1955
Sept. 19
Dec. 7

BETWEEN:

NATIONAL PAVING COMPANY LIMITED ..... APPELLANT,

AND

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

Revenue—Income tax—Payment to appellant not income derived from a business or any other source—Appeal allowed.

Appellant company in 1949 entered into an arrangement with B & M, a United States partnership, whereby appellant was to participate in a United States Army contract, herein called the York contract. Appellant was unable to provide the money agreed upon as its share of the necessary capital to carry out the York contract because of the refusal of the Foreign Exchange Control Board of Canada to permit the export of such money from Canada to the United States. In December 1950 B & M paid to appellant the sum of $225,000 in United States funds in consideration of its relinquishing any claim to any interest or right of profit participation it might have in the York contract. The respondent assessed appellant for income tax on the basis that such payment represented its share of the profits realized on the York contract. Appellant appealed to this Court.

Held: That since appellant's contribution of capital for the York contract depended on approval of the Foreign Exchange Control Board which approval was never obtained, and therefore appellant did not contribute any capital for the York contract nor participate in the management of the York contract or its re-negotiation and the payment to appellant was made before the profits from the York contract

had been fully determined, the payment was not income of the appellant derived from a business or income of appellant derived from any other source.

2. That the payment to appellant was not a transaction which resulted in a benefit being conferred on it by persons with which it was not dealing at arms length.

APPEAL under the Income Tax Act.

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

J. Ross Tolmie for appellant.

Harold W. Riley, Q.C. and *J. G. DeWolf* for respondent.

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

RITCHIE J. now (December 7, 1955) delivered the following judgment:

This is an appeal by National Paving Company Limited, hereinafter referred to as "the appellant company", from an income tax assessment in the amount of $112,012.68 made by the Minister of National Revenue in respect to its 1951 taxation year.

The objection of the appellant company to the assessment is that the Minister included in its taxable income an amount of $239,625, being the proceeds in Canadian funds of a payment of $225,000 in United States funds, received from Messrs. Bowen & McLaughlin, a United States partnership, in respect to a participation right in a United States Army contract for the rebuilding of 1300 tanks at York, Pennsylvania. The tank rebuilding contract hereinafter will be referred to as "the York contract".

The Minister contends the the $239,625 payment represents the appellant's share of the profits realized on the York contract.

The appellant company contends the payment is a capital receipt in consideration of which it relinquished any claim to any interest or right of profit participation it might have in the York contract.

The basic points in issue are, for the most part, questions of fact rather than of law.

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To understand the transaction forming the basis of the assessment from which this appeal is made it is desirable to have some understanding of the business and personal relationships of Mervin A. Dutton of Calgary, Reginald F. Jennings, of Calgary, John L. McLaughlin of Great Falls, Montana, O. W. McIntyre of Great Falls, and Truman Bowen of Phoenix, Arizona. It also will be helpful to refer to applications which Messrs. Dutton and Jennings and the appellant company made to the Foreign Exchange Control Board for approval of the purchase by Messrs. Dutton and Jennings of shares in the capital stock of the appellant company from Messrs. McLaughlin and McIntyre and the manner of dealing by the appellant company with United States funds it anticipated it might receive from the York contract.

Mr. Dutton is the president, a director and a shareholder of the appellant company.

Mr. Jennings is the secretary, a director and a shareholder of the appellant company.

Mr. McLaughlin is a general contractor, a partner in the firm of Bowen & McLaughlin and a former director and shareholder of the appellant company.

Mr. McIntyre is associated with Mr. McLaughlin in the contracting business and is a former shareholder and director of the appellant company but has no connection with the firm of Bowen & McLaughlin.

Mr. Bowen is a partner in the firm of Bowen & McLaughlin, a partnership having its headquarters in Phoenix, Arizona and in which Messrs. Bowen and McLaughlin are the only partners.

The business association of Messrs. Dutton, Jennings, McLaughlin and McIntyre, which dates back to at least 1947, has been successful and has resulted in close personal friendships developing among them.

So far as the evidence on the hearing of this appeal indicates, the first business dealings of Mr. Bowen with Messrs. Dutton and Jennings commenced in December, 1948 or January, 1949 when Mr. McLaughlin proposed that the York contract be handled as a joint venture on the basis of Bowen & McLaughlin being entitled to a two-thirds participation and the appellant company being entitled to a one-third participation.

