1952
Apr. 15 & 16
Oct. 20

BETWEEN:

SUTTON LUMBER AND TRADING CO. LTD., ... APPELLANT;

AND

MINISTER OF NATIONAL REVENUE RESPONDENT.

Revenue—Income—Excess Profits Tax Act 1940—Capital or income—Sale of an asset a transaction in ordinary course of business—Appeal dismissed.

Appellant company was incorporated with the objects for which it was established set out in the Memorandum of Association and more particularly in s. 2(*i*) thereof as follows: "To purchase, take on lease or otherwise acquire and hold any lands, timber lands or leases . . . . and to sell, lease, sublet or otherwise dispose of the same . . . .".

Appellant sold for a considerable sum of money a large tract of timber land which it had held for a number of years. The appellant was assessed for income tax on the proceeds of this sale. An appeal from the confirmation of such assessment by respondent was taken to this Court.

Held: That the sale of the timber tract was a transaction in the ordinary course of appellant's business and not the sale of a capital asset for cash, and the profit thereon was one made in the operation of appellant's business.

APPEAL under the Income War Tax Act.

The appeal was heard before the Honourable Mr. Justice Archibald at Vancouver.

C. K. Guild, Q.C. and *O. F. Lundell* for appellant.

C. C. I. Merritt and *J. D. C. Boland* for respondent.

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

ARCHIBALD J. now (October 20, 1952) delivered the following judgment:

This is an appeal by Sutton Lumber and Trading Company Limited from an assessment for excess profits tax for the year 1946, confirmed by the Minister of National Revenue. In the Statement of Claim, as well as in the "Opening Statement" made by counsel for the appellant, may be found in detail, information respecting the history of the appellant company and its holdings of timber land on the west and northern coasts of Vancouver Island.

It is not necessary, for the purposes of this decision, to repeat, in detail, the story of the various transactions and operations outlined at great length in the said "opening statement", but I wish to add in passing that the aforementioned "opening statement", when read in conjunction with the pleadings and the evidence, was of very great assistance to the Court.

Sutton Lumber and Trading Company Limited was incorporated in 1893, pursuant to the Companies Act of the Province of British Columbia, at that time in force.

The incorporators and directors of the Sutton Lumber and Trading Company Limited at that time were engaged in a relatively small way in operating a small mill in cutting lumber from approximately 5,000 acres, forming a portion of the lands and leases owned by the appellant company at the time of or subsequent to its "re-incorporation" pursuant to the provisions of the British Columbia Companies Act, (1897).

In or about the year 1902, the then directors and shareholders of the Sutton Lumber and Trading Company Limited, having first "re-incorporated" said appellant company, pursuant to said Companies Act of 1897, sold their holdings in Sutton Lumber and Trading Company Limited to Messrs. W. H. and A. F. McEwan of Seattle in the State of Washington, United States of America, who, at that time, operated the Seattle Cedar Company Limited, which was a company engaged in the manufacture and sale of cedar products. It should be noted also that the McEwans were interested in other companies trading in cedar and cedar lumber products.

About two years later, there came into the appellant company, V. W. Arnold of Albany, New York, and who, at that time, was an operator and a manufacturer of lumber, principally pine, in the eastern United States. The evidence also indicates that W. H. McEwan died in 1923, that A. F. McEwan died in 1947 and that V. W. Arnold died in 1932.

About, or shortly after the time when the McEwans became interested in the Sutton Lumber and Trading Company Limited, the appellant company acquired other lumber and timber lands in the west coast of British

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Columbia. These timber limits were acquired either by grant from the Government of British Columbia or by renewable leases, prior to 1905.

The lands also acquired by them, together with the lands purchased from the original holders of the appellant company, pursuant to its incorporation in 1893, were as follows:

(*a*) The Nootka Tract contiguous to Nootka Sound consisting principally of fir and estimated to contain approximately 300,000,000 feet board measure British Columbia Log Scale of timber, and covering an area of approximately 9,603 acres.

