1958
Sept. 23
1959
Apr. 2

BETWEEN:

JAMES VOORHEES DRUMHELLER ....APPELLANT;

AND

MINISTER OF NATIONAL REVENUE ..RESPONDENT.

Revenue—Income—Income Tax—Payment to petroleum engineer for aid in obtaining gas franchise—Capital or income—The Income Tax Act, S. of C. 1948, c. 52, ss. 3, 4, 5, 127 (1) (e) (l) (aa).

The appellant, a petroleum engineer, entered into a joint venture with one B for the purpose of obtaining a franchise to supply a town with natural gas. The arrangement between the parties was that after the franchise was obtained it would be transferred to a company and the appellant would receive a 25% interest therein and be appointed manager. The early stages of the negotiations were carried on by both the appellant and B but before they were completed the appellant found it necessary to find other employment and the franchise was issued to B who caused it to be transferred to a company formed for the purpose. The appellant subsequently sold his interest and all other rights to B for $10,000 and treated the payment as a capital receipt. The Minister assessed the payment as an income receipt and on an appeal to the Income Tax Appeal Board the assessment was confirmed. On an appeal from the Board's decision to this Court

Held: That the joint project in which the appellant and B engaged was a planned course of action which clearly falls within the meaning of the expression "an undertaking of any kind" as defined by s. 127(1)(*e*), now s. 139(1)(*e*), of *The Income Tax Act*.

2. That the sum received by the appellant in no sense represents a return of appreciation of capital invested in the joint project, the appellant's contribution being nothing but his personal efforts.

3. That what the appellant and B had in joint ownership at the time of the appellant's withdrawal represented, so far as the appellant was concerned, not invested capital but the product of the operation of the undertaking. This was profit from the undertaking and the sum which the appellant accepted as his share thereof was properly assessed as a revenue or income receipt.

APPEAL from a decision of the Income Tax Appeal Board.

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

T. J. Duckworth for appellant.

H. E. Manning, Q.C. and *T. E. Jackson* for respondent.

THURLOW J. now (April 2, 1959) delivered the following judgment:

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This is an appeal from the judgment of the Income Tax Appeal Board[1], dismissing an appeal by the appellant against an income tax assessment for the year 1951. The question to be determined is whether a sum of $10,000, which the appellant received in September, 1951, was an income or a capital receipt.

The sum in question arose in the following circumstances. The appellant is a petroleum engineer who from 1945 to 1948 had been engaged as an employee, first by the Standard Oil Company and later by the Gulf Oil Company. After the conclusion of the second of these employments, he was engaged on a fee basis in supervising drilling operations on behalf of oil companies which had no engineering or geological staffs of their own. The services offered by the appellant included arranging for a contractor to do the well drilling or advising thereon, attending at the site of the drilling operation and supervising the work in the interests of the owner, deciding when, in the course of drilling, tests should be made, arranging for such testing to be carried out, reporting the results to his client, and supervising the completion or abandonment of the operation. While the primary object of such operations was to discover oil, it was part of the appellant's duty to be on the lookout for indications of other substances, including natural gas, sulphur, and salt. Work of this kind was well paid but uncertain, and the appellant was anxious to turn to something more secure.

In the spring of 1949, an oil drilling operation in which the appellant had not participated on a property near the town of Stettler, Alberta, had resulted in the discovery of the presence of natural gas. The property belonged to a company in which a Mr. Brook was interested, and shortly after the discovery was made Mr. Brook and the appellant embarked on a scheme the object of which was to obtain a franchise for the supply of gas to the residents of the town of Stettler. For this purpose, it was necessary to obtain through testing an estimate of the quantity of gas available from the well in question and to locate, as well, other economical sources of supply. Upon establishing the existence of sufficient reserves, it was proposed to apply

[1] 17 Tax A.B.C. 60; 11 D.T.C. 212.

to the council of the town of Stettler for the franchise and, upon obtaining it, to transfer it to a company which would raise the necessary finances by debenture issues and proceed to construct and operate the distributing system. The appellant expected to be given the position as manager of such company. He also expected to have a 25 per cent interest in the franchise, if and when it was obtained, or in the company. Mr. Brook at the time was manager of an oil company and had had experience as a stock broker, and the arrangement between the appellant and him was that, in carrying out the project, each would do what he was qualified to do.

