BETWEEN:

C. W. LOGGING COMPANY LIMITED ..APPELLANT;

AND

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

1955
Oct. 6, 7
1956
Jan. 13

Revenue—Income Tax—Sale by logging operator—Of standing timber—Of freehold limits—Whether proceeds of each sale taxable income—The Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4.

The appellant, carrying on the business of a logging operator, sold in 1950 the standing merchantable timber remaining on a freehold tract of land it had logged in 1936. In 1952 it sold the land itself. The proceeds of each sale were credited to capital surplus and allocated to the purchase of timber limits contiguous to the appellant's other holdings. To the taxable income reported by the appellant for the taxation year 1950 the Minister added the amount received from the sale of the timber, and to that reported by the appellant for the taxation year 1952, the amount received from the sale of the land. The appellant appealed the reassessments to the Income Tax Appeal Board which dismissed both appeals.

Held: 1. That the sale of the residue of a mature timber crop was the sale of a current asset made in the course of the appellant's carrying on the business of dealing with timber either by logging operations conducted by the appellant itself or by the sale of stumpage. The proceeds of that sale were revenue and were properly included in the taxable income of the appellant.

2. That the sale of the freehold was the sale of a capital asset and the proceeds of that sale were not revenue received from the conduct of a trade or business and did not constitute taxable income.

Anderson Logging Co. v. *The King,* [1925] S.C.R. 45, distinguished. *Commissioner of Taxes* v. *Melbourne Trust Ltd.,* [1914] A.C. 1001 at 1010 approving *Californian Copper Syndicate* v. *Harris,* 5 T.C. 159, applied.

APPEAL from a decision of the Income Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Ritchie at Victoria.

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J. A. Baker for the appellant.

G. F. Gregory and *F. J. Cross* for the respondent.

RITCHIE J. now (January 13, 1956) delivered the following judgment:

The appellant has appealed from a decision of the Income Tax Appeal Board dated June 8, 1954, dismissing appeals by it from reassessments made by the Minister of National Revenue in respect to its income from the 1950 and 1952 taxation years. The two appeals were heard together.

The appellant was incorporated on February 6, 1934 under the authority of the *British Columbia Companies Act,* being chapter 11 of the Statutes of British Columbia for 1929, and amending Acts. The registered office on incorporation was Port Alberni, B.C., but on its income tax return for the taxation years in question the appellant shows Qualicum Beach, B.C., as its address.

The objection of the appellant to the reassessment for the 1950 taxation year is because the Minister of National Revenue added to its reported income an amount of $4,233 representing the proceeds from the sale of all merchantable timber over 16" breast high standing on Block 350, a freehold tract of land owned by it and situate in the vicinity of Nanoose Bay, B.C.

The appellant also objects to the Minister having included in its taxable income for the 1952 taxation year an amount of $6,500, the price at which in that year it sold the land comprising Block 350 to the same purchasers to which in 1950 it had sold all the merchantable timber standing thereon.

To support the reassessments the Minister relies on ss. 3 and 4 of *The Income Tax Act,* which read:

> 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.

The question to be decided is whether the proceeds of the 1950 sale of the standing merchantable timber and of the

1952 sale of the freehold tract of timber land constituted, in the hands of the appellant, income from a business or from a property. To determine questions of this nature in respect to corporations the courts have applied tests of intention, course of conduct, and the nature of the objects set out in the charter of the company. The evidence of the witnesses called by the appellant is comprehensive enough to permit application of all three tests.

