1941
Sept. 11 & 12.
1942
May 11.

BETWEEN:

HIGHWOOD-SARCEE OILS LIMITED...APPELLANT;

AND

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

Revenue — Income tax — Limited company — Objects of incorporation — Trade or business—Capital losses—Profits from investments—Income—Income War Tax Act, R.S.C., 1927, c. 97, secs. 3 & 6—Liability for tax—Appeal from decision of Minister of National Revenue dis-

missed—"Disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income."

Appellant company was incorporated for the purpose, *inter alia*, "to search for and recover and win from the earth petroleum, natural gas, oil, salt, metals, minerals and mineral substance of all kinds" . . . It also was authorized "to purchase, underwrite, guarantee the principal and interest of, subscribe for and otherwise acquire and hold and vote upon the shares, debentures, debenture stock, bonds or obligations of any company" . . .

Appellant from time to time acquired leases of oil lands in its own name but never drilled oil wells itself or developed such leases. It purchased shares of a company of which it later secured complete control. It also purchased shares in and loaned money to other companies. These latter investments proved losses for appellant.

In 1933, appellant entered into an agreement with certain parties whereby appellant advanced the sum of $60,000 for the drilling of an oil well on the understanding that appellant would receive back out of production of the well the money advanced by it and also acquire a 65 per cent interest in the well, its production and equipment This venture proved successful and appellant received in the taxation year 1935, the sum of $70,896 13 in cash, as the net proceeds of production of the well.

Appellant filed a return for the taxation year 1935 It deducted from receipts the amount of the losses incurred in its former ventures These deductions were disallowed by the Commissioner of Income Tax, whose assessment was affirmed by the Minister of National Revenue and an appeal was taken to this Court.

Held: That appellant was carrying on, in the material period, a trade or business within the terms of s. 3 of the Income War Tax Act, and that trade or business was one within the purposes and objects for which it was incorporated.

2 That the losses which appellant claims to set off against profits are capital losses and not expenditures incurred for the purpose of earning the income within the meaning of the Income War Tax Act.

3. That such losses are not deductible in arriving at appellant's taxable income and appellant is therefore liable for income tax.

APPEAL under the provisions of the Income War Tax Act from the decision of the Minister of National Revenue.

The appeal was heard before the Honourable Mr. Justice Maclean, President of the Court, at Calgary.

H. S. Patterson, K.C. and *E. D. Arnold* for appellant.

C. J. Ford, K.C. and *A. A. McGrory* for respondent.

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

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THE PRESIDENT, now (May 11, 1942) delivered the following judgment:

This is an appeal from a decision of the Minister of National Revenue (hereafter called "the Minister"), affirming an assessment made by the Commissioner of Income Tax upon the appellant, Highwood-Sarcee Oils Limited, in respect of income tax for the taxation year 1935, under The Income War Tax Act. The appellant was assessed for the said taxation period on a taxable income of $30,254.94, and the tax thereon was fixed at $4,538.24, together with interest in the sum of $350.50, altogether $4,888.74. The taxable income of the appellant was arrived at after disallowing certain amounts which the appellant claimed as deductible items in computing its net income for the year 1935.

The appellant, in its statement of claim, raised certain points, all of which were contested by the respondent in his statement of defence. Paragraphs 5, 6 and 7 of the statement of claim were abandoned at the hearing of the appeal by counsel for the appellant. The subject-matter of the appeal was therefore narrowed down to the one question as to whether the appellant was properly assessed as a corporation engaged in the development of prospective oil properties in Western Canada, or, whether it should be considered as "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", as alleged in paragraph 3 of its statement of claim, and therefore allowed to set off against profits any losses sustained as a result of such operations.

The Minister in affirming the assessment in question did so on the ground "that the expenditures representing development prior to the commencing of the 1935 accounting period and 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 and other provisions of the Income War Tax Act."

