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BETWEEN:

DOBIECO LIMITED .....APPELLANT;

AND

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

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 12(1)(a)(b)(e), 14(2) and 27(1)(2)—Deductions—Stock underwriter—Inventory reserve—Onus of proof—Determination of fair market value of inventory—Market price adjusted to alleged fair market value—Loss on sale of interest in oil syndicate—Business loss incurred in a subsequent year—Whether loss deductible in taxation year—Income Tax Regulations s. 1800—Appeal dismissed.

Appellant, an affiliate of the Toronto Stock Exchange, carried on the business of an underwriter of speculative shares of natural resource companies and, in addition, sometimes purchased interests in oil and mining syndicates. This appeal is from an assessment for income tax for the taxation year ending March 31, 1956 and concerns two unrelated issues: (1) In determining the value of its closing inventory of securities for the taxation year 1956, appellant calculated the book value of each stock held by taking the lower of cost or the closing bid price on the stock exchange. In the year under consideration appellant had engaged in underwriting the securities of ninety-six companies by negotiating agreements with those companies and purchasing outright from the treasury stock of such companies. The

responsibility of disposing of such shares then became that of appellant. It was obliged to dispose of such shares on the floor of the Toronto Stock Exchange. Appellant's business was therefore, that of a trader in securities and the securities held by it were its stock in trade, and at the end of its 1956 taxation year it had on hand several blocks of shares in mining or oil companies. The total book value of the shares held amounted to some $3.8 million from which appellant deducted $400,000 as a "Provision for market decline". This was disallowed on the ground that it was a reserve prohibited by s. 12(1)(e) of the Act. The appellant contended that since fair market price was not necessarily conclusive of fair market value, it was necessary to adjust the book value of its inventory downward to arrive at the lower cost or fair market value and submitted detailed figures to show the method of valuation used and the amounts, estimated to make up the deduction of $400,000. Several errors in the unit valuations were disclosed. The second issue in the appeal concerned an attempt by appellant to deduct as part of its 1957 business loss which was deductible in 1956 by virtue of s. 27(1)(*e*) of the Act, a loss assigned to its participation in a syndicate known as the "Jerd Syndicate", which had been formed by certain persons who agreed to make joint contributions under a plan to acquire an interest in certain oil leases and to drill for oil, the cost to appellant for its interest being $80,000. After unsuccessful attempts to find oil appellant refused to contribute further funds to the syndicate, and although the other members of the syndicate could have terminated appellant's interest therein, they continued to treat the appellant as a member indebted to the syndicate for the amount of the additional contribution. In 1958 appellant sold its interest in the syndicate for $1.00. This appellant treated as a loss incurred in 1957 and deducted such from its 1956 income. This was disallowed.

Held: That the appeal be dismissed.

2. That the determination of the fair market value of an inventory is a question of fact and appellant had not discharged the onus of proving that the respondent's assessment based on the book value of the securities inventory is incorrect.

3. That market price is the best evidence of fair market value, the price at which shares sell on the market might be regarded as *prima facie* evidence of their fair market value although not necessarily conclusive if rebutted by satisfactory evidence to the contrary and the only evidence offered was that of an interested expert whose figures used to arrive at the amount of the deduction contained several errors.

4. That the market action of the principal securities held by appellant, for several months before and after March 31, 1956, was such that the shares could have been disposed of without undue disturbance of the market and it was not correct to adopt a value which allowed for the depressing effect on the market if the inventory were disposed of all at once instead of in the normal course.

5. That it was incorrect to deduct in the valuation of the shares on hand, the amount of brokerage commission and transfer tax that would have to be paid thereon when sold.

6. That the loss in respect of the "Jerd Syndicate" was properly deductible from income but it was not sustained in appellant's 1957 taxation year, the evidence being clear that appellant's participation in the

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syndicate did not terminate in 1957 when it refused to make the additional contribution but in 1958 when it sold its interest.

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Cattanach at Toronto.

H. H. Stikeman, Q.C. and *P. N. Thorsteinsson* for appellant.

G. D. Watson, Q.C. and *M. A. Mogan* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CATTANACH J. now (February 22, 1963) delivered the following judgment:

This is an appeal from the appellant's income tax assessment for the taxation year ending March 31, 1956 (hereinafter referred to as the 1956 taxation year) whereby a tax in the sum of $1,103,618.83 was levied in respect of income for the said taxation year.

In this appeal there are two issues, which are unrelated and, therefore, each will be considered separately. One of the issues involves the question whether or not the appellant is entitled to deduct an amount of $400,000 from its closing inventory at the end of its 1956 taxation year and the other issue is whether or not the appellant incurred a loss in the amount of $80,567.38 in connection with an interest which the appellant had acquired in a petroleum syndicate (hereinafter referred to as the Jerd Syndicate) in its taxation year ending March 31, 1957 (hereinafter referred to as the 1957 taxation year) which alleged loss the appellant carried back against its income for its 1956 taxation year.