Included in the "objects" set out in the memorandum of association of the appellant are:

(a) To carry on business as timber-owners, timber-growers, timber and lumber merchants, wholesale and retail, saw-mill, shingle-mill, pulp-mill, paper-mill, and box-mill proprietors and operators, loggers, lumbermen, warehousemen, wharfingers, ship, scow, barge and raft builders, proprietors, and brokers, general brokers, general merchants and contractors, carriers by land or sea, store-keepers and boarding-house proprietors, water and electric power and gas plant proprietors; to manufacture and deal in articles of all kinds in the manufacture of which timber or wood is used, and to carry on any business which may seem to the Company capable of being conveniently carried on in connection with any of the above, or calculated, directly or indirectly, to render profitable or enhance the value of any of the Company's property or rights for the time being:

(b) To purchase or otherwise acquire, take or give mortgages on, buy, take on lease, licence, or charter, or on any other arrangement, grow, prepare for market, manufacture, build, construct, improve, manage, develop, let out, charter, hire, hypothecate, pledge, charge, import, export, turn to account, sell, and deal in generally, timber, timber lands, licences, or leases, mills, water records and powers and generally any and all real and personal property whatsoever nature or any interest therein.

(c) To carry on the business of merchants, dealers, traders, buyers, sellers, agents, factors, brokers, commission merchants, either retail or wholesale or otherwise, in respect of lumber, timber, logs, poles, posts, ties, whether manufactured or under manufacture, and in all stages and varieties of manufacture.

By agreement of counsel there was read into the record as evidence herein on behalf of the appellant, the testimony given at the hearing before the Income Tax Appeal Board by Francis Henry Parker, Chester Richards Matheson, and Archibald Stewart Kerr.

Mr. Parker, one of the original applicants for incorporation of the appellant and a former joint manager and superintendent of logging operations of the company, died prior to this hearing. Mr. Matheson is a forestry engineer, of some eleven years experience, employed by C. D. Schultz & Company, a firm of consultants in the field of forestry and

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professional engineering. Mr. Kerr is a professional forester who has been employed by the appellant since 1950. *Viva voce* testimony was given by Walter Stanley Moore, the president of the appellant. The respondent called no witnesses.

Since incorporation the operations of the appellant have been confined to Vancouver Island and, with two exceptions, to logging operations. In 1936 a large residential estate was cleared and fenced under contract for a private owner. In 1942 the appellant participated in a contract to clear the site of the Comox airport.

Francis Henry Parker and Parker E. Belyea, the two signatories to its memorandum of association, directed and managed the affairs of the appellant for some ten years following its incorporation.

The three principal areas in which the appellant has carried on logging operations are to the north of Cameron Lake, to the south of Nanoose Bay, and in the Errington area on Englishman River. During the ten years following incorporation of the company Mr. Belyea supervised the Cameron Lake operation, the Nanoose Bay operation was supervised by Mr. Parker, and the Errington operation came under their joint supervision.

The Nanoose Bay operation was on a tract of land purchased in 1936 and known as Block 350. The sale in 1950 of the merchantable timber on Block 350 and the sale in 1952 of the freehold title to Block 350 are the transactions to which the two appeals relate.

In 1943, Mr. Belyea being in ill health and unable to continue his supervision of logging operations in the Cameron Lake area, the appellant, on his recommendation, sold Block 359 which, under his supervision, had been from eighty-five to ninety per cent logged. Block 359 was about fifteen or twenty miles from the Englishman River tract in the Errington area on which logging operations then were being carried on under the supervision of Mr. Parker. Because of the distance separating the two areas and because it was not practical to use a common booming ground, the two areas could not be logged together efficiently.

In September, 1944, largely because of the continuing illness of Mr. Belyea and his consequent inability to continue active supervision of logging operations, all the outstanding shares in the capital stock of the appellant were sold to Moore-Whittington Lumber Co. Ltd.

Following acquisition of the outstanding shares in the capital stock of the appellant by Moore-Whittington Lumber Co. Ltd., Mr. Parker continued his association with the appellant and, until 1947, was employed as Superintendent of Logging Operation.

Walter Stanley Moore, the president and manager of the appellant, and also the president and manager of the saw mill division of Moore-Whittington Lumber Co. Ltd., testified that the latter company had acquired the outstanding shares of the appellant as part of a policy of acquiring timber lands and logging companies so as to ensure a regular supply of logs. Under the Moore-Whittington management the timber holdings of the appellant were materially increased and a more aggressive operation policy adopted.