Prior to 1947 Messrs. Dutton and Jennings were actively engaged on road construction work in the Province of Alberta and carrying on their principal activity through a company known as Standard Gravel and Surfacing of Canada Limited. Because in 1947 there was a scarcity in Canada of the kind of equipment required by Standard Gravel and Surfacing of Canada Limited for the most efficient handling of their contracts Messrs. Dutton and Jennings approached Mr. McLaughlin, who had the type of equipment they required, and proposed he make available to Standard Gravel and Surfacing of Canada Limited, on a basis satisfactory to him, certain equipment which he controlled. Mr. McLaughlin accepted the proposal on the condition that the equipment which he would cause to be furnished would be operated by a new company in which Messrs. Dutton, Jennings, McLaughlin and McIntyre each would hold one-fourth of the issued shares and which would pay rental for use of the equipment. Messrs. Dutton and Jennings accepted the condition imposed by Mr. McLaughlin and the appellant company was incorporated on April 15, 1947. The appellant company then leased equipment from McLaughlin Inc., one of the companies through which Mr. McLaughlin carried on his contracting activities. On the importation of the equipment into Canada, valuations for duty purposes were set by the Canadian Customs authorities.

Subsequent to incorporation and until December 20, 1950 Messrs. Dutton, Jennings, McLaughlin and McIntyre each held twenty-five of the one hundred outstanding shares of the capital stock of the appellant company.

In 1950 amendments to the Income Tax Act made it possible for the appellant company to elect to be assessed and pay a tax of 15% on an amount equal to its undistributed income on hand at the end of the 1949 taxation year and then make a tax-free distribution among its shareholders of the tax-paid surplus. The auditors of the company drew the Income Tax Act amendments to the attention of the company. Several conferences ensued between the auditors and Messrs. Dutton, Jennings, McLaughlin and McIntyre. Because any distribution of the tax-paid surplus would, under United States laws, be regarded as income in the hands of United States shareholders it was agreed

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that, to facilitate Messrs. Jennings and Dutton taking advantage of the Income Tax Act amendments, the fifty shares in the capital stock of the appellant company then held by Messrs. McLaughlin and McIntyre would be sold to Messrs. Dutton and Jennings for an aggregate consideration of $225,000.

Foreign Exchange Control Board approval of Messrs. Dutton and Jennings' purchasing fifty shares in the capital stock of the appellant company from Messrs. McLaughlin and McIntyre was sought by a letter (Exhibit 16) which counsel for the appellant company addressed to the board on December 22, 1950 and which states the $225,000 aggregate purchase price for one-half of the issued shares was based on an earned surplus of $405,219.56, plus an anticipated but undetermined profit, expected to accrue to the appellant company from the York contract, of at least $100,000, less the 15% tax under section 95A of the Income Tax Act.

Approval of the share purchase transaction was sought and granted by the Foreign Exchange Control Board on the basis that the $225,000 purchase price would be paid in three instalments of $75,000 immediately, $75,000 in 1951 and $75,000 in 1952 and that the payments would be deposited in a Canadian bank and used by Messrs. McLaughlin and McIntyre for participation with the appellant company or with Messrs. Dutton and Jennings in future Canadian contracts. Foreign Exchange Control Board approval was granted on December 22, 1950. The share transfers were completed forthwith. Messrs. McLaughlin and McIntyre then ceased to be directors and shareholders of the appellant company but, either personally or through a company controlled by them, continued to be associated with appellant company in the performance of Canadian contracts.

During the 1947 and 1948 contracting seasons the appellant company used and operated equipment owned by McLaughlin Inc. and for which it was charged rental.

On January 29, 1949 a remittance of $51,393.55, covering accumulated rental, less 15% withholding tax, was made to McLaughlin Inc. Foreign Exchange Control Board approval of this remittance had been obtained.

In 1948, the appellant company having acquired a cash position, it was decided it should purchase the equipment and so avoid payment of further rental. Foreign Exchange Control Board approval was sought and secured for the purchase of the equipment at the price of $145,191.63, which was computed on the basis of the Customs valuation. On April 2, 1949 the purchase price was remitted to McLaughlin Inc.