(*b*) The Clayoquot Tract contiguous to the various arms of Clayoquot Sound on the north and the Ucluelet Arm of Barclay Sound on the south, consisting principally of cedar estimated to contain approximately 2,250,000,000 feet board measure British Columbia Log Scale of timber, and covering an area of approximately 65,297·5 acres.

and the total acreage of the two tracts was approximately 70,000 acres.

A range of mountains separates the Nootka Sound tract from the Clayoquot tract. The Nootka tract is predominantly fir timber while the Clayoquot tract is predominantly cedar timber.

Subsequent to the acquisition of these timber limits, the appellant company erected a cedar mill at or near Mosquito Harbour in the Clayoquot tract and conducted an operation there in or about the year 1907. It manufactured three cargoes of cedar lumber which it despatched to the east coast of the United States, but owing to the great depression at that time, disposed of the lumber at a very heavy loss. No substantial operations were conducted on any of the holdings until the year 1937. The mill itself did not operate and in the year 1940, much of the machinery was requisitioned by the Dominion Government to be used in its wartime activities. It is worthy of note also, that after 1907, the appellant company did not maintain any business office in Canada and it should be noted that from 1926 to the date of the sale of the Nootka tract, the witnesses Schultheis and Fiskin were either individually or both directors of the appellant company.

In 1937 and 1938, the appellant company sold certain stumpage rights to a firm known as Gibson Brothers Limited and again in 1943 sold a large area of stumpage rights to the North Coast Timber Company Limited. Then

in 1946, and again it should be noted that the witnesses, Schultheis and Fiskin were still directors of the appellant company, the entire Nootka area was sold for cash to the British Columbia Forest Products Limited, the proceeds from the latter sale amounted to $315,000. An assessment, pursuant to the provisions of The Excess Profits Tax Act was made by the Department of National Revenue.

This assessment was appealed to the Minister of National Revenue and the said assessment was confirmed by him: thereupon an appeal was taken to this Court.

In its appeal, it is claimed on behalf of the appellant, that the sale to the British Columbia Forest Products Limited, was a sale of a capital asset and not a sale in the ordinary course of business of the appellant company and that the proceeds from the sale therefore, do not attract excess profits tax. In support of the appellant's contention, in addition to the evidence of the witnesses, there were submitted to the Court many exhibits and a large volume of evidence.

In the absence of any evidence from any of the shareholders or other responsible officers during the early years of the appellant company's existence, it becomes necessary to examine the acts and the conduct of the appellant company, to deduce, if possible, the actual intent of the appellant company during its early years.

To establish this intent, the appellant called a witness named Schultheis, who became an employee of the Seattle Cedar Company Limited, in 1896. He was employed by that company in a capacity sometimes described as "timber buyer" and sometimes referred to as "outside manager for the McEwans." As such, he had much to do with the Sutton Lumber and Trading Company Limited, in fact, he became vice-president of the appellant company in 1923 and in 1926, became a director as well.

On behalf of the appellant, an effort was made to indicate that during the time that he was associated with the McEwans and with the Sutton Lumber and Trading Company Limited, he had detailed knowledge respecting *all* the plans of the directors of the appellant company.

His evidence does not satisfy me that such was the case. Schultheis, notwithstanding his age, is still an alert, active gentleman, but his recollection of things that occurred forty

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or fifty years ago is not as clear nor as accurate as could be desired. I cannot accept his evidence as conclusive proof of the intent and purposes of the directors of the appellant company during the early years of its existence, in fact, I find his evidence entirely unsatisfactory in that regard.

I do not propose to analyse his evidence in detail in this regard. However, I must point out that with respect to this most striking incident that occurred in 1911, when the directors resolved at a meeting, and as so stated in the Minute Book, that they would proceed to sell the Nootka tract, Schultheis had no recollection of any such meeting of directors or of any such resolution made by them or of any purpose or decision to like effect proposed or purposed by the directors of the appellant company. Schultheis, at that time, was acting in the capacity of a lumber buyer or manager for the McEwans' interests in the outside activities of their companies, and it would be surprising indeed if he could, after all these years, recall sufficiently well incidents, which ordinarily, would not be part of his activities, to render his evidence helpful to the Court.