The appellant company was incorporated on June 7, 1928, by letters patent, issued by the Secretary of State

of Canada. The principal purposes and objects for which the company was incorporated are set out in paragraph 1 (*a*) of the letters patent. They are as follows:

1. (*a*) to search for and recover and win from the earth petroleum, natural gas, oil, salt, metals, minerals and mineral substance 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, metals, minerals and mineral substances of all kinds, and all products of any of the same, to trade in, deal in and contract with reference to lands and products thereof, or interests in land, mines, quarries, wells, leases, privileges, licences, concessions and rights of all kinds covering, relating to or containing or believed to cover, relate to or contain petroleum, natural gas, oil, salt, chemicals, metals, minerals or mineral substances of any kind;

For the purpose of considering the specific issue here raised it might be well to quote also paragraph 3 (*k*) of the letters patent. It reads:

3. (*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, bonds or obligations of any company or of any principal, public or other authority in the Dominion of Canada, the United Kingdom or elsewhere, and upon a distribution of assets or division of profits to distribute any such shares, stocks, bonds or obligations amongst the members of this company in specie, and to promote any company or companies, either in the Dominion of Canada, the United Kingdom or elsewhere, for the purpose of its or their acquiring all or any of the property, assets, rights and liabilities of the company, or for any other purpose which may seem directly or indirectly calculated to benefit the company, and to pay all or any of the expenses in connection with such promotion.

The letters patent states that "the capital stock of the said company shall consist of two million (2,000,000) shares without nominal or par value, subject to the increase of such capital stock under the provisions of the said Act; provided, however, that the said shares may be issued and allotted for such consideration as may be determined from time to time by the Board of Directors, not exceeding in the aggregate the sum of two million ($2,000,000) dollars or its equivalent."

The appellant began business shortly after its incorporation and, from time to time, acquired leases of oil lands in its own name but never drilled oil wells itself or developed such leases. The first venture of the appellant was to purchase shares in a company known as Highwood Petroleum & Natural Gas Company, Limited. Later on the appellant obtained control of this company. The agreement entered

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into between the appellant and this company was evidenced by a written document, dated May 15, 1930. It provided in clause 1 that: "The Old Company (Highwood Petroleum & Natural Gas Company, Limited), shall transfer, assign, set over and deliver to the New Company (Highwood-Sarcee Oils, Limited, the appellant) all its petroleum and natural gas leases, rights and concessions and all other of its properties, rights and other assets whatsoever and wheresoever situate, including all moneys and securities held by it or to which it is entitled, and the full benefit of all contracts and engagements to which the Old Company is or may be entitled." The consideration was the issue to the Old Company of certain fully paid shares of the capital stock of the appellant company and the assumption by the latter company of the liabilities of the former company, as of the date when the agreement was approved by the Old Company. The agreement also provided for the exchange by shareholders of the Old Company of their shares in that company for shares in the appellant company on the basis set out in the agreement.

The appellant also made an agreement with a company known as Western Alberta Oil Company, Limited, as evidenced by a written document dated April 11, 1930. This agreement was made between Western Alberta Oil Company, Limited, of the first part, Highwood-Sarcee Oils, Limited, of the second part (the appellant company), Clark, Martin & Company, Limited, of the third part, and William Martin Jr. of the fourth part. Counsel for the appellant referred to this agreement as a loaning agreement whereby appellant loaned $15,000 to Western Alberta Oil Company, Limited. It will be well to set forth the operative clauses of this agreement. After the introductory clauses have recited certain facts, and that William Martin Jr. held an option from Western Alberta Oil Company, Limited, to purchase from the said company 116,919 shares of its capital stock, it goes on to say:

> Now therefore in consideration of the premises, and the sum of $15,000 now paid by Highwood-Sarcee Oils, Limited, to Western Alberta Oil Company, Limited, the receipt of which sum is hereby acknowledged, it is mutually agreed between the Parties hereto as follows:—
>
> (1) Western Alberta Oil Company, Limited, shall forthwith issue and deliver to Highwood-Sarcee Oils, Limited, 50,000 fully paid up shares of its capital stock, being part of the aforesaid option held by William Martin, Jr., and the said William Martin, Jr., hereby consents to the

said 50,000 shares being issued and delivered to Highwood-Sarcee Oils, Limited, on account of the aforesaid Option, held by him from Western Alberta Oil Company, Limited.