The appellant is a corporation incorporated pursuant to the laws of the Province of Ontario by letters patent dated December 24, 1954 for the following objects:

> (*a*) *TO* underwrite, subscribe for, purchase, invest in or otherwise acquire and hold, either as principal or agent and absolutely as owner or by way of collateral security or otherwise, and to sell, exchange, pledge, transfer, assign or otherwise dispose of or deal in the bonds or debentures, stocks, shares or other securities of any government or municipal or school corporation or of any chartered bank or of any incorporated company or corporation;

(*b*) *TO* assist in the promotion, organization, development or management of any corporation or company and to raise and assist in raising money for and to aid by way of bonus, loan, promise, endorsement, guarantee of bonds, debentures or other securities or otherwise any company or corporation and to offer for public subscription any shares, stocks, bonds, debentures or other securities of any other company or corporation, and to act as agent, attorney, employee or manager of any other company or corporation or of any shareholder thereof;

(*c*) *TO* prospect for, acquire, own, lease, explore, develop, work, improve, maintain and manage mines and mineral lands and deposits, including oil and gas lands and deposits, and to sell or otherwise dispose of the same or any part thereof or interest therein;

(*d*) *TO* procure for any company or corporation and to convey and assign or cause to be conveyed and assigned thereto any properties, real or personal, rights, privileges, powers, contracts, concessions and franchises which such company or corporation may be authorized or empowered to make or acquire;

(*e*) *TO* make loans and advances on and to underwrite and guarantee all kinds of stocks, shares, bonds, debentures and securities; and

(*f*) *TO* act as agents for the purpose of collecting and converting into money the securities and properties of any person, firm or corporation;

In furtherance of the foregoing objects the appellant devoted itself primarily to carrying on business as an underwriter particularly of speculative shares of natural resource companies in Canada and, in frequent instances, the appellant purchased interests in and contributed funds to syndicates formed to prospect for, explore and develop petroleum and mineral resources in accordance with paragraph (*c*) of its objects with the additional expectation that any consequent underwriting business would be acquired by the appellant.

During the appellant's fiscal year ending March 31, 1956 which is also the appellant's 1956 taxation year, it engaged in underwriting the securities of 96 companies which are listed in Exhibit 2. The appellant conducted this phase of its business by negotiating agreements with companies, usually those which were recently incorporated, to underwrite shares in capital stock. These shares were purchased outright from treasury stock of such companies and the responsibility of disposing of the shares then became that of the appellant. It was customary for the appellant to take down an initial block of shares from the treasury of the company with which the appellant negotiated in a substan-

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tial number, usually 200,000 shares and the appellant would take options for still further shares, the options to be exercised within a stated period, not to exceed in all more than 18 months. The shares under option were normally 800,000 in number, the foregoing amounts and procedure being prescribed by regulations of the Toronto Stock Exchange of which the appellant was an affiliate and was bound thereby.

The relationship of an affiliate of the Toronto Stock Exchange also made it obligatory that any shares posted for trading on that Exchange could only be disposed of by the appellant on the floor of the Exchange during a session thereof at the prevailing bid price for a board lot as quoted on the Exchange. The obligation of the appellant to dispose of shares held by it on the floor of the Toronto Stock Exchange was subject to seven exceptions enumerated in By-law No. 456 of the Exchange and which was filed in evidence as Exhibit 7. Of the seven exceptions so made only two are applicable in the issues here raised, the first being an isolated wholesale transaction approved as such by the Exchange and the second being a transaction made on another stock exchange.

Therefore, the appellant's business in this respect, is that of a trader in securities and having regard to the nature of the appellant's business, there is no question that the securities held by it, were to be regarded as its stock in trade. At the end of its 1956 taxation year the appellant had on hand some 48 blocks of shares in mining or oil companies, in varying numbers which it had acquired under underwriting agreements as above outlined, as well as a lesser number of shares held in independent trading accounts, which the appellant had not disposed of during that period.

Accordingly it became necessary to value the shares so held for income tax purposes, as at the end of its 1956 taxation year, which the appellant did by calculating the book value thereof by taking either the lower of cost to the appellant, which would be the price paid by it for the shares when the appellant took the shares down from the treasuries of companies pursuant to underwriting agreements, or the price paid by the appellant for shares held in trading accounts, or published market quotations for board lots on the last trading day on the Exchange for the 1956

taxation year multiplied by the number of shares held by the appellant.

The foregoing calculation resulted in an amount of $3,866,923.01 for the shares so held and from this amount the appellant then deducted the sum of $400,000 on the basis that the actual market value of the shares so held as inventory was an amount of $400,000 less than the book value computed as above described.

By notice of reassessment dated October 30, 1957 the Minister disallowed as a deduction in the computation of the value of the appellant's inventory on hand at the end of its 1956 taxation year the amount of $400,000 that the appellant had deducted and thereby increased the taxable income for that year as reported by the appellant by a like amount.

By letter dated April 28, 1958, filed in evidence as Exhibit E, the solicitors for the appellant advised the Minister that they had been instructed to appeal against the disallowance of the $400,000, provision for market decline as noted in the Notice of Reassessment on the ground that the item of $400,000 was an adjustment of the value of large blocks of speculative shares held as inventory at the end of the taxation year and represented an adjustment to the lower of cost or market value in this inventory.

