LOSSES—DOCTOR—TRANSACTIONS IN COMMODITY FUTURES —WHETHER TRADER IN COMMODITIES—INCOME TAX ACT, R.S.C., 1952, c. 148, ss. 3, 4, 12 (1) (a) AND (b), AND 139 (1) (e). *ANDERSON* v. *THE MINISTER OF NATIONAL REVENUE*

On February 3, 1966 an appeal was heard by the Tax Appeal Board involving the interrelated interpretation of section 12 (1) (a) and section 139 (1) (e) of the *Income Tax Act*.[1] The facts of *Anderson* v. *The Minister of National Revenue*[2] were relatively straight forward. The Appellant, a practicing Physician in Windsor Ontario became interested in the Commodity Market while studying medicine in university. He spent considerable time familiarizing himself with the Market intricacies by visiting brokers and reading and studying quotations in the newspapers. In May, 1961 the Appellant, dealing exclusively through James Richardson and Sons, entered the commodities market, and between that date and December, 1962 engaged in 125 purchase and sale transactions in soya beans, cocoa, eggs, wheat, oats, rye and potatoes. The evidence stated that the Appellant spent approximately four hours per week on the transactions, contacting his broker approximately fifteen to twenty times per day. All dealings were carried out from his office where he practiced medicine, and there was no indication in his office or the telephone directory that he was dealing in commodity futures. It was also emphasized that the Appellant did not take delivery of any commodities represented by the futures.

During the twenty month period the Appellant suffered losses totalling $6,943.00 which he attempted to deduct from his taxable income for 1961 and 1962. The Minister of National Revenue disallowed the deductions under s. 12 (1) (a) of the Act which provides:

> In computing income, no deduction shall be made in respect of—an outlay or expense except to the extent that it made or incurred by the taxpayer for the purpose of gaining or producing income from property or a business of the taxpayer.

The disallowance was based on the Minister's contention that the Appellant was not in the "business" of a commodity dealer. The Appellant objected on the grounds that he was in the business of trading in the commodity market within s. 139 (1) (e) of the Act, and hence his losses were deductible under s. 12 (1) (a). Section 139 (1) (e) states:

> —'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;[3]

In dismissing the appeal and holding the losses to be non-deductible, the Chairman, Roland St-Onge proceeded on a two phase finding. First the Chairman held that the transactions did not constitute a "business" as required by s. 12 (1) (a) and supported this finding on a concerted negative analysis of case law criterion dealing with the question. Then Mr. St-Onge went on to hold that each transaction was "an adventure in the nature of trade and this cannot be treated as a continuing business, as each one is a distinct and separate adventure in the nature of trade."[4]

1 R.S.C. 1952, c. 148.
2 66 D.T.C. 166.
3 Emphasis added.
4 66 D.T.C. 168.

As a result of these two findings it was ultimately held that the losses incurred were not deductible in computing income under s. 12 (1) (a) of the Act.

There is an obvious contradiction in the Chairman's findings which can best be analyzed in the context of two propositions formulated by the writer as to the results of the decisions.

1. Assuming that the Appellant's transactions did in fact constitute an adventure in the nature of trade as was found by the Chairman, then the ultimate decision of non-deductibility under s. 12 (1) (a) is wrong, being based on a patent misinterpretation of s. 139 (1) (e) of the Act.
2. If an analysis of the law yields the conclusion that the Appellant's dealings did NOT amount to an adventure in the nature of trade, then the final conclusions of the chairman will be correct in result although totally inconsistant in reasoning.

The first of these propositions can be dealt with easily by a reference to the terms of s. 139 (1) (e) which include in the definition of "business" an "adventure in the nature of trade". Section 12 (1) (a) allows deductions for expenses incurred in earning income from a business, and hence expenses incurred in conducting an adventure in the nature of trade are likewise deductible. In holding the Appellant's transactions to be adventures in the nature of trade, and not allowing the resulting losses to be deductible under section 12 (1) (a), it is submitted that the Chairman has evidenced an unawareness of the terms of section 139 (1) (e). The decision is therefore erroneous.

