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June 3

ARTHUR COHEN ....APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 127(1)(e)—Income or capital—Profits realized on mortgages purchased at a discount—Appellant not engaged in an adventure or concern in the nature of trade—Capital accretions not taxable gains—Appeal allowed.

Appellant in 1948 and subsequent years purchased existing mortgages at a discount and held them to maturity. In so doing he acted on the advice of his solicitor accepting or rejecting such offers as were made to him from time to time by the solicitor. All mortgages purchased bore interest at the current and normal rate for investments of that type. In 1945 appellant in one transaction purchased at a discount a one-third interest in a block of 57 mortgages known as the Scarborough Mortgages. Appellant paid income tax on the interest received by him from these investments but did not declare as income the profit resulting from the purchase of the mortgages. He was assessed for the years 1949 to 1952 inclusive for income tax on the profit realized thereby. An appeal to the Income Tax Appeal Board was dismissed and from that decision he appealed to this Court.

Held: That the appellant was not engaged in an adventure or concern in the nature of trade and the profits realized were made on ordinary investments by an enhancement in value at maturity and are not taxable gains but capital accretions.

APPEAL from a decision of the Income Tax Appeal Board.

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

J. J. Robinette, Q.C. for appellant.

W. R. Jackett, Q.C. and *J. D. C. Boland* for respondent.

CAMERON J.:—This is an appeal from a decision of the Income Tax Appeal Board dated March 23, 1955, which dismissed the appellant's appeals from assessments made upon him for the years 1949 to 1952, both inclusive. It raises a question as to the liability of the appellant to pay income tax on the profits realized in those years on certain mortgages (including therein a small number of agreements for sale) which he had purchased at a discount. In each of the years, several of the mortgages were paid off, the appellant receiving the principal amount thereof in full. In the several years the respondent, in assessing the appellant, added to his declared income (which had included the

interest received on these and on all other mortgages owned by the appellant) amounts corresponding to the discount, namely, the difference between the amount paid for the said mortgages and the amounts received for principal upon payment of the mortgages. In the forms attached to the assessments, it was stated:

> You are deemed to be in the business of lending money and purchasing mortgages at a profit, and under section 3(*a*) and section 4 of The Income Tax Act, to be taxable on the profits therefrom.

It appears that the full amount of the tax levied by the assessments in dispute has been paid under protest.

It was agreed that the evidence adduced before the Income Tax Appeal Board should constitute the evidence in this appeal. It was further agreed that the amounts added in each year were accurate and therefore the sole question for determination is whether such amounts are taxable income of the appellant under *The Income Tax Act*.

There is no dispute as to the facts. The appellant, now about 76 years of age, resides in Toronto where for many years he had been active in the motion picture business, building and operating theatres, and as a senior executive of Famous Players Corporation and Regal Films. He had accumulated considerable wealth, a substantial portion of which up to 1947 was invested in stocks. In those investments he was advised by a well-known investment counsel. In that year, being fearful of a depression similar to that experienced in 1929, he decided to convert practically all his stocks into cash, the proceeds amounting to approximately $300,000. He had other assets of substantial value.

In the years in question he was semi-retired, his only active interests being in connection with the Casino Theatre (which he built) and with Allco Amusements Limited, which operated the Casino Theatre and in which he was the largest shareholder. He was in receipt of a salary from Allco and occupied a small office (the rent of which was paid by Casino Theatre) in which he transacted his business relating to those two companies.

In 1948 and in subsequent years, acting on the advice of his friend and solicitor, Mr. Henry Rosenberg, he purchased a number of mortgages or parts of mortgages from the mortgagees at a discount. About 16 of these mortgages were paid in full either at or before maturity during the

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four years in question; there were a few others purchased during these years which were not paid off until later. There is no evidence which establishes the length of time for which the mortgages were originally drawn. None were held by the appellant for a period longer than two years and some were paid in full within a few months after he had purchased them. There was no attempt to sell any of the mortgages, all being held until they were paid. Not all of the funds realized from the sale of stocks was invested in mortgages, the appellant at all times retaining substantial amounts in bank savings accounts. The profits realized on these 16 mortgages—*i.e.*, the difference between the price paid and the amounts realized (after allowing for legal expenses)—aggregated about $46,500 for the four years in question. That amount, plus certain other profits realized in these years from a one-third interest in a block of 57 mortgages purchased at a discount in 1945 from Principal Investments (and hereinafter referred to as the Scarborough mortgages), was added to the appellant's declared income.

