1962
Jan. 22
Jan. 25

BETWEEN:

ISRAEL GRADER ..... APPELLANT;

AND

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

Revenue—Income—Income tax—Payment for surrender of lease—Whether income or capital receipt—Income Tax Act, R.S.C. 1952, c. 148, ss. 3 and 4.

The appellant in 1948 leased his theatre from January 1, 1949, at a yearly rental of $5,400 under a lease that provided that the lessee should operate it as a moving picture theatre for not less than nine months in each year. By an agreement entered into in June, 1953 the term was extended for five years from January 1, 1954 at a rental of $5,800 per annum with an option to renew for a further five years at a yearly rental of $6,000. The lessee failed to operate the theatre for the stipulated nine months in 1955, and in June, 1956, a new agreement between the parties provided *inter alia* that notwithstanding anything contained in the 1953 lease, the lessee upon the payment of a monthly rental of $600 commencing July 1, 1956, and payable to the end of the term, should be free to close the theatre and would be discharged of all obligations under the lease and that the lessor for the remainder of the term could make such use of the theatre as he saw fit. On September 1, 1956, the lessor leased the theatre to another tenant at a rental of $3,000 per annum subject to an option to purchase at any time during the term of the lease for $38,000. Four months later the tenant vacated the premises and in 1959 the appellant sold the property for $21,000.

In re-assessing the appellant the Minister added to his declared income for the year 1956 the sum of $3,600 and the sum of $7,200 to his declared income for each of the years 1957 and 1958. The taxpayer's appeal from the assessment to the Tax Appeal Board was dismissed. On an appeal from the Board's decision

Held: That the appellant failed to establish that the closing of the theatre for longer than permitted or that the cancellation of the lease (assuming it took place), caused the property to depreciate and the appellant to suffer a loss when he came to dispose of it.

2. That the thirty monthly instalments of $600 each paid the appellant should be regarded as rental received, or payments in lieu of rental, or in the nature of casual profit derived from a property, and constituted income rather than amounts received on capital account. *Minister of National Revenue v. Farb Investments Ltd.* [1958] Ex. C.R. 113 at 119 followed. *Van Den Bergh Ltd. v. Clark* [1935] A.C. 431 and *Sabine (H.M. Inspector of Taxes) v. Lookers Ltd.* (1958) 38 T.C. 120 distinguished.

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

The appeal was heard before the Honourable Mr. Justice Kearney at Toronto.

[1] (1961) 26 Tax A.B.C. 150; 15 D.T.C. 157.

W. D. Goodman for appellant.

G. W. Ainslie for respondent.

KEARNEY J. now (January 25, 1962) delivered the following judgment:

This case concerns an appeal from a decision of the Tax Appeal Board[1] delivered on March 3, 1961 which affirmed three assessments levied by the respondent in respect of the appellant's income tax for the taxation years 1956, 1957 and 1958.

The parties admit the accuracy of the following particulars concerning the said assessments: By two assessments dated July 16, 1958 the respondent reassessed the appellant by adding $3,600 to his declared income for the taxation year 1956 and by adding $7,200 to his declared income for the taxation year 1957 and by assessment dated August 10, 1959 by adding a like amount of $7,200 to his declared income for the taxation year 1958. The appellant duly objected to the said reassessments but the respondent on reconsideration affirmed them and so advised the appellant by notice dated the 20th day of November 1959.

The said amounts of $3,600, $7,200 and $7,200, totalling $18,000, were received by the appellant in the years 1956, 1957 and 1958 respectively from United Century Theatres Limited (hereinafter referred to as "United Century") pursuant to an agreement dated June 26, 1956, and here the parties part company.

Briefly, it is claimed for the appellant that in the particular circumstances the sums in question were payments on account of capital and not taxable, and for the respondent it is said they were receipts on revenue account and taxable accordingly.

The main facts of the case are as follows. The appellant until 1958 was the owner of two-storey premises situated on the south side of King street in the city of Welland, Ontario, consisting of a moving picture theatre, with equipment, on the ground floor and two apartments on the upper floor. By indenture dated November 25, 1948 filed as Exhibit 1, the appellant leased to United Century the theatre portion of the said premises, together with the apartment, fixtures and other equipment, for use as a moving picture theatre, at a rental of $5,400 per annum payable

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$450 in advance on the first day of January 1949 and a like payment in each succeeding month. In view of subsequent events, it is important to note that the aforementioned indenture contained the following provision:

> The lessee covenants and agrees that it will operate such demised premises as a moving picture theatre for not less than nine months in each calendar year.

