BETWEEN:

JOSEPH SEDGWICK ..... APPELLANT;

1961
June 22, 23
1962
June 28

AND

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

Revenue—Income Tax Act, R.S.C. 1952, c. 148, s. 6(1)(c)—Partnership—Capital or income—Amount paid for relinquishing right to receive profits of partnership held a capital receipt—Appeal allowed.

In 1949 appellant and four other persons entered into an agreement with one Purcell to lend to Purcell a sum of money with which to purchase a seat on the Toronto Stock Exchange and to provide working capital for a stock brokerage business. The agreement provided for payment to each of the five lenders of a percentage of the annual net profits of the business after an allowance to Purcell and also that they were not to be considered as partners in the business but only as lenders. On the first day of February, 1956 the arrangement was rescinded by an agreement between the lenders and Purcell by which Purcell agreed to pay to the lenders the amount of the loan outstanding, the increase in value of the seat on the Exchange, the share of the lenders in the profits of the business for the fiscal year ending March 31, 1956 and the share of the lenders in the goodwill of the business. The Minister assessed the appellant for tax on his share of the profits of the brokerage business for the 1956 fiscal period. An appeal to the Tax Appeal Board was dismissed and the appellant appealed to this Court. The Court held that the arrangement between the parties was that of a partnership and not merely one involving the lending of money, and that the partnership must be considered as dissolved on February 1, 1956 the date of the agreement rescinding the 1949 agreement.

Held: That the amount paid to appellant for relinquishing his right to receive profits of the partnership was a capital receipt and not income.

APPEAL under the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Ritchie, Deputy Judge of the Court, at Toronto.

Terence Sheard, Q.C. for appellant.

F. J. Cross and *P. M. Troop* for respondent.

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

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RITCHIE, D.J. now (June 28, 1962) delivered the following judgment:

This appeal is from a judgment of the Tax Appeal Board affirming a re-assessment of tax made by the minister, pursuant to the provisions of the *Income Tax Act*, on the appellant's 1956 income. Little, if any, dispute exists respecting the facts involved.

Under date of March 31, 1949 Mr. Sedgwick and four other parties entered into an agreement with one John Edward Purcell who was desirous of purchasing a seat on the Toronto Stock Exchange. In the agreement the appellant and his associates are described as "the lenders" while Purcell is described as "the proposed exchange member". All of the lenders were personal friends of Purcell who had been employed by a brokerage house as a "customer's man".

For the purpose of financing the purchase of the stock exchange seat at a cost not exceeding $38,000.00 and providing working capital for the operation of a stock brokerage business, each lender agreed to advance Purcell $15,000.00 and postpone and subordinate the re-payment of such advance to all debts, liabilities and obligations which might be owing in respect of the operation of the business. The agreement did not provide for the payment of any interest in respect of the advances but, in lieu thereof and in consideration of the advances being made, it was provided that each of the five lenders should be entitled to receive an amount equivalent to eighteen percent of the yearly net profits of the business, to be computed after payment to Purcell of $7,000.00 "for his services in the said brokerage business" and provision for income tax. Purcell was to receive the remaining ten percent of the profits.

As paragraphs 4, 8, 9, 10, 12, 13 and 16 of the agreement appear to have particular relevance to the issue herein, I shall quote them in full, rather than attempt to paraphrase. They are:

> 4. If at any time while the said Brokerage business is in operation additional monies are required pursuant to the regulations of the Toronto Stock Exchange for the operation of the said brokerage business, and a majority of the Lenders agree that it is in the best interests of the said business that additional monies shall be advanced, each Lender shall, in addition to the advances then already made as set out above, advance by way of loan additional monies to the Proposed Exchange Member up to but not exceeding $5,000 on the understanding same shall be repaid pro rata with the other Lenders as soon as expedient, bearing in mind the provisions of the agreement marked "A" hereto annexed.

