

BETWEEN:

HELMUT WILLIAM BRUNO SCHRO-
DER and CHARLES GEOFFREY
VICKERS Executors of the Will of
EMMA CHRISTINE MARIA THEO-
DORE SCHRODER

APPELLANTS;

1952
Apr. 28 & 29
1955
Apr. 18
Sept. 12

AND

THE MINISTER OF NATIONAL
REVENUE

RESPONDENT.

Revenue—Succession duty—The Dominion Succession Duty Act, S. of C. 1940-41, c. 14, as amended, s. 2(e)—Death of a person domiciled outside of Canada—Fair market value at date of death of property situated in Canada—Debentures bearing no interest—Proper rate to be applied where face value of debentures to be discounted—Appeal from the Minister's assessment allowed.

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Baroness Schroder died testate on June 18, 1944, domiciled in England, and the Canadian assets of her estate consisted solely of \$1,500,000 face value, non-interest-bearing debentures of Winley Limited, a Canadian company, being 300 debentures of \$5,000 each, dated December 1, 1931, and all maturing on September 1, 1972. Because of the fact that the debentures bore no interest, the Minister valued them at \$531,165 being on a discount basis of 3.75 per cent. On an appeal from the assessment on the ground that the valuation was excessive appellants contended that the value is the fair market value of the debentures and asked for a discount rate of 4.25 per cent, or, on that basis, a valuation of \$445,000. On the evidence the Court found that there was no public market for the debentures nor was there any "special purchaser" thereof, including Winley Limited.

Held: That inasmuch as the debentures have not been listed on any stock exchange and there are no recent sales thereof or any "special purchaser", the proper approach to the problem is to ascertain the value of those securities which are most similar to the debentures in question and then make the proper allowances for the differences and, more particularly, for the "disabilities" which attached to the Winley debentures and which seriously affect their market value.

2. That on the whole of the evidence the Winley debentures at the date of death did not exceed in value the sum of \$445,000.
3. That here the evidence relating to the origin and history of Winley Limited from its inception was relevant and therefore admissible. In the absence of any stock exchange listing a prospective investor in the debentures would make the most thorough inquiries into the history of the company, its management, the nature of its investments, the rights of the shareholders, and the manner in which the affairs of the company had been managed. In that way only would he be able to obtain information as to what the debentures were worth and the prospects for the future. Here the same information should be available to the respondent in determining the value of the debentures and in making the assessment.

APPEAL under the Dominion Succession Duty Act, S. of C. 1940-41, c. 14 as amended.

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

Hugh O'Donnell, Q.C. and *Donald Myers* for appellants.

Guillaume Geoffrion, I. G. Ross and *A. L. DeWolf* for respondent.

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

CAMERON J. now (September 12, 1955) delivered the following judgment:—

This is an appeal from an assessment to succession duty on the ground that the property, the subject matter of the succession, has been excessively valued by the respondent.

The deceased, Baroness Schroder, died testate on June 18, 1944, domiciled in England, and the Canadian assets of her estate consisted solely of \$1,500,000 face value, non-interest-bearing debentures of Winley Limited, a Canadian company, being 300 debentures of \$5,000 each, dated December 1, 1931, and all maturing on September 1, 1972. Because of the fact that the said debentures bore no interest, the Minister placed a total value thereon of \$531,165, being on a discount basis of $3\frac{3}{4}$ per cent. It is admitted that that amount, if invested at the date of death (1944), would with accumulated interest compounded annually at $3\frac{3}{4}$ per cent, amount to \$1,489,004 on September 1, 1972, the maturity date of the debentures, an amount which is \$10,996 less than the face value of the debentures.

For the appellant it is contended that the value of the said debentures is the fair market value thereof; that such fair market value does not exceed \$445,000, which amount, if invested at $4\frac{1}{2}$ per cent, would with accumulating interest compounded annually amount to \$1,500,000 at the date of maturity of the debentures. It is in evidence that the Estate Duty Office, Inland Revenue Department of the United Kingdom, accepted a valuation of £100,000 (or \$445,000 at the then current rate of exchange) for the said debentures (Exhibit A-2). It is also shown that a similar valuation was accepted by the Succession Duty Department of the Province of Quebec in assessing the duties payable to that province on the said debentures (Exhibit A-3).

The appeal was originally heard by St. Pierre, Deputy Judge of this Court, but due to delays in extending some of the evidence, it was found impossible to complete the argument before his retirement. By consent of both parties, the matter came before me and I heard argument of counsel in Montreal on April 18, 1955.

“Dutiable value” is defined by section 2(e) of The Dominion Succession Duty Act, Statutes of Canada, 1940-41, chapter 14 as amended, and is as follows:

2. In this Act, and in any regulation made thereunder, unless the context otherwise requires,

- (e) “dutiable value” means, in the case of the death of a person domiciled in Canada, the fair market value, as at the date of death, of all property included in a succession to a successor less the allowance as authorized by section eight of this Act and less the value of real property situated outside of Canada, and means, in the case of the death of a person domiciled outside of Canada,

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the fair market value of property situated in Canada of the deceased included in a succession to a successor less the allowances as authorized by sections eight and nine of this Act;

The sole question for determination is the fair market value of the debentures. It is agreed that because of the fact that no interest is payable thereon, the fair market value is not the face value of the debentures and that the face value should therefore be discounted. The whole enquiry is directed to the problem of determining the proper rate to be applied in such discount.

