BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

NATHAN STRAUSS ..... RESPONDENT.

1959
May 27

1960
Apr. 12

Revenue—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 6 and 127(1)(e)—The Partnerships Act R.S.O. 1950, c. 270, s. 2 and 3(1)(3)—Capital or income—Partnership interest is a capital asset—Proceeds of sale of partnership interest do not constitute taxable income—Appeal dismissed.

Respondent, a practising barrister, owned an interest in a partnership which was engaged in developing and selling real estate. He disposed of part of his interest in the partnership for a sum of money over and above what it had cost him. The Minister of National Revenue assessed him for income tax on this amount and an appeal from such assessment was allowed by the Income Tax Appeal Board from whose decision the Minister appeals to this court.

Held: That whilst the income of a partnership is taxable to a member of the firm annually whether such share is withdrawn or not, the sale of his interest in the firm or a part of it at a profit constitutes a capital gain.

APPEAL under the *Income Tax Act*.

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

J. D. C. Boland and *W. R. Latimer* for appellant.

John G. McDonald and *D. A. Ward* for respondent.

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

FOURNIER J. now (April 12, 1960) delivered the following judgment:

In this case, the appellant appeals from a decision of the Income Tax Appeal Board[1] dated February 7, 1957, allowing the respondent's appeal from the reassessment of his income for the taxation year 1951 under the 1948 *Income Tax Act*. In reassessing the respondent, the Minister added to his declared income the sum of $9,166.67 on the assumption that this amount represented the profit made by the respondent on the sale of a part of his interest in certain land acquired by him and others for the purpose of disposition at a profit.

[1] 16 Tax A.B.C. 417.

1960

MINISTER OF NATIONAL REVENUE v. STRAUSS

Fournier J.

The onus is on the taxpayer to establish in fact and in law that the reassessment is based on an incorrect assumption.

The respondent is a barrister who has practised his profession since 1928 and who has never been engaged in any other business or enterprise. Some time in February 1951, he was told by one of his clients that Active Subdivisions Limited, which had an agreement of purchase and sale for a piece of land in Scarborough Township, thought of disposing of their right to purchase the property. It was suggested that a partnership or syndicate be formed to acquire the right, which was done. The partners were Ruth Loveless who had a one-third interest, the respondent a one-third interest and Augusto Boem and A. Andreoli, each a one-sixth interest.

On or about February 14, 1951, the respondent acquired from Active Subdivisions Limited a right to purchase from R. Buchanan and Minnie Buchanan the south half of Lot 33 in Concession 1 in the County of York, Province of Ontario, at a price of $105,000. When he acquired this right he was acting for the partners in his capacity of solicitor and trustee. The transaction of purchase and sale was to be completed on or before April 1, 1952, on which date vacant possession of the real property was to be given to the purchaser. In fact, it appears the transaction was completed on or about February 1, 1952. At the time the right to purchase was acquired the partners intended to develop the property for sale in a housing development.

The original subscription of the partners to the partnership fund was $35,000. For his one-third interest in the partnership the respondent paid $11,666.66. The other partners paid in proportion of their interest in the association. In August 1951, Ruth Loveless sold her one-sixth interest in the venture to Augusto Boem and A. Andreoli. On or about November 15, 1951, the terms of the original agreement for sale of the Buchanan property were altered to provide for the payment of $20,000 cash on December 1, 1951 ($35,000 had been paid upon the acquisition of the right) and the balance of $50,000 to be secured by a mortgage on October 1, 1952. The total of these amounts would cover the sum of $105,000, the price of the property. Some time in November 1951, the respondent sold to Ruth Burritt,

for $15,000, one-half of his one-third interest in the partnership. The purchaser of this one-sixth ($\frac{1}{6}$) interest assumed her share of accounts payable by the partnership and outstanding at the time of the sale. The respondent had paid $5,833.33 for that one-sixth interest he sold to Ruth Burritt for $15,000, thereby realizing a profit of $9,166.67 on the transaction. This is the amount which was added to the respondent's income for the year 1951.