8. As security for the monies advanced by each Lender hereunder, the Proposed Exchange Member covenants with each Lender to hold the Stock Exchange Seat and such other assets he may acquire from time to time by reason of the operation of the said brokerage business, in trust for the Lenders, their heirs, executors, administrators and assigns, but at all times subject to the provisions of the Agreement "A" hereto annexed. The Proposed Exchange Member doth hereby constitute and appoint a majority of the Lenders, their heirs, executors, administrators and assigns, the true and lawful attorneys of the Proposed Exchange Member to transfer, assign and set over unto the Lenders, their heirs, executors, administrators and assigns, or nominee or nominees, the said Stock Exchange Seat, and all other assets added thereto through the operation of the said brokerage business.

9. Each Lender covenants and agrees with the other Lenders that all and any matters relating to, arising out of, or concerned with this Agreement shall at all times be decided by the decision of a majority of the Lenders, and that once such a decision is given same shall be final and binding on all the Lenders as if it were a unanimous decision of the Lenders. Each Lender agrees with the other Lenders to do all things and execute such documents as may be necessary or useful in order to give full effect to the true intent and meaning of these presents.

10. No Lender may demand repayment from the Proposed Exchange Member of any monies advanced hereunder unless it is the decision of the majority of the Lenders that such demand be made, and then only subject to the provisions of the Agreement marked "A" hereto.

12. The Proposed Exchange Member covenants and agrees with the Lenders as follows:—

(*a*) Not to engage in any other business or venture, nor enter into any transaction or transactions for his separate account which might be entered into for the benefit of the business, except reasonable personal trading with his own private funds.

(*b*) To devote his whole time and attention during customary business hours to the management and conduct of the affairs of the said brokerage business.

(*c*) To act faithfully, honestly and diligently in the performance of his duties and in the interests of the said business.

(*d*) To conduct the business in accordance with good business practice and to only carry on a commission business.

(*e*) To make full disclosure at any time or times when requested so to do by the Lenders of all accounts, books of account and records, and all other matters or things pertaining to the said business and the conduct and operations thereof.

(*f*) To obey the lawful directions of the Lenders or their agent or agents in writing named.

13. The Proposed Exchange Member shall be paid for his services in the said brokerage business, as an expense of the business, the annual sum of $7,000 payable at the rate of approximately $135 weekly and his term of employment shall commence forthwith upon his election as a Member of the Toronto Stock Exchange and upon him devoting his entire time to the organization and/or operation of the said brokerage business, and shall continue in full force and effect until either party hereto terminates same upon 4 weeks' notice in writing to the other.

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Notwithstanding anything herein contained, the Lenders shall have full power hereunder to terminate the employment without notice if the Proposed Exchange Member is guilty of any breaches of any of his covenants hereunder, or is derelict in his duties in any way.

16. Nothing in this agreement contained shall be deemed to constitute the Lenders or any of them as partners in the brokerage business of the Proposed Exchange Member, or to make the Lenders or any of them liable to the creditors of the Proposed Exchange Member, it being agreed between the parties that the liability of the Lenders shall be restricted to the several advances by way of loan hereinbefore provided for.

Schedule A was executed by the lenders, Purcell and the Auditor of the Toronto Stock Exchange. It is a form of subordination agreement approved by the Exchange.

Mr. Sedgwick testified he had no thought of becoming a partner in the Purcell business "either in law or in fact" and, to make that fact abundantly clear, had insisted on the inclusion of paragraph 16 in the agreement. In his view it would be improper for him, as a lawyer whose practice is exclusively that of a barrister, to be a partner in a business of any kind.

While, under the terms of the agreement, the appellant was obligated to advance $15,000.00 to Purcell, he signed the agreement both on his own behalf and as trustee for a friend who did not wish to disclose his interest. His initial advance, accordingly, was only $7,500.00, one-tenth of the $75,000.00 total. Later, pursuant to the above quoted paragraph 4, he advanced additional amounts of $1,250.00 on May 19, 1952 and $2,500.00 in May, 1954 and so brought the total of his advance to $11,250.00, one-tenth of the total which eventually was advanced by the lenders.

Shortly after execution of the agreement Purcell, because of conflict with stock exchange policy, requested that paragraphs 8 and 12 (*f*) be deleted from it. The lenders immediately acquiesced but it was not until March 31, 1953 that each of them addressed a letter to Purcell reading:

I hereby agree that paragraph 8 on page 4 and clause (*f*) of paragraph 12 on page 5 of the original agreement dated March 31st, 1949 should be deleted from the agreement and henceforth should not be regarded as part of the said agreement.

