
1962
Nov. 27, 28
1963
Jun. 25

BETWEEN:

JACK BLUSTEIN .....APPELLANT;

AND

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

AND BETWEEN:

MURRAY BLUSTEIN .....APPELLANT;

AND

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

AND BETWEEN:

IRVING BLUSTEIN .....APPELLANT;

AND

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

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 85B(1), 139(1)(e)—Capital gain or income—Mortgages acquired at a discount or with a bonus—Whether profit realized upon maturity or prior sale—Profit from a business—Whether profit on resale of foreclosed property income from a business—Circumstances surrounding transactions negative characteristics of an investment—Appeals dismissed.

Appellants are three brothers who carried on a furniture business in partnership with their father. Prior to 1955 all had participated in investing money in mortgages which were purchased at a discount. After 1954 appellants continued the practice and in 1955 and 1956, on the recommendation of their solicitor, purchased 23 second mort-

gages and 2 first mortgages, some of which were purchased at a discount and some obtained as security for money advanced, in which case either a bonus was provided or a high rate of interest was demanded. Most of the mortgages were for very short terms and most of them involved a high degree of risk. It was only when no funds were available that they refused offers to buy mortgages. A separate partnership was formed by the three brothers in connection with their mortgage activities and registered in 1956. They did not advertise money to loan or solicit mortgages. Later in the same year they caused a corporation to be formed for the same purpose. Some of these mortgages matured, some were sold at a profit, and one was foreclosed upon and the property sold at a profit. Appellants in computing their income claimed such profits were capital gains from the realization of investments and they were deductible. The Minister disallowed the deductions and assessed the profits for income tax. An appeal to the Tax Appeal Board was dismissed and a further appeal was taken to this Court.

Held: That the appeals be dismissed.

2. That the discounts on the matured mortgages, the gain arising from the re-sale of mortgages, and the gain made on the sale of the foreclosed property were all income from a business within the meaning of sections 3 and 4 of the Act and taxable accordingly.

3. That the number of transactions, the second class nature of the mortgages and the short period of time within which the discounts were realized were indicative that the transactions in question were business ones.

4. That the appellants had engaged in the highly speculative business of purchasing mortgages at a discount in order to realize the maximum amount of profits out of the transactions. *M.N.R. v. MacInnes* [1963] S.C.R. 229 followed;

5. That the appellants did not carry out the various transactions for the purpose of receiving the interest from the mortgages but rather for the prospect of profit that would result when the discounts were realized.

6. That the appellants were engaged in a profit-making scheme or business, and the gains made by reselling mortgages and selling foreclosed upon property were just as much profits of this business as discounts realized when mortgages matured.

7. That the sale of the foreclosed upon property was an incidental remedy inherent in the business and the profit therefrom as much a profit as were the discounts realized.

8. That the fact that appellants did not seek out the mortgages or advertise they were in the market for them does not make the appellants investors in them and the circumstances under which all transactions were entered into by the appellants negative any *indicia* that normally characterize an investment.

APPEALS under the *Income Tax Act*.

The appeals were heard before the Honourable Mr. Justice Cattanach at Toronto.

W. D. Goodman for appellants.

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Donald Guthrie, Q.C. and *M. Barkin* for respondent.

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

CATTANACH J. now (June 25, 1963) delivered the following judgment:

These are appeals from judgments of the Tax Appeal Board[1] dismissing appeals by the appellants from assessments of income tax for the year 1956. As the same problem is involved in all three cases the appeals were heard together.

The three appellants are brothers who are partners with their father, Samuel Blustein, in a furniture and appliance business in the City of Toronto, Ontario known as Blustein's Furniture and have been so associated with their father for approximately twenty-five years.

Between the years 1949 to 1954 the four partners in Blustein's Furniture were in the practice of acquiring mortgages at a discount. The evidence of the witness, Jack Blustein was vague as to the number, total monetary amount and the nature and particulars of the mortgages acquired during this period which might be explained by the circumstance that the information was elicited in cross-examination. However, he did state that the amount of the mortgages purchased by Blustein's Furniture was between $30,000 and $40,000. The financial statement of Blustein's Furniture for the year 1956 contained an item "mortgages receivable—$86,784.09". The witness explained that the amount of $86,784.09 included two mortgages taken back on two buildings sold by Blustein's Furniture which were no longer required for the partnership business in the amounts of $45,000 and $6,000. Therefore, it follows that an approximate amount of $35,784 was receivable on outstanding mortgages in 1956. The witness stated that eight or nine mortgages were acquired in 1954.