It is necessary, I think, to set out in some detail the history of Winley Limited and the connection of the Schroder family therewith. The deceased was the widow of Baron Schroder who died in 1940 and they had three children, Marga, Helmut and Dorothea, all of the family being resident in England. Winley Limited was incorporated by Dominion charter in 1931 by or on behalf of the Schroder family. It was authorized to issue 240 Class A and 210 Class B shares at \$10 each, along with \$3,000,000 in non-interest-bearing debentures due September 1, 1972. The shares were issued to Marga (apparently on behalf of herself and her sister Dorothea) and to Helmut, or to their nominees. In 1933 Marga sold 140 Class B shares and Helmut sold 70 Class B shares to associated companies of Winley Limited, namely, Maculata Limited, Alta Limited, and Mithra Limited. At the death of the testatrix, all the shares of Winley Limited were beneficially owned by these three companies and the shares in the three companies were in turn held by separate trusts set up by Marga, Dorothea and Helmut for the benefit of their children; the trustee of these three trusts is "Trustee One-Forty-Five Limited" of London, England.

In 1919 and later, Baron Schroder made certain settlements of his funds, the benefit of which after his death would pass to his children. In 1932 Winley Limited purchased the then reversionary interest of the Schroder family settlement for \$60,000.00 face value of its debentures. These debentures were appointed to the three children of the deceased; they were redeemed at par by Winley Limited in 1938 under circumstances later to be mentioned and which satisfied the respondent's officers that the redemption at par had no direct bearing on the valuations now to be made.

In April, 1933, the funds of the family settlement were appointed as follows: one-third to Helmut and two-thirds to Marga (apparently to be held by Marga and Dorothea equally). In the same year Marga sold her two-thirds interest in the funds of the family settlement to Winley Limited, receiving \$1,400,000.00 of its debentures, and Helmut sold his interest therein to Winley Limited for \$700,000.00 of its debentures.

Later, in the same year, Marga sold to Alta Limited \$720,000.00 Winley debentures and 70 B shares of Winley Limited in consideration of Alta paying \$100.00 and assuming certain potential debts and possible indemnity obligations of Marga and in consideration of Alta Limited granting to Helmut an option to purchase the \$720,000.00 Winley debentures for \$100.00 and assuming the above obligations. Marga also sold like amounts of debentures and stocks to Maculata Limited for the same consideration, except that the option to re-purchase was in favour of Dorothea. Likewise, Helmut sold to Mithra Limited like amounts of debentures and stocks for the same consideration except that the option to repurchase was in favour of Marga.

Until 1938 all of the debentures so issued were held by Alta Limited, Maculata Limited and Mithra Limited. In that year Marga exercised her option on \$520,000.00 of Winley debentures held by Mithra Limited and directed that \$500,000.00 of the debentures be delivered to her mother, the deceased, and in consideration of Winley Limited redeeming at par \$20,000.00 of its debentures, Marga agreed to release Mithra Limited from her option on the remaining \$200,000.00 of Winley debentures. At the same time Dorothea and Helmut exercised their options upon similar terms and conditions. It was said that these gifts to the deceased of \$1,500,000.00 of Winley debentures by her three children were intended to make provision for her inasmuch as she was otherwise poorly endowed.

While Winley Limited purchased the reversionary interest of the three children in 1933, the distribution of the funds of the family settlement did not take place until 1936. That particular interest, in respect of which \$2,100,000.00 in debentures was issued, was valued by Winley Limited at \$1,537,500.00. The total discount on the debentures so

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issued was therefore \$562,500.00, of which amount \$401,800.00 represented the discount on the debentures owned by the deceased at her death, or a value of approximately \$73.00 per \$100.00 face value of the debentures which, as they were to mature in 1972, gave a yield-to-maturity rate of approximately 1 per cent. In 1936 the funds of the Schroder Family Trust were distributed and Winley Limited substituted cash and investments for its interest therein at a valuation which reduced the original discount of \$562,500.00 to \$26,007.02.

At the time of her death the testatrix was not a shareholder of Winley Limited, her only interest therein being that of a creditor to the extent of the value of her debenture holdings and there is no evidence which establishes that she ever had any other interest. At that time the total debentures outstanding had a par value of \$2,100,000.00.

The valuation of these debentures presents difficulties not usually found in assessing values of securities. Of special importance is the fact that no interest was payable thereon and that they would not mature until twenty-eight years after the death of the testatrix. They constituted only a floating charge on the assets of the company which had full power to deal with the assets as it deemed fit in the ordinary course of its business. The company of its own volition could pay them off in whole or in part at any time upon one month's notice. They became payable upon a court order or a company resolution for winding up, or if execution issued against the company's property or a receiver were appointed. Certain special powers were conferred on the holders of a majority of the issued debentures such as to sanction any modification or compromise of the rights of the debenture holders, including the extension of time for payment beyond 1972, and to accept securities other than the debentures themselves; such a majority also had power to appoint a receiver if the debentures remained unpaid at maturity.