The brokerage business prospered. From 1950 to 1955 inclusive the appellant received as his share of the profits:

1950	$ 3,206.12
1951	7,483.17
1952	8,596.59
1953	10,313.26
1954	5,229.31
1955	13,765.85
	$48,594.30

As he was entitled to one-tenth of the ninety percent share of the profits allocated to the lenders, it would seem the profits of the business, during those six years, ranged from a low of $35,623.56 in 1950 to a high of $152,953.89 in 1955. In the income tax returns filed by Mr. Sedgwick the above amounts were listed as "investment income".

About October 1955 the Stock Exchange management advised Purcell that, commencing January 1, 1956, only persons active in the business of a member house would be permitted to participate in the profits earned by it and that, accordingly, his agreement with the lenders must terminate not later than December 31, 1955. Quite naturally, the lenders were disturbed by the thought of losing a lucrative source of income. During the Christmas season the appellant discussed the situation with the president of the Stock Exchange and sought permission for the agreement to continue in effect. The president told him it was impossible to accede to that request but suggested the Governors might permit the lenders to continue their loans at a fixed rate of interest, not exceeding ten percent, and subject to an approved subordination agreement. Mr. Sedgwick then sought permission to have the agreement remain in effect until March 31, 1956, the end of the current fiscal period of the brokerage business. The president agreed to submit that request to the Board of Governors but they rejected it. The lenders and Purcell then entered into a new agreement under date of February 1, 1956.

Notwithstanding the fact that the lenders had purported to delete paragraph 8 from the former agreement, there is in the 1956 agreement a recital setting out that the stock exchange seat is held by Purcell in trust for the lenders. It also recites:

AND WHEREAS all Parties hereto are content to carry on the business on the terms and conditions it has been carried on in the past, but the Board of Governors of the Toronto Stock Exchange has made a

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ruling that as the Creditors are not actively engaged in the business they can no longer take a share of the net profits of the business as remuneration for the moneys which they have advanced to the business in lieu of a fixed rate of interest.

AND WHEREAS although representation on behalf of the Creditors has been made to the said Board of Governors, protesting against the injustice of such a ruling, nevertheless the said Board of Governors has been adamant and as a result the Parties hereto have no alternative other than to make the arrangements hereinafter set forth if the business is to be carried on, as Purcell is financially unable to pay off the moneys owing to the Creditors and still be in a position to meet the financial requirements of the Toronto Stock Exchange.

The agreement then continues in part:

1. It is mutually agreed:—

(*a*) That to date the advances of money to Purcell by the Creditors amount to ..... $112,500.00.

(*b*) That the increase in the market value of the said seat on the Toronto Stock Exchange is fixed at ..... $ 63,000.00.

(*c*) That the share of the Creditors in the cash surrender value of the insurance policy is hereby fixed at ..... $ 4,850.00.

(*d*) That the share of the Creditors in the net profits of the business for the fiscal year ending March 31st, 1956, is hereby fixed at .... $300,000.00.

(*e*) That the share to which the Creditors are entitled in the good will of the business is hereby fixed at ..... $ 69,650.00.

Total $550,000.00.

2. It is further agreed that the Original Agreement shall be terminated by mutual consent of the Parties hereto for the reasons set out in the third recital hereof, and that the Creditors shall no longer be entitled to share in the net profits of the business. As consideration for the Creditors terminating the Original Agreement and giving up their interest in the Stock Exchange seat, and in the physical assets of the business and their right to share in the profits of the business as aforesaid, Purcell covenants and agrees to pay to each of the Creditors the amount set opposite his name below, totalling in all $550,000.00, payable at the times hereinafter set forth:—

To Joseph Sedgwick	$220,000.00
To Kenneth W. Peacock	$110,000.00
To Isabel Manley	$110,000.00
To Donald George Ewen	$ 55,000.00
To Kenneth Ewen	$ 55,000.00
Total	$550,000.00

Purcell shall pay $150,000.00 on account of the said sum of $550,000.00 by April 15th, 1956 as follows:—

To Joseph Sedgwick	$ 60,000.00
To Kenneth W. Peacock	$ 30,000.00
To Isabel Manley	$ 30,000.00
To Donald George Ewen	$ 15,000.00
To Kenneth Ewen	$ 15,000.00

3. The balance of the said sum of $550,000.00, namely $400,000.00 (hereinafter referred to as "the loan") shall be a loan by the Creditors to Purcell and shall bear interest at the rate of 10% per annum until paid, and interest at the aforesaid rate shall be payable quarter-yearly on the last days of June, September and December in the year 1956 and thereafter on the last days of March, June, September and December in each year until paid.