The writer's second proposition raises a more subtle and complicated question, and that is whether or not the Appellant's dealings were correctly found to be adventures in the nature of trade. The difficulty is augmented by the Chairman's inconsistant reasoning in arriving at his conclusion, for although Mr. St-Onge expressly found the transactions to constitute trading adventures, it is submitted that it was not his manifest intention to do so.

The question of what constitutes an adventure in the nature of trade has been heavily litigated in both Canada and Britain, the Canadian Courts making continual reference to a leading Exchequer Court decision *The Minister of National Revenue* v. *Taylor*.[5] In that case the Appellant, a general manager of a lead fabricating Company purchased a large quantity of lead and resold to the Company at a profit. Thorsen, P., in holding the transaction to be an adventure in the nature of trade and the profits therefrom taxable, stated that the question of whether a transaction is an adventure in the nature of trade must be decided on the true nature of the transaction and the surrounding circumstances. No single criterion could so label a particular dealing but the learned judge laid down two particular tests:

1. Does the subject matter of the transaction by its very nature preclude the conclusion that an investment has been realized, and thus stamp the transaction as a trading nature?
2. Did the taxpayer deal with the subject matter in the same way as an ordinary trader of the subject matter would deal, thus characterizing

[5] 46 D.T.C. 1125, (1956) C.T.C. 189.

him as a trader, and the transaction as business or adventure in the nature of trade? If these two questions are answerable affirmatively, then other criteria such as isolation of the transaction, relation of the transaction to the taxpayer's ordinary business, degree of processing of the subject matter, and even a manifest primary intention to resell at a profit are not conclusive enough factors to alter the true nature of the transaction. It is submitted that in the present case the two primary questions are affirmatively answered and that the Appellant's transactions were correctly, if not intentionally held to be adventures in the nature of trade.

In submitting that the Appellant's transactions in this case did constitute adventures in the nature of trade, the writer places particular emphasis on the nature of the subject matter dealt with, as this in itself negatives any presupposition of *prima facie* investment. This emphasis is based upon the judgment of Martland, J. in the Supreme Court of Canada in *Irrigation Industries Ltd.* v. *The Minister of National Revenue*[6] where the Appellant Company's occasional purchases and sales of corporate shares were held not to constitute adventures in the nature of trade, and the profits therefrom non-taxable. Martland,J. cited examples of subject matter which would, by their nature raise a *prima facie* presumption that a resale would constitute an adventure in the nature of trade, and the examples were either commodities or analogous to commodities.[7] The learned justice then went on to state:

> Corporate shares are in a different position because they constitute something the purchase of which is, in itself, an investment. They are not, in themselves, articles of commerce, but represent an interest in a corporation which is itself created for the purpose of doing business. Their acquisition is a well recognized method of investing capital in a business enterprize.[8]

This analysis considered with the definition of an "investment" held down in *Gairdner Securities Ltd.* v. *The Minister of National Revenue*[9] substantiates the contention that commodity futures do not possess the "investment presumption" qualities, but quite conversely give raise to a presumption that they are only the subjects of trade. The definition of "investment" in the *Gairdner* case states:

> Investments, . . . look primarily to the maintenance of an annual return in dividends or interest substitutions in the securities take place, but are designed to further that primary purpose and are subsidiary to it. . . .[10]

The distinction between the nature of corporate shares and commodity futures is fundamental to a criticism of the present case, for the Chairman in holding the transactions not to constitute a business, relied exclusively for authority on *Funk* v. *The Minister of National Revenue,*[11] and the decision of *McLaws* v. *The Minister of National Revenue.*[12] In both cases

