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May 26 & 27

Oct. 2

BETWEEN:

GAIRDNER SECURITIES LIMITED .. APPELLANT;

AND

MINISTER OF NATIONAL REVENUE RESPONDENT.

Revenue—Excess Profits Tax—Income—Excess Profits Tax Act, 1940, 4 Geo. VI, c. 32, s. 2(1) (f)—Income War Tax Act R.S.C. 1927, c. 97, s. 3(1)—Company incorporated for purpose of dealing in securities—Profit derived through exercise of power for which appellant incorporated is taxable—Appeal dismissed.

Appellant company incorporated as Gairdner & Company Ltd. in 1930 had for its purpose and object *inter alia* (1) "to underwrite, subscribe for, purchase or otherwise acquire . . . . and to sell, exchange, transfer or assign or otherwise dispose of and deal in the bonds or debentures, stocks, shares, notes or other securities or obligations of . . . . any incorporated or unincorporated company, corporation . . . ." (2) "to transact and carry on a general financial agency and brokerage business, and to act as brokers and agents . . . . for the purchase, sale, improvement, development and management of any property, business or undertaking . . . .".

From 1930 to 1938 it carried on business in a large way as an investment dealer, buying and selling securities for customers or its own account, and also underwriting securities of various sorts and selling them to the public and in 1938 had on hand a large number of securities which it had acquired in its ordinary business of trading and was also heavily indebted to its bankers.

In 1938 appellant sold to a new company its physical equipment, books and records and goodwill for certain shares in the new company, retaining its securities and remaining liable for its indebtedness to its bankers. In 1944 the appellant and two other parties obtained a large number of shares of the capital stock of Dominion Malting Company, thereby obtaining control of that company. They caused new shares to be issued, the appellant obtaining a large number of such shares, some of which it sold immediately. Later it sold the remaining shares for a large cash consideration realizing a very substantial profit and on that profit it was assessed for excess profits tax and from such assessment it appeals to this Court.

Held: That the true nature of the transaction is to be determined from the taxpayer's course of conduct viewed in the light of all the circumstances and it was in fact not an investment but a speculation essentially of the same character as appellant had previously engaged in and one which it was specifically empowered to do, since appellant was authorized to acquire and hold, and to sell and exchange stocks in other companies as principal as well as agent as one of the essential features of its business and as one of the appointed means by which it would carry on business for a profit and its action was the exercise of the very power for which the company was incorporated.

2. That the whole scheme was an ordinary commercial transaction entered into for the purpose of making a profit and when that profit was made in carrying out the very business which appellant was empowered to carry on such profit is taxable.

APPEAL under the Excess Profits Tax Act.

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

H. H. Stikeman, Q.C., D. A. McIntosh, Q.C., S. E. Edwards and *A. L. Bissonette* for appellant.

J. W. Pickup, Q.C. and *F. J. Cross* for respondent.

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

CAMERON J. now (October 2, 1952) delivered the following judgment:

In 1946, the appellant company sold a large number of shares of Dominion Malting Company, realizing a substantial profit thereon. The respondent assessed the appellant under the Excess Profits Tax Act, Statutes of Canada, 1940, c. 32, as amended, in respect of such profits, and an appeal is now taken from that assessment.

By s. 2(*f*) of the Excess Profits Tax Act, the profits of a corporation for any taxation period are defined as the net taxable income of the said corporation as determined under the provisions of the Income War Tax Act in respect of the same taxation period. The question raised therefore is whether, as contended by the respondent, the sums in question fall within the definition of "income" in s. 3 of the latter Act, the applicable part of which is as follows:

s. 3(1) For the purposes of this Act "income" means the annual net profit or gain . . . . as being profits from a trade, or commercial or financial or other business or calling, directly or indirectly received . . . . from any trade, manufacture or business . . . .

For the appellant it is contended that the profit so realized was not "income," that the purchase of the shares was entered into as an investment, and that the realization of a profit when the shares were sold was merely the realization of an enhancement in value of that investment and therefore a capital gain not subject to tax.