By notification dated July 7, 1960 under section 58 of the *Income Tax Act*, 1952, R.S.C. c. 148 the Minister advised the appellant that the assessment, with respect to the disallowance of the deduction of the $400,000 in question, had been confirmed, in the following terms:

> that the amount of $400,000 claimed as a deduction from income in respect of a provision for market decline has been properly disallowed in accordance with the provisions of paragraph (*e*) of subsection (1) of section 12 of the Act; that the taxpayer's inventory of securities has been valued in accordance with the provisions of subsection (2) of section 14 of the Act and section 1800 of the Income Tax Regulations.

It is from this part of the assessment that an appeal is brought to this Court and constitutes the first issue before mentioned.

In the computation of business profits it has long been recognized that the value of trading stock is an important element and that the right method of ascertaining profit is

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to take into account the value of the stock in trade at the beginning and at the end of the accounting period. While for income tax purposes profits are normally those realized in the course of the taxation year, nevertheless, the ordinary principles of commercial accounting have provided an exception where traders still hold goods in inventory at the end of the year. The trader is permitted, in compiling his inventory, to enter those goods at cost or market value, whichever is the lower.

The accounting practice so described has been included in the *Income Tax Act,* section 14(2) of which is as follows:

> 14.(2) For the purpose of computing income, the property described in an inventory shall be valued at its cost to the taxpayer or its fair market value, whichever is lower, or in such other manner as may be permitted by regulation.

The effect of section 14(2) is to permit, what is called in common parlance, a "hidden reserve" which, but for section 14(2), would otherwise be precluded by the provisions of section 12(1)(*e*) of the *Income Tax Act* reading as follows:

> 12.(1) . . .
>
> (*e*) an amount transferred or credited to a reserve, contingent account or sinking fund except as expressly permitted by this Part,

Since the value of the closing inventory is deducted from the value of the sum of the opening inventory and goods purchased during the accounting period to obtain the cost of the goods sold and the result is, in turn, deducted from the value of the sales to arrive at the profits, it follows that it is a distinct advantage to the taxpayer, in order to reduce the amount of profit which would be subject to tax, to enter the closing inventory at as low a figure as is possible.

Section 14(2) provides two bases for determining the value of an inventory:

> (1) the lower of its cost to the taxpayer or its fair market value, or
>
> (2) in such other manner as permitted by regulation.

Section 1800 of the Income Tax Regulations reads as follows:

> 1800. For the purpose of computing the income of a taxpayer from a business

(*a*) all the property described in all the inventories of the business may be valued at the cost to him; or

(*b*) all the property described in all the inventories of the business may be valued at the fair market value.

Therefore, the taxpayer has the following choices, (1) he may consider each item in the inventory and value it at the lower of cost or fair market value, as provided by section 14(2) of the *Income Tax Act,* or (2) he may value all inventories at cost, or (3) he may value all inventories at market, the latter two choices being provided for in section 1800 of the Income Tax Regulations.

The appellant, in arriving at the inventory value of shares held by it at the close of its 1956 taxation year, adopted the process of ascribing to each item of inventory either the lower of cost to the appellant or the market price, the market price being the last published bid for a board lot for shares listed on the Toronto Stock Exchange. It is significant to note that the marekt price was the figure adopted whenever such price was lower than cost. The appellant thereby arrived at the amount of $3,886,923.01 from which amount it then deducted $400,000 which deduction is in dispute.

In the auditor's report dated May 7, 1956, attached to the financial statements of the appellant for the year ending March 31, 1956 the amount of $400,000 was dealt with in the following terms:

> Results for the year
> The operations of underwriting and miscellaneous trading resulted in a profit of $4,168,124.91, from which has been deducted a provision for market decline or losses of $400,000 and general expenses of $6,918.80.

The balance sheet in the financial statements as at March 31, 1956 contained a reference to the same item on the asset side as follows:

Marketable securities, valued at the lower of cost or market price	$3,886,923.01
Less provision for market decline	400,000.00
	$3,486,923.01

Counsel for the Minister submitted that the use of the term "provision for market decline" indicated that the appellant was setting up a reserve against a possible future contingency which would be prohibited by the provisions of the *Income Tax Act.*

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The president of the appellant company, H. E. Knight, and K. E. Greenwood, the auditor of the appellant, who was responsible for the preparation of the financial statements and the selection of the language used therein, both deny it was their intention to set up a reserve in the amount of $400,000, but state that the purpose of the deduction was to attempt to evaluate the inventory at its "fair market value."

While the words used were inept, I accept the contention that an evaluation of the inventory was attempted and in so concluding I am influenced by the use of the word "price" in the language "Marketable securities, valued at the lower of cost or market price", since the word "price" has a distinct meaning different from the word "value" and, therefore, the provision for market decline constitutes an attempt to arrive at the "value".

Counsel for the appellant submitted that the published market quotations for board lots are not conclusive of the fair market value and in determining the value of the shares held in inventory the appellant is entitled to look to other factors. In my view such submission is correct and well founded on authorities.

What the appellant did was to apply the opinion of Mr. Knight, its president, as the better criterion and the best measure of value.

I understand the words "fair market value" to mean what the securities would realize if sold by the taxpayer in the normal method used by the taxpayer in the ordinary course of his business in a market not exposed to any undue stresses and composed of willing buyers and sellers.