Paragraphs 5 (*g*), 6 (*b*), (*d*) and (*e*) are, in my view, also of importance. They read:

5. As further consideration for the Creditors terminating the Original Agreement on the terms and conditions set forth above, Purcell covenants and agrees with the Creditors that as long as the loan or any part is outstanding—

(*g*) That in each and every year he will make available to the Creditors for repayment on account of the loan such moneys of the business as the Auditor of the Toronto Stock Exchange consents he may make available, and he shall forthwith upon receiving such consent offer said available moneys to the Creditors as a payment on account of the loan.

6. It is mutually understood and agreed between the Parties as follows:

(*b*) Subject as aforesaid, if at any time moneys are available for repayment of all or any part of the loan, Purcell shall pay out of such funds such moneys as any Creditor is entitled to upon such Creditor making a formal demand for same, despite the fact such Creditor had previously refused to accept same.

(*d*) The loan, or such part as remains unpaid, shall become immediately due and payable upon the happening of any or all of the following events:—If Purcell or his successor in business becomes bankrupt; or if a receiving order is made against him; or if a judgment is obtained and remains unsatisfied for a period of twenty days.

(*e*) Subject to the terms of subsection (*g*) of Paragraph 5 and subsections (*b*) and (*d*) of Paragraph 6 hereof, the said loan of $400,000.00 shall be due six years from the date hereof, but that payment of same will at all times be subject to the terms and conditions of the Subordination Agreement referred to in Paragraph 4 hereof.

While paragraph 2 of the 1956 agreement provides that $220,000 shall be paid to the appellant, it is common ground he, on his own account, was entitled to receive only one-quarter of that amount, i.e., $55,000, being one-tenth of the total consideration. No clear explanation was advanced as to why Mr. Sedgwick is shown as entitled to receive $220,000. There is some suggestion he executed the 1956 agreement in three capacities, on his own behalf, as trustee for the one half share already referred to and as trustee for another full share which had been acquired by another party from one of the original lenders.

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During the year 1956 the appellant received $15,000 on account of his share of the consideration for the lenders entering into the 1956 agreement and also received $2,000 as interest on the $40,000 deferred balance payable to him thereunder. Because he was in England during the month of April 1957, his secretary prepared, signed and filed his 1956 income tax return. Under a heading "All Other Investment Income" there is included an item reading:

Purcell Investment Account (T20 in file of Jack Purcell) $32,000.00.

The notation "T20 in file of Jack Purcell" is hand written and appears to have been inserted by a departmental officer. My impression is there is an intra departmental form bearing the designation T20. The record is silent as to the connection between the T20 form in the file of Jack Purcell and the income tax return of the appellant.

The record also fails to disclose the information which led to inclusion of the $32,000 item in the tax return and how it was computed. Counsel, however, agreed that the amount included a sum of $2,000 received by the appellant in 1956 as interest on the deferred balance of $40,000 owing to him by Purcell. The Crown maintains the remaining $30,000 is the appellant's one-tenth share of the $300,000 allocated to the lenders from the 1956 profits.

The appellant maintains it was through an error his 1956 tax return listed the sum of $32,000 as received from Purcell. He concedes $2,000 of that amount is taxable as an interest receipt but maintains the only further amount he received from Purcell in 1956 was $15,000 which should be regarded as a capital receipt. There can be no doubt that $15,000, plus interest on the $40,000 balance payable to him, is all the appellant, under the terms of the 1956 agreement, could have compelled Purcell to pay him during 1956.

I am satisfied the $32,000 item was included in the appellant's income through an error on the part of someone.