It is established that all mortgages purchased by the appellant bore interest at the current and normal rate for such mortgages. The interest received therefrom, as well as interest on other mortgages where no discount was involved, was duly included in the appellant's tax returns. It is also proven that there was a substantial element of risk in all the mortgages purchased at a discount and that they were of such a nature that lending corporations would not be interested in acquiring them. Some were first mortgages and others second and third. Some were on hotels and others were building loans. The amount of the discount was that usual for securities of this type.

In the transactions Mr. Cohen appears to have relied to a very great extent on the advice of his solicitor, Mr. Rosenberg. The appellant did not advertise that he had money to loan or that he was in the market to purchase mortgages. When Mr. Rosenberg knew that a mortgage was for sale, he would personally investigate the security offered and if the terms, discount and security appeared suitable, he would advise the appellant of the offer he had received. In some cases, Mr. Cohen refused to purchase; in some cases, when the amount involved was substantial and he wished

to lessen his personal risk, he would join with one or two others in making the purchase; in other cases he accepted the offer as made. He knew none of the parties to the original mortgages and, except on one or two occasions when he drove with Mr. Rosenberg to see the property, had no personal knowledge of the security. He either accepted or rejected the offer as made, not attempting to secure a discount other than the mortgagee had offered. Mr. Rosenberg handled all legal matters, collected the interest and principal and remitted the proceeds, or a proper proportion thereof, to the appellant, less his fees for services rendered.

During the four years in question, the appellant suffered no losses on any of these mortgages, all being paid in full at or before maturity. He says that he deliberately chose mortgages with early maturity—"I am an elderly man and I have been doubtful as to whether I should go into long-term securities. I want to keep myself as liquid as possible".

For the years in question, the applicable provisions of *The Income Tax Act* were as follows:

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

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

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

127.(1) In this Act,

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

The real question in this case, therefore, is whether the amounts of principal received by the appellant in these taxation years in excess of the cost to him (equivalent to the amount of the several discounts) constitute income from a business either in the natural sense of that English word or in its statutory sense as defined in section 127(1)(*e*). The main submission of Mr. Jackett, counsel for the Minister, is that they are profits from "an adventure or concern in the nature of trade"; and, alternatively, that they are profits from "property" or "from a source" (section 3). If they are of that nature, the assessments were

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properly made, there being no dispute as to the amounts involved. If on the other hand, as submitted by Mr. Robinette, counsel for the appellant, they are to be regarded as accretions of capital on ordinary investments, they would not be taxable.

The transactions in question do not suggest that the appellant was engaged in the business of money lending. What he did was to purchase existing mortgages and hold them to maturity.

Mr. Robinette submitted that as the mortgages were bought to keep and not to sell, the transactions could not be considered as trading or as an adventure in the nature of trade. A similar submission was made and rejected in the case of *Barry v. Cordy (Inspector of Taxes)* (1). As that case is of importance on another point also and is much relied on by Mr. Jackett, I shall set out the essential facts. In that case Barry, a skilled mathematician, formulated a scheme whereby out of £100,000 available for investment he could ensure about £7,000 a year to spend for the rest of his anticipated life of twenty-three years. Over a period of eighteen months he bought on the open market endowment policies taken out by other people on their lives. From his outlay of £100,000, he calculated he would receive over the twenty-three years his required figure of £161,000, his purchases thus yielding a means of livelihood of £7,000 a year. These sums contained accretions on the sum originally invested. After holding the policies for some five years, during which time some of them matured, Barry contemplated an entire change in his mode of life and disposed of the policies remaining in his possession. He was assessed to tax from the profits made while he retained possession of the policies and also on the profits made upon the disposition of the remaining policies.

It was contended on behalf of Barry that all the receipts, actual or contemplated, were capital and not income, that the whole operation was pure investment and involved no trade either in the natural sense of that word or in its statutory sense as including "trade, manufacture, adventure or concern in the nature of trade". The Commissioners of Inland Revenue held that the respondent was engaged in "a concern in the nature of trade" resulting in profits which

(1) 28 T.C. 250.

were assessable to tax. Macnaghten J., on appeal, held that it was not an operation within the meaning of "trade" because there was no "dealing" in the policies in the sense of their being bought and sold again, since they were bought to keep and not to sell. In the Court of Appeal it was held that there was abundant evidence to support the finding of the Commissioners, which therefore was final; and that, in any event, their decision, for the reasons stated, was right. It was further held that the trial Judge's interpretation was too narrow and that the taxpayer's operations came within the meaning of both "adventure" and "trade" in the definition of trade.