By indenture dated December 21, 1953, filed as Exhibit 2, the parties extended the term of the above-mentioned lease for an additional period of five years commencing January 1, 1954 and terminating on the 31st of December 1958, at a rental of $5,800 per annum payable in equal monthly instalments in advance. The last-mentioned lease also gave to United Century the option to renew the said lease for a further period of five years at a rental of $6,000 per annum payable by monthly instalments in advance, and provided that all the other terms and conditions of Exhibit 1 shall remain in full force and effect.

While Exhibit 2 had still two years and a half to run, the parties entered into a new indenture dated June 26, 1956, filed as Exhibit 4. This last-mentioned indenture, although it covers less than two pages, is important because it gave rise to the assessments in dispute and I think it should be set out at length:

> Whereas by a certain lease dated the 21st day of December 1953 (hereinafter called the Lease) made between the parties hereto the Lessor demised and leased the premises known as The Community Theatre in the City of Welland in the County of Welland to the Lessee for a term expiring on the 31st day of December 1958, subject to the rent therein reserved and to observance and performance of the covenants and agreements therein contained, all as therein more particularly set forth.
>
> And Whereas under the said Lease it was provided, *inter alia*, that the Lessee would operate the said Community Theatre for at least eleven months in every year.*
>
> And Whereas the Lessee wishes to close the said theatre and the parties hereto have agreed to enter into these presents.
>
> Now Therefore This Indenture Witnesseth that in consideration of the premises and of the agreements herein contained and of other good and valuable consideration the parties hereto mutually covenant and agree as follows:
>
> 1. The Lessor agrees with the Lessee that, notwithstanding anything contained in the hereinbefore in part recited Lease, the Lessee shall be at liberty to close the said Community Theatre and to cease operating the same as a theatre.
>
> *Although unable to explain how the error occurred, the parties agree that the word "eleven" should read "nine".

2. The Lessee agrees with the Lessor that, commencing on the first day of July, 1956, and for the balance of the term of the said lease, the Lessee shall pay to the Lessor a rental of $600 per month in advance on the first day of each month, instead of the present rental set out in the said Lease.

3. It is expressly understood and agreed that, except as to the payment of the increased rental mentioned in the next preceding paragraph 2 hereof, the Lessee shall be relieved and discharged of and from the observance and performance by it of all the terms, covenants, conditions and agreements set forth in the said Lease, including without limiting the generality of the foregoing the obligation to operate the theatre, to repair, to supply heat and to pay insurance premiums or any other sums payable under the said Lease.

4. It is further understood and agreed that, during the remainder of the term of the said Lease, the Lessor may make such use of the said premises as he may deem fit.

5. It is further understood and agreed that all equipment and fixtures and all other contents of the premises now become the property of the Lessor; and that the Lessor may without limiting the generality of Paragraph 4 occupy the premises or rent the premises from the 1st of July, 1956, during the remainder of the said term and that the Lessee shall not thereby be relieved of its obligation to pay the rental hereinbefore stated, and further that the Lessee shall not disturb the possession of the Lessor or anyone claiming under him.

6. This indenture shall extend to and enure to the benefit of the parties hereto and their respective heirs, executors, administrators, successors and assigns.

In Witness Whereof the Lessor has hereunto set his hand and seal and the Lessee has hereunto affixed its corporate seal under the hands of its proper officers duly authorized in that behalf.

Two witnesses, the appellant and Francis P. Sorrentino, were called on behalf of the appellant; no evidence was adduced on behalf of the respondent.

The appellant, in addition to producing the above exhibits, testified that he derives his income from different businesses, Grakor Specialty, an auto parts business, and Selbest Specialty, dispensers of pet food. Apart from the income he derives from the property leased to United Century he also derives income from two stores in Welland as well as from a one-third interest which he has in an apartment house in Toronto.

The appellant stated that in 1955 United Century failed to keep the theatre open for nine months as provided in Exhibit 1. He also expressed the view that because United

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Century owned two other moving picture theatres in Welland, in order not to draw away patronage from these other two theatres, it did not put forward its best efforts with respect to the operation of his theatre.