Under date of November 30, 1948 the firm of Bowen & McLaughlin secured from the Detroit Ordnance District of the United States Army the York contract, Exhibit 3, for the re-manufacture, modification and processing of 1300 tanks on terms estimated to work out on an average at $5,000 for each tank.

Bowen & McLaughlin decided it would be advantageous to have $200,000 capital in addition to the $400,000 they were themselves prepared to invest in the York contract so sought such capital from former associates in the United States. The United States associates approached demanded, as a condition of their making a capital contribution, that they should supply personnel and participate in the management of the contract, which demands were regarded by Bowen & McLaughlin as not acceptable. Bowen & McLaughlin then decided to offer a one-third participation in the York contract to the appellant company on the basis of the participation being limited to the supplying of $200,000 capital and being entitled to a one-third share of the profits. The exclusive management of the contract and the selection of the personnel employed would be left to Bowen & McLaughlin.

On December 27, 1948 Mr. McLaughlin telephoned to Mr. Jennings and offered the appellant company the one-third participation in the York contract on the terms above stated. Mr. Jennings accepted the participation offer, subject to permission for the export of the $200,000 being obtained from the Foreign Exchange Control Board. On the following day, December 28, 1948, Mr. McLaughlin confirmed the telephone conversation by a letter (Exhibit 4) addressed to the appellant company.

Mr. McLaughlin testified that in his telephone conversation with Mr. Jennings he enquired how long it would take

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to secure approval for the export of the $200,000 as Bowen & McLaughlin needed it badly. On Mr. Jennings' replying he thought the money should be available in a week or ten days, Mr. McLaughlin said the appellant company would be considered as participating in the contract and that he would endeavour to borrow the required $200,000 on his own account on a temporary basis. Mr. McLaughlin was successful in borrowing the $200,000 and caused it to be deposited in the York contract account.

Mr. McLaughlin is emphatic in asserting that he did not make an advance of $200,000 to the appellant company to cover its share of the capital required for the York contract and that the advance was a private accommodation on his part for the firm of Bowen & McLaughlin.

On the accounting records of the York contract the $200,000 was credited to Mr. McLaughlin, not to the appellant company.

The books of the appellant company in no way reflect the $200,000 which Mr. McLaughlin borrowed and paid into the revolving fund of the York contract.

Under date of January 7, 1949 Bowen & McLaughlin and the appellant company executed a formal joint venture agreement (Exhibit 2) in respect to the York contract. The joint venture agreement required the appellant company, prior to January 15, 1949, to contribute $200,000 to the joint venture revolving fund and provided that it should be entitled to one-third of the profits derived from the contract.

A supplemental agreement (Exhibit 7), entered into between Bowen & McLaughlin and the appellant company under date of April 15, 1949, makes clear that the appellant company is to make no contribution to the venture other than the financing capital of $200,000 and, as remuneration for such advance of capital, is to receive one-third of the net income after price re-determination by the Re-Negotiation Board of the United States government plus the return of its original capital when payment for the completed work has been received in full. The dating and wording of the supplemental agreement constituted a waiver of the non-compliance by the appellant company with the January 15, 1949 deadline for its capital contribution to the joint venture and for that deadline substituted an open end.

Following the December 27, 1948 telephone conversation the appellant company, through its bankers, made application for Foreign Exchange Control Board approval of the $200,000 investment in the York contract, but the bankers were not successful in obtaining the approval applied for. Messrs. Dutton and Jennings personally and Mr. J. Ross Henderson, the auditor for the appellant company, then assumed the task of securing the necessary approval and during 1949 and 1950 made several trips to Ottawa for interviews with the Foreign Exchange Control Board officials but also without success. Notwithstanding repeated refusals, Messrs. Dutton and Jennings refused to give up hope and until the end of 1950 continued to seek the required approval. No correspondence with the Foreign Exchange Control Board in relation to the application for permission to acquire the interest in the York contract was produced. Apparently the negotiations were verbal. The refusal of the management and auditors of the appellant company to regard as final the non-approval of the application by the Foreign Exchange Control Board was not unusual.