That case indicates that in certain circumstances there may be an adventure in the nature of trade merely by purchasing securities and retaining them to maturity. But it was emphasized there, as in many other cases, that to be "in the nature of trade", the transaction must bear the *indicia* of trade. Counsel for the Minister submits that there are to be found in the instant case much the same *indicia* of trade as in *Barry's* case. There, Scott L.J., in delivering the judgment of the Court, said in part at page 259:

> The finding of the Commissioners in the present case is that Mr. Barry was "engaged in a concern in the nature of trade, resulting in profits—the fruit of the capital laid out—which are assessable to Income Tax under Case I of Schedule D." In our view there was evidence upon which they could so find; indeed, we doubt whether any other inference of fact was open to them. Having regard to the elaborate way in which Mr. Barry calculated out the annual yield of all his purchases, and the very large number of policies bought, and the fact that these were not ordinary investments, Case I appears to us the appropriate case under which to charge him.

And at page 260 he said:

> In the present case the finding that the present Respondent was engaged in a concern in the nature of trade is final unless it be shown that there was no evidence to support it. There appears to us to be abundant evidence to support this finding. The case is conclusive that he made up his mind to utilise the commercial market in endowment life policies for the express purpose of getting a means of livelihood at the average rate of £7,000 a year over a long period of years. He showed great mathematical skill—an element in the business of an average adjuster, an underwriter, a banker or a financier. He continued to make his purchases in the commercial market over a period of eighteen months, *i.e.*, until he had planted enough trees to yield him the fruit he wanted over the series of seasons for which he was making his purchases. To use an expression of Rowlatt, J., in *Graham v. Green,* 9 T.C., at page 313: "A person . . . can organize himself to do that (namely, to buy) in a commercial and mer-

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cantile way, and the profits which emerge are taxable profits, not of the transaction, but of the trade." In our opinion what Mr. Barry was doing comes within the dictionary definition of both words "adventure" and "trade", which we have quoted.

In my opinion, that case is distinguishable on its facts. There Barry, using great mathematical skill, worked out a very involved plan to provide himself with a means of livelihood for the balance of his anticipated life; the plan involved entering into the commercial market where, at auction sales, carefully selected endowment policies of certain amounts, and maturing at certain required dates, were purchased. Then, as stated in the judgment, such endowment policies were not ordinary investments. These were the *indicia* of trade, or the manner in which Barry "organized himself in a commercial and mercantile way" which resulted in the finding that he was engaged in a concern in the nature of trade. In the present case, nothing of that sort was done by the appellant. There was no scheme to provide himself with a means of livelihood over a period of years; there was no involved scheme worked out in an elaborate way or anything that involved great mathematical skill. Each mortgage purchased was made on its own merits and not with reference to any of the others. He did not commit any definite portion of his idle capital funds to the purchase of mortgages at a discount. In fact, all that he did was to accept or reject such offers as were made to him from time to time by his solicitor.

The most important distinction, however, is that in the present case all the mortgages purchased bore interest at the current and normal rate for investments of that type. In *Barry's* case the policies purchased were not interest-bearing securities and the only possible profit from such investments was the difference between the maturity value of the policies and their cost to him. In such a case the only reasonable inference would be that in purchasing the endowment policies, the gains made at maturity represented interest and nothing else. (Reference may be made to the cases of *Lord Howard de Walden v. Beck* (1) and to *Commissioners of Inland Revenue v. Thomas Nelson and Sons, Ltd.* (2).)

(1) 23 T.C. 384. (2) 22 T.C. 175.

The distinction between profits that are assessable to tax and those which are not is best stated in the principle laid down in the oft-cited case of *Californian Copper Syndicate v. Harris* (1), where the Lord Justice Clerk said at page 165:

It is quite a well settled principle in dealing with questions of assessment of income tax, that, where the owner of an ordinary investment chooses to 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. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies, which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realization, the gain they make is liable to be assessed for income tax.