Mr. Parker testified the price obtained from Moore-Whittington for the shares in the capital stock of the appellant owned by Mr. Belyea and himself was arrived at by estimating the value of the timber holdings and of the equipment owned by the company. In making up the estimate of the value of the timber holdings for the sale to Moore-Whittington no value was assigned to Block 350 which had been logged by the appellant in 1936 and on which there had been no further operation.

In the spring of 1945, shortly after the purchase of the shares in its capital stock by Moore-Whittington, the appellant sold Lot 90 and Blocks 526 and 592 in the Cameron Lake area. The three tracts of timberland sold were contiguous to Block 359 which had been sold in 1943 and were separated from the Errington and Nanoose Bay areas by a river. The appellant regarded it as good business to sell Lot 90 and Blocks 526 and 592 because they were small and, like Block 359, isolated from its other holdings, and had been logged.

Mr. Parker gave evidence regarding the purchase of Block 350 by the appellant in 1934. Evidence in respect to the reasons motivating the sale of the merchantable timber

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on Block 350 and the sale, two years later, of the land comprising Block 350 was given by Messrs. Kerr and Moore.

Mr. Parker, who, as already mentioned, was a joint manager of the company from 1934 until 1944 and its superintendent of logging operations from 1944 until 1947, testified that Block 350 had been purchased by the appellant in 1936 and had been completely logged under his direction in the same year. Mr. Parker was not an employee of the company at the time of the 1950 and 1952 transactions in respect to Block 350.

Mr. Matheson testified that in July 1949 he, as an employee of C. D. Schultz & Co., participated in a cruise of the timber limits owned by the appellant and found Block 350 comprised a total area of approximately 300 acres of which only 127 acres carried merchantable timber having a volume of 721,000 feet, board measure. About 100 acres carried a very nice second growth but, from the point of view of a company like the appellant, no merchantable stand of timber. The Schultz recommendation was to sell the mature timber, because of it being difficult to log by reason of being on rocky bluffs scattered over the entire block, preserve the second growth, and hold the land until such time as the appellant decided on a definite forestry policy.

Mr. Matheson explained that removal of the shade cast by the older trees would facilitate the growth of the younger timber, and estimated fifty or sixty years would elapse before the second growth would be of merchantable size.

Another reason advanced by Mr. Matheson for recommending disposal of the mature growth was that the older trees, because of their height, constituted a potential danger by reason of being subject to lightning strikes and because of their ability to scatter sparks in the event of fire.

Mr. Archibald Stewart Kerr, a forester with twenty-seven years of experience behind him, who entered the employ of the appellant in September 1950, testified that while he had not personally examined Block 350 he was familiar with the area and, after studying the Schultz cruise report, had advised the appellant to sell Block 350 because of its

isolation from the main holdings of the company, because of the difficulty of exercising supervisory control over it, and because of the fire hazard.

Mr. Moore testified the decision to sell the merchantable timber on Block 350 was based on the Schultz cruise report that it aggregated only 700,000 feet on 126 acres of timbered lands, or an average of the "ridiculous quantity" of 6,000 feet per acre against the 30,000 feet per acre required for economical logging, and because he believed it good business to sell isolated holdings and apply the proceeds to the acquisition of other timberlands adjacent to the main holdings of the company.

On January 9, 1950 the merchantable timber over 16" breast high standing, lying and being on Block 350 was sold for $4,500 to Herman and Emil Deering under the terms of a written agreement (Exhibit 8) requiring the purchasers to fell and remove the old growth trees by selective logging methods and to take all proper precautions for the protection of trees less than 16" breast high. Mr. Moore said this covenant was not one usually included in Pacific Coast cutting agreements but was inserted on the recommendation of the company foresters.