The amount of tax originally assessed in respect of the appellant's 1956 income was increased by an amount of $695.57 through a re-assessment made by the minister on March 5, 1958. Notice of objection to this re-assessment was filed on April 1, 1958. When drawing the objection, the appellant's solicitor took advantage of the opportunity to

object also to inclusion in the 1956 income of the $30,000 item. The re-assessment was confirmed by the minister on February 2, 1959 on the ground that

> the profit from the partnership of Jack Purcell and Company to the extent of $30,120.68 has been properly taken into account in computing the tax payer's income in accordance with the provisions of sections 3 and 4 and paragraph (*c*) of section 6 of the Act.

The appeal relates to inclusion in the 1956 income of the appellant of $30,189.84 made up of three items of $30,000, $125.68 and $64.16 respectively. Evidence, however, was lead and argument addressed only in respect of the $30,000 item.

The appellant advances two propositions:

1. The payment made and the payments agreed to be made by Purcell under the 1956 agreement, while calculated in respect of probable profits of the brokerage business, are not part of such profits but payment for relinquishment of the right to participate in future profits and for the relinquishment of other rights and, as such, are capital receipts.

2. If the $30,000.00 is income it does not accrue to the appellant as a partner but as a creditor and so only the cash actually received in 1956 should be included in his income for that year.

Three main contentions are advanced on behalf of the minister:

1. Under the 1949 agreement the lenders became partners in the firm of Jack Purcell & Company.

2. The partnership was dissolved by the 1956 agreement.

3. The amount of $300,000.00, designated by the 1956 agreement as "the share of the creditors in the net profits of the business for the fiscal year ending March 31st, 1956", constitutes earnings of the partnership in the 1956 taxation year of the appellant.

The question whether the lenders were creditors or partners of Purcell must, in my view, be determined by the substance of the relationship which was created between them by the 1949 agreement and which was terminated by the 1956 agreement rather than by the form of, or the precise language of any provision contained in, either agreement.

In the eleventh edition of Lindley on *Partnership* the learned authors state at page 50:

> Cases which present most difficulty are those in which persons agree to share profits and losses and at the same time declare that they are not to be partners. The question then arises, what do they really mean? If they have in fact stipulated for all the rights of partners, an agreement that they shall not be partners is a useless protest against the consequences of their real agreement.

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It is apparent that in settling the form of the 1949 agreement the draftsman had regard to rule 3(*d*) contained in section 3 of the *Partnerships Act*, R.S.O. 1960, chapter 288. It is:

> 3. In determining whether a partnership does or does not exist, regard shall be had to the following rules:
>
> 3. The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him a partner in the business, and in particular,
>
> (*d*) the advance of money by way of loan to a person engaged or about to engage in a business on a contract with that person that the lender is to receive a rate of interest varying with the profits, or is to receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such, provided that the contract is in writing and signed by or on behalf of all parties thereto.

A like provision of the English *Partnership Law Amendment Act*, 1865 (28 and 29 Victoria, chapter 86), sometimes referred to as Bovill's Act, was considered in relation to a somewhat similar agreement in *In Re Megevand; ex parte Delhasse*[1]. At page 67 of the Law Journal volume Lord Justice James said:

> If ever there was a case of partnership, this is one. Delhasse has all the essential powers of a partner, right to control the business, and a share of the profits and losses. But it is said that there are words in the agreement which prevent the operation of the contract to which I have referred—words that shew the relation of lender and borrower was intended. The words are a recital of section 1 of Bovill's Act, and a declaration in article 4 of the agreement that Delhasse's advance is by way of loan under that section, and does not, and shall not, be considered to render Delhasse a partner in the business. Now, do those words control the rest? It is clear they do not. The word "loan" is put in, it is true; but looking at all the stipulations, they are utterly inconsistent with a real loan. There is nothing to make the two personally liable in respect of the loan in any circumstances whatever. The loan was not a loan to the two on their personal responsibility, but a loan to the business, which was to be carried on by the two partners for the benefit of all three, and was to be paid out of the business, and that only. The words introduced are a mere sham and contrivance to elude the law of partnership, to call that thing a loan which was not a loan, and to enable a man to be the real and substantial owner of a business, and yet not be liable to losses in case they are incurred.