(2) William Martin, Jr., covenants to and with the Parties hereto to forthwith pay to Western Alberta Oil Company, Limited, the sum of $15,000 in consideration of the said Western Alberta Oil Company, Limited, issuing and delivering to him 50,000 fully paid up shares of its capital stock, the same being issued on account of the aforesaid Option.

(3) William Martin, Jr., and Clark, Martin & Company, Limited, hereby covenant with Highwood-Sarcee Oils, Limited, that the total liabilities of Western Alberta Oil Company, Limited, as of this date do not exceed the sum of $14,000 and that Calgary & Edmonton Corporation, Limited will forthwith issue to Western Alberta Oil Company, Limited, a Lease covering the Petroleum and Natural Gas Rights in the following lands and premises, namely,—Legal Sub-divisions Eleven (11) to Sixteen (16), in Section Seven (7), Township Seventeen (17) and Range Two (2), West of the Fifth Meridian, and the East Half of the North East Quarter of Section Seven (7), Township Sixteen (16) and Range Two (2), West of the Fifth Meridian, being a total of 320 acres, in form and subject to conditions satisfactory to Highwood-Sarcee Oils Limited.

(4) William Martin, Jr., hereby gives to Highwood-Sarcee Oils, Limited, an irrevocable option to purchase from him 50,000 fully paid no par value shares of Western Alberta Oil Company, Limited, at the price of thirty cents per share at any time within two months after petroleum or natural gas has been struck in commercial quantities on any of the aforesaid land.

(5) Western Alberta Oil Company, Limited, covenants with Highwood-Sarcee Oils, Limited, that Highwood-Sarcee Oils, Limited, shall have the right to appoint two of the Directors to the Board of Western Alberta Oil Company, Limited.

(6) Clark, Martin & Company, Limited, and William Martin, Jr., each covenant with Highwood-Sarcee Oils, Limited, that on the breach of any of the covenants herein by any of the Parties hereto that they will repay to Highwood-Sarcee Oils, Limited, the sum of $15,000 paid by it to Western Alberta Oil Company, Limited, on delivery to either or both of them of 50,000 fully paid no par value shares of Western Alberta Oil Company, Limited.

This agreement is not a loan agreement at all. It provides for the outright purchase of 50,000 shares of Western Alberta Oil Company, Limited, by appellant for $15,000 in cash. There was no obligation whatever for repayment to the appellant of that amount. This was a straight capital investment made by the appellant but which turned out to be a loss. Any attempt, in 1935, to write off this loss against income of that year would therefore appear to be wholly untenable.

The appellant also advanced the sum of $500 to a company known as the Signal Hill Company. It, also, in 1933, bought shares in and made advances to a corporation known as Pine Hill Petroleum, Limited, in the aggregate

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amount of $56,511.28, and consequent upon this venture the appellant, in 1933, also advanced to a company known as Sheldon Burden of Canada, Limited, the sum of $2,500.

We may now turn to the appellant's balance sheet, as of June, 1935, and there we find that the appellant purports to write off and deduct from revenue the investments made and moneys advanced by it in some of the ventures outlined above, namely: Pine Hill Petroleum, Limited, $56,511.28, Western Alberta Oils, Limited, $15,000, and Sheldon Burden of Canada, Limited, $2,500, altogether $74,011.28. The appellant takes the position, on the ground I have already explained, that it is entitled to set off these amounts, which it considers as investment losses, against any revenue received by it during the taxation year in question.

We may now consider the source of the appellant's revenue for the taxation period in question. On July 20, 1933, a written agreement was entered into between T. O. Renner, S. J. Davies and C. H. Snyder, therein called "the 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.

The appellant company also sold some of its securities from time to time and reinvested the proceeds in other bonds and securities, sometimes profiting from the transactions and, at other times, losing. It also renewed from time to time oil leases that it held, and dropped other

leases which it considered not worth holding, thereby saving rental charges,—all of which would be the usual course pursued by any other company similarly situated or engaged. The appellant received according to the evidence of the auditor of the appellant company, in the taxation year 1935, the sum of $60,000, the amount advanced under the agreement with Renner et al., and in addition the sum of $10,896.13. These amounts, totalling $70,896.13, were received in cash as the net proceeds of production of the Highwood-Sarcee Well No. 1. It is against this income that the appellant seeks to set off the losses of $74,011.28, which I have already mentioned. The appellant had not been in receipt of any revenue or earnings prior thereto, except for any interest it had derived from investments. It will be observed therefore that the appellant claims it had sustained a deficit in its operations for the taxation period in question.