The debentures are not listed on any security exchange and are so unusual in their terms that not one of the witnesses who gave evidence was able to say that he had at any time been called upon to value a security of similar nature. All were in agreement, however, that in accordance with the provisions of the Succession Duty Act, it was their duty to

endeavour to ascertain the fair market value as at the date of the death. They were also in general agreement that the proper approach was to endeavour to arrive at a value at the date of death which, with interest at a proper rate, would, when accumulated to maturity, total the sum of \$1,500,000.00.

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The assets of Winley Limited are, of course, of great importance in determining the value of its debentures. As of December 31, 1943—the year prior to the date of the deceased’s death—the assets had an estimated value in Canadian dollars as follows:

Cash in banks and in transit	\$ 786,110.10
Investments	
Quoted securities at market value	571,912.00
Other securities at current value as estimated by the financial advisers	1,113,236.00
Interest under Trust Deed dated August 26, 1932, at cost	60,000.00
Discount on debentures	20,950.08
	\$ 2,552,208.18

The balance sheet showed that after due allowance of a small amount for debts, for the balance of income tax, and for the outstanding debentures and capital stock, there was a capital surplus of \$202,944.14 and an earned surplus of \$240,083.50. The total income for the year was \$34,903.35 and after allowance for cost of administration and for income taxes in the United Kingdom, the United States and in Canada, there was a net profit for the year of \$14,781.27.

The quoted securities consisted mainly of foreign bonds and shares having a market value substantially less than their book value. “Other investments” consisted mainly of 5,714 shares in J. Henry Schroder Banking Corporation of New York, having a book value of \$674,026.55 and an estimated current value of \$1,099,945.00. The cash in bank was very substantial, consisting in the main of deposits in J. Henry Schroder & Co., London, of approximately \$770,000.00, a substantial part of which was in blocked sterling.

The first witness for the appellant was Gordon S. Small of Montreal, for many years a partner in the well-known firm of chartered accountants, Messrs. Riddle, Stead, Graham and Hutchison. Since 1935 he has been a director and

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vice-president of Winley Limited; he is a director of several industrial companies and many private investment companies, having specialized in investment company administration. In analyzing the assets of Winley Limited, he pointed out that the largest holding was that in the J. Henry Schroder Banking Corporation of New York and that these shares are closely held and are not listed or traded on any market. He placed a value thereon of \$192.00 per share for 1943 and 1944 and that valuation was accepted as accurate by the respondent. He stated that certain of the other assets consisted of Sterling securities and sterling cash which in the hands of any one outside the sterling area were blocked under the rulings of the United Kingdom Foreign Exchange Control Board. For that reason he valued them at \$3.38 to the pound instead of at the official or fixed rate of exchange of \$4.43 to the pound at that time. Taking into account the reduced value of the blocked sterling securities and cash, he valued the assets as of December 31, 1943, at \$2,232,345.42 (instead of \$2,526,577.56), and at December 31, 1944, at \$2,331,612.38 (instead of \$2,655,656.49).

He was of the opinion that to an investor these debentures would be unattractive when compared with those of an ordinary investment company. In the latter, the debentures are usually secured by assets valued at $2\frac{1}{2}$ to 3 times the par value of the debentures, whereas on his valuation the outstanding debentures of Winley Limited (\$2,100,000.00) had a coverage of only 106 per cent. The main asset—the shares in J. Henry Schroder Banking Corporation—were not readily marketable, paid no interest, and represented about one-half of the total assets. There was inadequate diversification. The bonds and stocks held would be unattractive and unfamiliar to an investor as they consisted of “tag ends of German, Chinese and South American bonds”. There was no ready market for the debentures themselves and the purchaser could not readily dispose of them, but would have his funds frozen for a period of twenty-eight years and receive no interest in the meantime. He would have no control over the operation of Winley Limited which could at any time declare dividends to its shareholders of its entire income, thus prejudicing seriously the possibility that the debentures would be paid in full at maturity.

Mr. Small compiled a list of Canadian investment company debenture yields as of May—June, 1944 (Exhibit A-9), which, while not truly comparable to Winley securities, were as nearly comparable as could be found. All were interest-bearing, readily marketable, well managed and secured by well diversified portfolios. In each case, the company assets were valued at two or three times the face value of the debenture issue. On the average, these debentures had $12\frac{1}{2}$ years to run and at the quoted prices the average yield-to-maturity rate was 5.13 per cent. and the average issue rate was $4\frac{1}{2}$ per cent. He pointed out that consideration should be given to the fact that the longer the period to maturity, the higher would be the yield-to-maturity rate, a factor in this case where the debentures had 28 years to run. After mentioning the disadvantages and risks regarding the Winley debentures which I have set out, he reached the conclusion that a possible purchaser would expect a substantially higher return than could be obtained from the listed Canadian investment companies. In his opinion the Winley debentures should be discounted at a rate of not less than $5\frac{1}{2}$ per cent. He characterized the rate of $3\frac{3}{4}$ per cent. fixed by the respondent as altogether too low. On his estimate of a discount rate of $5\frac{1}{2}$ per cent., the present value of the debentures owned by the deceased at the time of her death was \$331,315.60.