[1] (1878) 7 Ch. D. 511 (C.A.); 47 L.J. 65; 38 L.T. 106; 26 WR. 338.

And at page 68:

> I am of opinion that the mere putting in of words to the effect that this was a loan under the statute, a loan by one to the others, cannot alter the real transaction. The loan never had any of the real characteristics of a loan, and the agreement was in truth one for a real partnership.

There are at least three respects in which the 1949 agreement is inconsistent with the real characteristics of the relationship of debtor and creditor. They are:

> 1. No maturity date for repayment of the advances is set nor is any provision made for the advances automatically becoming due and payable on the happening of certain specified events.
>
> 2. Paragraph 12 is in terms more usually found in a partnership agreement than to one covering monetary advances. I already have referred to clause (*f*) of this paragraph being deleted from the agreement.
>
> 3. The provisions of paragraph 13, hereinbefore quoted, also are more consistent with a partnership agreement than with one to loan monies to a sole proprietor. The last sentence puts the lenders in the position of being employers of Purcell.

If the lenders really had been loaning money to Purcell the time for, or manner of, repayment of the loans would have been provided for by the terms of the agreement. A minimum provision would have been that in the event of any breach of his covenants by Purcell or in the event of his being derelict in his management duties, the lenders should have the right to declare the amount of their advances to be due and payable and to appoint a receiver-manager for the business.

The 1956 agreement conflicts with the former agreement in several respects and also negatives the relationship of debtor and creditor.

Paragraph 8 of the 1949 agreement, which the lenders purported to delete, declares the stock exchange seat and such other assets as Purcell might acquire through operation of the brokerage business are to be held by him in trust for the lenders as security for the monies advanced by each of them. Notwithstanding the purported deletion of this paragraph, the third recital of the 1956 agreement reads:

> AND WHEREAS while the seat on the Toronto Stock Exchange referred to in the last recital is held in the name of Purcell, same is held in trust by Purcell for and on behalf of the creditors.

That recital contains no suggestion of the seat having been so held only as security for the advances made by the lenders.

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The latter agreement provides Purcell shall pay the lenders $550,000 in consideration of them

(a) terminating the 1949 agreement;

(b) giving up their interest in the stock exchange seat and in the physical assets of the business; and

(c) relinquishing their right to share in the profits of the business.

Included in the computation of the $550,000 consideration are amounts identified with the stock exchange seat, the cash surrender value of a life insurance policy and the good will of the business. All three items are what I am in the habit of referring to as "capital assets". They all come within the language of the paragraph 8 which was supposed to have been deleted from the original agreement.

It is apparent the lenders not only had a right to participate in the profits of the business but also owned an interest in the ownership of the stock exchange seat, the surrender value of an insurance policy (presumably on Purcell's life) and the good will of the business. While the lenders did not intend to incur the liabilities of partners, they did intend to share in the profits of the brokerage business. The application of the monies purported to have been advanced to Purcell was restricted and a right of the lenders to supervise his management of the business was exacted. Any assets acquired either through their "advances" or from the operation of the business were, according to the language of the 1949 agreement, to be held in trust for the appellant and his associates.

As a result of the Stock Exchange ruling the 1949 agreement must be terminated, Purcell agreed to pay the lenders $550,000 in consideration of their agreeing to such termination. The advances totalled only $112,500. A debtor would hardly agree to pay $550,000 in order to satisfy a liability of $112,500.

I find the relationship created by the 1949 agreement between Purcell and the lenders was that of partners rather than that of debtor and creditor.

Section 6(1)(c) of the *Income Tax Act*, R.S.C. 1952, chapter 148 is:

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

Despite the reference to "income from a partnership" in section 6(1)(*c*), my finding that the appellant was a partner in the Purcell firm does not necessarily mean the $30,000 item, or any part of it, is taxable as income in his hands.

The appeal must be disposed of on the issue of whether any of the monies, other than interest, payable to the appellant under the terms of the 1956 agreement constitutes income in his hands. That issue, like the question of whether a partnership was created by the 1949 agreement, must be determined by the substance of the transaction as a whole, rather than by the form or wording of the agreement.