The reports of the directors of the appellant company to the shareholders thereof should be of some significance here. The directors' report submitted to the shareholders at its annual meeting of October 27, 1932, contains the following paragraph:

> The policy of your Directors has been to keep in touch with and carefully examine all likely oil development work within the Province and keep the expenditures within its income, so that the capital of the Company will not be depleted. Following this policy, examinations and investigations have been made in connection with the following areas:
> . . . . .

This report contains a reference to an area known as Two Pine structure and it reads as follows:

> The chief operations of the Company over the past year have been carried on in this area. For the purpose of assisting in intensive geological examination of the area considerable trenching and pit-digging was carried out in the Fall of last year and the early Spring of this year. This work was done under the supervision of our own Geologist, Dr. Willis, in co-operation with the Geological Survey Staff of the Dominion Government. When this work was completed Dr. Willis prepared as complete a report as he was capable of from surface geology, but in view of the information obtained from the results of the operations so far carried forward at the Cotton Belt, Elbow Oils and Signal Hill Wells, some doubt as to proper interpretation of the structural conditions maintained and it was strongly recommended that we endeavour to arrange for a Seismograph Survey to be made of the area under observation. This meant bringing a Seismograph Survey party and outfit in from the States. After considerable negotiations, arrangements were made to do this in conjunction with the Nordon Company. The Seismograph Survey party is now in the field and the results of their work and report will have a large

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bearing on the immediate further work of the Company in this neighbourhood. It is hoped that arrangements can be made to have this outfit make a report on the Company's holdings in the Highwood and Sarcee Reserve as well as on the Two Pine, but this will be largely dependent on weather conditions, and the success of the work as it proceeds.

The report of the directors submitted at the annual meeting of the shareholders held on October 30, 1933, contains the following:

In regard to the policy of the Company, it will be recalled by the shareholders who have followed the history of the Company with interest, that previously care had been taken to conserve the liquid assets of the Company, whilst at the same time investigating all prospects of a promising nature in various fields where tests for oil and gas were either being conducted or where there was reasonable promise of profitable operations. During the year previous to the one under review there were many such propositions investigated and reported upon. It was felt, however, that the time had arrived when the Company should go into activity and with that in view, after many further offerings had been considered and analysed, your directors decided to enter into agreements for two distinct enterprises.

One was a proposition to become interested with the lease owners of the NE. ¼ of Section 21, Township 18, Range 2, West of the 5th Meridian, being in the South end of Turner Valley, with the object of drilling a well thereon.

The other was concerned with the acquisition of rights in approximately 12,000 acres in Southern Saskatchewan known as the Dirt Hills area upon a structure which had been surveyed geologically by several authorities on different occasions and highly recommended.

The commitment of the Company in connection with the NE. ¼ of Section 21, in the South end of Turner Valley is an amount of $60,000, and your Directors see no reason why this sum will have to be exceeded.

The commitment in connection with the well at Avonlea, Saskatchewan, will involve the Company ultimately in a sum of from $30,000 to $35,000, for which the Company expects to hold its present controlling interest in Pine Hill Petroleum, Limited, the Company which owns the well and acreage. In this connection there is a Turnkey Contract with Sheldon Burden of Canada, Limited.

The wells in both the above areas are progressing satisfactorily and a successful and profitable outcome is the hope of your Directors. The depth of the well in Turner Valley on Saturday, the 28th inst., was 1,685 ft., the Benton contact having been passed at 520 feet. The depth of the Saskatchewan well was 2,217 ft. on Saturday, and there have been several showings of gas that have been tested out during the drilling.

Your Directors have in view that, having regard to the present condition of the Company and value of its liquid assets, the present commitments of the Company will leave a substantial sum in the treasury.