At the end of the year, 1954, Samuel Blustein, the father, did not wish to participate any further in the acquisition of mortgages and the activities of Blustein's Furniture in this type of mortgage transactions ended.

Beginning on January 5, 1955 the appellants in partnership began to acquire mortgages on their own behalf as dis-

[1] (1961) 26 Tax A.B.C. 238, 240.

tinct from the partnership known as Blustein's Furniture consisting of themselves and their father.

Between January 5, 1955 and November 1956 the appellants acquired twenty-five mortgages, eleven during the year 1955 and fourteen during the year 1956.

Eighteen of the twenty-five mortgages were existing second mortgages purchased by the appellants at substantial discounts and each such mortgage had but a short time to run to maturity. In only one instance did the unexpired term extend to four years.

The seven other mortgages acquired by the appellants during the same period were taken as security for monies advanced in each instance except three with bonuses. Of the three mortgages on which bonuses were not obtained, one bore interest at the rate of 12 percent, the second was taken back on the sale of a property which had been foreclosed and the third was on a first mortgage bearing interest at the rate of 10 percent in which a half interest was owned by the appellants.

Twenty-three of the twenty-five mortgages held by the appellants were second mortgages and the other two were first mortgages. Fifteen bore interest at 6 percent, five bore interest at 6½ percent, two at 12 percent and one at 10 percent. Two mortgages purchased by the appellants at a discount in the latter part of 1956 were acquired on behalf of a joint stock company which the appellants had caused to be incorporated under the name of Gary Securities Ltd. and were transferred to this Company early in 1957 at cost.

The prevailing rate of interest on prime first mortgages of Toronto residential properties where the loan did not exceed 60 percent of the valuation of the property in the years 1954 to 1956 was 6½ percent.

The three appellants contributed the monies wherewith the mortgages were acquired in equal shares and any profits realized were also shared in equal proportions. The appellant, Jack Blustein, was the youngest of the three appellants and any decision to obtain any mortgage offered to them for purchase was left by the other two appellants to his sole discretion. The three brothers were comparatively young men actively engaged in their businesses with the exception of Murray Blustein who was in poor health.

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The manner in which the appellants came to purchase the mortgages may be described briefly. They did not go out looking for mortgages to purchase or upon which to advance funds, nor did they advertise in any public way their willingness to acquire such mortgages.

A solicitor, practising in Toronto, Mr. Sidney Roebuck, who had been a friend of the Blusteins, would telephone to say that mortgages were available at a discount. He would advise the appellants of the amount of the discount, the terms of the mortgage and would express the view that it was a relatively safe transaction. He would also advise the appellants of the amount of their cheque necessary to consummate the transaction. If the appellants had funds available they would invariably acquire the mortgages so offered relying exclusively on the recommendations of the solicitor. It was only when the appellants had no monies available that offers were refused. They made no investigation of the premises on their own initiative prior to acquiring a mortgage thereon.

In this the appellants followed the identical procedure and routine as had been followed by Blustein's Furniture between 1949 and 1955 so in effect they merely continued the pattern adopted when their father had also been a participant.

The greater number of the recommendations to the appellants to purchase mortgages as above described emanated from Mr. Sidney Roebuck, but in other instances they were advised of the availability of mortgages at a discount or bonus by another solicitor, Mr. Irving Aitkin, also a friend of the Blusteins and on one occasion by Mr. Arthur Zadlin, also a solicitor and a friend of the appellants' father.

The funds required to effect the purchases or loans were provided by the appellants by drawing on surplus funds available to them in Blustein's Furniture with the full concurrence of their father and recorded in the books of Blustein's Furniture as advances to the appellants. These advances by Blustein's Furniture were not in the nature of loans, but rather monies to which they were entitled as partners in Blustein's Furniture. However, Blustein's Furniture operated its business with a bank overdraft during the relevant period and the funds of the appellants consequent upon their mortgage transactions were available

to and in fact utilized by Blustein's Furniture on one occasion to discharge an outstanding account.

The total face value of the twenty-three mortgages held by the appellants was $94,207, the amount paid therefore was $62,500.47, so that the appellants stood to realize by way of discounts or bonuses an amount of $31,706.53 on maturity. From these figures I have excluded the amounts of the two mortgages acquired on behalf of Gary Securities Ltd. and transferred to that Company by the appellants in early 1957.