In furtherance of this scheme, the appellant arranged for a testing company to examine and test the well, and he himself spent most of his time for about a month during the summer of 1949 observing the conduct of the tests and taking what part he could. The tests indicated that the well was a good one. In the months that followed, Mr. Brook arranged for the drilling of wells on other properties, and ultimately the presence of sufficient reserves was established. In the spring of 1950, the application was made for the franchise, and after a plebiscite it was granted to Mr. Brook. In connection with the application for the franchise, the appellant attended meetings of the town council with Mr. Brook, and over the period from the time the scheme was originated until the franchise was granted they had numerous conferences with one another. The appellant, however, had nothing to do with the drilling or testing of the other wells, nor did he contribute to the expenses of engaging an expert who made a study of the project, prepared a report, and presented the application to the council. By the time the franchise was granted and the financing of the project arranged, the appellant had become involved in another business venture known as Redwater Servicing Company, by which he was employed as manager, and he was no longer interested in the position of manager of the gas distributing company. He discussed this with Mr. Brook, and it was then agreed that Mr. Brook should take over his interest in the project for $10,000. In September, 1951, the appellant, being in need of money to purchase or build a dwelling, applied to one of Mr. Brook's companies, he being away, for payment of the $10,000, and

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that sum was thereupon paid to him. Subsequently, in April, 1952, the appellant at the request of the company signed a document acknowledging receipt of the $10,000 from the company on behalf of Mr. Brook, as payment in full for all his rights and interest in the Stettler gas franchise.

The appellant maintains that the sum so received was capital, but the Minister takes the position that it was either a profit from a business or the salary, wages, or other remuneration from an office or employment and further that the onus is upon the appellant to establish that it was neither a profit from a business nor salary, wages, or other remuneration from an office or employment.

By s. 3 of *The Income Tax Act,* S. of C. 1948, c. 52, which was applicable to the year in question, the income of a taxpayer for a taxation year is declared to be his income for the year from all sources inside or outside Canada and to include income from all (*a*) businesses, (*b*) property, and (*c*) offices and employments. By s. 4 it is declared that, subject to the other provisions of Part I of the Act, income for a taxation year from a business or property is *the profit therefrom* for the year. The expression "business" is defined by s. 127(1)(*e*) [now s. 139(1)(*e*)] as including a profession, calling, trade, manufacture, or undertaking of any kind whatsoever, and as including an adventure or concern in the nature of trade but not including an office or employment.

By s. 5, income from an office or employment is declared to be the salary, wages, and other remuneration, including gratuities, received by the taxpayer in the year.

"Office" is defined as follows in s. 127(1)(*aa*) [now 139(1)(*ab*)]:

127. (1) In this Act,

* * *

(*aa*) "office" means the position of an individual entitling him to a fixed or ascertainable stipend or remuneration and includes a judicial office, the office of a Minister of the Crown, the office of a member of the Senate or House of Commons of Canada, a member of a legislative assembly, senator or member of a legislative or executive council and any other office, the incumbent of which is elected by popular vote or is elected or appointed in a representative capacity and also includes the position of a corporation director; and "officer" means a person holding such an office;

"Employment" is defined in s. 127(1)(*l*) [now 139(1)(*m*)]:

127. (1) In this Act,

* * *

(*l*) "employment" means the position of an individual in the service of some other person (including His Majesty or a foreign state or sovereign) and "servant" or "employee" means a person holding such a position;

In *Johnston* v. *Minister of National Revenue*[1] the onus of proof in cases of this kind is discussed by Rand J. as follows at p. 489:

Notwithstanding that it is spoken of in section 63(2) as an action ready for trial or hearing, the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant. If the taxpayer here intended to contest the fact that he supported his wife within the meaning of the Rules mentioned he should have raised that issue in his pleading, and the burden would have rested on him as on any appellant to show that the conclusion below was not warranted. For that purpose he might bring evidence before the Court notwithstanding that it had not been placed before the assessor or the Minister, but the onus was his to demolish the basic fact on which the taxation rested.