The next witness for the appellant was William Collier, president of a firm of investment dealers in Montreal and a partner in a brokerage firm having seats on various exchanges. He is a past president of the Investment Dealers Association of Canada and a governor of the Investment Bankers Association of America for many years. He was a governor of the Montreal Stock Exchange for two years. From 1910 to 1919 he was connected with the Royal Trust Company as manager of its investment department, and from 1919 to 1931 was with Wood, Gundy & Company. While with the latter firm he valued all securities of the insurance companies of Canada for the Dominion Department of Insurance. During the late war he was with the National War Finance Committee, arranging the financing of victory loans and the sale of securities for institutions and large investors throughout Canada. Throughout his

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entire business life he has been closely connected with dealings with securities, underwritings, issuings and buying, selling and valuing securities.

Mr. Collier examined the annual statements of Winley Limited for 1943 and 1944 and of the Schroder Banking Corporation of New York. He found very little equity behind the debentures—only about 120 per cent.—without taking into consideration the effect of the blocked sterling assets—a coverage far too low, in his opinion, for any debenture to sell in Canada. He agreed with Mr. Small that the coverage should be between 200 and 300 per cent. He was of the opinion, also, that the profits shown were too low to pay interest on the debentures had they been interest-bearing. He thought that the provision whereby the debentures could be paid off at par at any time by the company was not a factor of any importance to a purchaser as the company would be very unwilling to exercise that power which would deprive it of a large amount of capital on which it paid no interest. He was of the opinion that a purchaser of the debentures would have no assurance that they would be paid at maturity and that to compensate him for all risks involved, he would buy them only at a very substantial discount. He did not think they could be sold readily at any price and for that reason it was difficult to accurately assess their value. He found that three well-known Canadian investment corporation bonds were then selling at a price to yield an average return to date of maturity of $5\frac{1}{4}$ per cent. The average return on the higher grade interest-bearing and readily marketable corporation bonds such as those of Shawinigan Power Company was 4 per cent. Taking everything into consideration, he was of the opinion that the discount rate should be 5 per cent., a rate which gave a value to the deceased's debentures at the date of her death of \$382,635.00. Mr. Collier was not cross-examined.

The last witness for the appellant was John Pemberton, the Associate Treasurer of the Sun Life Assurance Company of Montreal, with which company he became associated in 1927 after graduation from McGill University. At first he was with the Investment Department, of which he became supervisor; he was appointed Assistant Treasurer in 1945 and Associate Treasurer in 1949. He was one of the four senior investment officers of the company responsible for the

administration of the company's entire investments of over two billion dollars and for twenty-five years has had wide experience in all phases of investment. He is also a director and officer of various other corporations.

In the main, his conclusions were the same as those of Mr. Small. After referring to the special characteristics of these debentures, he compared them with quotations of such other securities as seemed to resemble them and made adjustments for the differences. He stated that in June, 1944, moderate to good grade investment trust debentures were selling in Canada to yield between 5 and 6 per cent.

He considered that in estimating the value of a security, it is customary to take four principal matters into account. The first is the degree of equity behind the debentures. He found the coverage for the total value of the debentures to be 106 per cent. compared with a normal equity of 200 to 300 per cent. He thought that the shares of the J. Henry Schroder Banking Corporation were considerably over-valued at \$192.50 and should have been valued at a figure closer to their book value of \$152.00. The second important matter is the earnings of the company. He considered the earnings of Winley Limitel very low in relation to the earnings to be expected from an investment company of its size. One reason for the low earnings was the large amount of uninvested cash and another was the fact that the J. Henry Schroder Banking Corporation paid no dividends on its stock and its shares were therefore not earning assets. He found no reason to assume on the basis of past performance that one could look for increased earnings in the future to build up the amount required to pay the debentures at maturity.

The third point was the quality of the corporation's assets. He considered these of doubtful quality; a large amount was in blocked sterling; there was inadequate diversification. The last point is that of marketability. He considered the debentures quite unmarketable and that it would be difficult to find a buyer who would be willing to lock up his investment in the debentures for a period of twenty-eight years without interest. He also gave his opinion that the assets of Winley Limited were not readily marketable, particularly the share holdings in the J. Henry Schroder Banking Corporation. He would not have allowed

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his company to purchase the debentures at a discount of $3\frac{3}{4}$ per cent. He found it necessary to place the discount rate at a figure in excess of the yields from normal investment trust securities. His conclusion was that a conservative discount rate would be $5\frac{1}{2}$ per cent. in estimating the present value of the debentures, thereby agreeing with the rate set by Mr. Small. He had not seriously considered the possibility that Winley Limited itself might be a buyer of the debentures and could see no advantage in its doing so unless they could be purchased at a very, very substantial discount.

The first witness for the respondent was George Ovens, Chief Valuator in the Succession Duties Branch of the Department of National Revenue and the officer responsible for the assessment under appeal. He is a certified public accountant of Ontario; prior to the Second World War he had spent nine years with International Business Machines and one year with Dominion Worsteds and Woollens in industrial accounting. After war service with the Royal Canadian Air Force, he joined the Department of National Revenue as a junior valuator. With the exception of one year, he has been with the Department engaged exclusively in valuation of securities. The unit which he now heads values the securities of about two hundred companies each month. His opinion was that the debentures owned by the deceased should be valued at \$531,165.00, or approximately \$36.00 per \$100.00 of face value; that figure was arrived at by applying a discount rate of $3\frac{3}{4}$ per cent. for the 28 years prior to maturity. The assessment was made accordingly.