In the report of the Directors last year you were informed that arrangements had been made in conjunction with the Nordon Company to bring in to this district a Seismograph Survey party and outfit, in order that some testing by this method might be made to confirm the findings of the geologists who had previously gone over the structures in which the Company is interested. These arrangements were eventually carried out and reports were made and data furnished by the seismograph party, which, so far as the Southern Saskatchewan area is concerned, were

entirely confirmatory of previous reports of geologists, and which furnished a substantial recommendation for the drilling of a test well in the area mentioned. This may fairly be said to have been the deciding factor upon which your Directors proceeded to make the arrangements for the investment in the Dirt Hills well and acreage.

With regard to the Two Pine area, the Seismograph Operator who was in charge reported that the results obtained only served to show that his apparatus was not able to furnish reliable data and results owing to the peculiarly faulted and disturbed nature of the strata in the foothills area.

It may be mentioned that a somewhat similar result was reported from an attempt made by the Seismograph party to make determinations in the Southern end of the valley. Your Directors consider it of the highest importance that the tests made by the Seismograph Apparatus, which is considered to be the last word in scientific sub-surface surveying, and which has been eminently successful in prairie structures in the United States of America, was available for use in Southern Saskatchewan area.

The report of the directors submitted at the annual meeting of August 22, 1934, contains the following:

The inclusion in the current assets of the actual expenditures on Highwood-Sarcee Well No. 1 naturally gives a very conservative value to such current assets, and there is no doubt that this item is worth a great deal more to the Company than the figures would suggest.

In regard to development work it is with the utmost satisfaction that your Directors refer to the successful completion of what is known as the Highwood-Sarcee Well No. 1 located on the NE. ¼ of Section 21, Township 18, Range 2, West of the 5th Meridian. This well has now been completed and is definitely ascertained to be capable of producing 500 barrels per day of Naphtha. The production is being marketed under contract to Imperial Refineries for the present.

In this connection there are some deferred liabilities to be paid out of production and these will absorb the proceeds of the production for several months to come. Your Company's position, however, is that it will be repaid its outlay of approximately $60,000, and will then succeed to a 65 per cent. interest in the well and equipment and the lease of the quarter section. This is considered to be a most favourable situation, and your Directors have given very close attention to the whole of the details over the past year. Your Company is sensible of the very able co-operation of its associates in this venture, and particularly appreciative of the expert work of Mr. Clarence Snyder, who was in charge of the operations throughout the whole period of drilling.

With reference to the well in Saskatchewan, this was referred to in your Directors' report of last year and the commitment in connection was mentioned as ranging from $30,000 to $35,000 representing a controlling interest in Pine Hill Petroleum, Limited, the Company which owns the well and controls approximately 12,000 acres in the vicinity. There was a turnkey contract with Sheldon-Burden of Canada, Limited, you were informed. Unfortunately, operations had to be given up at a late date in 1933 owing to severe weather and lack of water, and shortly afterwards disaster overtook Sheldon-Burden of Canada, Limited, of such a nature that it is scarcely hoped the Company will ever revive. The well on shutting down last Fall was approximately 3,000 feet deep, and, as the objective was 4,000 feet, arrangements have been made for a new contract with another drilling company to complete the well. This unfortunate situation has been met by your Directors subscribing for a further block

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of shares in Pine Hill Petroleum, Limited. Work under the new contract is now in full swing. The hole has been cleared out, and on the morning of the 31st of July 400 feet of new hole had been drilled, the depth attained being 3,350 feet.

Your Directors last year informed you of an Agreement with Dr. Robin Willis under which your Company split several of its leases in the Pekisko Hills area and made over some acreage to Dr. Willis on condition that a well would be drilled by him and his associates to prove the area This situation resulted in operations by the Pekisko Hills Company, Limited, which has drilled a well on the acreage adjoining that assigned by your Company, so far successfully to the extent that the well has obtained a depth of 1,400 feet and is certified to be in the limestone formation, with an eight inch hole. It is understood that casing has been cemented in the lime and drilling is proceeding. Considerable gas is flowing from the well and, according to the anticipation of Dr Willis and his associates, it may be reasonably expected that final success will be achieved in the production of oil or naphtha from the limestone in paying quantities. Your Directors feel that in dealing with these leases in the way they have been handled, as outlined, the position of your Company has been considerably improved and strengthened, and its remaining holdings in the Pekisko Hills area very much enhanced in value.