The nature of the securities held by the appellants is best illustrated by the testimony of Jack Blustein when in reply to a question concerning the risk involved in the mortgages, he answered, "Well, they must have been pretty poor. . . two or three of them turned out bad . . . we lost them."

Three of the mortgages were foreclosed. The appellants found that payments were usually late and resort was frequently had to legal proceedings or the threat thereof to assist in collection.

There was no set pattern followed by the mortgagees in paying the amounts due under the mortgages. In most instances payments were made to the solicitors' offices and were then forwarded to the appellants by them and in other instances payments were made directly to the appellants.

On November 21, 1956 the three appellants signed and filed a Declaration of Partnership in the Registry office for the County of York reciting that they had carried on and intended to carry on trade and business as mortgage brokers at 531 Queen Street, Toronto, Ontario, in partnership under the name of Gary Mortgage Company and that the said partnership had subsisted since October 2, 1956. The address, 531 Queen Street, is that of one of the retail stores of Blustein's Furniture. Of the twenty-five mortgages acquired by the appellants between January 5, 1955 and November 26, 1956 seventeen were acquired prior to October 2, 1956 and eight subsequent to that date.

The appellant, Jack Blustein, in giving evidence stated that the Declaration of Partnership was completed and filed merely as a convenient method of segregating the mortgages acquired by the appellants and those held by Blustein's Fur-

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niture and to facilitate the establishment of a separate bank account in which all receipts from mortgages held by the appellants were deposited.

The only partnership records maintained by Gary Mortgage Company was a mortgage ledger in which was recorded the particulars of the mortgages held by the appellants and entries of payments received, all of which were personally made by the appellant Jack Blustein. This mortgage ledger also contained identical information with respect to mortgages held by Blustein's Furniture.

Late in 1956 the appellants caused to be incorporated a joint stock company under the name of Gary Securities Limited for the purpose of conducting any further mortgage transactions of the nature described above through this particular corporate entity. The last two of the twenty-five mortgages acquired by the appellants in late 1956 were acquired on behalf of the Company while the incorporation thereof was pending and they were transferred to the Company at their cost to the appellants in early 1957 immediately following its incorporation.

During the appellants' 1956 taxation year, two mortgages acquired by the appellants at discounts matured, the face values thereof being $2,950 and $1,500 for which they had paid $2,250 and $955, thereby realizing profits of $700 and $545 respectively, being a total profit of $1,245, which was allocated to the appellants in equal amounts of $415.

On December 5, 1956 and on December 3, 1956 the appellants sold two mortgages which had been purchased on November 22, 1956 and November 26, 1956 for $4,920 and $1,950 at prices of $5,450 and $2,400 thereby realizing profits thereon of $530 and $450 respectively, being a total profit of $980 which was allocated to the appellants as follows, Jack Blustein, $326.67, Irving Blustein, $326.67 and Murray Blustein, $326.66.

In the 1956 taxation year a second mortgage held by the appellants on a property in the City of Toronto municipally described as 45 Maybourne Avenue, fell into default. Foreclosure action was instituted and a final order received in May 1956 following which the property was sold for $10,600. The profit on the sale amounted to $4,433.82 after deducting costs of $6,166.18 comprised of the advance of $2,200 on the second mortgage which was foreclosed, less $385 prin-

cipal payments received at the date of foreclosure, being unrecovered costs of $1,815, a $3,535 first mortgage assumed by the purchaser, $292.35 arrears of principal and interest on the first mortgage paid by the appellants and $523.83 legal costs of foreclosure.

After deducting a reserve for the profit elements in a second mortgage taken back by the appellants in accordance with section 85B(1) of the *Income Tax Act* an amount of $1,754.75 is arrived at as being the net income for taxation purposes. This amount is allocated among the appellants as follows, Jack Blustein, $584.92, Irving Blustein $584.91 and Murray Blustein $584.91, totalling $1,754.74.

The foregoing figures were agreed upon between counsel before trial and constitute a recalculation of the assessments of the appellants' income, the taxability of which is in dispute in these appeals.