Throughout 1949 and 1950 Messrs. Dutton and Jennings would be in touch from time to time with Mr. McLaughlin in connection with their other business ventures and, whenever the subject of the York contract was mentioned, would assure him that, despite the long delay, they were confident approval for their participation in the York contract eventually would be granted. As Mr. Dutton put it, he was always hoping.

On August 19, 1950 Bowen & McLaughlin addressed a letter (Exhibit 8) to Messrs. Dutton and Jennings, saying, "As per instructions from Mr. Truman Bowen we enclose herewith our cheque #1893 in the amount of $100,000. This amount is being charged to your account." This letter is dated at Phoenix, Arizona and is signed by "Mary L. Baker, Office Manager." On August 28, 1950 the appellant company returned the $100,000 cheque with the request that it "be made payable to the National Paving Co. Limited, who are the signers of the original contract drawn between them and Mr. Bowen and Mr. McLaughlin." The request of the appellant company was complied with and a cheque

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for $100,000 forwarded to it on August 31, 1950. On September 8, 1950, Standard Gravel & Surfacing of Canada Limited wrote to Mr. W. McIntyre as follows:

> Please find enclosed herewith letter and a cheque received from Miss Baker in respect to National Paving Co. Limited. I think this should be held at your office until a further meeting of the directors is held to ascertain disposition of same.

The cheque never was cashed.

There is no clear-cut explanation of why the $100,000 cheque was issued by Bowen & McLaughlin to the appellant company. Apparently on August 28, 1950 both parties to the agreements of January 7 and April 15, 1949 were continuing to expect the appellant company to become a partner in the York contract.

It can be inferred that the appellant company returned the $100,000 cheque because it did not want to put itself in the position of having accepted United States funds on account of profits derived from a participation in a United States contract, approval of which had been refused by the Foreign Exchange Control Board but was still being sought. It also can be inferred that the $100,000 cheque tendered by Bowen & McLaughlin to the appellant company formed the basis of the reference to "an undetermined profit of at least an additional $100,000 accruing to the National Paving as at October 31, 1950 from the York, Pennsylvania deal" contained in the letter (Exhibit 16) which counsel for the appellant company addressed to the Foreign Exchange Control Board on December 22, 1950.

When Mr. Bowen's attention was directed to the $100,000 cheque sent the appellant company he said, "Well, to be honest, I did not know where I was at. I did not know where they were at. So I thought 'Well, by God, I will send a cheque and find out.' So I got the cheque back. I did not know their financial set-up."

While Messrs. Dutton and Jennings were positive the investment of $200,000 in the York contract would result in substantial profits being earned in United States dollars and open the way to participation in United States contracts on a far larger scale than was possible in Canada, the Foreign Exchange Control Board officials were more cautious and regarded the project as a risk venture from which a loss might result instead of a profit.

Because of the board adhering to their original refusal to grant approval of the appellant company exporting $200,000 to the United States or of it borrowing that amount of money in the United States, the appellant company never did provide the $200,000 capital it had undertaken to provide for the York contract.

The actual physical work on the 1,300 tanks covered by the York contract was completed about July, 1950 but shipments still were being made and discussions were being carried on with the Ordnance Department respecting re-negotiation and regarding an extension of the contract. Re-negotiation of the York contract was completed in March, 1951.

Towards the close of 1950, when it had become apparent an extension of the York contract or new tank rebuilding contracts would be forthcoming, Messrs. Bowen and McLaughlin examined the situation arising from their agreement to allow the appellant company a one-third participation in the York contract and the appellant company's failure to fulfil its obligation to furnish $200,000 capital. Mr. McLaughlin testified the firm of Bowen & McLaughlin were in a difficult and embarrassing position because neither the Ordnance Department nor the Army knew of their relationship with the appellant company and in order to negotiate a contract extension it was essential that full disclosure be made of all parties entitled to participation rights. Legal advice sought and obtained from the partnership attorneys was to the effect that Bowen & McLaughlin should have obtained United States Army permission before executing the participation agreement and that the appellant company might have a claim not only to participate in the profits arising from the York contract but in the profits earned from any extensions of that contract or in other contracts arising from it and of a like nature. The attorneys for Bowen & McLaughlin may have had regard to the elimination of the deadline date by which the $200,000 capital was to have been supplied by the appellant company.