Some time later in 1951, Boem and Andreoli sold parts of their interest in the association to George Lipson, Jack Jacobson and Eddy & Son Construction Limited, the nominee of E. Green. So at the end of 1951 the partners and their interest were as follows:

Nathan Strauss	one-sixth interest
Augusto Boem and A. Andreoli	one-third interest
Ruth Burritt	one-sixth interest
George Lipson	one-ninth interest
Jack Jacobson	one-ninth interest
E. Green	one-ninth interest

Filed as exhibit is a memorandum dated the 24th of March 1952, signed and executed by the respondent and George Lipson, Jack Jacobson and A. Andreoli, in which they acknowledged and declared that they were in partnership for the purpose of developing and selling the Buchanan property and that the profits or losses of the partnership were to be divided or borne in proportion to the shares or interests held by each partner in the joint venture.

In 1952, the partnership commenced its selling operations. This must have started after the transaction of the purchase had been completed. The deed of the property was signed and delivered on February 19, 1952 and registered on February 22, 1952, as appears in Ex. 5 which was filed as part of the evidence before the Court.

The profits realized by the operating of the partnership were divided between the partners in proportion of their interest in the venture and the respondent alleges having paid income tax on same.

1960

MINISTER OF NATIONAL REVENUE v. STRAUSS

Fournier J.

The partnership which was organized in 1951 to purchase land for development and sale purposes is still in existence and the partners as of the end of 1951 are still the same. There have been no additions or subtractions and the matters of the partnership are still incomplete. Hence the adventure in the nature of a trade of the partnership, to wit, that of selling lots for housing purposes, has become a continuing business.

The question to be determined is whether the sum of $9,166.67 received by the respondent from the sale of one-half of his one-third interest in the partnership over and above the amount he had paid for same was a capital gain or a profit from an adventure in the nature of trade.

The appellant submits that the sale by the respondent to Ruth Burritt was a sale of a one-sixth interest in the land which had been purchased by the partnership or syndicate and that the profit realized therefrom was taxable income within the meaning of ss. 3, 4 and 127(1)(*e*) of *The Income Tax Act*, S. of C. 1948, c. 52. These sections provide:

> 3. The income of a taxpayer for a taxation year for the purposes of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all
>
> (*a*) businesses,
>
> (*b*) property, and
>
> (*c*) offices and employments.
>
> 4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.
>
> 127. (1) In this Act,
>
> (*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment;

On the other hand, the respondent contends that what he sold to Ruth Burritt was a portion of his investment in the paid-up capital of a partnership which had been formed to purchase and sell land for building purposes. What he did was to dispose of a capital asset which had enhanced in value. The gain he made, he says, was made not as part of a scheme of profit-making or trade but resulted from the enhanced value of his investment.

The above mentioned provisions of the Act, on which the appellant relies, are to the effect that a taxpayer's income for a taxation year is his income from all sources and includes income for the year from business and property and that the income from a business is the profit therefrom for the year. "Business" also includes an adventure or concern in the nature of trade.

The respondent has been practising law for many years in the city of Toronto, where he is still practising his profession. He testified at the trial and filed documents to substantiate his oral testimony. Finding no reason to doubt his credibility, I am bound to consider seriously his uncontradicted evidence in determining the issue.

As the respondent's whole course of conduct in this matter is the best test to be applied under the circumstances, I shall point out certain facts which, in my mind, were well proven. As solicitor, he had a wide experience in general commercial practice and as such had often acted for supply companies and a number of builders in construction work. He was also well versed in conveyancing of properties. In 1951, he joined three of his clients in forming a syndicate or partnership which would acquire a certain property, have it subdivided and sell the lots to prospective builders. He acted in this matter as solicitor and trustee. The profits to be realized from the sale of the lots were to be divided between the partners in proportion to their share of interest in the partnership. The respondent undertook to acquire a one-third interest and to assume a one-third of the liabilities of the partnership.

It seems clear to me that the association formed by the respondent and his three clients and later extended to other parties was a partnership.

The Partnerships Act of the Revised Statutes of Ontario 1950, c. 270, s. 2, defines the expression "partnership" thus:

> 2. Partnership is the relation which subsists between persons carrying on a business in common with a view of profit, but the relation between the members of any company or association which is incorporated by or under the authority of any special or general Act in force in Ontario or elsewhere, or registered as a corporation under any such Act, is not a partnership within the meaning of this Act.

1960

MINISTER OF NATIONAL REVENUE v. STRAUSS

Fournier J.

The rules determining whether a partnership does or does not exist are set out in section 3 of the Act.