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts, the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

In this case, I am unable to find that the appellant so "organized himself" (to buy mortgages at a discount) in a commercial and mercantile way "or that the capital accretions represented gain *made in an operation of business* in carrying out a scheme for profit-making". I can find neither organization in a commercial way nor an operation of business. If either of these necessary elements were present, the capital accretions would be taxable for it is a part of such a business to take capital risks. The appellant had disposed of some of his prior investments and had kept the proceeds in bank savings accounts where they would produce a relatively low return of interest. He was looking for investments which would yield a fair return. The mortgages in question bore what he considered a fair return on his investments. There was another feature, namely, the risk involved in this particular type of investment—a risk of capital loss if some or all of the mortgages were not paid in full. There was also the possibility that if there were no loss, or but little loss, he would make a gain on some or most of the capital invested. Balancing the risk of loss against

(1) 5 T.C. 159 at 165.

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the possibility of such gain, he decided that it was worth while to risk his capital. It is submitted on behalf of the Minister that because he embarked on such a scheme, bought short-term mortgages at a discount, extended his purchases over a period of some four years and, in fact, suffered no losses, skill, care and good business judgment were brought to bear on the operations and that his primary purpose was to secure a profit on the operations equivalent to the discounts received, and not the fixed interest on the mortgages. It is clear that if he suffered no losses, his accretions to capital would substantially exceed the annual interest he might receive from the mortgages, but it does not follow that his primary purpose was to secure the discounts. It was doubtless one of his motives, but so was his desire to secure the interest. The skill and care which he exercised were precisely that of a prudent investor who desires to spread his investments among a number of carefully chosen securities. He had very substantial assets and in this case the fact that he diversified his investments is of relatively little importance. The fact that the mortgages would mature in a relatively short time may suggest that he was looking for a quick return rather than for investments; but in his case and because of his advanced age, it was reasonable and proper for him to secure investments which would mature at an early date, particularly as they are proven to have borne a substantial degree of risk.

The possibility that a profit might be made in the event that the mortgages were paid at maturity was undoubtedly one of the motives which prompted the appellant to make his purchases.

It was made clear, however, in *Jones v. Leeming* (1), that a mere profit motive is not sufficient to make the profits taxable. There, Lord Warrington stated at page 425:

> The fact that the parties intended from the first to make a profit does not in my opinion affect the question we have to determine.

In the same case, Lord Buckmaster said at page 420:

> An accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value if it does so rise, its realization does not make it income.

(1) [1930] A.C. 415.

In the case of *Minister of National Revenue v. Taylor* (1), the President of this Court said:

> The intention to sell the property at a profit is not of itself a test whether the profit is subject to tax for the intention to make a profit may be just as much the purpose of an investment transaction as of a trading one.

It seems to me that the discounts here realized are not of such a nature as to be considered as additional interest or as taxable profits, but rather as a gain made by a mere enhancement in value by realizing a security—a capital accretion. So far as I have been able to ascertain, this is the first case in which our courts have been asked to find that the profits realized as a result of purchasing securities at a discount constitute taxable profits. There is no provision in our Income Tax Act similar to that found in Case III of Schedule D of the United Kingdom Income Tax Act which brings into tax "all discounts" which are annual profits or gains. However, as pointed out in Simon's Income Tax, Volume II, at page 450, not all sums described as discounts fall within the charge under Case III; they may on analysis turn out to be capital funds. Under our Act, discounts which are realized are not taxed *per se*; but under section 6(*g*) amounts received by a taxpayer *as premium,* paid by a corporation on the redemption or acquisition of any of its shares, are to be included in completing the taxpayer's income. Further, it provides for taxing portions of those payments which may be reasonably regarded as being in part payment of interest or other payment of an income nature and in part in payment of a capital nature (section 7).

In the case of *Lomax (Inspector of Taxes) v. Peter Dixon & Son, Ltd.* (2), the Court of Appeal considered the nature of discounts and premiums received by the taxpayer from a subsidiary company which it had established in Finland. By an agreement for the funding of a debt of £319,600, the Finnish company issued to its creditor 680 notes of £500 each; this was a discount of 6 per cent. The notes were to bear interest at 1 per cent. above the lowest discount rate of the Bank of Finland, the maximum interest to be 10 per cent. One hundred notes were redeemable within a few days after the date of the agreement and 29 in each

(1) [1956] C.T.C. 189. (2) 25 T.C. 353.

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of the next 20 years. It was provided that each note redeemed was to bear a premium of 20 per cent. if, in the year preceding the redemption, the profits of the Finnish Company reached a specified level. It was held (Court of Appeal) that the discount at which the notes were issued and any premiums payable on redemption, were capital sums and that the appellants were not assessable to income tax thereon.