Messrs. Bowen and McLaughlin once more discussed the situation, this time having particular regard to the opinion of their attorneys, and made a definite decision to offer the

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appellant company the sum of $225,000 for a complete surrender of any claim to participation rights in the York contract. Payment of $225,000 was regarded as justified because of probable extensions to the York contract. Mr. Bowen testified that the overall gross of the York and subsequent contracts of a like nature approximated $100,000,000.

On December 28, 1950 Mr. McLaughlin met Messrs. Dutton and Jennings at Great Falls, Montana. The situation in respect to the York contract and the inability of the appellant company to fulfil its capital commitment was discussed. On behalf of Bowen & McLaughlin, Mr. McLaughlin offered to pay the appellant company $225,000 in consideration of it surrendering any claim to participate in the York contract. The offer was quickly accepted. Mr. Dutton's testimony was that he was absolutely amazed because the appellant company had not lived up to its obligations and he did not consider it had any rights.

Under date of December 28, 1950 an agreement (Exhibit 19) was executed by the firm of Bowen & McLaughlin and by the appellant company. Under the terms of this agreement the appellant company, in consideration of $225,000, United States dollars, relinquished all its rights under the joint venture agreements of January 7, 1949 (Exhibit 2) and April 15, 1949 (Exhibit 7).

Following the execution of the December 28, 1950 agreement Bowen & McLaughlin immediately deposited $225,000 to the credit of the appellant company in the Great Falls National Bank at Great Falls, Montana, subject, however, to a stipulation that $50,000 would be held by the bank until approved for disbursement by Messrs. Bowen and McLaughlin. The $50,000 was held to protect Bowen & McLaughlin against any contingencies which might "arise in connection with the sale of the contract covered by the $225,000 consideration." The $50,000 was released about March, 1952. The United States government claimed no income tax from the appellant company in respect to the $225,000 payment. No withholding tax was paid by Bowen & McLaughlin.

The only witness called on behalf of the Minister was Jack J. Williams, a special agent for the Internal Revenue Service of the United States Treasury Department. Mr.

Williams testified that on June 23, 1955, accompanied by Mr. Robert D. A. Amos, the chief of the Treasury Intelligence Division, and by Canadian investigators, he, in the course of investigating the affairs of Bowen & McLaughlin, interviewed Mr. McLaughlin regarding the December, 1950 payment of $225,000 to the appellant company. Mr. Williams says Mr. McLaughlin told him the $225,000 payment represented a distribution of the profit on the York contract. Mr. Williams also testified that on the question of the contribution of capital by the appellant company to the New York contract Mr. McLaughlin was a little vague as to how the capital had been contributed but assured him the contribution had been made and suggested he discuss it with Mr. McIntyre, who looked after his financial affairs and would have the answer.

Mr. Williams says Mr. McIntyre, who was interviewed by him and the other investigators on June 27, 1955, confirmed the $225,000 was a distribution to the appellant company of its share of the profits realized from the York contract and told him specifically that the appellant company had contributed the $200,000 capital to the York contract by making payments to Mr. McLaughlin on equipment and thereby making available to Mr. McLaughlin the $200,000 required for the York contract. On cross-examination Mr. Williams was not so specific as to the manner in which the contribution had been made.

Mr. Williams also testified that Mr. McIntyre told him the profit distribution on the York contract was handled as a contract purchase on the books of Bowen & McLaughlin because the appellant company wanted it that way in order to obtain a tax benefit in Canada.

I attach little weight to the evidence of Mr. Williams. Positive statements by Mr. Williams on direct examination became indefinite and vague when subjected to cross-examination.

Regardless of what Mr. McLaughlin may or may not have told Mr. Williams in the course of a United States Treasury investigation into the affairs of Bowen & McLaughlin, we have Mr. McLaughlin's sworn testimony that while, until pretty well into the York contract, he and Mr. Bowen expected the appellant company would become a partner in the venture, they were compelled to

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adopt a different status when they realized the capital commitment of the appellant company could not be fulfilled.

