tax Act* certain losses which it suffered should have been allowed as deductions; that in the taxation year in question and previously it was carrying on the business of financing other concerns engaged in or interested in the development of prospective oil properties and in trading and dealing in oil lands, leases, oil stocks, etc., and in the taxation year in question it was not in receipt of income within the meaning of said Act but made a loss. Respondent claimed that appellant's business in respect of which it claimed the deductions was the development of oil or gas properties by the investment of its capital for said purpose, and for its benefit of a share in the production of such properties as gains or profits to it from such outlay of capital, and that no deduction could be allowed for such investments or outlay by virtue of s. 6 (1) (*b*) of the Act.

Held (affirming judgment of Maclean J., [1942] Ex.C.R. 56): The deductions claimed for by appellant should not be allowed.

Per Rinfret, Davis, Hudson and Taschereau JJ.: On the evidence it could not be said that appellant carried on the business of buying and selling

*PRESENT:—Rinfret, Davis, Kerwin, Hudson and Taschereau JJ.

oil shares or oil properties; it acquired shares and properties but there was no record of its having sold any; the only reasonable inference from the method of conducting its business was that its purpose was to acquire oil properties and hold them with the hope that ultimately they might become producing wells, as was the case in the particular enterprise which resulted in profits; its real business was aptly described as "oil operators"; its moneys invested in oil shares and its loans made were in their nature capital investments; and were investments in the nature of fixed, and not of circulating, capital.

Per Kerwin J.: On the facts, what appellant sought to deduct from its admitted income was a loss of capital, and that was prohibited by s. 6 (1) (*b*) of the Act.

APPEAL from the judgment of Maclean J., late President of the Exchequer Court of Canada (1), dismissing the appellant's appeal from the decision of the Minister of National Revenue affirming an assessment of the appellant for income tax under the *Income War Tax Act* (R.S.C. 1927, c. 97, and amendments) in respect of the appellant's fiscal year ended June 30, 1935, and disallowing as deductions certain losses which the appellant claimed it was entitled to set off against profits. The appellant claimed that in the taxation year in question and in previous years it was carrying on the business of financing other concerns engaged in or interested in the development of prospective oil properties and in trading and dealing in oil lands, leases, oil stocks, and other properties and securities, and that in the taxation year in question it was not in receipt of income within the meaning of the said Act, but on the contrary made a loss in the said taxation period; that it had been assessed on the basis which had been applied to the taxation of companies engaged in the development of prospective oil properties and that said basis of assessment was not applicable to the business which it had carried on. The respondent claimed that the business of the appellant in respect of which it claimed the deductions was the development of oil or gas properties by the investment of its capital for the said purpose, and for the benefit of the appellant of a share in the production of such properties as gains or profit to the appellant from such outlay of capital, and no deduction could be allowed for such investments or outlay by virtue of s. 6 (1) (*b*) of said Act; that the basis of assessment on which the appellant had been assessed for income tax pur-

(1) [1942] Ex. C.R. 56; [1942] 3 D.L.R. 38.

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poses for the said taxation period was the basis applicable to the business carried on by the appellant, according to its income tax return.

H. S. Patterson K.C. for the appellant.

R. Forsyth K.C. and *A. A. McGrory* for the respondent.

The judgment of Rinfret, Davis, Hudson and Taschereau JJ. was delivered by

HUDSON J.—This is an appeal from a judgment of the late President of the Exchequer Court (1), which dismissed with costs an appeal by the appellant against its assessment for income tax for the taxation year 1935.

The appellant filed a return for the period in question showing a net loss, but the Minister adjusted the income and declared that the appellant had taxable income of $30,254.94 for the period in question. This amount was arrived at after making certain customary allowances and disallowing a sum of $74,011.28, the amount of investments written off by the appellant's return. The decision of the Minister was that the

> investments in shares of and advances to other companies and persons were not expenditures of the taxpayer wholly, exclusively and necessarily laid out or expended for the purpose of earning its income, but were in fact capital in their nature, specifically disallowed for income tax purposes under the provisions of section 6 of the Act.