The appellant was incorporated in 1930 under the Dominion Companies Act, as "Gairdner & Company, Ltd." Its purposes and objects included the following:

(*a*) 1. To underwrite, subscribe for, purchase 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, transfer, assign or otherwise dispose of and deal in the bonds or debentures, stocks,

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shares, notes or other securities or obligations of any government or municipal or school corporation or of any bank or of any other incorporated or unincorporated company, corporation, commission, association, syndicate or individual and to exercise all the rights and privileges of ownership in respect thereof;

2. To transact and carry on a general financial agency and brokerage business, and to act as brokers and agents for the investment, loan, payment, transmission and collection of money and for the purchase, sale, improvement, development and management of any property, business or undertaking and the management, control or direction of corporations, syndicates, partnerships, commissions, associations and companies;

From 1930 to 1938, the appellant carried on business in a large way as an investment dealer, buying and selling securities for customers and on its own account, and also underwriting securities of various sorts and selling them to the public. By 1938 it had encountered financial difficulties, having on hand a large number of securities which it had acquired in its ordinary business of trading, but which it could not readily dispose of, and also being heavily indebted to its bankers in amounts equal to or in excess of the then value of such securities.

The appellant in 1938 changed its name to "Gairdner Securities Limited" and dropped its membership in the Investment Dealers Association, but otherwise its legal and corporate structure has remained unchanged since its incorporation. A new company, "Gairdner & Company, Ltd.," was incorporated by provincial charter, became a member of the Investment Dealers Association, and carried on thereafter the business of an investment dealer. By an agreement dated April 30, 1938 (Ex. 5), the appellant sold to the new company its physical equipment, its books and records, and goodwill, for certain shares in the new company, retaining, however, its securities, and remaining liable for its indebtedness to its bankers.

For the moment, I shall pass over the operations of the appellant company from 1938 to 1944, and turn to the transaction which resulted in the profits now in question.

In 1938, Mr. Gairdner had a conversation with a friend as to the possibility of acquiring Dominion Malting Company, but nothing materialized at that time. Some time in the early part of 1944 he again became interested in its purchase as he understood that the estate of the late president desired to liquidate its holdings. Before any

progress had been made he found that another financier, Mr. E. P. Taylor, also had in mind the acquisition of the company. Negotiations were entered into with Mr. Taylor and in the result it was decided that the appellant, Mr. Taylor and one Barnes should jointly offer to purchase the preferred and common shares of Dominion Malting, their respective interests in the stock to be in the proportion of forty per cent, forty per cent and twenty per cent. Arrangements were made by which the Montreal Trust Company was to submit an offer to all the shareholders of Dominion Malting to purchase the 6,180 preferred shares of a par value of $100 at par, and 6,680 common shares at $86.50 per share, those shares being the only shares issued and outstanding. Further arrangements were made with the Royal Bank to finance the purchase on behalf of all. The offer to purchase was duly made but owing to an offer made by another party, the bid for the common shares was increased to $100 per share. One of the conditions attached to the offer was that before any of the shares were taken up, Dominion Malting should take out supplementary Letters Patent converting it into a public company. That condition was complied with and by June 30, 1944, about 98 per cent of both preferred and common shares were acquired on the terms I have mentioned.

After securing control of the company, the new owners in August, 1944, caused to be issued and sold new five per cent preferred shares, and with the proceeds redeemed all the old seven per cent preferred shares, the appellant and its associates thereby being relieved of their liability to the Royal Bank in respect of the purchase price of the old preference shares. The new issue of preferred shares was underwritten by the appellant (Ex. C) and Dominion Malting was to pay to it or to whom it might direct, a commission of five per cent or $32,500, but the appellant turned its rights over to its associate—Gairdner & Company, Ltd.—which company marketed the shares and received the commission.

At the same time, the common shares were split ten for one so as to make them more readily marketable and they were placed on an annual dividend basis, commencing November 1, 1944.