* * *

The allegations necessary to the appeal depend upon the construction of the statute and its application to the facts and the pleadings are to facilitate the determination of the issues. It must, of course, be assumed that the Crown, as is its duty, has fully disclosed to the taxpayer the precise findings of fact and rulings of law which have given rise to the controversy. But unless the Crown is to be placed in the position of a plaintiff or appellant, I cannot see how pleadings shift the burden from what it would be without them. Since the taxpayer in this case must establish something, it seems to me that that something is the existence of facts or law showing an error in relation to the taxation imposed on him.

In the present case, the taxation of the sum in question is based on alternative and mutually exclusive assumptions, and it becomes necessary to determine whether and to what extent they have been disproved. I shall deal first with the plea that the sum was salary, wages, or remuneration from an office or employment. In my opinion, it is obvious that this sum was neither salary nor wages and that it did not arise from an office as defined in the statute. The question is thus narrowed down at once to whether or not the sum was remuneration from an employment, as defined in s. 127(1)(*l*). On this issue, the appellant contends that

[1] [1948] S.C.R 486.

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the relationship between himself and Mr. Brook was a joint venture and not an employment, and on the evidence I am of the opinion that the appellant has made out his case. There are circumstances, such as the payment of expenses by Mr. Brook, the making of important decisions by him alone, and the appellant's lack of knowledge of details which one might expect a partner to know, which militate against the conclusion that the project was a joint venture, but I accept as credible the appellant's evidence that that was the relationship between them, and I think this view is supported by the size of the sum paid by Mr. Brook, having regard to the minor extent of the appellant's participation in the project. Accordingly, I find that the sum was not remuneration from an employment.

I turn now to the Minister's alternative plea that the sum was profit from a business. Business is defined by the statute in wide terms. It is not limited to trading or manufacturing but includes, as well, the carrying on of a profession or vocation. It also includes an undertaking of any kind and an adventure or concern in the nature of trade but not an office or employment. The expressions used in this definition are not mutually exclusive, nor are they all equally broad. Some overlap with others. In particular, the expression *an undertaking of any kind* appears to me to be wide enough by itself to embrace any undertaking of the kinds already mentioned in the definition; that is to say, trades, manufactures, professions, or callings, and any other conceivable kinds of enterprise as well.

In the present case, it is clear that what the appellant and Mr. Brook were doing when they embarked on their joint project was not engaging in a mere hobby or game but carrying out a deliberate and planned course of action with economic gain as its object. Whether or not this project can properly be classified either as a trade or as an adventure or concern in the nature of trade is, to my mind, quite immaterial for, in my opinion, it clearly falls within the meaning of the expression *an undertaking of any kind* and must accordingly be regarded as a business for the purposes of *The Income Tax Act*. It is, however, only *the profit therefrom* that is subjected to tax as income under the Act, and it does not follow that, because there was profit,

such profit was *ipso facto* profit from such business. An answer must accordingly be sought to the further question, was the $10,000 which the appellant received for his interest in this business a profit which accrued to him from the carrying on of the business, otherwise referred to as an income receipt, or was it a return with appreciation of his capital invested therein?

In *Ryall* v. *Hoare*[1] Rowlatt J. at p. 454 expressed this distinction as follows, in determining that a commission received in an isolated transaction by the director of a company for guaranteeing its overdraft was taxable under Case VI of Schedule D of the English *Income Tax Act* as an annual profit or gain:

> First, anything in the nature of capital accretion is excluded as being outside the scope and meaning of these Acts confirmed by the usage of a century. For this reason, a casual profit made on an isolated purchase and sale, unless merged with similar transactions in the carrying on of a trade or business is not liable to tax. "Profits or gains" in Case 6 refer to the interest or fruit as opposed to the principal or root of the tree.

