BETWEEN:

1960
Jan. 21
Mar. 21 & 22
Aug. 2

STERLING PAPER MILLS INC. .....APPELLANT;

AND

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

Revenue—Income or capital gain—Income Tax Act R.S.C. 1952, c. 148, ss. 3, 4 and 139(1)(e)—Purchase of wood lots with paper mill—Business not successful and assets disposed of—Sale of cutting rights on wood lots to recoup part of investment not a venture in the nature of trade—Money received from disposal of cutting rights is realization of part of capital and does not constitute income but is a capital gain—Appeal allowed.

Appellant purchased a paper making mill from Dominion Paper Company and in order to do so was compelled to purchase from the same vendor as a part of the transaction certain wood lots owned by the vendor and not required by the appellant and of no value to it. Later appellant sold the cutting rights on the wood lots in order to save some of the money paid for the entire estate, after it had vainly tried to dispose of all the assets purchased by it and had decided to cease operations.

Respondent assessed appellant for income tax on the "net proceeds on the sale of standing timber on a stumpage basis" as calculated by respondent. From this assessment the appellant appealed to this Court.

Held: That the appellant did not deal with the wood lots in the same way as a dealer in timber limits or cutting rights would have dealt and the transaction was not a venture in the nature of trade. The timber formed part of the entire assets purchased by appellant and the money it received from the sale of the cutting rights was the proceeds of the realization of part of its capital and did not constitute income but was a capital gain.

APPEAL under the *Income Tax Act.*

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

H. H. Stikeman, Q.C. and *P. N. Thorsteinsson* for appellant.

Paul Boivin, Q.C. and *Albert Sauvage* for respondent.

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

FOURNIER J. now (August 2, 1960) delivered the following judgment:

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In this case the appellant appeals from the income tax assessments of the Minister of National Revenue bearing dates March 7, 1957 and March 5, 1958 respectively, whereby a tax in the amount of $34,308.99 was levied in respect of the appellant's income for its taxation year 1955.

The facts alleged by the appellant, with a few exceptions, were admitted by the respondent. The Minister does not admit that the respondent, in July 1953, decided to sell all the assets it had acquired from Dominion Paper Company, or had attempted at the time to dispose of same, or that the sale made in 1954 of cutting rights on wood lots was its first opportunity to begin to recoup part of the capital it had invested in purchasing the assets. The burden of establishing these facts rests on the appellant.

The appellant is a corporation having been incorporated on May 12, 1952 under the laws of the Province of Quebec. From the date of its incorporation until the sale of all its assets in 1957, it carried on the business of making paper. In 1952, it purchased for $285,000 all the assets of the Kingsey Falls, Quebec, paper mill of Dominion Paper Company except inventory. The purpose was to obtain the Kingsey Falls paper mill and to produce paper.

Among the assets purchased were wood lots of approximately 4,673 acres in the Province of Quebec. The appellant did not wish to purchase the wood lots but Dominion Paper Company would not sell the mill at Kingsey Falls without the said wood lots. The appellant in fact never used the wood on these wood lots. It operated the mill and manufactured paper thereat from May 1952 until February 1957 and reported and paid tax on the operating profits in the intervening years in which profits were earned. The appellant or its representatives were motivated to purchase these assets by the fact that when the negotiations were commenced in 1950 and continued in 1951 there was a shortage of paper products on the market. The supply could not meet the demand and at one stage a quota system had to be applied to the clientele.

The assets were purchased in 1952, though the balance between supply and demand of papers manufactured by the appellant had been reestablished, because the negotiators had previously agreed to the sale and purchase and

on the conditions of the deal. After the acquisition of the mill, the appellant made improvements to the mill and its equipment. But the appellant was not successful in its enterprise: it had difficulty in marketing its products. It decided to sell all the assets it had purchased from Dominion Paper Company and to cease its operations at the Kingsey Falls mill.

On the facts which were not admitted by the respondent, Mr. J. I. Oelbaum was heard as a witness. He had experience in the manufacture of Kraft papers and knew that the then projected corporation, the appellant in this instance, would need a paper mill. He negotiated the deal with Dominion Paper Company on behalf of the appellant. He stated that in 1950 he had been informed that the above company had advertised that it had a paper mill for sale. He approached that company and offered to purchase their mill at Kingsey Falls. He was not successful because the company would not dispose of its mill without other assets including certain wood lots. Not needing the wood lots, he tried to interest other parties in their purchase. Among the companies he solicited was the St. Regis Paper Company, which, after having the lots surveyed and investigated, declined to make a deal because it would not be profitable to their operations. The other parties approached decided against the transaction for various reasons. This oral evidence is substantiated by documents filed as exhibits at the trial. I am satisfied that the appellant did not need the wood lots and accepted to purchase them as part of the other assets in order to acquire the paper mill.

