BETWEEN:

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

AND

BONAVENTURE INVESTMENT COMPANY LIMITED ..... RESPONDENT.

1962
Jan. 22
Feb. 26

Revenue—Income tax—Payment in settlement of claim for breach of option to convey lots to builder—Capital or income receipt—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4 and 139(1)(e).

The respondent, whose business was the building of houses for sale, purchased fifty building lots from a syndicate and secured an option to purchase fifty more lots at the same price. The vendor subsequently refused to honour the option but on threat of suit paid the respondent $7,500 in settlement of its claim. In re-assessing the respondent for its 1956 taxation year the Minister added $7,500 to its taxable income. The respondent appealed from the assessment on the ground that the payment constituted non-taxable compensation for damages of a capital nature which should not have been treated as income. The Tax Appeal Board allowed the appeal. On an appeal by the Minister from the decision of the Board.

Held: That the building lots in question formed part of the respondent's stock in trade and the payment of $7,500 was to compensate it for the loss of business profits and therefore was properly included in computing its taxable income. *Burmah Steam Ship Co. Ltd. v. Commissioners of Inland Revenue* 16 T.C. 67 at 71, and *Jesse Robinson & Sons v. Commissioners of Inland Revenue* 12 R.T.C. 1241 at 1247, referred to.

APPEAL from a decision of the Tax Appeal Board[1].

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

[1] (1960) 23 Tax A.B.C. 408; 60 D.T.C. 136.

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Paul Boivin, Q.C. and *Rolland Boudreau* for appellant.

Mitchell Klein for respondent.

DUMOULIN J. now (February 26, 1962) delivered the following judgment:

This is an appeal from a decision of the Tax Appeal Board, on date February 25, 1960[1], annulling a reassessment by the Minister of National Revenue, whereby an amount of $7,500 was added to respondent's taxable income for the year 1956.

The facts giving rise to this litigation are uncontradicted and quite simple.

Bonaventure Investment Co., Ltd., is described by its secretary-treasurer, Mr. Bernard Lazarowitz, as a "construction company . . . buying some farms for a bigger amount of land, and . . . building it up (cf. transcript of evidence before Tax Appeal Board, pp. 4-9)". The respondent's income tax return, for the fiscal period ended March 31, 1956, (photostats filed as ex. R-1), states the nature of this company's business under the caption of "real estate and builders".

It began operating at the start of 1953, says Mr. Lazarowitz, so that this firm had existed no longer than six or seven months when, on July 24 of that same year, it . . . "offered to purchase from Messrs. Morris Schwartz, Harry Finestein and David Miller, fifty building lots forming part of lots 9 and 10, Parish of Lachine, Town of Dorval."

The second paragraph of this offer (ex. A-1) reads thus:

> In addition you (i.e. Messrs. Schwartz, Finestein and Miller) agree to give us an option to purchase an additional (50) fifty lots out of the same parcel of land and of the same approximate area at the same price; such offer to be exercised by the undersigned in writing within a period of four (4) months after date of execution of your Deed of Sale for the purchase of the entire parcel of land.

Another paragraph, the third of this private agreement, proposed an over-all price of . . . "One Hundred and Fifty Dollars ($150.00) per lot above your costs for each lot . . .".

A few days after, on August 10, Morris Schwartz inscribed on this document (ex. A-1) the significant words: "Offer hereby accepted", under which appears his sign-manual.

No complications occurred in connection with the first block of 50 lots bought outright, legal ownership of which was regularly delivered to Bonaventure Investment, this company then proceeding to build 50 bungalows and disposing of the entire development.

Matters, however, turned out differently in the case of the parcel under option, quibbles and misunderstandings set in to such an extent that both parties threatened a recourse to legal redress. Eventually an amicable settlement of the dispute was decided upon, as evidenced in ex. A-8, merely dated 1955, intituled: "Memorandum of Agreement", whereby Schwartz, Finestein and Miller, undertook to pay $7,500 to Bonaventure Investment Ltd., without any admission of liability, but solely to "settle and transact their respective claims" with respect to the option aforesaid. This sum of $7,500, and that alone constitutes the moot point under discussion. In respondent's opinion, as appears in section 4 of its Reply to Notice of Appeal:

> 4. The amount at issue received by the Respondent constituted non-taxable compensation for damages and are of a capital nature.

To this proposition, the appellant replies that (cf. Notice of Appeal, section 17):

> 17. The building lots in question formed part of the stock in trade of the Respondent, and, in the same way as the profits from the disposal of these lots would have been income in the hands of the Respondent, the compensation received in lieu of such profits is likewise income taxable in the hands of the Respondent.

Accordingly, the appellant relies on sections 3, 4 and 139(1)(*e*) of the *Income Tax Act* (1952, R.S.C. c. 148).

Capital increment or trading receipt, then is the problem calling for a solution.