The appellants in completing their 1956 income tax returns included the interest received upon mortgages held, but did not include the amounts realized from the two mortgage discounts, profit from the purchase and sale of two mortgages and the profit arising from the sale of the property acquired by foreclosure proceedings which in accordance with the recalculations outlined above are Jack Blustein $1,326.59, Irving Blustein $1,326.58 and Murray Blustein $1,326.57.

The Minister in assessing the appellants added the profits from these sources to the appellants' taxable income to which addition the appellants lodged a Notice of Objection alleging that the profits so received were realization of investments.

After reconsideration the Minister notified the appellants that the profits from the transactions in mortgages were properly taken into account in computing the appellants' income in accordance with the provisions of sections 3 and 4 of the *Income Tax Act* and that the profit from the sale of the property foreclosed upon was also properly included in computing the appellants' income in accordance with sections 3 and 4 and paragraphs (b) and (d) of subsection (1) of section 85B of the Act.

The issue in these appeals is thus a now familiar one, namely, whether the profits realized by the appellants from the transactions into which they had entered were capital

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accretions from investments as claimed, by them, and, therefore not subject to income tax on profits from a business or an adventure in the nature of trade, as found by the Minister, and, therefore, taxable income within the meaning of sections 3 and 4 and section 139(1)(*e*) of the *Income Tax Act*. R.S.C. 1952, c. 148.

Sections 3 and 4 above referred to read as follows:

3. The income of a taxpayer for a taxation year for the purpose of this Part is his income for the year from all sources inside or outside Canada and, without restricting the generality of the foregoing, includes income for the year from all

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

4. Subject to the other provisions of this Part, income for a taxation year from a business or property is the profit therefrom for the year.

Section 139(1)(*e*) defines business as follows:

(*e*) "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade but does not include an office or employment.

The distinction between profits that are subject to income tax and those that are not, together with the test to be applied in determining on which side of the dividing line they fall, was clearly stated in the classical case of *Californian Copper Syndicate (Limited and Reduced) v. Harris*[1] as follows:

It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realize it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realization, the gain they make is liable to be assessed for Income Tax.

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its

[1] (1904) 5 T.C. 159 at 165.

facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realizing a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?

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It is well settled that each case must be considered according to its facts. This principle has been stated by the Supreme Court of Canada in many decisions the citations of which are referred to by Thorson P. in *The Minister of National Revenue v. L. W. Spencer.*[1]

On the facts as above outlined herein, I have no hesitation in finding that the profits realized by the appellants were taxable income since I fail to see how the appellants' purchases of mortgages of the kind in question can be considered as investments. They were certainly not ordinary investments of the kind referred to in *Californian Copper Syndicate (Limited and Reduced) v. Harris (supra).* The mortgages were not the kind of securities that a prudent investor would consider. They were attractive to the appellants only because of the high rate of discount at which they could be purchased or the bonuses which were obtainable and the prospect of profit therefrom. All were second mortgages, except two. They were, therefore, very second class securities and highly speculative in nature. These conclusions follow irrebuttably from the evidence of the appellant, Jack Blustein, who admitted the mortgages were in fact a poor risk and that his prime concern was the amount of the discount when advised by the solicitors of their availability for purchase.

In my view the mortgages were purchased or obtained for the purposes of realizing the profits that would result from the discounts or bonuses within the short time the mortgages had to run to their maturity. The attraction to the appellants of these transactions was not the income receivable by way of interest on them, but rather the prospect of profit that would result when the discounts or bonuses were realized.

The appellants cannot avail themselves of an excuse similar to that put forward by the taxpayer in *Cohen v. Minister of National Revenue*[2] that they entered into short

[1] [1961] C.T.C. 109 at 125. [2] [1957] Ex. C.R. 236.

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term mortgages to keep themselves "as liquid as possible" or that it was desirable to do so because of advanced age as was the case of the taxpayer in *Minister of National Revenue v. MacInnes*.[1] In the present case all three appellants were young men and the purchase of short term mortgages is more indicative of a business operation than of an investment for it makes for a more rapid turnover and an increased opportunity for profit-making. I am confirmed in this conclusion by the fact that the appellants from November 21, 1956 (the date of filing of a Declaration of Partnership) maintained a separate bank account under the partnership name of Gary Mortgage Company in which deposits were made of all receipts from the mortgages held by them and with the funds in that account further mortgages were purchased.