In delivering a judgment with which the other members of the Court concurred, Lord Greene, M.R. analysed the nature of many classes of transactions relating to payment or recompense to lenders of money. He pointed out that in some cases the question whether a receipt is to be regarded as capital or as income may sometimes be answered by the terms of the contract itself; in others it is to be arrived at by the terms of the contract as properly interpreted in the light of all admissible extrinsic evidence. After considering the case of an ordinary issue of debentures by a company with good credit rating and ample security, he said at page 364:

> Now let me take the opposite case where the credit of the company and the security which it offers are not such as to enable it to offer its debentures at par at a normal rate of interest applicable to sound securities. The object of the company is to make its issue attractive and various alternatives are open to it. It may make the issue at par but give a high rate of interest. Here the defect in the security is expressed in terms of interest. The whole of the interest is unquestionably income and is taxable as such although the high rate of interest is, in part, attributable to the capital risk. Another course which the company may take, and for commercial reasons probably will take, is to fix the rate of interest at a more normal level and make the issue at a discount; or it may make the issue at par and offer a premium on redemption; or it may combine both methods. Here the defect in the security is expressed in terms of capital. I venture to think that no business man would regard the discount or the premium as anything but capital matters. In each case the result is the same—the subscriber is paying for a more or less hazardous investment less than the figure at which it is to be redeemed, and in exchange has to be content with a lower rate of interest. Another way of making good the defect in the security would be for the company to take out a guarantee policy—a practice which was common in the days of the Law Guarantee Trust & Accident Society of unhappy memory. In such a case the issue might be at par. The subscriber would be paying more for a safer investment than he would have paid if the guarantee policy had not been taken out. No one would suggest that the premiums paid by the company were part of the subscriber's income. Yet the policy would be playing exactly the same part as would have been played by a reduction in the issue price, or the offer of a premium on redemption, or a combination of the two.

The amount by which the issue price falls short of par or the redemption price exceeds par can, of course, as has been done in the present case, be reduced to terms of income if any one chooses to make the calculation; and this is often done by a stockbroker advising a client, particularly when the redemption date is drawing near. But this does not mean that these amounts are income. If they were income and taxable as such when received on redemption, it would appear to follow that in the case of a debenture issued at a premium and redeemable at par, the amount of the premium ought to be treated as an income loss. A premium on redemption and a premium on issue are in their nature precisely the same and come into existence for the same reason, viz., the desire to express in the former case the greatness, in the latter, the smallness, of the risk in terms of capital rather than in terms of interest.

And at page 365 he said:

The Inland Revenue authorities have never sought to tax the amount by which the redemption price of debentures exceeds the issue price. We were informed by the Solicitor-General that these amounts are regarded, not as income but as capital sums which the company bears in consideration of the risk attaching to the investment which is borne by the investor. In my opinion this view is undoubtedly correct. In passing, I may point out that the reason given by the then Solicitor-General in *Wilson v. Mannooch,* 21 T.C. 178, for not claiming tax on discounts or premiums in the case of debentures, was quite different to that given by the present Solicitor-General in the present case.

I can find no ground for distinguishing the present case from that of an ordinary issue of debentures by a trading company. If at the date of the agreement the Appellants had lent to the Finnish company a sum of £319,600 to be secured by an issue of notes at 94 repayable over 20 years at 120 and bearing interest at a rate fixed by reference to bank rate in the usual way, the Revenue authorities would not have claimed tax on the discount or the premium. The element of capital risk was quite obviously a serious one, and the parties were entitled to express it in the form of capital rather than in the form of interest if they bona fide so chose. It is said, however, that there is a difference between the case of a security issued for a present loan and that of a security issued to cover an existing loan. This argument found favour with Macnaghten, J., but, with all respect to him, I cannot follow it. The parties to the transaction, faced with an existing debt which the Finnish company was obviously not in a position to repay there and then, did what in effect amounted to writing down the capital value of the debt which by the terms of the agreement was now to be repaid over a long period of years, bearing interest in the meantime at a normal commercial rate. I can see no difference between writing down the capital value of an existing debt and writing down the capital value of a new debt which is what is done where a company makes an ordinary issue of debentures at a discount or repayable at a premium. Moreover, it is quite common for a company to issue debentures as security for an existing loan. This is often done in the case of a company's bankers who call for security, and also not infrequently under schemes of arrangement when debentures are issued to existing creditors of the company. In such cases circumstances may well call for a writing down of the value of the debts.