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By arrangement with the appellant, Taylor and Barnes gave an option to Gairdner & Company, Ltd. to take up 19,780 and 12,030 of the new common shares at approximately $12 per share (Ex. 18), which company sold shares of Messrs. Taylor and Barnes and the appellant to the public at $13.25 per share (Ex. 19). Upon the conclusion of that operation, Taylor and Barnes together retained about fifteen per cent and the appellant twenty-two per cent of the common stock in Dominion Malting. It is admitted in the appellant's Reply that upon the sale of 11,460 common shares in 1944, it realized a profit of $13,509.53.

It was then decided to expand and improve the facilities of Dominion Malting, the cost of which was financed by the sale in March, 1945, of bonds in the sum of $850,000, and of additional preferred shares of a par value of $200,000, both such issues being marketed by Gairdner & Company, Ltd.

The appellant made no efforts to dispose of its remaining 15,844 common shares of Dominion Malting. Early in 1946, Mr. Taylor on behalf of a brewing company which he controlled, intimated to Mr. Gairdner that in order to secure a regular supply of malt he was prepared to negotiate the purchase of all the output of Dominion Malting. Mr. Gairdner was not in favour of the suggestion as he did not wish the appellant company to hold the largest block of stock in a one-customer company. At the same time he was apprehensive that the Taylor interests might be adding to their holdings, and that there might be a battle for control which he wished to avoid. In the result, Taylor made a further proposal that the appellant should sell its 15,844 common shares of Dominion Malting to Canadian Breweries for $514,930, or $32.50 per share, that price then being about $6 per share over the current market price of the stock. That offer was accepted and the terms of the sale embodied in an agreement dated February 11, 1946 (Ex. 21), and was carried out on February 22, 1946. From Ex. 10, however, it would appear that the actual number of shares transferred to Canadian Breweries was 15,493 and the consideration $502,902.73. It is the profit arising from that transaction that has given rise to this appeal.

It was a very substantial profit, the shares being sold at $22.50 per share in excess of the original cost of $10. It is apparent that to some extent at least the decision to sell was based on the profit to be made. In answer to a question by counsel for the appellant as to whether the size of the profit motivated the company in selling at that time, Mr. Gairdner stated, "Well, it always has a bearing."

I may note here that at the time the appellant and its associates were acquiring the controlling interest in Dominion Malting, the appellant on June 26, 1944, accepted the offer of Trafalgar Securities Ltd. (also controlled directly or indirectly by Mr. Gairdner) to purchase all (or practically all) the appellant's remaining securities other than the Dominion Malting Company shares. In the result, the appellant company was left without assets of any kind except the Dominion Malting Company stock which it was then in the process of acquiring, and without liabilities except the debt to its bankers which it had incurred in connection with the same matter.

From these facts alone it would appear that the buying and selling of Dominion Malting shares belonged to that class of profit-making operations provided for in the appellant's charter, and which it had previously carried on. *Prima facie,* therefore, the profits therefrom would constitute taxable income. In *Anderson Logging Company* v. *The King* (1), Duff J. (as he then was) stated at p. 56:

> the sole raison d'être of a public company is to have a business and to carry it on. If the transaction in question belongs to a class of profit-making operations contemplated by the memorandum of association. *prima facie,* at all events, the profit derived from it is a profit derived from the business of the company.

It is submitted by the appellant, however, that certain other facts in this case are sufficient to establish that the purchase of shares in Dominion Malting was not entered into as a profit-making scheme, but as an investment, and that the realization of profit when the shares were sold, under the circumstances mentioned, was merely the realization of an enhancement in value of that investment and therefore a capital gain not subject to tax.

(1) (1925) S.C.R. 45.

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In support of this contention, counsel for the appellant relies in the main on the evidence of Mr. Gairdner. He was one of the incorporators of the appellant company and was a shareholder and director until at least the end of June, 1944 (Ex. 1). On June 26 of that year he was appointed general manager of the company for a period of twenty years, retroactive to June 25, 1943, with complete authority to acquire and sell securities on its behalf. Shortly thereafter he ceased to be a director and shareholder, having sold his interest to his children. I have no doubt that at all material times he operated the affairs of the company as he thought fit and without the intervention of the shareholders or directors. Mr. Gairdner states that in 1938, when the new company, "Gairdner & Company, Ltd.," was formed, and certain assets turned over to it, it was the intention thereafter to operate the appellant company as an investment company only, that is to say, it would discontinue buying and selling on behalf of the public and confine its activities to the realization of the securities which it retained and the investment of the proceeds on behalf of the company itself; the business of an investment dealer would be carried on by "Gairdner & Company, Ltd."