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6 [1962] S.C.R. 346; (1962) 33 D.L.R. (2d) 194; 62 D.T.C. 1131.
7 [1962] S.C.R. 352: Cases in which the nature and quality of the property purchased and sold have indicated an adventure in the nature of trade include *The Commissioner of Inland Revenue* v. *Livington* 11 T.C. 538 (a cargo vessel); *Rutledge* v. *Commissioners of Inland Revenue* 14 T.C. 490, (a large quantity of toilet paper); *Lindsay* v. *Commissioners of Inland Revenue* 18 T.C. 43, and *Commissioners of Inland Revenue* v. *Fraser* 24 T.C. 498 (a large quantity of whiskey); *Edwards* v. *Bairstow* [1956] A.C. 14 (a complete spinning plant); and *Regal Heights Ltd.* v. *M.N.R.* [1960] S.C.R. 902 (40 acres of vacant city land).
8 [1962] S.C.R. 352.
9 54 D.T.C. 1015; [1954] C.T.C. 24.
10 54 D.T.C. 1016.
11 37 Tax A.B.C. 391; 65 D.T.C. 139.
12 37 Tax A.B.C. 132; 65 D.T.C. 1.

the "business" issue in s. 12(1) (a) of the Act arose as was the case under consideration, but in both cases the subject matters of the transactions were corporate shares. The decision in each case relied on Martland, J.'s dissertation on the nature of shares in the *Irrigation Industries Ltd.* case, the *McLaws* case in particular relying on the "nature of the subject matter" test propounded in *Taylor*.[13] It is submitted that these cases cannot be of significant weight to support the contention that the present Appellant's commodity transactions did not constitute a business within the terms of s. 139(1) (e) of the Act.

Another factor arising from the peculiar nature of commodity future transactions and which substantiates their "trading" nature is the fact that the sole purpose of their purchase is a subsequent resale at what is hoped to be an increased price. These transactions are speculative, and although the *Taylor* case specifically states that an intention to resell at a profit is not a conclusive indication of a trading characteristic, a primary resale motive cannot be completely ignored. In *Rutledge* v. *The Commissioners of Inland Revenue*,[14] the Lord President held the Appellant's toilet paper transactions to constitute an adventure in the nature of trade and stated:

> It is no doubt true that the question whether a particular adventure is "in the nature of trade" or not must depend on its character and circumstances, but if—as in the present case—the purchase is made for no purpose except that of resale at a profit, there seems little difficulty in arriving at the conclusion that the deal was "in the nature of trade" though it may be wholly insufficient to constitute by itself a trade".[15]

This statement is particularly applicable in cases such as the present where the subject matter dealt with, unlike corporate shares, precludes a presumption of investment, and the intention factor although not conclusive, supplies weighty evidence of the "trading" nature of the transactions.

The second major question laid down in *Taylor,* i.e. whether the Appellant conducted himself as a dealer in the same subject matter, is also answerable affirmatively in this case, although the answer is also determined basically on the ground of the nature of the subject matter transacted. Two findings of the chairman in this case have a bearing on the answer to this test, and those are the isolation or disconnection of the transactions to the Appellant's primary business, and the fact that the Appellant did not take delivery of the commodities represented by the futures. In support of the finding that the Appellant's transactions did not constitute a business the Chairman used these two criteria to distinguish twelve cases cited by the Appellant in support of the opposite conclusion. The first factor, the relation of the transactions to the Appellant's main business, must be considered, but the weight to be given it can be ascertained from a statement in *Taylor* where Thorsen, P. stated:

> . . . the fact that a transaction is totally different in nature from any of the other activities of the taxpayer and that he has never entered upon transactions of that kind before or since does not, of itself, take it out of the category of being an adventure in the nature of trade."[16]

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13 *Op. cit.* n. 5.
14 *Op. cit.* n. 7.
15 *Id.*, at 496.
16 56 D.T.C. 1137.