Subsequently the appellant had discussions with a Mr. Taylor, representing United Century, who, according to the witness, tried to induce Mr. Grader to not insist on the non-closing clause. The witness also stated that if a sum of money were paid for cancellation of the lease he would be disposed to sell the property at a lesser price than otherwise would be the case.

He listed the leased property for sale at an asking price of $55,000 to $57,000, but the best offer made was $30,000, which he received through Mr. Francis P. Sorrentino, real estate broker.

As was his privilege so to do, by indenture dated August 8, 1956 the appellant leased the theatre to Ralph Biamonte of the city of Niagara Falls for a period of one year commencing September 1, 1956 at a rental of $3,000 per annum payable in monthly instalments of $250 each. This indenture does not contain any clause requiring the lessee to maintain the theatre open for any specified period and it contained an option in favour of the lessee to purchase the theatre building and land for $38,000 at any time during the term of the lease, the whole as appears by reference to Exhibit 5.

The witness stated originally that Mr. Biamonte failed to continue to pay the rent after three months, though he continued to operate the theatre for a further month, but could not make a go of it and vacated the premises. Upon being recalled at my instance in order to clear up some ambiguity in his testimony, the witness stated that Mr. Biamonte was unable to procure suitable pictures for the theatre and that after endeavouring to operate it from four to six months he gave up the venture. The witness did not testify as to what was done with the theatre after Mr. Biamonte had vacated it, beyond stating that the property was finally sold for $21,000 in 1958.

Mr. Sorrentino stated that he had been engaged in the sale of commercial real estate in Welland since 1946 and that he knew market values in that city. Although he was unable to secure a better offer than $30,000 for the property, he gave it as his opinion that if it were operating and

repaired it should fetch $55,000. He added that it was located on a secondary street, that B-class pictures had been shown in the theatre and he had observed that during performances the theatre was usually half to three quarters empty. On cross-examination the witness admitted that he had no experience in connection with the sale of theatres and had no financial interest in any theatre companies. He agreed, however, that in connection with theatres goodwill is the most important thing and that he had never attempted to appraise the goodwill of the appellant's theatre. On re-examination he stated that he thought the effect of having allowed the theatre to be closed was detrimental.

In support of the submission that the receipt by the appellant of the $18,000 referred to in paragraph 2 of Exhibit 4 constituted a payment on account of capital his counsel made the following submissions:

(1) That a careful reading of the agreement of June 26, 1956, Exhibit 4, reveals that the sum of money stipulated in the agreement was not paid as rent, notwithstanding the terminology used, but as compensation for the cancellation of the lease.

(2) That it was compensation for a capital loss which it was anticipated that Mr. Grader would suffer when he came to resell the property, by reason of the fact that the theatre was closed.

(3) That Mr. Grader held the leased property as an investment for the purpose of receiving rental income and this theatre did not form part of any business which he carried on.

(4) That in these circumstances the sum which he received was a capital receipt, being compensation for the capital loss which he was expected to suffer and which he did in fact suffer.

It was submitted by counsel for the respondent that the agreement of January 26, 1956 did not operate as an express surrender to the landlord of the term vested in the tenant under the demise and that the amount received thereunder

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by the appellant could not be regarded as anything but rent; and alternatively, that, even if it were found that such surrender occurred, the received amounts in question were casual profits from a property and income from a business within the meaning of ss. 3 and 4 of the Act.

Because of the conclusion which I have reached on the assumption that a complete and effective surrender of the property had occurred, I do not think it necessary to inquire into or to deal with the submission that no complete surrender had occurred.

Usually, to determine whether a receipt of money falls within a category of income or capital is by no means an easy task and often much depends on the particular circumstances of each case.

In Exhibit 4 the monthly payments of $600 are variously specified as "rental" instead of "present rental" and as "increased rental", and since it bears the signature of the appellant, I think, in the circumstances, it falls in the category of evidence against the signatory's own interest. In addition, it is incumbent on the suppliant to show conclusively that on the facts the assessment in question is unjustified.

Although it is lacking in precision, I consider the appellant's evidence established that during the year 1955 the leased theatre did not remain open for the full nine months as required by Exhibit 4. I do not think, however, that it has been established that the fact that the theatre remained closed longer than permitted, or the cancellation of the lease (assuming that it took place) caused the appellant to suffer a loss when he came to dispose of it.