A first question logically coming to one's mind is the true nature of the commercial transactions carried on, normally, by Bonaventure Investment. In other words, whenever this "builders and real estate" company sold one or several lots, with house thereon, was it parcelling off so many capital assets or simply plying its regular line of activities and dealing, for an adequate consideration, with its stock in trade? The answer seems unescapable, and if I may be permitted such expressions in reference to real property, the respondent's "wares" his one and only kind of "inventory goods" consisted in land holdings. Erection of cottages on these grounds just superimposed, on the plots of real estate, a

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second profit earning item and nothing else. I mention this in reply to respondent's assumption that its uniform practice of dealing only in built-up lots and not in resales of bare land (cf. transcript p. 10) might have some legal bearing on the issue. And again, it could go without saying that the company's gains have a twofold basis, computed on a percentage of its purchase price of the soil and on subsequent construction costs.

In consequence of a breach of contract the respondent company was restricted in the exercise of its trade, failing to obtain delivery of fifty (50) "inventory assets", and obtained, as a compensation, a sum of $7,500. Admittedly the current expression of "compensatory damages" aptly qualifies such a payment.

Even so a second question arises, namely: Were these "compensatory damages" granted "to fill a hole in respondent's capital assets or rather a hole in its commercial profits?" as said in *Burmah Steam Ship Co., Ltd. v. C.I.R.*[1]

The company's purpose, its one and only interest in the option, was to transact the sales of those fifty lots immediately after the building of so many cottages; it never intended any long term retention of this property which alone might, in time, impart to the deal a characteristic feature of an investment. To a curtailment of trading profits corresponded an indemnity of a like nature, with the result that Bonaventure Investment derived a certain amount of pecuniary benefits from a single source instead of from a possible fifty. Therefore, appellant's suggestion that: "the building lots in question formed part of the stock in trade . . . and the compensation received in lieu of such profits is likewise income taxable in the hands of the respondent", seems fully vindicated.

Out of several precedents quoted, two are of particular assistance: Referring anew to the *Burmah* case, *supra*, the undergoing statement made by Lord President Clyde singles out an instance of differentiation between profits of trade and a capital gain.

> Suppose some one who chartered one of the Appellant's vessels breached the charter and exposed himself to a claim of damages at the Appellant's instance, there could, I imagine, be no doubt that the damages recovered would properly enter the Appellant's profit and loss account for the year. The reason would be that the breach of the charter was an injury inflicted on the Appellant's trading, making (so to speak) a

[1] (1930) 16 T.C. 67 at 72.

hole in the Appellant's profits and the damage recovered could not therefore be reasonably or appropriately put by the Appellant—in accordance with the principles of sound commercial accounting—to any other purpose than to fill that hole. Suppose, on the other hand, that one of the Appellant's vessels was negligently run down and sunk by a vessel belonging to some other shipowner, and the Appellant recovered as damages the value of the sunken vessel, I imagine that there could be no doubt that the damage so recovered could not enter the Appellant's profit and loss account because the destruction of the vessel would be an injury inflicted, not in the Appellant's trading, but on the capital assets of the Appellant's trade, making (so to speak) a hole in them, and the damages could therefore—on the same principle as before—only be used to fill *that* hole.

More in line still with the issue at bar was a pronouncement by Rowlatt J. in re: *Jesse Robinson & Sons v. The Commissioners of Inland Revenue*[1]. There, the following facts had engendered the litigation as reported at pages 1241 and 1242:

> On 17th March, 1920, the Appellants entered into a contract to sell a quantity of yarn at a specified price. On 21st June, 1921, they agreed with the purchaser to cancel the uncompleted portion of the contract upon payment by the purchaser of a sum of £200 in four monthly instalments, . . .
>
> On 29th August, 1919, and 15th March, 1920, the Appellants entered into contracts for the sale of certain quantities of yarn at specified prices. On 19th July, 1920, the purchaser wrote to the Appellants purporting to cancel the first contract so far as it was unperformed and purporting wholly to cancel the second contract. On 16th June, 1921, the purchaser agreed to pay to the Appellants £12,500 in settlement of their claim for damages for breach of contract. The said sum was paid on the 18th June, 1921.
>
> In computing the profits of the Appellants for the accounting period of one year . . . the Commissioners of Inland Revenue treated the said sums of £200 and £12,500 as trading receipts of that period.

On appeal of this decision to the High Court of Justice, the learned Judge took the view that:

> . . . there was a broken contract, and an action was commenced in respect of it, and the action was settled by payment of damages for breach of contract. It seems to me that there is no reason why the sum received in that respect for breach of contract is not a sum which is part of the receipts of the business for which that contract was made.

Notwithstanding any legal distinctions attaching to chattels (yarn) and real property (residential lots), an admissible analogy exists between the *Jesse Robinson* precedent and the instant case. Indeed, a decisive factor arises, not so much out of the species of things sold, moveable or immoveable, as from the transaction (commercial or otherwise) in

[1] (1929) 12 R.T.C. 1241 at 1247.

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the course of which the sale occurs. I renew my conviction that this payment of $7,500 to Bonaventure Investment Co., Ltd., compensated it for the loss of business profits, and, therefore, ranges such a receipt well within the compass of ss. 3 and 4 of the *Income Tax Act*.

For the reasons previously given, the appeal is allowed and respondent's assessment restored, as of May 22, 1958, when appellant, by notice of assessment, included the amount of $7,500 in the taxable income of Bonaventure Investment Company Ltd., for taxation year 1956.

The appellant is entitled to recover its costs after taxation.

Judgment accordingly.