He tested his valuation of \$36.00 per \$100.00 in face value by comparison with the issue price of \$73.00 some eleven years earlier, and which price he assumed was bona fide and arrived at on an arms' length transaction. He considered that by using the figure of \$73.00 per \$100.00 as a starting point and after eliminating the increase in value of the company's assets between 1933 and 1944 and the adjustment inherent in the issue price, the valuation made by him was more than adequate to offset changed conditions due to war and all possible contingencies.

Then he considered other valuations of the company's assets, but I need say little as to that for in the main he was in general agreement with the valuation placed upon

them by Mr. Small, except that he would not have allowed any deductions for blocked sterling securities and cash. His valuations are therefore the same as I have set out in detail above, namely, a total of \$2,526,577.56 as of December 31, 1943, and of \$2,655,656.49 as of December 31, 1944. These valuations represent a coverage of approximately 120 per cent. in terms of the whole debenture issue and of 342.5 per cent. on the valuation of \$531,165.00 established by the Department (when applied to the whole of the issued debentures). He was unable to see that in any set of circumstances the debenture holders would not receive at least the departmental valuation at date of death or the Department's valuation increased at any subsequent date as the company's net assets increased, were the company wound up. He also thought that the company could redeem the debentures at par either in cash or securities both at or before maturity, leaving a substantial profit for the common shareholders who purchased their interests at \$10.00 per share.

His next approach to the valuation was on a discount basis, that is, by discounting the debentures at an appropriate rate from maturity date backwards to date of death. While inclined to the view that the debentures might be paid off at par prior to maturity because of the fact that Winley Limited is a "private" holding company with all its securities held in a close family group which might be expected to work very closely together, he decided, for lack of definite assurance that the debentures would not be redeemed prior to maturity, to use the maturity date as the discounting date. In his initial attempts to find a suitable yield-to-maturity rate, he compared quotations and yields from a list (Exhibit R-6) of long-term Canadian bonds and debentures, dominion, provincial and municipal bonds, but assumed that these yields-to-maturity rates did not of themselves suggest a fair rate of discount for the Winley debentures. The average yield of 3.28 per cent. thereon was therefore increased at first to 3½ per cent. and finally to 3.75 per cent. to allow for the differences between debentures which are long term issues of this nature and those of Winley Limited. The first part of the list was made up of seven public utility company bonds with interest rates bearing from 3¼ to 5 per cent. and averaging a

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yield-to-maturity rate of 3.55 per cent. Then seven provincial bond issues were chosen with an average yield-to-maturity rate of 3.70 per cent.; if the Saskatchewan and Alberta issues were eliminated, the average rate was 2.91 per cent. Seven municipal issues showed an average yield of 3.51 per cent. Dominion of Canada and Dominion Guaranteed bonds showed an average yield of 3.28 per cent. The list also contained a number of United Kingdom municipal bonds of long maturity showing a yield of 3.13 per cent. Finally, a list of twenty British Investments Trusts (Exhibit R-7) showed an average indicated yield-to-maturity rate of 3.75 per cent.

Mr. Ovens was of the opinion that the discount rate should not be increased by reason of non-marketability of the debentures. While admitting that it would be difficult, if not impossible, to induce a member of the public to purchase the debentures, he was strongly of the opinion that there was a ready and special market for them, namely, by Winley Limited or its shareholders. With that in mind, he was at first of the opinion that the debentures should be valued at par, but finally came to the conclusion that as the shares were held in trust, the trustees might commit a breach of trust by causing Winley Limited to redeem the debentures at par.

Mr. Ovens considered that it would have been mutually advantageous to the company and its shareholders to purchase, and to the executors to sell at a proper figure at the date of death. His computation is shown in Exhibit R-8 and therein it is assumed that the sale price of the \$1,500,000.00 debentures would be \$550,000.00, a figure somewhat in excess of the value placed thereon in the assessment. From the company reports, he estimated that the average return on capital employed from 1936 (when the company exchanged its former holdings in the reversionary interests of the Schroder Family Trust for securities) to December 31, 1943, was 2.43 per cent. and he therefore assumed a somewhat higher return of 2.5 per cent. for purposes of his calculations. Assuming that the company continued to earn at that rate to the maturity date of the debentures with all the debentures remaining outstanding, the capital employed at maturity would be \$4,086,138.93 and after redeeming the debentures at par, nearly \$3,000,000.00 would

remain for the shareholders. If, however, the deceased had sold the debentures to the company at December 31, 1943, for \$550,000.00, then on the same assumptions the capital employed in 1972 would be \$3,988,063.93, and after providing for payment of the remaining \$600,000.00 in debentures, the net amount available to the shareholders would then be \$3,388,063.93, or \$401,925.00 more than if all the debentures were redeemed in 1972. The further advantage to Winley Limited if it purchased the debentures in 1943 at \$550,000.00, would be the making of a tax-free investment at $3\frac{3}{4}$ per cent. until maturity, against which no income tax allowances need be made. Its rate of tax in 1944 was approximately $22\frac{1}{2}$ per cent. Mr. Ovens pointed out, also, that at the date of death the company was in a position to redeem the debentures either in cash or in securities at his valuation of \$550,000.00. Finally, the witness filed a statement entitled "Information re Indicated Yields to Maturity on Canada and Foreign Investment Trusts as Compared with Net Yields to Maturity, After Estimated Allowances for Income Tax" (Exhibit R-9). By applying an estimated income tax rate of $33\frac{1}{2}$ per cent, he reduced the indicated net yield-to-maturity rate to 3.37 per cent.