In *Lowry* v. *Field*[2] several individuals had invested money in prospecting enterprises carried out by a company of which they were not shareholders. If the prospecting turned out satisfactorily, the company would exercise an option to purchase the property and a development company would be formed in which the company and the individuals would be allotted shares in proportion to their several investments in the enterprise. The individuals were assessed upon the difference between the amount of their subscriptions and the nominal value of the shares allotted to them. On the facts Lawrence J. held the profit on the subscriptions to be of a capital nature. After referring at p. 741 to *Cooper* v. *Stubbs*[3] and observing that in that case Atkin L. J. had "found an element of revenue in the profit which he was there considering largely from the fact that there was no investment of capital," Lawrence J. said at p. 741:

> . . . I am inclined to think that wherever there is an investment of money there must be a possibility of the profit upon that money recurring for it to be a revenue profit, and where, as here, the particular profit which it is sought to tax is not a profit which can recur, it is in such a case a profit of a capital nature. In my view that reasoning harmonises with the cases which have held that recurring profits where there is no investment of money may be of a revenue nature, *the conception being that the capital*

[1] [1923] 2 K.B. 447.
[2] [1936] 2 All E.R. 735.
[3] [1925] 2 K.B. 753.

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there involved is nothing more than the individual's efforts, and the individual's efforts always being capable of recurring, the profit which is so derived from the individual source is treated as being a casual profit which may fall under case VI. It seems to me to agree with the principle of the decision in *Cooper v. Stubbs* and with the observation of ATKIN, L. J., that there was no investment of capital at all.

Lowry v. *Field* is also authority for the view that the tax position is not necessarily the same for all parties to such a joint enterprise, for in that case the company's share in the profit from it was considered to be a revenue item. In this connection Lawrence J. observed at p. 736:

> There is no doubt that the Selection Trust, Ltd., carries on a trade in respect of those ventures and is taxable on the balance of its profits and gains in connection therewith.

The situation in the present case is in sharp contrast with that of the individual participants in *Lowry* v. *Field.* The sum received by the appellant in no sense represents a return or appreciation of capital invested in the joint project, for he had put no money or property into it. Nor did he or his associate have a franchise, when they embarked on their joint scheme. What they put into the project was almost entirely personal effort. Indeed, the appellant's contribution was nothing but his personal efforts, and his rights in the assets (which consisted principally of the franchise) gained in carrying out the venture represented his return for what those efforts, carried out as they were in conjunction with further efforts by Mr. Brook, had produced. Nor is it without significance on this question that each was to do what he was qualified to do and that, in arranging for and attending the testing of the well, the appellant was doing much the same sort of thing as he customarily did in carrying out his profession as an engineer. The arranging for testing of the well, the testing of it, and the supervision of the testing were all part of the procedure which it was necessary or desirable to carry out to attain the first objective of the project; that is, to acquire the franchise, which in itself was a thing of value. While the plan envisaged a further stage in which, in exchange for the franchise, the appellant and his associate would obtain shares in the proposed company, the project, so far as it was their personal project, was substantially that of putting forth the efforts necessary to obtain the franchise and promote the company. They had no scheme for operating or

even for acquiring a gas distributing system for themselves. Their personal venture would be completed when the company to be incorporated came into the picture and purchased what assets had in the meantime been acquired. Had the scheme proceeded to its conclusion as planned, I think it is clear on the authority of the judgment in the *Gold Coast Selection Trust, Ltd.* v. *Humphrey*[1] that the appellant would have been required to bring into the computation of his income from this undertaking the value of the shares issued to him. In the view I take of the case, what the appellant and his associate had in joint ownership at the time of the appellant's withdrawal from the project represented, at least so far as the appellant was concerned, not invested capital at all, but the product of the operation of the undertaking. This, in my opinion, was profit from the undertaking, and the appellant realized his share of it, not in the form of shares as originally planned, but in cash, when he accepted $10,000 for his interest therein. Accordingly, I am of the opinion that the sum in question was a revenue or income receipt rather than capital and that it was properly assessed.

The appeal therefore fails, and it will be dismissed with costs.

Judgment accordingly.