3. (1) Joint tenancy, tenancy in common, joint property, common property, or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof.

(3) The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him a partner in the business, . . .

The subsections of s. 3 then enumerate the cases where a person, though receiving a share of the profits of the business, is not a partner.

In the present instance, at the outset four persons made a verbal arrangement by which they would join together to purchase for the group a certain property, subdivide it in lots and dispose of them at a profit. So the purpose of the arrangement was to carry on a business in common with a view to profit. It was not an agreement to purchase land for the purpose of becoming part or co-owner of it; it was to be sold at a profit by the partnership. No part of the property could be sold without the consent of all the parties to the arrangement. Each party was to contribute to the common fund in proportion to the interests or shares each person had in the association. The evidence of the respondent is corroborated by the memorandum signed on March 24, 1952 by four of the associates at the time. It reads:

The said parties hereby acknowledge and declare that they are in partnership for the purpose of developing and selling the south half of Lot 33, Concession 1, Township of Scarborough, and that the profits or losses of the said partnership are to be divided or borne in proportion to the shares or interests as set out below opposite the names of the parties:

This acknowledgment and declaration was signed following the formalities of acquiring the property and having subdivided it in building lots. The unincorporated business association was then in a position to operate its business, that of selling lots at a profit if possible. There is no doubt in my mind that from the moment the interested persons formed a group to carry on a business in common with a view to earning profits their relationship was that of partners.

In the same line of reasoning, Mr. Justice Duff, in *Robert Porter & Sons Limited* and *J. H. Armstrong*[1], wrote (p.329, *in fine*):

> Partnership, it is needless to say, does not arise from ownership in common, or from joint ownership. Partnership arises from contract, evidenced either by express declaration or by conduct signifying the same thing. It is not sufficient there should be community of interest; there must be contract.
>
> The real question is whether, from the evidence before us, one ought to infer an agreement in the juridical sense that the property these two persons intended dealing with was to be held jointly as partnership property, and sold as such. Is this what they contemplated? Had they in their minds a binding agreement which would disable either of them from dealing with his share—that is to say, with his share in the land itself—as his own separate property? A common intention that each should be at liberty to deal with his undivided interest in the land as his own would obviously be incompatible with an intention that both should be bound to treat the corpus as the joint property, the property of a partnership. . . . The partner's right is a right to a division of profits according to the special arrangement, and as regards the *corpus*, to a sale and division of the proceeds on dissolution after the discharge of liabilities. This right, a partner may assign, but he cannot transfer to another an undivided interest in the partnership property in specie.

In the present instance, four individuals made a verbal agreement by which they would join in the purchase and sale of a certain property for development purposes. This was not an arrangement to purchase land so that each individual would become co-owner thereof. The purchase of the land was made for business purposes by the parties acting not personally but as a group. The association among the persons concerned was an unincorporated business association. The property acquired was held and applied by the group exclusively for the purpose of the association, to wit for its sale and the realization of profits to be divided in accordance with the agreement and the terms of the memorandum.

Believing as I do that the arrangement between the respondent and the other parties was an agreement of partnership, it follows that legally the property, in part or in whole, could not have been disposed of without the consent of each and every partner. Each partner's right was not a right to dispose of the land but a right to participate in the division of the profits realized by the business

[1] [1926] S.C.R. 328.

1960

MINISTER OF NATIONAL REVENUE v. STRAUSS

Fournier J.

operations of the partnership. It being a partnership, it was subject to the rules provided for in the *Partnerships Act*, Revised Statutes of Ontario 1950 (op. cit.). True the Act does not give partnership a legal personality, but the 1948 *Income Tax Act* in different sections considers a partnership as an entity for tax purposes. The charging provision of the Act is s. 6(*c*) which reads as follows:

> 6. Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year
>
> (*c*) the taxpayer's income from a partnership or syndicate for the year whether or not he has withdrawn it during the year.

Consequently, the income which a taxpayer is entitled to receive or has received from a partnership or syndicate for the year must be included in the taxpayer's income for the year. This means that profits realized from the business or the property of the partnership for a year, whether or not the partner has withdrawn it during the year, is to be included in his income. The respondent stated that every amount to which he was entitled from that source had been computed in his income and that he had paid the tax.