Considerable information is furnished in the auditor's report in regard to leases held by your Company. After extensive negotiation, arrangements regarded by your Directors as being of a favourable nature were made with the Department at Edmonton. The question of these leases is engaging the earnest attention of your Directors at this time and decisions will be shortly made as to the surrender or retention of the various leases held by the Company as a matter of policy.

In regard to the general policy of the Company, your Directors are continuing to investigate every proposition of consequence where tests for oil and gas can be made with fair promise of returns In the immediate future the policy of the Company will be guided in a great measure by the outcome of the operations in Southern Saskatchewan, the facts on which should be available at a relatively early date.

Arrangements have been recently completed with the Stock Exchange in Toronto where Highwood-Sarcee stock is now listed for trading. An application for similar privileges on the Vancouver Stock Exchange has been recently submitted and it is fully expected that as soon as certain details have been approved, your Company's stock will be listed in that City. Arrangements have also been made with the Toronto General Trusts Corporation to act as transfer agents in the Cities of Toronto and Vancouver, and it is felt by these measures that adequate facilities have been provided for the convenience of shareholders and others in regard to the purchase and sale of holdings in the Company.

Then, in the directors' annual report submitted to the shareholders at the annual meeting of the company held on October 7, 1935, we find the following:

During the year of operation covered by the report two outstanding accomplishments are recorded, the first being the completion of the well in Saskatchewan by Pine Hill Petroleum, Ltd, in which concern your Company held a controlling interest, and the second, the recovery of the loan, approximately $60,000, made by your Company to the Highwood-Sarcee Well No 1 undertaking and the placing of your Company in the position of enjoying a majority interest in this producing well, the drilling equipment, and the lease of the quarter section on which the well stands.

The well in Saskatchewan was completed and abandoned in the Fall of last year after every precaution had been taken to exploit all its possibilities. The failure to find gas production was a disappointment to your Directors Since that time good gas production has been found in other parts of Saskatchewan where perhaps the indications were not so favourable for success, and certainly where geology did not give so much encouragement However, the business of gas and oil prospecting to which your Company is committed, is highly speculative, and it is refreshing to turn from the failure, and to survey the brighter side of the picture

The well in Turner Valley, since the last report was before you, has yielded so satisfactorily that it has paid off the deferred drilling charges, and by April of this year had repaid to your Company the whole of the cash advanced for drilling costs, etc. Since that date to the date of the Auditors' Report, revenue to the amount of $10,896 13 had been brought into the Company's treasury flowing from its interest in the production from the well. This is shown in the figures as "Deferred Revenue". Highwood-Sarcee Well No. 1 is standing up reasonably well as a producer, subject to normal depletion, and your Directors are anticipating a favourable future for this well.

Arrangements have recently been completed to participate in the drilling of a further well in Turner Valley. This new well will be known as Highwood-Sarcee Well No. 2, and it will be drilled and operated under similar conditions to those obtaining regarding Well No 1

An agreement has been made with the British American Oil Company, Limited, under which that Company acquires for cash, 30 per cent of the Lessee's interest in the Well, and of the remainder your Company will own 65 per cent, the other 35 per cent being held by the Company's associates in No 1 Well, which associates are bearing their proportion of the cost of drilling the No. 2 Well.

Having carefully considered the position of your Company, your Directors feel that the past year can be regarded as one of progress, and perhaps the most successful year in the history of the Company. At present the recently arranged venture of drilling Highwood-Sarcee Well No 2, gives the Company reasonable expectation of further improving and strengthening its position. Looking to the future, it would appear to be good policy to continue to develop along lines which will keep the Company active in the producing field, and to take every opportunity of investigating new situations of a promising nature.

I have already stated the question for decision here, and the opposing contentions of the parties. These I need not repeat. In all these cases the initial difficulty which presents itself is that the matter for decision is a question of fact. As was stated by the Lord Justice Clerk in the case of *Californian Copper Syndicate* v. *Harris* (1), it is quite a well settled principle in dealing with questions of assessment of income tax, that where the owner of an ordinary investment chooses to realize it, and obtains a greater price for it than that at which he originally acquired it, the enhanced price is not profit assessable to income tax. He pointed out that it was equally well established

(1) (1904) 5 T.C. 159.