The only other witness for the respondent was H. C. Kent, employed by A. E. Ames & Company, investment dealers in Montreal. For twenty years he was employed by the Guaranty Trust Company of New York, in England, engaged in its operative and executive duties. In 1940 he came to Canada to organize the United Kingdom Securities Deposit under the British Treasury. Since 1946 he has been with Ames & Company in a general capacity, concentrating mainly on underwriting operations and general management of the Montreal office. He had read Mr. Ovens' report (which corroborated his evidence as set out above) and agreed with it. He was not prepared to comment on the processes used by Mr. Ovens in reaching his conclusions but stated the result of his own survey of reports which showed the yield-to-maturity rates of a large number of Canadian and foreign securities. In Canada, ninety-six cases were used comprising bonds and debentures of the Dominion, provinces, municipalities, industrial corporations and bank shares, and these showed an average yield-to-maturity rate of 3.60 per cent. A list of sixty-eight

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United States securities of like nature showed an average yield of 3.02 per cent. Long dated British Government bonds yielded 3.25 per cent. The result of this survey confirmed his opinion that from the point of view of average returns from representative securities in 1944, the proposed discount rate of 3.75 per cent. on the debentures as submitted by Mr. Owens was reasonable.

It is clear from the evidence as a whole that there was no public market for the debentures. The average investor, whether an individual or a corporation, would not be interested in purchasing debentures which bore no interest and which were not repayable for 28 years. Neither the debentures themselves, nor the securities of Winley Limited, were readily marketable. The assets were not of a quality to attract the ordinary investor and compared with those of the normal investment trust, were insufficiently diversified; the coverage for the *face value* of the debentures—and that is what an investor would be most interested in since no interest was payable—was inadequate. The debentures formed only a floating charge on the assets, the directors having full power to change investments at will. The control of the company was entirely with the shareholders or the directors representing them, and their interests might very well clash with those of the debenture holders. The directors could at any time declare dividends to the shareholders to the full extent of the earned income, thereby putting in jeopardy the possibility that the debentures would be paid in full at maturity. It is significant to note that if an amount of \$531,165.00—the Department's valuation of the deceased's debentures—were invested in 1944 with accumulating interest compounded at 3½ per cent, per annum (the discount rate fixed by the respondent), it would amount to \$1,489,004.00 on September 1, 1972—the maturity date of the debentures. The most that a purchaser could then receive would be \$1,500,000.00, and I am quite satisfied that the possible gain of approximately \$11,000.00 over a period of 28 years would not be sufficient to attract an investor when all the other risks and factors which I have mentioned are taken into consideration.

This point needs no further elaboration inasmuch as all the witnesses were of the opinion that it would be extremely difficult and probably impossible to sell the debentures to

the general public. From the capital structure of the company and the nature of the debentures which bore no interest and which ran for 41 years, it is apparent, I think, that the result of the issue of the debentures in that particular form—if not one of its purposes—was to make the debentures non-marketable to the general public.

As I have stated above, the main contention of the respondent is that there is, however, a market for the debentures and that it is to be found either in Winley Limited or its shareholders. No effort was made to substantiate that contention so far as the shareholders were concerned. I think what was intended was that if the debentures were purchased by the company at the valuation made by the Department, the shareholders, under the assumption made, would be eventually benefited to a substantial extent.

Mr. Ovens pointed to the fact that the beneficial shareholders of Winley Limited are members of the Schroder family and that at the date of death all its shares and debentures were held by or on behalf of members of the same family. He suggested that the provision in the debentures relating to compromises was designed to secure a flexibility in the operation of the company for the purpose of making mutual adjustments from time to time as the family interests might warrant. He pointed to the redemption at par of \$60,000.00 of debentures in 1938 as an instance which showed the flexibility with which the owners of both debentures and shares conducted their affairs in their mutual interests. From that he was of the opinion that if similar situations arose in the future, they could and would be handled to the mutual advantage of both groups.

To demonstrate his point that Winley Limited would be financially better off in 1972 if the company bought the debentures of the deceased in 1944 at the valuation he put upon them than they would be by redeeming them at par at maturity, Mr. Ovens made the mathematical calculations set out in Exhibit R-8, the details of which I have given above (he assumed a sale price of \$550,000.00 or slightly in excess of his estimate). On the assumptions he made therein, that part of the computation appears to be correct. It also proved that, on the same assumptions, the company would be a great deal better off if it were able to purchase

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the debentures at the value placed upon them by the appellants' witnesses (or at the valuation I am asked to make by the appellants) than at the valuation made by the respondent.