Now the only income under our Statute which is not subject to tax is the profit realized from an investment. The test for deciding whether the profit is of a capital nature or income is always the same.

The rule laid down in *Californian Copper Syndicate v. Harris*[1] by the Lord Justice Clerk is well known (p. 165, *in fine*):

> 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 realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of . . . the Income Act. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation 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 a gain, dealing in such investments as a business, and thereby seeking to make profits.
> . . . the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

[1] (1903-11) 5 T.C. 159.

When the respondent joined the partnership and made the necessary outlay to acquire a one-third interest in it, he no doubt expected a return on his investment. He must have had in mind that the partnership would make profits from its business operations of selling lots and that he would share in these profits in proportion to his one-third interest. As I see it, the income expected from his outlay was the profits of the partnership's business of selling building lots. The adventure in the nature of trade was that of the partnership and not that of the partners. The partners were to receive their share of the profits realized from the business and their responsibility was, if necessary, to pay their share of its losses.

The respondent was not acquiring a share in the partnership to resell it, repeat the same with other partnerships and carry on a trade in shares or interests in partnership, but as an investment. After the partnership had been organized, the negotiations for purchasing the land were well on their way and the property was being subdivided, it would seem that its prospects of success were such that other parties were disposed to pay a higher price for the shares or interests in it than that paid by the original joiners.

So in November 1951, before the partnership started its selling operations, the respondent sold one-half of his one-third share in the partnership at a higher price than he had paid for it. The adventure in the nature of a trade in this instance was the purchase and sale of land. What the respondent did was not the sale of land, which he personally had not the power to sell, but the sale of his right to the profits of the sale of lots which would eventually be made by the partnership. The respondent's transaction had no effect whatsoever on the land which had been acquired by the partnership to be sold. The right he disposed of was a part of his investment in the capital structure of the partnership. It was not a business operation or a scheme of profit making. He sold part of his capital asset, kept the other part and later on derived therefrom taxable income.

The Court was referred to numerous decisions. The basic test applied in connection therewith is the same—Is an investment sold or is a trade being carried on? When in

1960

MINISTER OF NATIONAL REVENUE v. STRAUSS

Fournier J.

doubt, one has to scrutinize the whole course of the taxpayer's conduct to find out his intention and draw what may be considered as a proper deduction. This I have done.

What I have stated is that the sale of a source of income does not always give rise to taxable income, though under certain circumstances it may be considered as income and assessed as such.

In the case of *Minister of National Revenue v. Shaw*[1] Mr. Justice Duff (later Chief Justice), at p. 342 said:

> The Legislature, it seems to me, is at pains to emphasize the distinction between the income and the source of income. The income derived from the capital source is income for the purposes of the Act. The source is not income for the purposes of the Act.

The taxpayer in this instance had a potential source of income, his right to share in the profits of a partnership. He disposed of part of his source of income which in my opinion was a capital asset. I would readily admit that when a person makes a business of acquiring such sources of income with the intention of disposing of them at a profit and thus carried on a trade of that nature, or has embarked on an adventure in the nature of trade for the same purpose, the capital could be considered as income.

The evidence has convinced me that the transaction between the respondent and Ruth Burritt had no business character. The gain was not made through an operation of business in dealing in an investment in partnership's shares or interests, nor made in carrying out a scheme of profit making; it was an enhancement in value of the shares or interests of the partnership. There is nothing before the Court which could justify the conclusion that the respondent when he made the outlay to acquire a right to divide in the profits of the partnership had any intention of disposing of it at a profit. This he did for reasons he made clear in his testimony and which I have commented in these notes. In principle, to be taxable the profit must arise from trading activities, not from a sale of capital as such. In my opinion, the right which the respondent disposed of was an asset and does not constitute trading or an adventure in the nature of trade. This rule was applied in *Commissioner of Taxes v. British-Australian Wool Realization Association, Ltd.*[2]

[1] [1939] S.C.R. 338.

[2] [1931] A.C. 224.

The sale herein provided a profit as compared with the price the respondent had paid for the right to participate in the profits of the partnership and does not constitute income subject to be taxed.

I have come to the conclusion that the amount of $9,166.67 added to the respondent's declared income did not represent a profit from the operations of the partnership and was not subject to taxation.

Therefore, the appeal is dismissed with costs.

Judgment accordingly.