As against Mr. McIntyre's alleged statement to Mr. Williams that the $225,000 payment was a distribution of profits we have Mr. McLaughlin's testimony at page 65 of the transcript:

Q. What is that you say, National Paving were not on the bond?

A. They were not on the bond. They were not to supply any talent to do the work, and they were not named in the contract that we had. We were in a rather embarrassing position. We could not go to the Army and get a change of contract nor any addition. Our submission was already made, we could not change the position at all. We thought we would clear our house and put it in order and pay off our associates and there was no scientific way of declaring what their, what we owed them. It was an arbitrary figure. It was a nuisance value figure. That probably is not the right word. But it was not on the basis of scientific declaration in accordance with the principles of our contract agreement. It was just a figure we picked out of the air, and we cleaned our skirts and we felt that was the honourable thing to do under the circumstances.

Q. Now did you feel that it was also a good thing to clear up any implied promise or implied situation for National Paving Company coming into subsequent contracts with the Ordinance Department?

A. Well, our attorney advised us they could have followed through. Ordinarily in our country it is common practice in the construction industry, or any groups of association, when they receive a contract and there is a continuation of it, it is common practice to have your associates in your first contract persist with the remaining contracts. That is very common. We have been in many instances in our contracts with other people, we have always been included. We wanted to get this thing cleared away as far as these boys were concerned, and that is one of the reasons we made that liberal contribution.

In contradiction of Mr. Williams' testimony as to the manner of contribution of capital by the appellant company we have, at page 60 of the transcript, Mr. McLaughlin's testimony regarding his December 27, 1948 conversation with Mr. Jennings:

. . . I asked him, as I remember it, how long would it take him to get this money to us because we needed it very badly. We were already under way in the performance of our contract. He felt, as I remember, he just picked this time out of the air, a week or ten days at the outset. I agreed with him over the 'phone they would be considered as participants in the contract and that I would see what I could do to secure, to borrow this $200,000 from the bank on my own account on a temporary basis, which I was successful in being able to do, and I so notified Mr. Jennings.

And at page 61:

Q. MR. TOLMIE: While we are on that point, Mr. Henderson testified a few moments ago that that temporary advance by you to Bowen & McLaughlin of $200,000 capital, which you hoped National would be able

to provide, was that ever treated as an advance in Bowen & McLaughlin of the National contribution to the capital of Bowen & McLaughlin?

A. No. It was a private accommodation on my part. Bowen & McLaughlin did not borrow this money. I prevailed on a banker friend of mine to supply us with these funds on a temporary basis.

As against the not precise statements of Mr. Williams on cross-examination, that Mr. McIntyre told him the capital contribution of the appellant company was made by making payments on account of equipment to "either Mr. McLaughlin personally, or McLaughlin Inc. or McLaughlin—", we have the very precise statement of Mr. J. Ross Henderson, a chartered accountant and a member of the accounting firm who in 1950 were the auditors of the appellant company, as to how the equipment transactions were handled. Mr. Henderson's testimony was that the appellant company rented equipment from McLaughlin Inc. in 1947, that the remittance of $51,393.55 made to that company on January 29, 1949 was in payment of accrued rental and the remittance of $145,191.63 on April 2, 1949 was the purchase price of the equipment previously rented. The consideration for each remittance in respect to equipment was earmarked very definitely and was approved by the Foreign Exchange Control Board. The equipment remained in Canada and became an asset owned wholly by the appellant company.

Mr. McIntyre in June 1955 was not a director or shareholder of the appellant company and there is nothing in the evidence on the hearing of the appeal that indicated he has had any connection with it since 1950.

That Mr. McIntyre had no authority to speak for Bowen & McLaughlin is made very clear by Mr. Bowen's testimony at page 83:

Q. MR. TOLMIE: Can you tell us . . .

A. Well, as far as McIntyre was concerned, I want this very straight. He has nothing to do with Bowen & McLaughlin, he never has had, and as far as I am concerned he never will. Now, is that plain?

Q. I was going to ask you that the next question. In your opinion, was Mr. McIntyre involved in the affairs of Bowen & McLaughlin?

A. Definitely he has not been for fifteen years. J. L. and I have been together, but he never has been, never on any deal in any shape or form.

Q. He worked for Mr. McLaughlin, did he?

A. That is right.

Q. But never for Bowen & McLaughlin?

A. Never.

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I am satisfied that whatever answers Messrs. McLaughlin and McIntyre made to the questions addressed to them by Mr. Williams were made having regard primarily to how such answers would affect the United States income tax position of Mr. McLaughlin. Mr. McIntyre was a third party having no direct connection with the appellant company or with the partnership of Bowen & McLaughlin.