Ex. 10 is a statement prepared by the appellant's auditors for the period April, 1938, to December 31, 1946, comprising, (*a*) a list of the securities purchased; (*b*) a list of the securities sold, and (*c*) a further list of securities sold, those marked "X" representing securities held by the appellant at December 31, 1937, and those marked "Y" representing securities exchanged for those held on the same date. From the evidence of Mr. Gairdner, it is apparent that from 1938 on, the appellant discontinued its former business of buying and selling securities for the public and that one of its operations, and perhaps its main one, was to hold and nurse the securities it held and to sell them at a profit when a convenient occasion presented itself. Ex. 10 establishes, however, that that was not its sole activity between 1938 and 1944 and that to some extent it was still engaged in buying and selling stocks, not as an investment, but as a dealer therein. As one instance of the latter, I refer to a purchase of 17,075 shares of National Breweries stock on June 14, 1943, for $495,175. On the same date

16,700 shares were sold for $553,400, and the remaining shares were disposed of later in the same month, the whole transaction resulting apparently in a gross profit of over $70,000. In all, there were approximately 100 purchases of securities between the dates mentioned, and so far as I can ascertain from the evidence, many of these purchases had nothing to do with the business of liquidation of the old securities.

Mr. Gairdner states that about 1943 or 1944, he decided that it would be in the best interests of his sons to be placed in executive positions in suitable industries rather than be engaged in the more precarious business of buying and selling securities; that he began to look around for companies with good prospects which could be bought outright or in which a controlling interest could be secured, and thereafter to place his sons in executive positions therein. He says that, having that in mind and realizing the possibility that Dominion Malting, if acquired, could be expanded substantially under new management, he decided to secure control thereof as a permanent investment, the purchase to be made through the appellant company.

Much is made of Mr. Gairdner's evidence that at the beginning of the negotiations he intended that the appellant should acquire the whole interest in Dominion Malting and that it was only when he found that Taylor was also interested that it was decided to make it a joint venture; that the marketing of the new preferred shares and of the common shares which were sold was not carried out by the appellant but by one of the affiliated companies; that the sale of the common shares in 1944 was part of the entire scheme of making the investment, it being necessary to do so in order to secure some profit thereon which would assist in paying in part or in whole for the remaining shares which were to be held. It is also stressed that between the time when the shares were acquired in 1944 and the final sale was made in 1946, Mr. Gairdner on behalf of the appellant became a member of the Board of Directors of Dominion Malting and through his efforts the plant was substantially improved and enlarged, thus indicating the intention to retain a permanent interest therein. Then it is pointed out that while the market for common shares

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was continually rising, no further effort was made to dispose of them and that, when finally sold to the Canadian Brewing Company in 1946, it was only under the pressure of the circumstances which I have outlined above; and that the proceeds of the sale to Canadian Breweries have been used in the purchase of blocks of securities which the appellant has retained as investments.

Mr. Gairdner also states that in furtherance of his desire to place his sons in industry, he pursued a similar policy through Trafalgar Securities Ltd. (of which company he was also general-manager), that company between 1944 and 1947 acquiring ownership or control of some three or four other industrial concerns, the shares in which after the necessary refinancing had been carried out, are still retained by Trafalgar, his sons having been given executive positions therein. Finally, he states that for a number of years prior to 1946, the appellant company, while engaged in liquidating its old securities, treated any profits realized thereon as a capital gain; that in its income tax returns for those years it claimed and was allowed the status of a personal corporation, no objection being taken to the allocation of such profits to capital rather than to revenue account. He points out, also, that under the Excess Profits Tax Act, no application was made to establish the standard profits of the appellant such as would have been the case had the appellant continued in the business of a dealer.