Although the appellant testified the Governors of the Stock Exchange insisted the 1949 agreement must be terminated as of December 31, 1955, there is in the 1956 agreement no mention of that date or of any other date on which the original agreement is to terminate. The partnership, therefore, must be taken to have been dissolved as of February 1, 1956, the date of the agreement and two months prior to the termination of the then current fiscal period. From the material in the record, I infer there was no determination of the profits actually earned up to the date of dissolution. Also lacking is any evidence as to the profits of the brokerage business for the full 1956 fiscal period. During his cross-examination of the appellant, counsel for the minister did suggest the 1956 profit was $467,000. Whether that suggestion had any foundation of fact was left to the imagination. The $300,000 share of the profits which the lenders were purportedly allotted certainly has no relation to $467,000.

Prior to execution of the 1956 agreement all the profits of the business had been distributed annually and, in no year, had the share of the lenders in the profits exceeded $137,658.50. The terms of the dissolution agreement did not require Purcell to pay, apart from interest, the lenders more than $150,000 during 1956. At no time was he in a position to withdraw $30,000 from the business as his share of the 1956 profits of the partnership.

In the absence of proof of what profits actually were earned in 1956, I infer the $300,000 is an arbitrary figure agreed upon as an item to be included in the computation

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of the total consideration to be paid the lenders for relinquishing their rights to share in the profits earned by the business in that and subsequent years and for relinquishing their interests in certain partnership assets.

An authority applicable to the main issue herein is *Van Den Berghs, Ltd. v. Clark (Inspector of Taxes)*[1]. In 1908 the V.D.B. company had entered into an elaborate agreement with a Dutch company to regulate their respective activities and to share their respective profits and losses. In 1927, at the request of the Dutch company, the V.D.B. company agreed to terminate the agreement in consideration of the payment to it of £450,000 as "damages". The House of Lords held this payment to be a capital receipt.

Lord McMillan (All E.R. Rep. 887) said:

> Now what were the appellants giving up? They gave up their whole rights under the agreements for thirteen years ahead. These agreements are called in the stated case "pooling agreements", but that is a very inadequate description of them, for they did much more than merely embody a system of pooling and sharing profits. If the appellants were merely receiving in one sum down the aggregate of profits which they would otherwise have received over a series of years the lump sum might be regarded as of the same nature as the ingredients of which it was composed. But even if a payment is measured by annual receipts, it is not necessarily itself an item of income. As Lord Buckmaster pointed out in *Glenboig Union Fireclay Co. v. Inland Revenue Commissioners* (1922 S.C. at p. 115):
>
> > "There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the test".

A case upon which the appellant relied strongly is *Rutherford v. The Commissioners of Inland Revenue*[2]. There an agreement had beeen entered into under which a retiring partner should receive from the remaining partners:

(1) the sum of £1,500 "in full satisfaction of his whole share and interest in the profits of the firm for the year" ending December 31, 1921;

(2) a further sum of £200 in respect of outstanding accounts; and

(3) further sums "out of the future profits of the business", diminishing from £500 in the first year after his retirement to £100 in the fifth year, payable by quarterly installments in advance.

The court held the £1,500 was not a share of the profits of the business. At page 692 of the T.C. report the Lord President (Clyde) said:

> The sum of £1,500 was made payable to the retiring partner independently of what might turn out to be the profits actually made in the current year, either as a whole, or during that part of it which preceded

[1] [1935] A.C. 431 (H. of L.); 104 L.J. K.B. 345; 19 T.C. 390; [1935] All. E.R. 874.

[2] (1926) 10 T.C. 683; [1926] S.C. 689.

the date of dissolution. It was nothing but the consideration in respect of which the retiring partner gave up any right he might have had in the profits made in that part of the year; and it would have remained a debt due to him by the remaining partners, personally, even if no profits at all had been shown on a balance struck by the remaining partners—whether at the date of dissolution or at the end of the current year.