About two years after the sale of the cutting rights on the merchantable timber standing on Block 350 in the Nanoose Bay District to Herman and Emil Deering, the same purchasers sought to buy the freehold title to Block 350 and, after further consultations with the company forester, a sale was consummated for the price of $6,500. Mr. Moore said his approval of the sale of the Block 350 again was influenced by the tract being isolated from the other holdings of the company, because it was an impossible block for the company itself to operate and because it was a risky block to watch for fire hazards.

The 1943 sale of Block 359 in the Cameron Lake area, the 1945 sale of Lot 90 and Blocks 526 and 592 in the Cameron Lake area, and the 1952 sale of Block 350 in the Nanoose Bay area have been the only sales of timberlands owned by the company.

Among the exhibits filed were financial statements of the appellant as of July 31, 1944 (Exhibit 7), March 31, 1950 (Exhibit 5), and March 31, 1952 (Exhibit 6). The 1944

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statement contained no operating figures. The values of the company timberlands as shown on each of the three statements is:

1944	*1950*	*1952*
$17,462.50	$399,525.23	$392,141.11

In all three years the timber lands were carried as capital, or fixed, assets. The $4,233 received in 1950 for the sale of the cutting rights on Block 350 was credited to capital surplus. The same disposition was made of the $6,500 received on the sale of the freehold title to Block 350.

Since 1944, when the appellant became a Moore-Whittington subsidiary, the income of the appellant has been almost 100% derived from log sales. In the 1950 fiscal period gross income was $230,276.34 of which log sales accounted for $222,836.98 and miscellaneous income $7,439.36. In 1952 gross revenue was $282,395.02 divided into $258,963.99 log sales and $23,431.03 miscellaneous income. In the three years from 1950 to 1952, inclusive, miscellaneous income comprised:

	1950	*1951*	*1952*
Poles and piling and salvage	$ 1,748.91	$ 2,425.03	$ 2,134.23
Stumpage receipts	5,100.57	2,386.73	19,966.83
Interest on bonds	300.00	300.00	300.00
Interest received	4.14	21.51	65.07
Sales of rock	250.00		
Sales of gravel		95.00	
Commission	2.50	3.00	4.00
Discounts earned	33.24	64.25	69.81
Sundry		60.00	
Rents of yarder and donkey			891.09
	$ 7,439.36	$ 5,355.52	$ 23,431.03

The inclusion of stumpage receipts in the income of the appellant for the years 1950-1952 inclusive seemed to be of special importance but counsel for the appellant and respondent agree the term "stumpage receipts" is a misnomer and that the income shown under this classification actually was derived from the sale of logs cut on timber limits owned by the appellant or on which it held cutting rights.

The objects set out in the memorandum of association of the appellant include expressions such as "to carry on business as timber-owners, timber-growers, timber and lumber

merchants, wholesale and retail," "to carry on any business which may seem to the company capable of being carried on in connection with any of the above, or calculated, directly or indirectly, to render profitable or enhance the value of any of the Company's property," "to turn to account, sell, and deal in generally, timber, timber lands, . . . and generally any and all real and personal property of whatsoever nature or any interest therein," and finally, "to carry on the business of merchants, dealers, traders, buyers, sellers, agents, factors, brokers, commission merchants either retail or wholesale or otherwise in respect of lumber, timber, logs, poles, posts, ties whether manufactured or under manufacture and in all stages and varieties of manufacture."

I am concerned more with what business or businesses the appellant, from a realistic and practical standpoint, actually did carry on or engage in rather than with what business or businesses it, under the terms of its memorandum of association, has authorization to carry on or engage in. Objects and powers included in the charter of a company often go far beyond actual and practical requirements.

The inclusion in its memorandum of association of a power to sell and deal in timberlands is not evidence that the appellant actually was engaged in the business of buying timberlands with a view of selling such lands at a profit. *Sutton Lumber and Trading Co. Ltd.* v. *Minister of National Revenue* (1). In view of the nature of the testimony to which I have referred and the absence of any testimony as to the circumstances under which the objects and powers conferred on the company were included in the memorandum, I am prepared to disregard the wording of the memorandum of association.