It is submitted that the cumulative effect of the evidence establishes that the appellant in 1938 ceased to be a dealer in securities, that after 1938 it was an investment company and that there was a clear intention in acquiring the Dominion Malting shares to make an investment therein of a permanent nature.

The principles to be followed in cases such as the present one were explained by the Lord Justice Clerk in *Californian Copper Syndicate* v. *Harris* (1), where at p. 165 he said:

> 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

(1) 5 T.C. 159.

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?

It must be kept in mind, also, that even if it be admitted that certain transactions resulted in capital accretion, they may give rise to taxable income if they form part of a scheme for profit-making or trade. In *Collins* v. *The Firth Brearley Stainless Steel Syndicate* (1), Rowlatt, J. said:

Now the principle I think is very clear and has been established by many cases. The appreciation of an article, the subject of property, whether it is the property of an individual or whether it is the property of a company, is not taxed as such; but it is taxed if the realization of that appreciation forms part of a trade, because then the trade is taxed, and this is an item in the trade. That is all there is in the principle.

Notwithstanding the evidence of Mr. Gairdner as to the intention to make the transaction an investment in Dominion Malting shares, I am of the opinion that its true nature is to be determined from the taxpayer's whole course of conduct, viewed in the light of all the circumstances. Now on the facts which I have set out, it seems to me impossible to conclude that there was here any investment. Prior to the time when the appellant transferred its securities to the parent company—Trafalgar Securities—it was virtually bankrupt, and when the securities were sold it was left with no assets and no liabilities. At the time of the transaction in question, therefore, it had nothing with which to make any investment.

On the contrary, I think it was in fact a speculation essentially of the same character (although perhaps of a more complicated nature) as it had previously engaged in and one which it was specifically empowered to do. Reference may be made to *Scottish Investment Trust Co.* v. *Forbes* (2). In that case an investment trust company had

(1) 9 T.C. 564. (2) 3 T.C. 231.

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power to vary its investments and generally to sell or exchange any of its assets, and it was held that the net gain by realizing investments at larger prices than were paid for them constituted profits chargeable with income tax. The Lord President stated in part at p. 234:

> As its name indicates, this is an Investment Company. and the Memorandum makes it plain that its profits are to be derived from various operations relating to the investments. The third head of the Memorandum professes to state the objects of the Company, and in head (6) of this enumeration occur the words "to vary the investments of the Company, and generally to sell, exchange, or otherwise dispose of, deal with, or turn to account any of the assets of the Company."
>
> It is true that the doing of any of these things might be incidentally necessary in the conduct of the business of any Company. It is also true that this Memorandum states in the latter heads of the same article several things which are less properly described as objects of a Company than as incidental acts of administration. But from the structure of the Memorandum it appears that the varying the investments and turning them to account are not contemplated merely as proceedings incidentally necessary, for they take their place among what are the essential features of the business. In my view such speculations are among the appointed means of this Company's gains. Accordingly, I should consider it legitimate for the directors to divide profits so made, although in determining the amount divisible they would necessarily have regard, not alone to the individual transaction yielding profit, but to the general results of their changes of investments. It would be right that they should maintain as strictly as possible the relative rights of separation between capital and income, and make all apportionments necessary in that behalf.

Now in the present case, the appellant was empowered to acquire and hold, and to sell and exchange stocks in other securities as principal (as well as in the capacity of agent), as one of the essential features of its business and as one of the appointed means by which it would carry on business for profit. What was done here was not something merely incidental to the exercise of the powers conferred on the company, but exercise of the very powers for which the company was incorporated. It is admitted that the appellant at the time of the transaction was carrying on a business and it must follow that when it made profits in carrying out the very business which it was empowered to carry on, that such profits are chargeable to tax. It would be impossible to suppose that a company which for years had carried on the business of buying and selling

securities could enter upon a single similar transaction and escape taxation by saying, "In this case if the transaction turns out well the profits realized therefrom will be entered in my books as a capital profit and I will retain as many shares as I can as a permanent investment."