The appellant company was incorporated by letters patent and given a wide range of powers, only two of which need be referred to. They are:

> (*a*) 1. To search for and recover and win from the earth petroleum, natural gas, oil, salt, metals, minerals and mineral substances of all kinds, and to that end to explore, prospect, mine, quarry, bore, sink wells, construct works or otherwise proceed as may be necessary to produce, manufacture, purchase, acquire, refine, smelt, store, distribute, sell, dispose of and deal in petroleum, natural gas, oil, salt, chemicals, * * *
>
> (*k*) To purchase, underwrite, guarantee the principal and interest of, subscribe for and otherwise acquire and hold and vote upon the shares, debentures, debenture stock, * * * of any company * * *

The appellant, by its income tax return, stated the nature of its business to be that of "oil operators".

The transactions giving rise to the profit were as stated by the learned President:

> On July 20, 1933, a written agreement was entered into between T. O. Renner, S. J. Davies and C. H. Snyder, therein called "the

(1) [1942] Ex. C.R. 56; [1942] 3 D.L.R. 38.

Operators", of the one part, and the appellant company, therein called "the Company", of the other part. This agreement may be summarized by saying that the Company made available to the Operators, upon terms and conditions, $60,000 for the purpose of drilling a well on a lease which the Operators had secured from the trustee of a bankrupt. The Company was to be paid back the said $60,000 out of production and to receive a 65 per cent. interest in the well, its production and equipment. There are clauses in the agreement providing for the payment of prior charges, the termination of the agreement, and so on, but these provisions are unimportant. It is to be noted, however, that the Operators were to assign to the Company an undivided 65 per cent. interest in the lease. This venture proved successful and a producing well resulted which became known as Highwood-Sarcee Well No. 1. The lease also provided for participation by the Operators and the Company in drilling further wells if desired.

On these facts the learned President held that the profit arising on this transaction was income.

The transactions giving rise to losses which the appellant claims the right to set off appeared in the balance sheet of the company as of June 30, 1935, as follows:

Investments and Advances written off—		
Pine Hill Petroleums Limited	$56,511.28	
Western Alberta Oils Limited	15,000.00	
Sheldon Burden of Canada Limited	2,500.00	74,011.28

These transactions arose out of the purchase of shares in two other companies engaged in oil development and in loans to these companies or to persons connected with their operations. They were held by the learned President to be in the nature of capital investment and, for that reason, the claim to set off these losses was disallowed.

It appears from the evidence that the appellant did not carry on the business of buying and selling oil shares or oil properties. They acquired shares and properties but there is no record of their having sold any. The only reasonable inference from the method of conducting their business was that their purpose was to acquire these properties and to hold them with the hope that ultimately they might become producing wells, as was done by them in the case of the particular enterprise which resulted in profits. The real business of the company is, I think, aptly described in their return as "oil operators".

The argument pressed most strongly by Mr. Patterson is that the transactions in the case of the losses were essentially of the same character as those in the profitable transactions and that if the profits were taxable in the one, losses in the others might properly be set off. He con-

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tended that the activities of the company were analogous to those of an insurance company which did marine, fire and life insurance and lost in one branch and made profits in the other, and it was held that the business of all should be read as one for the purpose of ascertaining taxable income.

It could not, I think, on the facts be successfully contended that the moneys invested in these shares and the loans made were not in their nature capital investments, and the only point that has caused me some difficulty is whether or not this capital investment could be considered as in the nature of circulating capital and not fixed.

The illustrations are those of manufacturers having purchased raw material and of merchants trading in goods which they got for resale, or loans made by a brewery company to its customers. In each of these cases capital moneys are used and yet losses were allowed.

In the present case the shares were not acquired to be turned over like a merchant's stock of goods, but to be held with a view of future profit from development. The loans were not made for the purpose of furthering the day to day business of the company. For these reasons, I think the investments were in their nature of fixed and not of circulating capital.

The appeal should be dismissed with costs.

KERWIN J.—On the facts of this case, what the appellant seeks to deduct from its admitted income is a loss of capital. That is prohibited by the provisions of section 6 (*b*) of the *Income War Tax Act*. The appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: *Patterson, Hobbs & Patterson.*

Solicitor for the respondent: *W. S. Fisher.*