On behalf of the Minister it was, in effect, submitted that the appellant company, notwithstanding the refusal of the Foreign Exchange Control Board to approve of it doing so, actually had become a partner in the York contract venture and so was in a position of being entitled to share in the profits and of being liable to contribute to the losses, if any, resulting from the contract.

As I see it the following seven facts negative the submission that the appellant company actually was a partner in the York contract.

1. The parties to both the joint venture agreement of January 7, 1949 and the supplemental agreement of April 15, 1949 agree that the obligation of the appellant company to provide $200,000 capital for the York contract was subject to it being able to obtain the approval of the Foreign Exchange Control Board. Such approval never was granted.
2. The appellant company did not contribute any capital for the York contract and had no part in the management of the contract.
3. The appellant company did not participate in and had no knowledge of the re-negotiation of the York contract.
4. Financial statements relating to the York contract were not made available for perusal on behalf of the appellant company nor by its auditors until after this appeal had been launched.
5. The United States income tax returns of Bowen & McLaughlin do not disclose any interest of the appellant company in the York contract.
6. The $225,000 payment was made to the appellant company prior to re-negotiation of the York contract and so a time when the profits from that contract had not been finally determined.

7. The United States government has not demanded any income tax from the appellant company and Bowen & McLaughlin paid no withholding tax in respect to the $225,000 payment.

I have had regard to section 125 (now section 137) (2) and (3) of the Income Tax Act as applicable to the 1951 taxation year of the respondent and have concluded the payment of $225,000 to the appellant company was not a transaction which resulted in a benefit being conferred on it by persons with which it was not dealing at arms length.

Regardless of any conflict, or seeming conflict, between the verbal evidence adduced at the hearing of the appeal and some of the representations made to the Foreign Exchange Control Board, by or on behalf of the appellant company or by or on behalf of Messrs. Dutton and Jennings, I am convinced the wording of the agreement entered into between Bowen & McLaughlin and the appellant company on December 28, 1950 correctly expresses not only the form but also the substance of the transaction it purports to record.

To find that the payment of $225,000 in United States funds, made to the appellant company by Bowen & McLaughlin, was made in the course of distributing the profits earned on the York contract and represents the share of such profits that the appellant company was entitled to, I must disbelieve the evidence of Messrs. Dutton, Jennings, Bowen and McLaughlin. That I am not prepared to do. Messrs. Dutton, Jennings, Bowen and McLaughlin all are, in my opinion, blunt but truthful. I accept their evidence as to the true nature of the transaction. I am satisfied that if the transaction had been in the nature of a distribution of profits Messrs. Dutton and Jennings would have required the production of financial statements.

That Messrs. Dutton and Jennings believed they had no legally enforceable claim to participate in the York contract does not detract from the bona fides of the agreement they executed on December 28, 1950. Messrs. Bowen & McLaughlin based their offer to pay $225,000 for a surrender of any claim for participation on an opinion

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of counsel that, as Mr. McLaughlin summarized it, the appellant company "could have followed through" and "it would be proper to make a settlement." The door for the appellant company to come in had been kept open for too long. It was good business to close it.

The amount of the settlement may seem large but it is a figure fixed by Messrs. Bowen & McLaughlin to secure a quick settlement and put an end to a worrisome situation. Having regard to the gross amount of approximately $100,000,000 to which continuations of the York contract ultimately ran, the $225,000 figure may not be out of proportion.

The fact that the $225,000 payment approximates one-third of the estimated profit on the York contract in December, 1950 does not make it income. Likewise the fact that the existence of an especially friendly relationship between the parties may have influenced the amount of the payment does not change its character.

The appellant company has satisfied the onus of establishing that the assessment is in error. The payment of $225,000 in United States funds, which was the equivalent of $239,625 in Canadian funds, was not income of the appellant company derived from a business or income of the appellant company derived from any other source.

The appeal will be allowed with costs, to be taxed.

The assessment will be set aside and the matter referred back to the Minister for re-assessment on the basis of the amount of $239,625 not being included in the 1951 taxation year income of the appellant company.

Judgment accordingly.