Even though any particular assets may be difficult to value, nevertheless, the best possible valuation must be made.

While valuation may well be an art rather than an exact science, nevertheless, I cannot imagine anything that is more clearly a question of fact than what is the value of stock in trade at a particular time.

How, then, did Mr. Knight arrive at a figure of $400,000 as being the proper amount to deduct from the book value

of the appellant's inventory as at March 31, 1956 to determine the fair market value at that date.

The auditor of the appellant, Mr. K. E. Greenwood prepared a working sheet in the course of his audit, which was filed in evidence as Exhibit A, upon which was listed the names of the 48 companies in which the appellant held undisposed of shares, the number of shares held in each company, the market price, the book values, and a heading entitled "Reserve". Mr. Greenwood then consulted with Mr. Knight who settled the amount to be inserted under the column headed "Reserve" with respect to eight specific companies which represented the appellant's largest monetary holdings. In short, the deduction of $400,000 was attributed to the holdings in these eight specific companies and the determination of the amount attributed to each of the eight companies was the responsibility and decision of Mr. Knight.

I reproduce in tabular form information respecting the eight companies which formed the basis of the deduction of $400,000.

Company	No. of Shares Held	Unit Price at Lower of Cost or Market Price	Book Value	Basis of Valuation Used Market Price or Cost	Deduction	Approximate Percentage of Deduction	Correct Market Price	Difference
1. Consolidated Red Poplar Minerals Ltd.	721,243	.50	$360,621.50	market price	$50,000	14%	.53	$21,637.29
2. Eastern Mining & Smelting Corp. Ltd.	73,466	5.67	416,741.50	"	40,000	9¾%	5.95	20,570.48
3. Lake Cinch Mines Ltd.	128,400	2.50	321,000.00	"	40,000	12½%	2.80	38,520.00
4. Merrill Island Mining Corp. Ltd.	195,400	2.75	537,350.00	cost	75,000	14%		
5. New Delhi Mines Ltd.	253,300		240,091.60					
Trading acct.	755,600		717,820.00					
	1,008,900	.95	957,911.60	market price	150,000	15%	1.00	60,534.00
6. Silver Hill Mines Ltd.	250,000	.20	50,000.00	cost	40,000	80%		
7. Soil Builders Ltd.			7,500.00	"	7,500	100%		
8. Yale Lead and Zinc Mines Ltd.	400,000	.45	180,000.00	"	20,000	11%		
					Total			Total
					422,500			$141,261.77

The first column lists the companies by name. The second column sets out the number of shares held in each company by the appellant as at March 31, 1956. The third column lists the unit price per share used by Mr. Greenwood, the appellant's auditor. In the fourth column are listed the book values of the blocks of shares held in the eight enumerated companies which the auditor arrived at by multiplying the number of shares held by the unit price. The fifth column sets out the basis of valuation used in each instance, that is whether the unit price set out in the third column was cost to the appellant per share or the published bid price per share for a board lot on the last trading day on the Toronto Stock Exchange. The auditor used as unit price whichever was the lower.

Then in the sixth column are listed the amounts Mr. Knight deducted from each of the blocks of shares in the eight companies which were the basis of the deduction of $400,000. The figures listed in this column total $422,500 which figure was rounded out to arrive at the ultimate deduction of $400,000.

In the seventh column I have computed the approximate percentage of each individual deduction.

In the cross-examination of Mr. Greenwood it was established that where market price was used as the basis of valuation in four instances, namely; Consolidated Red Poplar Minerals, Ltd., Eastern Mining & Smelting Corp., Ltd., Lake Cinch Mines Ltd., and New Delhi Mines Ltd., it was not the correct one, but in each instance was lower than the actual published bid quotation on the pertinent day.

In the eighth column I have listed what was established to have been the correct market price and in the ninth column I have listed the difference which results from the difference between the market price used and the market price established as having been the correct one.

In the four instances where the basis of valuation used was market price, namely; Consolidated Red Poplar Mines, Ltd., Eastern Mining & Smelting Corp., Ltd.; Lake Cinch Mines, Ltd., and New Delhi Mines, Ltd., the error as to the correct market price as quoted on the Exchange has the

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effect of increasing the deductions applied to the respective companies by the respective amounts set out in the concluding column in the foregoing tabulation.

I am convinced that Mr. Knight, in forming his opinion as to the amount of deduction to be made to arrive at what he considered to be the "fair market value", was not aware of the error from which it follows that his estimate should have been $141,261.77, (being the total of the amounts listed in the last column of the tabulation), less than $400,000.

The book values listed in the fourth column with respect to Eastern Mining & Smelting Corp., Ltd. and New Delhi Mines Ltd., being the figures used by the auditor in the computation of the value of the inventory are not the correct product of the number of shares, in the second column, multiplied by the unit price set out in the third column. In both instances the product used is less than the correct product which would again result in a lesser inventory valuation.

It was established in cross-examination that within three months from March 31, 1956 the appellant's position with respect to the shares of Eastern Mining & Smelting Corp., Ltd. had been liquidated at prices between $5.95 and $7.00 per share and the appellant was in a short position of $6,000. It was also established that the appellant's entire position with respect to Merrill Island Mining Corp., Ltd. was liquidated at prices in excess of $3.40 per share prior to the end of April, 1956, that is within one month from the valuation date.