I should point out also, that his evidence respecting the cruises or other examinations of the timber limits as obtained by the appellant company, was far from satisfactory. He endeavoured to give the impression that the preponderance of the fir timber in the Nootka tract did not come to the knowledge of the appellant company until 1923. Any such suggestion I am unable to accept. There was an examination of the timber holdings made in the years 1903 and 1904 and again in 1911, and it is true there was a detailed cruise made in 1923, which indicated the kinds, qualities and quantities of timber on the lands, but I am satisfied that a man possessing the experience and knowledge of Mr. Schultheis, with regard to the Nootka area, would have known, in a general way, that there were there large holdings of fir lumber. In this regard, it should be noted also, that on his cross-examination, he finally admitted that at no time while he was a director of the appellant company or in fact, at any time prior thereto, had there been an opportunity to dispose of any of the lumber, either fir or cedar, to advantage. Neither was any of the evidence of the other witnesses helpful in determining this question of intent.

Witness Travelle impressed me as a very competent witness but he could speak only, and in fact attempted to speak only, respecting the impossibility, until very recent years, of conducting a joint fir and cedar operation in the same mill.

Witness Fiskin's evidence had to do with the period since 1938 when he became a director of the appellant company and since 1930 when he became associated with the Seattle Cedar Company Limited. He did not attempt to give any evidence as to the intent of the officers and directors of the appellant company in the earlier years. He did, however, it is true, make one very important and useful observation when he stated, on cross-examination, that normally a company holding timber lands would have three ways of realizing upon its holdings, namely, to log and cut those logs in the owner's mills, or log and sell the logs on the open market or the third, to sell the timber.

On behalf of the appellant it was argued, and argued with great force, that the Sutton Lumber and Trading Company Limited was established in 1893 and later in its "re-incorporation" for the purpose of manufacturing cedar and cedar products. While it is true that the McEwan interests had, through the years, been engaged to a large extent in manufacturing and trading in cedar in its Seattle and other operations, and while it is true that the handling of cedar products on Vancouver Island was one of its main interests, nevertheless it was by no means its sole interest. The evidence is clear that they knew that they had large holdings of fir timber, and while they considered disposing of same in 1911, the fact is that they did not do so, and could not profitably deal in lumber of any description on their holdings on Vancouver Island until 1937, in which year, and again in 1938 and in 1943, the appellant company made substantial sales of lumber on a stumpage basis. It is important to note that they treated these sales on a stumpage basis as sales made in the course of their business and did not use the cedar mill, or any cedar mill, in conjunction with any cedar logs cut pursuant to the contracts under which any logs were cut.

In fact, with the exception of the disastrous operations of the cedar mill in or about 1907, the sole operations of the appellant company in trading or "turning to account" its

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holdings in the Nootka and Clayoquot areas were concerned in the selling of timber on a stumpage basis and when those sales were made, the proceeds were treated as trading operations and subject to income tax.

Counsel for the appellant as well as counsel for the respondent, stressed that resort must be had to the Memorandum of Association, because as I have already indicated, the evidence of neither Schultheis nor Fiskin convinced me that the intent of the McEwans and other shareholders of the appellant company was restricted to operations and dealings in cedar lumber only. My finding is that the evidence does not establish any such contention. Therefore, the appellant has failed in its evidence to discharge the burden of proof—that the assessment is not correct. Such being the case, it becomes necessary to examine the appellant company's Memorandum of Association. This Memorandum of Association is dated November 17, 1902, and the main or primary objects for which the appellant company was established are to be found in section 2 of said Memorandum of Association. This section, together with the words of introduction, reads as follows:

THE COMPANIES ACT, 1897

Section 5.

MEMORANDUM OF ASSOCIATION
OF THE
SUTTON LUMBER AND TRADING COMPANY
LIMITED.

1. The name of the Company is the "Sutton Lumber and Trading Company, Limited."

2. The objects for which the Company is established are:

(i) To purchase, take on lease, or otherwise acquire and hold any lands, timber lands or leases, timber claims, licences to cut timber, rights of way, water rights and privileges, forshore rights, wharves, saw mills, factories, buildings, machinery, plant, stock-in-trade, or other real and personal property, and equip, operate and turn the same to account, and to sell, lease, sublet or otherwise dispose of the same, or any part thereof, or any interest therein.