In my view the statement in the formal declaration of partnership that the appellants had carried on trade or business as mortgage brokers is conclusive of the fact that such business subsisted since October 2, 1956. However, two of the categories of the transactions the consequences of which are now in issue arose prior to October 2, 1956, namely, the realization of a profit on the discount on the two mortgages acquired in 1955 and which matured in 1956 and the profit upon the sale of property subject to a second mortgage acquired in 1955 which was foreclosed during May 1956.

The only logical inference which can be drawn from the facts recited herein is that the partnership of the appellants subsisted in fact from January 5, 1955 and the declaration of partnership signed and filed by the appellants on November 21, 1956 is an *ex post facto* recognition thereof.

In Hannan and Farnsworth "The Principles of Income Taxation", it is stated on page 177, "The existence of a partnership implies the existence of a business, . . .". While such implication is not conclusive, since a partnership can exist to hold investments, nevertheless, the course of conduct of the appellants from 1949 to 1955 when the three appellants participated in identical transactions with their father as they did on their own behalf from 1955 onward indicates that the transactions were joint ventures for profit rather than joint investments.

[1] [1962] Ex. C.R. 385.

The third category of transaction in issue is the sale at a profit during the first week of December 1956 of two mortgages acquired in the last week of November 1956. These transactions were subsequent to the formal declaration of the appellants that they were engaged in the trade or business of mortgage brokers. In my opinion it is inconceivable and unrealistic to consider these sales at a profit as a realization of investments.

The fact that the appellants did not seek out the mortgages or advertise they were in the market for them, does not make the appellants investors in them. The mortgages were acquired by the appellants on the recommendations of certain solicitors in the manner described and the only times that mortgages so offered for purchase were refused was when the appellants did not have funds available. No investigation was made of the premises which were the subject of security by the appellants until after the mortgages had been acquired and were in default.

To me the circumstances under which all transactions were entered into by the appellants negative any *indicia* that normally characterize an investment.

On the contrary, in my opinion, the number of the transactions, the second class nature of the mortgages and the short period within which the discounts were realized, are indications that the transactions in question were business transactions. There is support for this opinion in *Noak v. Minister of National Revenue*[1] in which case Kerwin J. as he then was said at page 137:

> The number of transactions entered into by the appellant and, in some cases, the proximity of the purchase to the sale of the property indicates that she was carrying on a business and not merely realizing or changing investments.

While this was a decision on whether the appellant in that case was carrying on a "business" within the meaning of the term as used in the *Excess Profits Tax Act,* S. of C. 1940 c. 32, nevertheless the statement is applicable to the facts of the present case.

On the evidence I have no hesitation in finding that the appellants, in the language of Judson J. in delivering the unanimous judgment of the Supreme Court of Canada, in *Minister of National Revenue v. MacInnes*[2] reversing the

[1] [1953] 2 S.C.R. 136. [2] [1963] S.C.R. 229.

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decision of the Exchequer Court, "had engaged in the highly speculative business of purchasing mortgages at a discount and holding them to maturity in order to realize the maximum amount out of the transaction".

Counsel for the appellants particularly emphasized that the profit realized upon the sale of the property which the appellants were forced to foreclose upon was a capital profit and not assessable to income tax since the appellants had no history of trading in real estate and, therefore, the profit did not arise from the conduct of a business.

Since I have found that the present appellants were engaged in a scheme of profit-making, it follows that the sale of a property under the covenant in a mortgage thereon or the instigation of foreclosure proceedings are incidental remedies of that business and any profit arising therefrom is as much a profit in the business as holding the mortgage to maturity and realizing the discount thereon where no foreclosure proceedings were necessary. In highly speculative ventures such as the appellants engaged in, they must be taken to have contemplated that the monies might have to be realized by foreclosure and sale rather than by being collected at maturity.

I find, therefore, that the profits realized by the appellants are income from a business within the meaning of sections 3 and 4 of the Act and are taxable accordingly.

The Minister was, therefore, right in assessing the appellants as he did by adding to their taxable income the profits arising from the discounts on the mortgages, the gain arising from the sale of the foreclosed property and from the resale of two mortgages with the result that the appeals herein must be dismissed and the assessments referred back to the Minister to be adjusted in accordance with the recalculation thereof as outlined herein and as agreed upon by counsel. The figures were agreed upon well before trial so the only dispute was on the principles involved. The Minister is, therefore, entitled to costs to be taxed in the usual way.

Judgment accordingly.