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Then, at page 367 he summarized his conclusions as follows:

> It may be convenient to sum up my conclusions in a few propositions. (1) Where a loan is made at or above such a reasonable commercial rate of interest as is applicable to a reasonably sound security, there is no presumption that a "discount" at which the loan is made or a premium at which it is payable is in the nature of interest. (2) The true nature of the "discount" or the premium, as the case may be, is to be ascertained from all the circumstances of the case and, apart from any matter of law which may bear upon the question (such as the interpretation of the contract), will fall to be determined as a matter of fact by Commissioners. (3) In deciding the true nature of the "discount" or premium, in so far as it is not conclusively determined by the contract, the following matters together with any other relevant circumstances are important to be considered, viz., the term of the loan, the rate of interest expressly stipulated for, the nature of the capital risk, the extent to which, if at all, the parties expressly took or may reasonably be supposed to have taken the capital risk into account in fixing the terms of the contract.

On page 362, after referring to the case of *Lord Howard de Walden v. Beck* (1) (in which certain promissory notes bore no interest rate but were repayable at a premium equivalent to a reasonable commercial rate of interest) and after stating that those facts led as a matter of common sense to the inference that the 4 per cent. was interest, he stated:

> A rather different case is that of a moneylender who stipulates for payment by instalments of a sum very much larger than that which he lends. From a business point of view, the excess, one would have thought, is referable largely, if not mainly, to the capital risk. So long as the moneylender is carrying on his business this is immaterial since he will be assessed under Case 1 of Schedule D. It is part of his business to take capital risks.

That case, of course, is not precisely the same as the present one. In fact, there are many obvious differences. But it does lay down principles which are of use in determining the true nature of a discount or a premium. If a moneylender who is not carrying on a business stipulates for a larger sum than that which he advances (when the security bears a normal commercial rate of interest), the premium is referable mainly to the capital risk involved. I think the same principle must apply when, as here, Cohen did not lend money on mortgages but bought existing mortgages at a discount.

In my opinion, the principles laid down by the Master of the Rolls in summarizing his conclusions are of equal if not of greater application when considering the position of one

(1) 23 T.C. 384.

who purchased securities at a discount but did not advance funds to a borrower. Since in the instant case the mortgages all bore a reasonable commercial rate of interest, there is no presumption that the discounts received were in the nature of interest. As I have stated above, there were very special reasons in this case for preferring mortgages of early maturity, namely, the advanced age of the taxpayer and his natural desire in the circumstances to keep his affairs reasonably liquid. The main feature is that in every case the discounts represented a very real capital risk in all the mortgages. Some were on hotels where the loss of a license would seriously affect the security; others were on building loans where there was a risk of being involved in litigation with lien holders and the possibility that tenants might not be found; others were second and third mortgages, some of which were collaterally secured by chattel mortgages. The evidence that in every case there was a high degree of risk was not challenged by the respondent. I am satisfied on the evidence that the taxpayer took this capital risk into account in purchasing the mortgages at a discount.

In my opinion, the profits realized by the appellant cannot be distinguished from those made by another investor, who, instead of purchasing mortgages at a discount, purchases a number of bonds or debentures in various companies at a discount. The Act does not tax such gains where they are not realized in an operation of business. In my view, the profits here realized were made on ordinary investments by an enhancement in value at maturity and are not taxable gains, but rather capital accretions.

Having found that the appellant was not engaged in an adventure or concern in the nature of trade and that the profits made were capital accretions, it is not necessary to consider the further submissions of counsel for the Minister that they were profits from property or from a source.

I stated above that in 1945 the appellant in one transaction had purchased at a discount a one-third interest in a block of 57 mortgages known as the Scarborough Mortgages. As the evidence in regard to that purchase is of the same nature as that regarding the other mortgages, my finding in regard thereto must be the same.

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In the course of the argument it was stated that in assessing the appellant for the year in question, the assessor had included the interest on all the mortgages as earned income (presumably because in the opinion of the assessor the appellant was engaged in the business of money lending), thereby excluding them from the surtax applicable to investment income. Because of my finding, it becomes necessary to refer the assessments back to the Minister, not only for the purpose of reducing the assessments to the extent of the mortgage discounts realized in the respective years, but also for the purpose of adding to the investment income the amount of interest received in each year on the mortgages and adjusting the surtax accordingly.

For these reasons, the appeal will be allowed, the decision of the Income Tax Appeal Board will be set aside and the matter referred back to the Minister for the purpose of re-assessing the appellant in each of the years in question in accordance with my finding.

Judgment accordingly.