In my opinion, the whole scheme was an oridnary commercial transaction entered into for the purpose of making a profit. It was realized from the outset that some of the common shares purchased by the appellant would have to be sold at a profit if the plan were to succeed. Over 11,000 shares were actually sold at a substantial profit and with that profit, and in view of the fact that the shares were steadily rising in value, the appellant was able to pay off the bank loan by borrowing from the parent company and thereby retain its shares.

The joint purchase of the shares which enabled the appellant to embark upon the enterprise with somewhat less risk than would have been the case had it been the sole purchaser, the stipulation that the Dominion Malting Company must be turned into a public corporation, the redemption of the former 7 per cent preferred stock by the issue of new shares at 5 per cent (which would enhance the value of the common shares), the splitting of the common shares so as to make them more readily marketable, the agreement by which the appellant underwrote the new issues of preferred shares at a discount of the actual marketing thereof by an associate of the parent company, the expansion of the business, the marketing of the new issue of bonds and shares by the associated company—all these steps, arranged and carried out by Mr. Gairdner on behalf of the appellant, all point to the fact that what was planned for and what was achieved was an enhancement in the value of the shares to be purchased and the making of a profit thereby. It is the familiar case of a financial organization acquiring control of a privately owned corporation, reorganizing its financial structure so as to ensure a ready distribution of the shares, and selling those shares to the public at a profit. Under the circumstances of this case, I am unable to see that it is of any importance what-

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ever that the shares were retained for a period of eighteen months, or that Mr. Gairdner had in mind that if the venture were successful, the company would retain some of the shares for the purpose of advancing the interests of his sons.

An observation in the *Anderson Logging* case, to which I have referred above, seems to me to be applicable to the facts in this case. There it was stated at p. 49:

> The appellant company is a company incorporated for the purpose of making a profit by carrying on business in various ways including, as already mentioned, by buying timber lands and dealing in them. It is difficult to discover any reason derived from the history of the operations of the company for thinking that in buying these timber limits the company did not envisage the course it actually pursued for turning these limits to account for its profit as at least a possible contingency; and, assuming that the correct inference from the true facts is that the limits were purchased with the intention of turning them to account for profit in any way which might present itself as the most convenient, including the sale of them, the proper conclusion seems to be that the assessor was right in treating this profit as income.

In the instant case there is a clear inference that in purchasing the shares, it was with the intention of turning them to account for profit in any way which might present itself as the most convenient, including the sale of them. As I have pointed out, a very substantial number were sold in 1944, a sale which in my view was entirely a trading transaction. I do not think that the appellant can now be heard to say that the sales made in 1946 of the remaining shares acquired under precisely the same circumstances do not constitute an ordinary trading transaction.

For the year 1946 there was no provision in the Income War Tax Act exempting the profits of the business of an investment company. S. 4(*w*) as enacted by s. 3(7), Statutes of Canada, 1946, c. 55, provided for exemptions for certain limited types of investment corporations, but was first made applicable to the year 1947. In any event, the appellant would not have fallen within its provisions. For the taxation year 1946, however, s. 7(*f*) of the Excess Profits Tax Act did provide for an exemption from the tax

under that Act, not for the profits of all investment corporations, but only for those diversified investment corporations which came within the conditions therein mentioned. The appellant was clearly not within the provisions of that subsection. In exempting from tax only those investment companies which fell within the conditions of s. 7(*f*), I think it must be inferred that Parliament intended that the profits of all other investment corporations should fall to be taxed as "income" under s. 3(1) of the Income War Tax Act.

For these reasons, I am of the opinion that the profit realized by the appellant upon the sale of its shares in Dominion Malting in 1946, fell within the provisions of s. 2(1) (*f*) of the Excess Profits Tax Act, was "income" within the meaning of s. 3(1) of the Income War Tax Act, and that the appellant was therefore subject to assessment under the Excess Profits Tax Act in respect thereof. The appeal will therefore be dismissed with costs.

Judgment accordingly.