On the point that the appellant decided to sell all the assets it had purchased from Dominion Paper Company and made repeated attempts to dispose of same, the evidence, oral as well as documentary, establishes beyond a doubt this to be a fact. Eventually, on October 27, 1954 the appellant did succeed in selling to one Paul Vallée cutting rights on the wood lots. It was the first real opportunity the appellant had of disposing of something of which it had become the proprietor by the purchase of the assets of Dominion Paper Company at Kingsey Falls, Province of Quebec. In 1957, it sold the paper mill and its equipment to the Quebec Government.

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The evidence establishes that the appellant, by the purchase contract of March 12, 1952 (Ex. A3), bought all the assets of Dominion Paper Company at Kingsey Falls, except inventory, for a lump sum of $285,000. This purchase included the wood lots in question but the contract did not allocate any part of the total purchase price thereto or to any other assets involved in the purchase. Only after the purchase was made did the appellant's auditors make an allocation for internal purposes of $17,200 to the wood lots in question.

During its operations of the mill, the appellant invested approximately $32,000 in improvements to the mill. So the total outlay for the purchase of the above assets and the improvements to the mill amounted to the sum of $317,000. These assets were disposed of in two sales: 1) sale of cutting rights, $100,000; 2) remainder assets, $112,500, or a total of $212,500.

The cutting rights were sold to one Vallée. The memorandum of agreement between the appellant and the latter is on file as Ex. A10; the important provisions thereof are as follows:

1. The company accords to Vallée the right to cut and remove standing timber on its lands and to retain for his own use any fallen timber on the said lands, which lands are more fully described . . .

2. The rights to cut timber as stated in paragraph 1 are limited to the following:—soft wood 3 inches and over in diameter on the stump.

3. The total consideration payable by Vallée shall be $100,000 payable as follows:

$50,000 in cash or by certified cheque at the time of the signing of these presents.

Payment of the balance of $50,000 shall be made as deliveries are made by Vallée to Waterloo Plywood Lumber of Waterloo, Quebec, and in any event the following amounts shall be paid not later than the dates specified:

$25,000 by July 1, 1955, without interest until July 1, 1955, and subsequent to that date with interest at the rate of 6% per annum on any unpaid balance of purchase price during the period July 1, 1955 to June 30, 1956;

The remaining $25,000 not later than July 1, 1956, with interest payable as stated in the clause immediately aforegoing.

19. The right accorded to Vallée in accordance with these presents to cut timber on the lands of the company as stated in paragraph 1 hereof shall endure for a period of six (6) years from the date of signing of these presents as long as he conforms with his obligations under the present agreement. . . .

These clauses of the agreement deal with the object of the transaction, to wit, the right to cut and remove timber from the appellant's lands during a period of six years for a total consideration of $100,000 to be completely paid by or on July 1, 1956, notwithstanding any other stipulation of the agreement, in the words of the document, "and in any event . . . the amounts shall be paid not later than the dates specified."

During its fiscal period or its taxation year ended June 30, 1955, the appellant received from Vallée a sum of $75,822.79 for the right to cut and remove timber from its land. In its taxation year ended June 30, 1956 it received from Vallée a sum of $24,177.21 as a balance for the same rights. In its 1955 income tax return the appellant disclosed receipt of the sum of $75,822.79 but did not include it in its taxable income. The respondent reassessed the appellant on two occasions for its taxation year 1955. The first reassessment, dated January 18, 1956, was for a total tax of $3,309.01 and no tax was levied on the basis of the sum of $75,822.79 received for the right to cut and remove timber from its lands. The second reassessment, dated March 7, 1957, added to appellant's income the sum of $51,373.79 on the ground that this amount constituted "net proceeds on the sale of standing timber on a stumpage basis." To arrive at this amount, the respondent had allowed as deductible the cost of the wood lots at $17,200 as allocated by the appellant in its opening book entries after it took over the assets of the Kingsey Falls paper mill.

The appellant objected to the notice of reassessment of March 7, 1957, but the respondent advised the appellant that it had reconsidered the assessment objected to and enclosed another notice of reassessment dated March 5, 1958, adding to the appellant's taxable income for the taxation year 1955 a further amount of $24,177.21 as follows:

Taxable income previously assessed		$ 73,146.33
Add: Sale price of timber as a stumpage basis ..	$100,000.00	
Less: Amount revised to June 30, 1955	75,822.79	24,177.21
Taxable income revised		$ 97,323.54

The appellant submits that there was no profit in the circumstances, because it suffered an overall loss on the purchase and subsequent resale of the Kingsey Falls paper

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mill assets. If there was a gain, it was outside the taxing provisions of the *Income Tax Act,* to wit, it was a capital gain and not a profit from carrying on a business or concern in the nature of trade. Furthermore, such gain, in any event, was not taxable, because it was realized in the course of liquidation of the appellant's assets carried out pursuant to a decision to cease operations and wind up its business.