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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, the Lord Justice Clerk stated, 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, which, as I understand it, is the position here claimed for the appellant, and in which cases losses, incurred in the same taxation period, may be set off against gains. 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 is whether the sum or gain that has been made is 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 considering such cases it is not sufficient to consider merely what are the powers and objects of the company concerned, though that is of importance, but rather what, in fact, the company was doing in the taxation period in question. That is my apology for quoting at such length from the reports of the directors of the appellant company to its shareholders, in order to ascertain what its real position was.

I may quote from the judgment of the Lord Justice Clerk in the case of the *Californian Copper Syndicate supra,* and this will disclose the facts of that case and what was the opinion of the court upon the point there in issue. He said:—

> This Syndicate was formed with a capital of £30,000, *inter alia,* to acquire copper and other mines, and certain mines named in particular, and to prospect and explore for the purpose of obtaining information, and to enter into treaties, contracts, and engagements with respect to mines, mining rights, and a number of other matters in the United States and elsewhere. It was also to carry on mercantile, commercial, financing and trading businesses, and to work minerals, to establish and form companies for such objects, to subscribe for purchase, or otherwise acquire, shares or stock of any company, and accept payment in shares for properties sold or business undertaken or services rendered, and to hold, sell, or dispose of the same, to promote companies for the purpose of acquiring the undertaking, property, and habilities of the Company, or carrying on business being conducive of the prosperity of the Company
>
> These are shortly some of the main purposes of the Company, and they certainly point distinctly to a highly speculative business, and the

mode of their actual procedure was in the same direction Of the £28,332 realized by shares which were subscribed for, £24.000 was invested in a copper-bearing field in the United States, and the balance was spent in development of the field and in preliminary and head office expenses.

The Company then were successful in selling the property to the Fresno Company—£300,000 in fully paid up shares being given by the Fresno Company for the property. Although that was a sale, the price to be paid in shares, I feel compelled to hold that this company was in its inception a Company endeavouring to make profit by a trade or business, and that the profitable sale of its property was not a truly substitution of one form of investment for another

It is manifest that it never did intend to work this mineral field with the capital at its disposal. Such a thing was quite impossible. Its purpose was to exploit the field, and obtain gain by inducing others to take it up on such terms as would bring substantial gain to themselves. This was that the turning of investment to account was not to be merely incidental, but was, as the Lord President put it in the case of the *Scottish Investment Company*, the essential feature of the business, speculation being among the appointed means of the Company's gains.

Another case, which is of some assistance here, is that of *The Commissioners of Inland Revenue* v. *Korean Syndicate Ld.* (1). The head note of this case will sufficiently set out the facts. It reads:

A company was incorporated as a limited company having for its principal object the acquisition and working of concessions and turning the same to account. In 1908 the company entered into an agreement to lease a concession in Korea which it had acquired in consideration of the lessees paying what was therein described as a royalty, but which was in fact a percentage based on the profits made by the lessees. The company also received the interest on a certain sum of money on deposit at a bank. The company's operations were confined to the collection and distribution of these two sources of income and to the payment of the premiums on a sinking fund policy.

It was held, upon the construction of the memorandum and articles and the agreement of 1908 that the company was carrying on the business for which it was incorporated —namely, the acquisition of concessions and the turning of the same to account—and was, therefore, carrying on a business within the meaning of s. 39 of the Finance (No. 2) Act, 1915, and was accordingly liable to be assessed to excess profits duty under that Act. The point at issue in this case, and the conclusion reached by the Court of Appeal were clearly stated in one paragraph of the judgment of Atkin L.J., and that is as follows:

Now I quite agree that it does not necessarily follow that because a company is incorporated under the Companies (Consolidation) Act, 1908, it is carrying a business. The Act allows any number of persons

(1) (1921) 3 K.B. 258.