Events subsequent have demonstrated that Mr. Knight's opinion respecting these two items of inventory was grossly in error. These facts have shown that the deductions of $40,000 and $75,000 attributed to Eastern Mining & Smelting Corp., Ltd. and Merrill Island Mining Corp., Ltd. and totalling $115,000 were without justification, there being no reduction in market value. Accordingly a deduction of $115,000 was wholly unwarranted.

The four companies in which the basis of valuation was cost to the appellant were Merrill Island Mining Corp., Ltd., Silver Hill Mines, Ltd., Soil Builders, Ltd. and Yale

Lead and Zinc Mines Ltd. Since these four companies were entered at cost, which was lower than market price, the advantage permitted by section 14(2) of the *Income Tax Act* inured to the appellant.

The shares of Silver Hill Mines Ltd. were not listed for trading on the Toronto Stock Exchange. The shares were bought by the appellant at a cost of 20 cents per share on February 29, 1956, that is the last day of the month preceding the inventory valuation for the period ending March 30, 1956. Mr. Knight's recollection was that this stock was listed on the British Columbia Stock Exchange and that the bid price was 10 cents. Mr. Greenwood's recollection was that the stock was not listed, but he did not verify the market price from such sources as over the counter prices from brokers who were not members of a recognized stock exchange and he unequivocally accepted Mr. Knight's opinion that $40,000 was the proper deduction from a cost of $50,000. Accordingly the value of this item was written down by 80% within the comparatively short period of one month.

The evidence as to the nature of the appellant's expenditure of $7,500 in Soil Builders, Ltd. was particularly scant. The object of the company was to market a type of soil enrichment into which the appellant paid $7,500 about two years prior to March 31, 1956. The appellant did not receive any shares in the capital stock of the company and, therefore, I can only conclude that the funds were advanced in the nature of a loan. There was no evidence that the appellant attempted to, or could recover any portion of this expenditure.

Yale Lead and Zinc Mines Ltd. had advanced beyond the speculative stage and was in production having paid a dividend to shareholders in May 1955 and 1956. In my view, therefore, the value of the shares was susceptible of a more accurate estimate based upon, the assets owned, prospects and like criteria.

The original working document which was used by Mr. Greenwood in consulting with Mr. Knight and which was used by Mr. Knight in formulating his opinion as to the appropriate allowance to be made for the adjustment of

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inventory valuation, was Exhibit A. For the purposes of this trial Mr. Greenwood prepared a document entitled "Calculation of requirements for reduction to true market value" which was introduced as Exhibit 5. Exhibit 5 was prepared at a time considerably subsequent to the preparation of Exhibit A and when the matter of the disallowance of the deduction of $400,000 by the Minister became an issue. Exhibit 5 was substantially a reproduction of the material contained in Exhibit A, but with significant additions. In addition to the eight companies before mentioned, which were the only companies for which valuation adjustments were made to arrive at the figure of $400,000, there are seven further companies in Exhibit 5 as to which valuation adjustments were made in the amount of $75,000.

There were two further additions in Exhibit 5 which were not in Exhibit A being a column listing the brokerage commission which the appellant would be obligated to pay on the sale of the shares held in inventory and a further column listing the amount of tax which would be payable on the sale of the shares which would also be obligatory upon the appellant to pay.

The amounts listed in Exhibit 5 under the columns headed "Commission on Sale" and "Tax on Sale at Book Values" total $79,070.24, which was rounded to $75,000.

Because a further amount of $75,000 was inserted in Exhibit 5 as a valuation adjustment and an equal amount of $75,000 was deducted as commission and tax on sales, it is not surprising that the total valuation adjustment in Exhibit 5 is identical to that in Exhibit A.

Since Exhibit 5 was prepared some considerable time after Exhibit A and when the issue of the deduction of $400,000 arose, it has the attributes of an attempted subsequent justification of a previous conclusion.

I, therefore, conclude that Mr. Knight and Mr. Greenwood did not take into account commission and tax on sales when Mr. Knight made his original estimate and in my opinion the factors of commission and tax on sales, while obligatory upon the appellant to pay at some future time, are not the proper subject matter for deduction for income tax purposes until the sales of the securities actually occur.

Mr. Knight, whose experience as an underwriter of highly speculative securities was extensive, was the only expert witness called and he was not a disinterested expert.

Mr. Greenwood relied exclusively on Mr. Knight's judgment as to the proper deductions to be made to arrive at "fair market value". Mr. J. B. Howson, a chartered accountant, confirmed that it was accounting practice for an auditor in ascertaining fair market value to consult and accept the estimate of the president of a company as the best source of information on the subject.

Mr. A. J. Trebilcock, a past-president of the Toronto Stock Exchange testified that under Exchange regulations it was possible for a member of the Exchange to dispose of a wholesale lot of shares to the minimum value of $25,000 at less than the market price if permission of the board was first obtained. The permitted discounts below market price on the Exchange range from 25 percent to 10 percent dependent upon the Exchange trading price of the shares. The stock exchange regulations deal in generalities, but in any event wholesale sales were not contemplated in valuating the appellant's inventory, the criterion being Mr. Knight's opinion. Mr. Knight did not suggest that the shares held in the appellant's inventory were not saleable, but rather that the shares were not saleable at a price Mr. Knight thought they should fetch.