Seven cases,[17] including the *Tayolr* case were distinguished from the present case by the Chairman on this ground alone, and it is respectfully submitted that in disposing of those cases in that manner, the Chairman has given inadequate consideration to the principles for which each case can be said to stand. Numerous cases, including in particular *Rutledge* v. *The Commissioners of Inland Revenue*[18] have held transactions to be adventures in the nature of trade where they have been totally unrelated to the taxpayer's business. The reverse case is also true and a transaction related closely to the Appellant's main line of business is not precluded on that basis alone from being an investment.[19]

The other factor relied on by the Chairman in dealing with cases cited to support the content that the transactions constituted a business, was the fact of no delivery of the commodities transacted. This factor is particularly important when considering whether or not the Appellant acted in the same manner as a dealer or trader in the same subject matter. It is submitted that the Appellant did act as a dealer in commodity futures would act, and the fact of non-delivery is of little significance. The fact that the Appellant was entitled to an equity of one to ten thousand dollars would indicate the volume of commodities concerned, and delivery of a ten thousand dollar consignment of a particular commodity would be of little practical value unless the Appellant was involved in an additional processing or manufacturing concern. Physical delivery of such large consignments especially with respect to commodity futures dealers cannot, it is submitted, be considered a necessary segment of such a business. Clearly if the Appellant did take delivery, the "business" or "trade" aspect of his dealings would be substantiated, but non-delivery cannot be fatal to the finding of a trading venture in light of the other criteria. Indeed Thorsen, P. in the *Taylor* case expressly stated that the fact there was nothing done with respect to the subject matter does not take the sale out of the realm of an adventure in the nature of trade. This would be especially applicable to cases such as the present one where the entire purpose of the transactions is speculative in nature.

A future interesting consideration is that the cases distinguished by the Chairman in this case on a non-delivery basis, included *The Commissioners of Inland Revenue* v. *Fraser*[20] where the Appellant purchased whiskey in bond through an agent in three lots, and in six sales realized a profit of 712 pounds. This was held to be an adventure in the nature of trade and the profits therefore subject to tax. The Lord President Normand stated:

> He had no special knowledge of the whiskey trade; . . . he neither took delivery of the whiskey nor did he have it blended or advertised.[21]

This case is substantial authority for the contention that delivery was not essential in the present case, and also to refute the emphasis placed on

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17 *Morrison* v. *M.N.R.* (1928) Ex. C.R. 75, 1 D.T.C. 113; *Gordon* v. *M.N.R.* 51 D.T.C. 230, 4 Tax A.B.C. 352; *Honeyman* v. *M.N.R.* (1955) Ex.C.R. 200, 55 D.T.C. 1094; *Atlantic Sugar Refineries Ltd.* v. *M.N.R.* (1949) S.C.R. 706, 49 D.T.C. 602; *Cooper* v. *Stubbs* 10 T.C. 29.

18 *Op. cit.* n. 7. The Appellant was a cinema director but his "adventure in the nature of trade" was the purchase and sale of a consignment of toilet paper.

19 *Graham* v. *M.N.R.* 64 D.T.C. 409, 35 Tax A.B.C. 367, 370.

20 24 T.C. 498.

21 *Id.*, at 501.

the fact that the Appellant did not promote or advertize in the resale of the commodities.

The writer wishes finally, to make reference to *Townsend (H.M. Inspector of Taxes)* v. *Grundy*,[22] where the Appellant, a manufacturer of agricultural implements, engaged in sixteen transactions in four years involving cotton futures. There was no delivery of the cotton and the profits realized totalled 6000 pounds, and these profits were held to be taxable. This case was cited as the strongest authority for finding the present transactions to be adventures in the nature of trade but the Chairman disposed of it by what might be termed a completely contradictory distinction. Mr. St-Ange discussed the case and stated:

> It was held the transactions gave rise to taxable profits, but that does not mean they constituted a business. They were adventures in the nature of trade or business.[23]

It is submitted that this statement speaks for itself and in view of s. 139 (1) (e) of the Income Tax Act it is a patent contradiction.