On the other hand, the respondent contends that the appellant was assessed for the amounts received from the sale of the timber cutting rights because the cutting rights sold by the appellant were disposed of in the course of carrying on business and that the profit realized therefrom is taxable in the year of sale pursuant to ss. 3, 4 and 139(1)(*e*) of the *Income Tax Act.*

The provisions of these sections of the Act read,

3. The income of a taxpayer for a taxation year for the purposes 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 employment.

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.

139(1)(*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 difficulty in cases of this category is to determine if the facts established before the Court fall within the meaning of the terms of the above provisions of the Income Tax Act. Was the purchase of the wood lots in question and the sale of the timber cutting rights on same a business, an adventure or concern in the nature of trade or the acquisition and disposal of a capital asset? In the first instance the profit realized from the sale would be taxable, while in the second case it would not be subject to the taxing provisions of the Act. In other words, profits made in the sale of merchantable timber cutting rights are income if the timber lots constitute part of the trading rather than the capital assets of the taxpayer.

As there are seldom two cases wherein the facts are identical, it is generally acknowledged that each case must be determined upon the evidence adduced. Though decisions in similar matters are not always helpful, they should be kept in mind when considering the facts which form the basis of the issue before the Court. Seeing that the case of *Sutton Lumber and Trading Co. Limited and Minister of National Revenue*[1], heard in the Exchequer Court and appealed to the Supreme Court of Canada, was quoted by both parties in their argument, I think it useful to state the following words of Locke J., speaking for the Court (p. 93),

> The question as to whether or not the present appellant was engaged in the business of buying timber limits or acquiring timber leases with a view to dealing in them for the purpose of profit is a question of fact which must be determined upon the evidence. . . .

In that case a company sold a block of fir standing timber in 1946 after holding it for about fifty years. The only manufacturing operation carried on was the running of a cedar saw mill in 1907 on another tract. This Court held that the profit on the sale was subject to excess profit tax under the *Excess Profits Tax Act 1940,* but the Supreme Court of Canada reversed the decision on the ground that the company did not engage in the business of buying and selling standing timber.

It is apparent in the present case that the facts are most unusual. The taxpayer was intent on acquiring a paper mill to produce a special kind of paper. It was not interested in wood lots. Its production was based on sulphate pulp which it bought. The timber on the wood lots was not suitable for its purpose. It did its utmost to acquire the mill, the machines and equipment without the wood lots, but was not successful. It then approached several parties whom it thought would be interested in the timber lots before the deal was agreed to. Wrongly or rightly, it decided to purchase all the vendor's assets so that it could become the owner of a paper mill which it needed for its business of manufacturing and selling paper.

[1] [1953] C.T.C. 237; [1953] 2 S.C.R. 77.

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From these proven facts, in my view, one can draw the inference that the appellant invested $285,000 in the purchase of capital assets which would bring forth income from its business operations. True, part of the assets could not be used in the production of the special paper, but its inclusion in the assets was a *sine qua non* condition of the transaction. It was not included so that it may be disposed of at a profit or for the purpose of trading in wood lots or timber cutting rights. It was a part and parcel of the entirety of the capital assets acquired. So the capital in the amount stated *supra* was an investment in capital assets acquired by the appellant for the purpose of manufacturing and selling its special kind of paper. In other words, it was an investment in a property for the purpose of earning income which would attract taxation. I believe this to be a proper inference from the proven facts as to the appellant's intention when the assets were acquired and the manner in which the assets became its property.

Then when the appellant came in possession of the assets, it made improvements to the mill and the equipment and proceeded to manufacture its product. The operation had no success due to lack of market for its paper and to its poor quality. Eventually it decided to dispose of the assets as a whole. In 1953 it had prolonged negotiations for the sale of the entire operation and had advertised and negotiated for the sale of the wood lots, but without success. It decided to close down the operations in Kingsey Falls, dismantle the paper machine and have it removed and operated in Toronto. It was then that the Kruger Paper Company of Montreal said it would consider the purchase of the whole outfit. The purchase price was to be $285,000, the sum originally paid for the assets of the Dominion Paper Company at Kingsey Falls. The deal fell through because the Kruger brothers would not personally guarantee the transaction. After that it attempted to sell to the Canadian National Railway, the Quebec Government and some larger paper firms. It was only in October 1954 that it sold the timber cutting rights for $100,000, the Quebec Government taking over in 1957 the remainder of the assets for $112,000.

Those are the material facts which have been established and which are to be considered in determining if the amount of $100,000 received from the sale of the timber cutting rights on the wood lots, less the amount of $17,200 allocated by the appellant's auditors in its books for internal purposes, e.g., to determine the capital cost allowance which it would claim on the other assets, was a profit from a business or adventure in the nature of trade and taxable or a profit from the disposal of a capital asset and non taxable.