Now the evidence of Mr. Ovens on this point is made with the view of establishing that in this case there is a "special purchaser", namely, Winley Limited. That class of purchaser is referred to in Green's Death Duties, Third Edition, at p. 278, as well as in Hanson's Death Duties, Ninth Edition, at p. 164, and certain authorities are there referred to. In the former text the principle is stated thus: "One of the possible elements in valuation is the existence of a person or class of persons to whom the property in question is more valuable or more desirable than to the general public", and it is stated that the principle would apply to shares in a private company, as respects surviving members, or to partnership assets, as respects a surviving partner, or to professional goodwill, as respects a son who acted as the deceased's professional assistant. In Hanson's text the principle is put in this way: "It seems to follow that an estimate of the price which property would fetch in a market in which all would-be purchasers are present must allow for the prices which persons particularly interested would be prepared to give".

In making the assessment now under appeal, the assessor places very great weight on the possibility that Winley Limited would be within a class of "special purchasers". In the mathematical calculations that he submitted, he endeavoured to establish that it would be in the interests of the company to purchase the debentures in 1944 for \$550,000.00. All that he did establish, however, was that on the assumptions he made the company would make a substantial profit. On the evidence as a whole I must find, however, that Winley Limited was not a "special purchaser" of its own debentures.

The evidence of Mr. Small, one of its vice-presidents who has been intimately associated with its affairs for many years, is most convincing on that point and I accept it without any reservation. He says that it was never the intention of the company to traffic in its own debentures and that with the exception of a small amount redeemed at par in 1938 under very special circumstances, it had never done so. He emphasizes his view (which was concurred in by the

other witnesses for the appellants) that under no circumstances would it be advisable for the company to purchase the debentures and thereby deprive itself of capital on which it paid no interest, unless the discount rate to maturity was very substantial and not less than 6 per cent. The direct evidence of Mr. Small as to the intention of the company in regarding its unwillingness to offer \$550,000.00 for the debentures in 1944 entirely refutes the theory of the assessor that the company was in the position of a "special purchaser" because it would have made some profit by doing so, if all the assumptions of the assessor proved to be correct.

Further, Mr. Small stated (and his evidence is not contradicted) that it was the main intention of the company to use its funds for the purchase of stock in the Schroder Banking and Investment Company as that stock became available. As of December 31, 1943, the stock in that firm was the company's largest asset. The evidence is that over a period of six years the company had made a capital gain of approximately \$400,000.00 on that stock alone. That fact also is sufficient proof of the wisdom of the directors in preferring to invest its funds in the bank rather than to purchase its own debentures at a value fixed in the assessment. As stated in Hanson at p. 166: "In such a case, however, the existence of other competing forms of investment may substantially mitigate the influence of a 'special purchaser' when the property is not of a unique character such as are, for example, specific items of real estate, collectors' pieces, or (in relation to a life tenant) a reversion."

It is to be noted, also, that the interests of the deceased (as well as those of his beneficiaries) in the debentures were distinct and separate as a matter of law from those of the beneficial owners of the shares in Winley Limited. The officials of the company had full knowledge of the trusts under which the shares were held and would be obliged to carry them out in the best interests of the beneficiaries rather than in the interests of the debenture holders.

On the evidence as a whole I must reject the suggestion put forward by the respondent that Winley Limited was within the class sometimes known as a "special purchaser", particularly at the value put upon the debentures by the

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respondent, and a further suggestion that, as the debenture holders and beneficial owners of the shares in Winley Limited were all members of the Schroder family, they would, merely because of that fact, be willing to arrange their affairs in such a way that the former would sell and the latter purchase the debentures at the valuation made by the respondent. In each case the evidence is to the contrary.

The finding which I have just made is of great importance in considering the evidence of the witnesses for the respondent. Mr. Kent admitted that if Winley Limited was not interested in buying the debentures, his views as to their value would be changed, and Ovens agreed that it would affect his computations also.

It is not suggested that there is any other "special purchaser" and it therefore becomes necessary to endeavour to envisage a hypothetical market based on the evidence of those qualified to give an opinion, and, after taking all relevant matters into consideration, to fix a rate of discount based on ordinary commercial principles.

I shall first consider three points raised by counsel for the respondent in support of his valuation. It was said that as the debentures were issued in 1933 at a rate of \$73.00 per \$100.00 face value, the assessment at \$36.00 for \$100.00 face value in 1944 is more than sufficient to take care of any changes occasioned in the meantime by the war, higher taxes, or otherwise. What I have to determine, however, is the value in 1944 and the price paid by another purchaser eleven years earlier and under conditions which have not been fully disclosed is of no practical assistance. Then it is said that the debentures were adequately secured, the gross assets of the company being in excess of the face value of all debentures and having a value of over three times the debentures if the latter were priced at \$36.00 per \$100.00 face value. It is therefore suggested that under any circumstances it was highly improbable that a purchaser of the debentures when discounted at 3.75 per cent. would not in any event receive his investment, together with interest at that rate. I fully agree that the value of the assets is of great importance in determining the value of any security. But, as I have pointed out above, the small gain of \$10,000.00 (over and above the return of his capital and

interest) is the most a purchaser could expect to receive after twenty-eight years, when the debentures matured, and would be insufficient to attract purchasers when all the other factors which I have mentioned—such as the tying up of his capital over an unusually long period and the lack of any control over the management of the company's affairs—are taken into consideration. The third point is the possibility that the debentures might be paid off at par before maturity and that that possibility might be an inducement to purchase the debentures. The evidence is convincing, however, that such an event is highly improbable and I accept the evidence of the appellants' witnesses that it would be of little if any importance in valuing the debentures.