It would appear at this point, that the Chairman is attempting to base his finding on the lack of continuity in the Appellant's dealings for he then goes on to state:

> One may deduct losses incurred in a continuous business operation, but not from occasional transactions involving outlays of capital.[24]

Later the Chairman states;

> There is not sufficient continuity in what the Appellant did to make of it a business in itself.[25]

These statements are ignoring the entire existence of the "adventure in the nature of trade" phenomena. The entire line of cases dealing with this area of tax jurisprudence expressly or impliedly rejects the "isolated transaction" factor as giving rise to a substantial presumption of investment.

It is respectfully submitted that the Chairman's finding that the Appellant's commodity futures transactions were "adventures in the nature of trade" is a correct one, based upon the tests laid down in *Taylor*,[26] and particularly on the authority of *Townsend (H.M. Inspector of Taxes)* v. *Grundy*,[27] and *Inland Revenue Commissioners* v. *Fraser*.[28] However the process of reasoning used by the learned chairman in reading the conclusion appears to be so inconsistent that the conclusions appear ludicrous. Mr. St-Onge has ostensibly attempted to find that these transactions were not a business, and has inadvertantly held them to constitute adventures in the nature of trade, at the same time inadequately negativing the factors which would support this conclusion. In so proceeding the Chairman has relied upon two cases which are completely distinguishable from the present case due to the subject matter dealt with in each case.[29] The writer concludes that the decision is permeated

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22 18 T.C. 140.
23 66 D.T.C. 168.
24 *Ibid.*
25 *Ibid.*
26 *Op. cit.* n. 5.
27 *Op. cit.* n. 22.
28 *Op. cit.* n. 7.
29 *McLaws* v. *M.N.R. op. cit.* n. 11, *Funk* v. *M.N.R. op. cit.* n. 12.

with a complete lack of awareness or understanding of the terms of s. 139 (1) (e) of the Income Tax Act and the jurisprudence relating thereto.

In conclusion it is submitted that the impact of the case will not be profound due to inconsistencies to which reference has been made above. What is important, however, is that the Appellant's tax liability was determined by patently contradictory findings in circumstances where an appeal would appear to be economically unadvisable. This in itself deserves comment.

—J. P. PEACOCK*

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ESTATE PLANNING—"FREEZING"—LIABILITY TO TAX—THE MEANING OF "COMPETENT TO DISPOSE" IN ESTATE TAX ACT[1]

Estate Planners received an unpleasant surprise in 1966 in the form of the decision of the Tax Appeal Board in the case of *ESTATE OF FRANK FREDERIC BARBER* v. *MINISTER OF NATIONAL REVENUE*.[2] At first sight the decision appeared to sweep away the advantages of a holding or investment company, capitalized so as to "freeze" the value of an estate for estate tax purposes. Although further consideration suggests that the effect of the decision will not be as far reaching as had at first appeared, it is nevertheless a decision which will have to be taken account of when drafting the "capital" clauses in the incorporating documents of a company which is to be used for estate tax purposes.

In its simplest form, a company incorporated for this purpose usually has a capital consisting of:

(i) voting preferred shares entitled to a fixed non-cumulative dividend, the holders of which have no right to participate in the assets of the company beyond the paid-up par value of their shares, and

(ii) a limited number of common shares, comprising the equity in the Company, but subject to the controlling vote of the preferred shares.

The person wishing to "freeze" the value of his estate will transfer to the company, say $50,000.00 worth of securities, in return for $50,000.00 worth of the preferred shares. Members of his family or others whom he may wish to benefit subscribe for the common shares. If at the time of the Testator's death the value of the securities has grown to $150,000.00, the value of his interest in the company, for estate tax purposes, will still be $50,000.00 (or so it was hoped) and the increase in value will belong to the holders of the common shares.

Margot Investments Limited (the company incorporated by Mr. Barber) was capitalized in a slightly different manner. There were Class A and Class B shares each having equal votes, but the Class A shares carried the right to a fixed cumulative dividend of five percent

1 1958 S.C. c. 29 s. 3(1)d.
2 41 Tax A.B.C. 27; 66 D.T.C., 315.