In my opinion no satisfactory proof was made of the market value of the theatre prior to and following the closing complained of. The so-called expert evidence given by Mr. Sorrentino was unconvincing because of his limited efforts and qualifications. He made no attempt to ascertain what the trend was in respect to the saleability of moving picture theatres and whether or not the appellant's experience of not being able to secure a satisfactory price for his theatre was not the common experience of others in the same line of business and attributable to other causes, such as the increasing adverse effect of television and other entertainment media on the picture house industry. The fact that the

appellant was offered $30,000 for the theatre in 1956 but that two years later the best price he could obtain was $21,000 is, I think, some indication of a downward trend in the value of moving picture houses.

Furthermore, the evidence shows the leased theatre remained open during four to six months while it was being operated by Mr. Biamonte, but it failed to attract audiences and Mr. Biamonte could not make enough money to pay his rent; and as evidenced by the Biamonte lease, the appellant, within a matter of months, had reduced the asking price for his property from $55,000 to $38,000.

Mr. Sorrentino testified that what the leased premises lacked was packed houses; yet, no proof was made that other picture houses were not suffering from the same complaint.

I cannot accept the submission of counsel for the appellant that it was sufficient for the appellant to allege or consider that the depressed value of his property was due to the failure of United Century to keep the theatre open in 1955 as was their duty.

Turning again to the evidence of Mr. Grader, I was unfavourably impressed by his otherwise unsupported statement to the effect that he considered the United Century had deliberately kept down the attendance at the leased premises in order to attract greater audiences to the two other moving picture houses owned by that company, particularly when it is in evidence that the United Century had occupied the leased premises for seven or eight years and there is no evidence that any similar complaint was ever made during that period.

I am disposed to the view that regardless of whether the United Century had continued to occupy the leased premises it would not have enabled the appellant to procure a higher price for his property when he sold it in 1958.

Counsel for the appellant referred to *Van Den Bergh Ltd. v. Clark*[1] wherein an English company and a Dutch company which were trading rivals in the manufacture of margarine entered into an agreement to share profits and losses in the proportion which on an average of five years the profits of the rival tradings in margarine bore to each other. Years later disputes arose and the Dutch company paid the

[1] [1935] A.C. 431.

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English company a sum of £450,000 as damages, but the parties did not specify the cause of action in which the damages were paid and it was held that this sum was in the nature of a capital asset and not an income receipt.

Counsel for the appellant also referred to *Sabine (H.M. Inspector of Taxes) v. Lookers Ltd.*[1] wherein it was held that the compensation paid for the variation in the continuity clause of an agreement, which weakened the whole of the profit-making structure of the company suffering such variation was a capital receipt.

The transactions in the above-mentioned cases were extraordinary commercial contracts and the relationship and responsibilities of the parties were, I think, far removed from those arising, as in the present instance, from an ordinary contract of lease and hire of property.

No two cases are exactly alike, but I think a marked similarity exists between the facts in the present case and those which arose in *Minister of National Revenue v. Farb Investments*[2], notwithstanding that in the *Farb* case, instead of a single lease, a lease and a sub-lease were involved. I am also of the opinion that the reasoning set out in the dictum of Cameron J. which is reported at page 119 is apposite in the present case; it reads:

> I may add, however, that quite apart from the above considerations, I would have been inclined to the view that the sum received was not a capital receipt. The question to be decided is not whether in some senses or in some contexts such payment might be called a "capital payment", but whether within the meaning of ss. 3 and 4 of The Income Tax Act, it is the profit arising from the business or property of the respondent. It is not necessary to reach any final conclusion on the matter, but I would point out that the cancellation of the old lease and the giving of a new lease to Imperial Oil in no sense affected the profit-making apparatus of the respondent and its capital structure remained precisely the same as it had previously been.

I think, taking into account all the circumstances of the case and the evidence before me, that the thirty monthly instalments of $600 each paid to the appellant should be regarded in his hands as rental received, or payments in lieu of rental, or in the nature of casual profit derived from a property, and constituted income rather than amounts received on capital account.

[1] (1958) 38 T.C. 120.

[2] [1959] Ex. C.R. 113.

For the above reasons the appeal must be dismissed. The respondent will be entitled to his costs.

Judgment accordingly.

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