Lord Blackburn, at page 696 T.C., put it this way:

It so happened that in October, 1921, one of the partners in the firm, Mr. Frank Rutherford, who under the partnership deed was entitled to 18/64ths of the profits, desired to retire, and an agreement was entered into between him on the one hand and the Appellant and the third partner, Mr. John Smith, on the other, as to the terms on which he should do so. It is on the construction of the terms of this agreement that the answer to the question in this case depends. The second clause of the agreement provides that for five years after the dissolution of the partnership on 31st October, 1921, the retiring partner should be entitled to receive annually "out of the future profits of the business" sums which were to diminish gradually from £500 to £100 per annum. The third clause provides that on the execution of the agreement the two partners who were to continue to carry on the business should pay him a sum of £1,500 "in full satisfaction of his whole share in the profits" for the year current at the date of dissolution. There is a marked contrast between the terms of these two clauses in respect that the payments under clause 2 are expressly described as a payment "out of the profits", while the payment under the third clause is a debt payable by the remaining partners irrespective of what might be ascertained eventually to have been the actual value of the retiring partner's share in the profits as at 31st October, 1921, when the agreement was executed. The retiring partner was paid the £1,500 on that date, and it subsequently proved that the share of the profits to which he would have been entitled amounted to less than that sum. The Appellant contends that the £1,500 should be deducted from the ascertained profits of the firm for the period 5th April to 31st October, 1921, before his own share of the profits for that period can be ascertained. The fair construction of the agreement does not appear to me to provide any justification for treating this sum as a charge upon the profits. In my opinion it must be regarded as a price paid to the retiring partner for his share in the profits and a sum for which the remaining partners remained liable irrespective altogether of what the profits of the firm for the year might prove to amount to.

The lenders agreed to the dissolution of the partnership under protest. The amount they stipulated for as the consideration for their agreement was substantial. It is a computation of five items, being:

1. Total advances by the lenders	$112,500.00 or	20.45%
2. Increase in market value of the stock exchange seat	63,000.00 or	11.45%
3. Share in cash surrender value of insurance policy	4,850.00 or	.88%
4. Share in net profits of business for 1956 fiscal period	300,000.00 or	54.55%
5. Share in good will	69,650.00 or	12.66%
	$550,000.00	99.99%

1962

SEDGWICK v. MINISTER OF NATIONAL REVENUE

Ritchie D.J.

The only item having any relation to income is the amount of $300,000 which constitutes 54.55% of the total consideration. Following the same line of reasoning, only 54.55% of the $15,000 the appellant received from Purcell in 1956 had any relation to income. That relationship does not, *per se*, render it taxable income.

The mechanics involved in dissolving the partnership did not include winding up of the business and distributing the assets among the partners. Purcell, as a sole proprietor, continued the business previously carried on by the partnership. The real effect of the 1956 agreement was that Purcell, for a price of $550,000, purchased the interest of the retiring partners in the partnership. The total consideration could not be paid in cash because, as recited in the agreement, Purcell was

> financially unable to pay off the moneys owing to the creditors and still be in a position to meet the financial requirements of the Toronto Stock Exchange.

The first installment on account of the purchase price was set at $150,000, to be paid by April 15, 1956. Payment of the $400,000 balance, referred to as a loan carrying interest at the rate of 10% per annum, was deferred. No set times were set for payment of any installments on account of the $400,000 balance. Under certain circumstances, payment of the entire balance might be deferred until 1962 and, even then, payment was subject to the terms of a subordination agreement.

I am of opinion the $550,000 consideration was a fixed sum. The fact that in computing it an item of $300,000 associated with profits was included does not affect its character or quality. Nor is the character or quality of the fixed sum consideration affected by the times for payment of any installments on account of the unpaid balance being subject to the approval of the stock exchange auditor and the wish of any lender. I have in mind the dictum of Lord Buckmaster quoted by Lord McMillan in *Van Den Berghs, Ltd. v. Clark (supra)*.

The right of the lenders to receive any share of the 1956 profits was extinguished by the agreement to accept $550,000 in consideration of them relinquishing their interest in the partnership. Purcell then became entitled to

the 1956 income in full. Any monies received by the appellant, or which he would be entitled to receive, on account of his share of the $550,000 consideration would be a receipt of capital.

In my view the amount of the appellant's 1956 taxable income was $30,000 less than that determined by the re-assessment.

The appeal will be allowed with costs.

Judgment accordingly.