Inasmuch as the debentures have not been listed on any stock exchange and there are no recent sales of the debentures or any "special purchaser", the proper approach to the matter, in my opinion, is to ascertain the value of those securities which are most similar to the debentures in question and then to make proper allowances for the differences and, more particularly, for the "disabilities" in the debentures themselves which I think seriously affect their market value and which I have above set out. On this point I have no hesitation in accepting the evidence of the appellants' witnesses in preference to that of the respondent's. They have had a great deal of actual experience in buying and selling securities and in handling the investments of large corporations. Their long association with the security markets gives them a special knowledge of those factors which affect security prices and influence the attitude of possible purchasers of any security. Mr. Ovens, the main witness for the respondent, has had no practical experience in buying and selling securities, and while his experience in the Department of National Revenue has been extensive, I am unable to conclude that his opinion should outweigh those of the three witnesses for the appellants. The same may be said of the opinion of Mr. Kent who has not been a buyer or seller of securities and whose experience in investment firms has been mainly in the executive and administrative branches.

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I shall not attempt to re-state the details of the lists of those securities which the parties have submitted as being somewhat comparable to the Winley debentures. In my opinion, the quoted market values of Government, municipal and public utility bonds can be of but little assistance as that type of security is usually regarded as being in a class by itself by reason of its greater security. Investment trusts debentures are perhaps the most similar in nature to those of the Winley debentures. Exhibit A-9 is a list of six Canadian investment trusts, and at the prices quoted for May-June, 1944, the average yield-to-maturity rates on these debentures was 5·13 per cent., with the “years-to-maturity” averaging 12½ years. These debentures were all readily marketable, paid interest regularly and were well secured by well diversified portfolios.

Exhibit R-7 is a list of about twenty United Kingdom investment trusts, the debentures of which give an average yield-to-maturity of 3·75 per cent. It is shown that these companies were among the oldest and best managed of the investment trusts in the United Kingdom.

Counsel for the respondent submitted that these yields would be reduced by reason of income tax payable by the recipients, whereas a purchaser of the Winley debentures would be making a capital gain as the debentures bore no interest; and that, therefore, the latter would be willing to purchase at a price which would give a lower yield-to-maturity. Whatever merit there may be in this submission, I am satisfied that it is outweighed by the “disabilities” which attached to the debentures in question and which I have noted above. I accept the evidence of the appellants’ witnesses as to the effect such “disabilities” would have on an intending purchaser and that the discount rate would have to be substantially in excess of 3·75 per cent. As I have said, Mr. Small and Mr. Pemberton placed that rate at 5½ per cent. But taking all the facts into consideration and giving some small weight to the possibility of the debentures being redeemed prior to maturity either at par or at a figure agreed upon between the debenture holders and the company, I have reached the conclusion that a discount rate of 5 per cent.—the rate set by Mr. Collier—is more nearly correct.

The appellants, however, have asked for a lesser discount rate and are content to have the debentures valued at \$445,000.00, the discount rate at that valuation being 4½ per cent. The appellants have satisfied me on the whole of the evidence that the debentures at the date of death did not exceed in value that sum.

Accordingly, the appeal will be allowed. The assessment made upon the appellants will be set aside and the matter referred back to the Minister to reassess the appellants upon the basis that the Canadian assets of the deceased at the date of death had a fair market value of \$445,000.00. The appellants are also entitled to their costs after taxation.

While in the result the valuation I have now made upon the securities is the same as that fixed by the Estate Duty Office of the United Kingdom and the Succession Duty Department of the Province of Quebec, I should point out that in reaching my conclusions I have paid no attention whatever to the valuations accepted by those departments. Their valuers were not called to give evidence and for that reason I considered that the mere fact that they had accepted a valuation of \$445,000.00 (which was in evidence) could be of no assistance to the appellants.

It will be noted, also, that I have given consideration to the origin and history of Winley Limited from its inception. That evidence was supplied to the respondent by the appellants during the course of negotiations and used by Mr. Ovens in expressing his opinion. Counsel for the appellants submitted that it was irrelevant and therefore inadmissible, mainly on the ground that the valuation of the debentures must be made as of the date of death, and under the conditions then existing. The trial Judge who heard the evidence reserved his ruling on the question. While in some cases such evidence may be irrelevant, I am of the opinion that on the special facts of this case it was relevant and therefore admissible. In the absence of any stock exchange listing, I think that a prospective investor in the debentures would make the most thorough inquiries into the history of the company, its management, the nature of its investments, the rights of the shareholders, and the manner in which the affairs of the company had been managed. In

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that way only would he be able to obtain information as to what the debentures were worth and the prospects for the future. In my opinion, the same information in this case should be available to the respondent in determining the value of the debentures and in making the assessment.

Judgment accordingly.