Exhibit F was introduced in evidence and was a résumé of the opening, high, low and last prices on the Toronto Stock Exchange for the shares of Consolidated Red Poplar Minerals Ltd., Eastern Mining & Smelting Corp., Ltd., Lake Cinch Mines Ltd., Merrill Island Mining Corp., Ltd., New Delhi Mines Ltd. and Yale Lead and Zinc Mines Ltd. for the months of January, February, March, April, May and June of 1956, that is three months before and three months after March 31, 1956. Exhibit F also showed the volume of shares in each of the companies traded on the Exchange in each of the six months in question. The volume of shares traded was considerable with respect to each company mentioned above in each month which would, therefore, indicate an active market.

It is, therefore, reasonable to suppose that the appellant could have disposed of the shares held in the normal course

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of its business and that the market was capable of absorbing the shares without undue disturbance.

Mignault J. in delivery of the unanimous judgment of the Supreme Court in *Untermyer Estate v. Attorney General for British Columbia*[1], said:

> I would not deduct anything from the market value of these shares on the assumption that the whole of them would be placed on the market at one and the same time, for I do not think that any prudent stockholder would pursue a like course. To make such a deduction in a case like the one at bar, would be to render the "sacrifice value" or "dumping value" of the shares the measure of valuation.

Accordingly it would not be proper, in the present case, to make any deduction on the assumption that the appellant's shares would all be placed on the market at once, thereby depressing the market value since such course would not be either normal or prudent in the appellant's business.

The expression "fair market value" has been defined in different ways, depending generally on the subject matter which the person seeking to define it had in mind. In my opinion the discussion of the meaning of the expression in *Untermyer Estate v. Attorney General for British Columbia (supra)* at p. 91 is a useful guide to the meaning of the expression in section 14(2):

> We were favoured by counsel with several suggested definitions of the words "fair market value". The dominant word here is evidently "value", in determining which the price that can be secured on the market—if there be a market for the property (and there is a market for shares listed on the stock exchange)—is the best guide. It may, perhaps, be open to question whether the expression "fair" adds anything to the meaning of the words "market value," except possibly to this extent that the market price must have some consistency and not be the effect of a transient boom or a sudden panic on the market. The value with which we are concerned here is the value at Untermyer's death, that is to say, the then value of every advantage which his property possessed, for these advantages, as they stood, would naturally have an effect on the market price. Many factors undoubtedly influence the market price of shares in financial or commercial companies, not the least potent of which is what may be called the investment value created by the fact—or the prospect as it then exists—of large returns by way of dividends, and the likelihood of their continuance or increase, or again by the feeling of security induced by the financial strength or the prudent management of a company. The sum of all these advantages controls the market price, which, if it be not spasmodic or ephemeral, is the best test of the fair market value of property of this description.

[1] [1929] S.C.R. 84 at 91.

In the quoted passage Mignault J. treats the market prices not as the fair market value, but as the best evidence of fair market value. The price at which the shares were selling on the stock market might be regarded as *prima facie* evidence of the fair market value, although not necessarily conclusive if rebutted by satisfactory evidence to the contrary.

In the present case the only evidence to the contrary is the opinion of Mr. Knight who was an interested expert. In the eight companies the holdings in which formed the basis of Mr. Knight's opinion, it has been shown that in two of the eight instances Eastern Mining & Smelting Corp., Ltd. and Merrill Island Mining Corp., Ltd., his opinion was grossly in error, the appellant subsequently disposing of the shares of these two companies at prices far in excess of the market price as at March 31, 1956 a short time thereafter. In addition, the market prices used in the valuation of the inventory were shown to be in all instances less than the actual market prices at the relevant date.

While the shares were all of a highly speculative character and the market prices volatile, nevertheless, the prices have been shown to have been reasonably consistent for three months before and three months after March 31, 1956 and during such time the market was quite active.

In *Minister of National Revenue v. Simpsons Ltd.*[1], the President held that an assessment carries with it a presumption of validity until the taxpayer establishes that the assessment is incorrect either in fact or in law, and the onus of proving that it is incorrect is on the taxpayer. Therefore, in this case the onus is on the appellant to establish the invalidity of the assessment.

An assessor in the Department of National Revenue testified that during his experience in the Department over a period of 15 years the consistent practice has been to apply the market price of shares listed on an exchange as the value thereof.

In my opinion, therefore, in the language of Rand J. in *Johnston v. Minister of National Revenue*[2] the appellant

[1] [1953] Ex. C.R. 93. [2] [1948] S.C.R. 486.

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has not discharged the onus which was its "to demolish the basic fact on which the taxation rested."

The appeal against the disallowance of $400,000 as a deduction is, therefore, dismissed.

The second issue raised in the appeal involves the question as to whether the appellant incurred a loss in its 1957 taxation year in the amount of $80,567.38 in connection with an interest in the Jerd Petroleum Syndicate, which alleged loss was carried back against its income for its 1956 taxation year.