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associated together for any lawful purpose, to be registered in accordance with its provisions, and one knows that a company may be registered for professional purposes, or as what is called in the Act an association for purposes not for gain; but in this case there is a Syndicate formed by an association of persons clearly for a profit, and the purpose for which they are associated is described by it in its memorandum as that (*inter alia*) of acquiring concessions and turning them to account for the purpose of making a profit, which it may distribute amongst its shareholders; and, having taken those powers, it has in fact availed itself of them, and that is the course it has adopted. It has acquired concessions, and it has turned them to account, and the profits that arise in this matter are profits that arise from its so turning them to account. It seems to me that it does not at all matter how it chooses to turn them to account In this case, dealing with the question of the mining, concessions, it has obtained a part share in a very important concession in Korea which gives it the right to prospect over a very large area, and exclusive rights of working minerals within a particular district in that area. That concession it proposed at one time to work itself and with its own capital, and if it had done that, no question at all would have arisen; but after some two or two and a half years it came to the conclusion that it would not be advantageous to it to do so, and it therefore proceeded to do what many persons have done as a matter of business before—namely, instead of working its rights with its own capital, it handed them over to another company to work on the terms that the Syndicate would receive an annual payment. I think it matters very little what that annual payment is called or how it is calculated, and in the case of a company of this kind, to my mind, it would make no difference whether the payment was based upon a calculation of the output or was a mere rent; but in fact in this case the payment is called, in the agreement of March 25, 1908, a sum equal to 8 per cent of the net profit, and in the other part it is called a share of the profits, but whatever way it was. it was the way in which the Syndicate chose to make a profit It made it by turning this concession to account in this way, and it has received annually, and still receives, a regular sum, and that sum, together with the other income that is received from a sum of money that it has made placed on deposit, it distributes as profits, and it distributes them as a dividend among the shareholders on the terms of an article (art. 125) which provides that no dividend shall be payable except out of profits arising out of the business of the company.

I would also refer to the case of *The Commissioners of Inland Revenue* v. *The Budderpore Oil Co. Ltd.* (1), in which the decision of the Court of Appeal in the *Korean Syndicate* case, *supra*, was followed.

Upon the facts here I find no difficulty in reaching the conclusion that the appellant company was in point of fact carrying on, in the material period, a trade or business within the meaning of sec. 3 of the Income War Tax Act, and which trade or business was one within the purposes and objects for which it was incorporated. Where a limited

(1) (1921) 12 T.C p. 467.

company comes into existence for some particular objects or purposes, and if, in fact, it becomes engaged in some or all of such objects or purposes, then, that is a matter to be considered, when you come to decide whether doing that is carrying on an ordinary trading business or not. The account of the activities of the appellant company, as found in the annual reports of its directors to the company's shareholders, would seem to make it quite conclusive, or so it appears to me, that the company was carrying on a trade or business for profit-making. The money invested by the appellant in oil leases was not made primarily with a view to a resale of its interest in the well or wells to be developed, but to something that would produce a revenue to the appellant, and this it did. And it was that alone that earned income for the appellant company. It was only the appellant's money that made possible the successful development of the Highwood-Sarcee Well No. 1, and it purchased a 65 per cent interest in the lease of this property and its equipment. It might have been of interest to have had in evidence the correspondence exchanged between the appellant and the managers of the stock exchanges to whom the former applied for the listing of its shares, to see if they were to be listed as the shares of a trading or business organization, or that of an investment company only. The fact that the appellant associated itself with others in leasing oil lands, or in developing or operating oil lands or oil wells, or that it disposed of some of its interests to others under the terms of an agreement whereby, in certain events, it was to participate in any profits ultimately realized, does not make it any the less a trading or business organization. It is immaterial whether the appellant hired prospecting or drilling crews to work on any of the leases under its control or whether it hired others to do this work. The fate of the ventures in which it placed its funds and lost is of no consequence. The form in which it pleases to deal with any profit is not of importance; that it so deals with it, in some form other than in cash, would not affect the claim of the taxing authorities for the tax payable on such profit, if any. This is, I think, a case where the appellant was engaged in a trade or business for the purpose of profit-making, and any profit made is subject to the tax. The losses made, and which the appellant claims to set off against

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profits, were, I think, clearly capital losses, and not expenditures incurred for the purpose of earning the income, within the meaning of the Act, and are not therefore admissible as deductions. The appeal must therefore be dismissed and with costs.

Judgment accordingly.