The purchase and sale by the appellant of Block 350 are entirely different from the purchase and sale of timberlands considered in *Anderson Logging Co.* v. *The King* (2). In the *Anderson* case no evidence was given as to the nature of the business actually carried on by the company for several years following its incorporation. The evidence given on these appeals has covered all activities of the appellant, including the intention and subsequent course of conduct of the appellant in purchasing Block 350, in

(1) [1953] 2 S.C.R. 77. (2) [1925] S.C.R. 45.

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logging it and finally selling it. It is not necessary to rely on the memorandum of association of the appellant in order to determine the questions in issue herein.

In *Commissioner of Taxes* v. *Melbourne Trust Ltd.* (1) Lord Dunedin, who delivered the judgment of the Judicial Committee, quoted with approval the now well-known rule enunciated in *Californian Copper Syndicate* v. *Harris* (2):

> It is quite a well settled principle in dealing with questions 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 a realization or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business.

To classify the acquisition of Block 350 as an investment from which the appellant expected to derive income does not require the use of any imagination. Even though Mr. Parker did not directly state the intention motivating the appellant to purchase Block 350 the surrounding circumstances leave no room for doubt as to what the intention was. The land was acquired in 1936 with the sole intention of making a profit by logging it, converting the standing timber into logs, and that purpose, so far as the purposes of the appellant were concerned, was achieved in the same year. There was no change of intention, as to the use to which the land was to be put. The proceeds of the sale of Block 350 were allocated to the acquisition of other limits more contiguous to the company holdings in the Errington area. The intention of the sale was to effect a change in an investment.

The business carried on by the appellant since its inception has been that of logging. The excursions into the contracting field in 1936 and 1942 were temporary, isolated ventures that have no bearing on these appeals. At no time has the appellant engaged in the business of buying timber limits with a view of selling them at a profit. Any timber limits purchased were purchased with a view of realizing a profit from logging them. Any timber limits sold were sold because the appellant believed that so far as

(1) [1914] A.C. 1001 at 1010.

(2) (1904) 5 T.C. 159; 6 F. 894.

its purposes were concerned the limits had been completely logged and because they were not suitably located for economical operation by the company.

The 1952 sale by the appellant of the freehold land comprising Block 350 was the sale of a capital asset. The proceeds of that sale were not revenue received from the conduct of a trade or business and so did not constitute taxable income.

A distinction must be drawn between the sale, in 1950, of the cutting rights covering the merchantable timber standing on Block 350 and the sale, in 1952, of the freehold title to Block 350. The two transactions are completely different in nature.

Standing timber, like grain or vegetables, is a crop which, in the absence of a specific reservation, changes ownership when the land on which it stands is sold. Standing timber is a crop regardless of whether the owner of the land has adopted and is following any reforestration policy or is allowing nature to take its course and produce new growth. A sale of land which includes the growing crop is, as a rule, the sale of a capital asset. A crop, however, can be harvested by the owner or sold standing to a purchaser with permission to enter on the land and harvest it. A sale of standing crop only, with title to the lands remaining in the vendor, is the sale of property which is akin to stock-in-trade or an inventory of raw material. Such a sale is of a current asset.

The 1950 sale by the appellant for a lump sum of the cutting rights to all the merchantable timber of 16″ in diameter breast high remaining on Block 350 was a sale of the residue of the mature timber crop and was made in the course of carrying on a business of dealing with timber either by logging operations conducted by the appellant itself or by the sale of stumpage. That the standing timber was not such as the appellant cared to log does not change the nature of the transaction. The proceeds of that sale were revenue which should be included in the 1950 taxable income of the appellant.

The appeal in respect to the reassessment for the 1950 taxation year of the appellant will be dismissed, with costs to be taxed.

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The appeal in respect to the reassessment for the 1952 taxation year of the appellant will be allowed, with costs to be taxed, and the assessment referred back to the Minister for revision.

Judgment accordingly.