By notice of reassessment dated October 30, 1957 the Minister reduced the amount of loss for the 1957 taxation year carried back against 1956 income by the amount of $80,567.38 with respect to the Jerd Syndicate. On December 5, 1957 the appellant filed a Notice of Objection with respect to this reduction of the 1957 loss carried back against 1956 income and by notification dated July 7, 1960 the Minister advised the appellant that the assessment had been confirmed in the following terms:

> and hereby confirms the said assessment in other respects as having been made in accordance with the provisions of the Act and in particular on the ground that the amount of $80,567.34 claimed as a deduction from income in the 1957 taxation year in respect of Jerd Petroleum Limited interests has not been shown to have been a loss sustained by the taxpayer in the 1957 taxation year has been correctly determined for the purpose of paragraph (*e*) of subsection (1) of section 27 of the Act.

Section 27(1)(*e*) reads as follows:

> 27 (1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted from the income for the year such of the following amounts as are applicable;
>
> . . .
>
> (*e*) business losses sustained in the 5 taxation years immediately preceding and the taxation year immediately following the taxation year.

The appellant was incorporated on December 23, 1954 for the objects previously set forth, paragraph (*c*) of which is repeated here and reads as follows:

> *TO* prospect for, acquire, own, lease, explore, develop, work, improve, maintain and manage mines and mineral lands and deposits, including oil and gas lands and deposits, and to sell or otherwise dispose of the same or any part thereof or interest therein;

Prior to the incorporation of the appellant a partnership known as Draper Dobie and Company carried on business

in two branches, an underwriting and trading branch and a commission branch. On its incorporation the appellant took over the underwriting and trading business formerly carried on by the partnership.

Among the assets so acquired from the partnership by the appellant was an interest in the Jerd Petroleum Syndicate. In March, 1955 the partnership had contributed $50,000 to the Syndicate. In June, 1956 and March, 1956, the appellant made two further contributions of $7,900 and $22,668.34 respectively. The total of $80,568.34 is the amount presently in issue.

The partners in Draper Dobie and Company included Mr. H. W. Knight, Mr. Knight's father and Mr. Geo. W. Gooderman. Mr. H. W. Knight and Mr. Geo. W. Gooderman are shareholders and officers of the appellant holding the offices of President and Vice President respectively.

Before the appellant was incorporated, Mr. Robert Bryce, a mining engineer and promoter and manager of mining and oil exploration and development companies was interested in a prospective oil producing area in Alberta adjacent to the British Columbia border. He first obtained a reservation which he later converted into lease holdings. It was a condition of the leases so obtained that Mr. Bryce should expend $200,000 in exploration. The area was comprised of 40,000 acres in all, but a 25% interest in the area had been acquired by another party. The expenditure of $200,000 by Mr. Bryce would entitle him to a 75% interest. In short, on the expenditure of $200,000 Mr. Bryce would own the leasehold in 30,000 acres and the other party owned 10,000 acres. The area of 40,000 acres was unsurveyed. The 10,000 acres owned by the other party comprised a corner of each section, the balance being owned by Mr. Bryce. Because of the fact that the area was unsurveyed it followed that the limits of the respective holdings of Mr. Bryce and the other party could not be clearly defined.

In order to raise the amount of $200,000 which was to be expended as a condition of the lease Mr. Bryce formed a syndicate. Mr. H. W. Knight, Mr. Knight's father and Mr. Gooderman personally participated in this syndicate. The amount of $200,000 was raised through the syndicate so formed and was expended in the drilling of an oil well on

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the property. The amount of $200,000 was exhausted in drilling without oil being discovered and a company was formed under the name of Jerd Petroleum Company, Limited which then became the owner of the leasehold interest in the 30,000 acres. The members of the syndicate became shareholders in Jerd Petroleum Company, Limited in proportion of their participation in the syndicate and the syndicate was dissolved.

However, oil had not been discovered and in order to finance further drilling, Mr. Bryce, who was the prime motivator throughout and still continues as such, formed a second syndicate. This second syndicate is the one described herein as the Jerd Syndicate.

Draper Dobie and Company was a member of this syndicate and as indicated above made an expenditure of $50,000 as its proportionate share. It was this interest which was acquired by the appellant from the partnership.

The members of the Jerd Syndicate were Mr. Bryce, 10%, Mr. Wayne 10%, Amerex Oil, 20%, Decalta Oil 30% and the appellant 30%. There were subsequent changes in proportion and membership which are not material in this matter, but throughout the material time the interest of the appellant remained a constant 30%. Jerd Petroleum Company, Limited owned a half interest in this second venture and contributed half of the funds expended and the Jerd Syndicate owned the remaining half interest and was obligated to contribute one half of the funds to be raised. Jerd Petroleum Company, Limited was not a member of the Jerd Syndicate.

The Syndicate agreement was not reduced to writing. The custom in the trade was to conduct such arrangements orally and if necessity should arise to commit the arrangement to writing at a later time. It was understood, however, that each member of this syndicate was required to put up an amount of money in proportion to his membership interest each time an assessment was called and if the member did not meet the assessment then that member's interest was lost and the remaining members were to be offered the opportunity to take up the defaulted interest.