In my opinion, it is of great importance that this power "to sell" is to be found in paragraph 2(i) and it forms an important portion of that subsection dealing with the main and primary objects of the appellant company. This power is equally as important as any of the other powers enumerated in that subsection. This power "to sell" moreover,

is not limited nor restricted by provisions in any other subsections of the said Memorandum of Association. I again emphasize that the proof is wanting either by direct or by inescapable inference to justify any conclusion to the contrary.

Counsel for the appellant argued that this was a sale of a capital asset for cash, not the sale of an asset in a manner based on production or use.

On the other hand, counsel for the respondent, after having again emphasized that the burden of proof is on the appellant to show the assessment is wrong, argued with force that this was a transaction in the ordinary course of this appellant company's business. With this argument I agree, and I am firmly of opinion that this was a transaction which was in the minds of the incorporators of the appellant company, and its directors throughout, certainly one thought of as a remote possibility.

Moreover, I do not think that the mere fact that Sutton Lumber and Trading Company Limited, by having the power to carry on a saw mill and did in fact conduct a saw mill back in 1907, justifies the conclusion that the appellant thereby excluded itself from the use of any of the other powers capable of being exercised in the normal use of its powers.

It also must be remembered that the evidence of the witnesses was consistent with the willingness of the directors of the appellant company to exercise this power to sell part of its timber lands at a profit, consistent with it carrying on a saw mill business.

The suggestion that this is an isolated transaction and therefore not taxable, does not apply to an incorporated company in all the circumstances of this case. As has been frequently stated, the question is "was the profit in question a profit made in the operation of appellant company's business? If it was, it is taxable." In turning these timber lands to account for a profit, it is reasonable to think that a sale of part of the lands must have been envisaged, as in fact the Minutes for 1911 clearly indicate.

Counsel for both appellant and respondent directed my attention to numerous authorities. Having regard to the facts as I find them in this case, it is necessary for me to

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discuss two of them only. The first one is the decision of Duff, J. (as he then was) in *Anderson Logging Company* v. *The King* (1). His remarks at pages 47 and 49 are particularly interesting in considering this appeal. He says at p. 47:

> it is sufficiently clear from the memorandum of association that one of the substantive objects of the company was to acquire timber lands and timber rights with a view to dealing in them and turning them to account to the profit of the company.

and again at p. 49 he says:

> 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 wih 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.

Counsel for both appellant and respondent quoted at length from his decision as reported. I do not think it necessary, for the purpose of my decision, to repeat the citations referred to me. *Anderson Logging Company* v. *The King* (*supra*) is a most important one and the decision in it, among other things, lays down the principle that:

> Where the powers of a company, incorporated to take over as a going concern a logging business, included the power to acquire timber lands with a view to dealing in them and turning them to account for the profit of the company, and it bought a tract of timber land and sold it at a profit the same is not a capital profit but one derived from the business of the company and as such assessable to income tax—

Counsel for the appellant argued before me that the decision in *Anderson Logging Company* v. *The King* (*supra*) resulted because of the lack of evidence submitted to the Court in that case, and counsel for both appellant and respondent referred to "the conspiracy of silence" in that case. It is apparent that the evidence adduced in that case was not considered sufficient, but, in my opinion, much the same, if not exactly the same situation prevails in the instant case.

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

The evidence, including all exhibits, is not sufficient to discharge the onus on the appellant, nor is that evidence sufficient to raise even a *prima facie* case that the assessment complained of is wrong.

In the other case urged on me by counsel for the appellant, namely, *Attorney General for British Columbia* v. *Standard Lumber Company Limited* (1), it was held on appeal from the Court of Revision, there were evidence and specific findings of fact, which entirely distinguish the case from the *Anderson Logging Company* v. *The King* (*supra*), and is entirely inapplicable in the instant case.

As already stated, I do not make any such finding or findings in the instant case.

My decision is that the appeal should be dismissed with costs.

Judgment accordingly.

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(1) (1936) B C.R. 481.