The purpose of the appellant in entering into the Jerd Syndicate was two-fold, first, if oil were discovered the

appellant would participate in the benefits thereof and second, if success attended the venture, there was a tacit understanding, though an unwritten one, that the appellant would be given the first refusal to underwrite the shares in a company which might be formed to acquire and operate the oil or gas field. The appellant had exercised care to ensure that it was the only member of the syndicate which also carried on the business of underwriting. Furthermore, the appellant had participated in syndicates of this nature formed by Mr. Bryce on previous occasions to its commercial and financial advantage.

The Jerd Syndicate, in conjunction with Jerd Petroleum Company, Limited, sank the well to a depth of 4,779 feet. At that depth harder rock was encountered than had been anticipated. A heavier drill would be required to penetrate deeper, but because of the cost involved, drilling was stopped on March 9, 1956 and has not since been resumed.

At the time drilling ceased the syndicate's funds actually on hand were exhausted, but the annual lease rental of $30,000 being $1 an acre continued, a payment in that amount falling due on July 4th of each year. Jerd Petroleum Company, Limited was responsible for $15,000 of the annual rental and the Jerd Syndicate was also responsible for an equal amount. The appellant's proportionate share of this liability was $4,500 for July 4, 1957. The appellant did not pay this amount into the syndicate.

Mr. Bryce, in his capacity as head of the Jerd Syndicate, called on Mr. Knight in March, 1957 for the purpose of obtaining the appellant's payment of $4,500. Mr. Knight, as president of the appellant, informed Mr. Bryce that the appellant did not intend to contribute any further. The appellant's interest in the Jerd Syndicate was not terminated upon this default as was possible under the terms of the verbal syndicate agreement previously outlined, but on the contrary the appellant was continued to be looked upon as a member of the syndicate by the other syndicate members. The syndicate treated the appellant as a member which was indebted to the syndicate in the amount of $4,500.

A further leasehold rental was falling due on July 4, 1958. Accordingly in March, 1958 Mr. Bryce again approached

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Mr. Knight for the appellant's contribution. Mr. Knight reiterated the appellant's previous decision to participate no further in the Jerd Syndicate and offered to sell the appellant's interest therein to Mr. Bryce for $1 and Mr. Bryce's assumption of the appellant's outstanding obligation to the Jerd syndicate of $4,500 as well as a further obligation of $4,500 becoming due on July 4, 1958. Mr. Bryce consulted the other members of the Jerd Syndicate who agreed to Mr. Bryce purchasing the appellant's interest.

On June 5, 1958 the appellant executed an agreement for sale of its interest in the Jerd Syndicate for the consideration of $1 in cash and the assumption of appellant's outstanding obligation of $4,500 and a future obligation of $4,500 due on July 4, 1958. The consideration so paid was $4,501, but this has no bearing on the amount of the appellant's alleged loss of $80,567.38 because if the obligation of $4,500 had been paid then the loss of $80,567.38 claimed by the appellant would have been increased by an amount of $4,500 and when the monetary consideration received was deducted from that greater figure, the amount of the loss would remain constant at $80,567.38.

To resolve the question in issue it is necessary to consider three matters (i) did the amount of $80,567.38 constitute a loss, (ii) if the first matter is answered affirmatively, then was the loss deductible for income tax purposes and (iii) if the first two propositions are answered affirmatively, then consideration must be given as to when the loss occurred in point of time.

The appellant, in entering into the Jerd Syndicate, was pursuing the objects for which it was incorporated. The primary expectation of the appellant was the prospect of profits from the sale of any oil or gas discovered added to which was the incidental possibility that any underwriting business which might arise would be acquired by the appellant which was also within the objects set out in the appellant's letters patent. Further the appellant had conducted its business in this identical manner on previous occasions.

There is no doubt whatsoever that the appellant did expend $80,567.38 as its share in the Jerd Syndicate. The

venture and rights acquired by the appellant therein were not of a capital nature, but were part of the appellant's normal business. It, therefore, follows that if a profit had been realized it would have been properly taxable and it conversely follows that a loss incurred would be properly deductible.

Therefore, the first two propositions must be answered affirmatively, (i) there was a loss of $80,567.38 and (ii) the loss was properly deductible (unless otherwise precluded by the provisions of the *Income Tax Act*).

It, therefore, remains to determine when the loss occurred.

While it was possible that the appellant's interest in the syndicate might have been forfeited in March, 1957 by reason of the appellant's failure to pay its assessment of $4,500 in accordance with the verbal syndicate agreement, nevertheless, the appellant's participation was not ended at that time. The syndicate did not act upon the default, but continued to treat the appellant as a member indebted to the syndicate in the amount of the default. The appellant, on its part, also considered itself a member otherwise it would not have been able to sell its interest to Mr. Bryce as it did on June 5, 1958, some fourteen months later. In my opinion the loss was not in the fiscal year ending March 31, 1957, but in the 1958 taxation year.

The Minister was, therefore, right in disallowing the deduction of $80,567.38 and the appeal against this disallowance must also be dismissed.

It follows that the appeal herein must be dismissed with costs.

Judgment accordingly.