Counsel for both parties referred the Court to several decisions which may help to solve the problem at issue. They each gave what they thought was the proper interpretation to be given to the findings in the two hereinabove mentioned decisions. I shall now express my opinion.

The outstanding case is that of *Sutton Lumber and Trading Co. Limited* and *Minister of National Revenue* (*op. cit.*).

In that matter the company had acquired a number of timber limits and had disposed of them in three different sales, because, although they had been acquired for the purpose of being used in the operation of its saw mill, it found that they were unusable in connection therewith. In the present instance the wood lots were not acquired for the purpose of the manufacturing operations of its paper mill, but only to enable it to purchase the paper mill to be used in the manufacture of kraft paper.

Here are some remarks of Locke J. (p. 94),

> In the present case, the Nootka limits which were sold in 1946 were assets in which the company had invested with a view to cutting the merchantable timber into lumber in a mill to be erected by it in the Clayoquot District and the sale merely a realization upon one of its capital assets which was not required and did not fit into the company's plans for the operation of its main property and one which was not made in the course of carrying on the business of buying, selling or dealing in timber limits or leases.

The Supreme Court of Canada acknowledged that the sale of merchantable timber at an agreed stumpage rate could give rise to a capital gain.

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Another case on which the appellant relied was that of *Thomson* and *Deputy Federal Commissioner of Taxation*[1], involving an appeal from the Supreme Court of Western Australia to the High Court of Australia. The facts being the basis of the appeal are as follows:

The appellant, Elizabeth Viola Thomson, was the lessee of a grazing lease of 1,000 acres of land selected from the Crown under ordinary grazing conditions and included in the farm of her husband. It had been acquired in 1903, and had been used for agistment purposes. In 1925 the appellant and her husband entered into an agreement with a timber company to sell to the company the growing timber not less than 4 feet 6 inches round the butt at a height of 3 feet from the ground, on her property and part of the property of her husband. The company was to cut and take away the timber for five years, for which the company paid £1,800, and of this sum the Commissioner of Taxation allocated £1,400 to the appellant and assessed her for income tax on that amount as income from property for the financial year 1926-1927. An appeal by the appellant to the Supreme Court of Western Australia against this assessment was heard by Draper J., who dismissed it on the ground that the proceeds of the sale of the timber after severance assessable as income in the same way as the proceeds of crops were grown and sold from cultivated lands or grass consumed by sheep on agistment.

This decision was reversed by the High Court of Australia. The judgment reads in part thus (p. 363):

> . . . She had taken up this land as far back as 1903. Neither she nor her husband took up the land with a view to growing or selling timber, and at first they had used it for grazing. It had, however, been eaten out by overstocking. There is therefore no question in this case of a business, trade, pursuit or avocation; and this the Commissioner in effect admits by treating the sum in question as income from property. Upon these facts we see no reason why the proceeds of the sale of the timber should be considered as income. The timber formed part of the asset which the appellant acquired when she took up the land. It is true that timber increases by growth, but that growth is not an increase in the value of the asset which may be detached and yet again recur annually or periodically. It would be contrary to facts to regard the land as a capital asset by which timber was produced with regularity as something in the nature of a recurring profit from the land.

[1] (1929-30) 43 C.L.R. 360.

The Court held that the money received by the appellant on such sale was the proceeds of the realization of part of her capital, and not assessable under the *Income Tax Assessment Act*, 1922-1927.

Two other cases, decided by the Exchequer Court, were quoted and dealt with by counsel for both parties. The first one is that of *C. W. Logging Company Limited* and *Minister of National Revenue*[1].

The appellant company was incorporated in 1934 under the *British Columbia Companies Act* with powers including that of carrying on business as timber merchants as well as conducting logging operations. Since incorporation the company confined its operations to logging on Vancouver Island except for two separate contract land clearing jobs. In 1950 it sold the merchantable timber of certain dimensions standing on a block of approximately 300 acres of land for $4,500. This block had been purchased by the company in 1936 and had been logged in that year. In 1952 the persons who purchased the cutting rights to the standing timber in 1950 also purchased the freehold title to the land on which the timber stood for $6,500. The Income Tax Appeal Board dismissed the company's appeal from assessments for 1950 and 1952 and included the two payments in income. On appeal to the Exchequer Court, Ritchie J. held (*inter alia*),

> That the 1950 sale of the cutting rights to the merchantable timber was a sale of the residue of the mature timber crop and was made in the course of carrying on a business of dealing with timber either by logging operations conducted by the appellant itself or by the sale of stumpage;
>
> That the 1952 sale by the appellant of the freehold lands was the sale of a capital asset purchased with a view of realizing a profit from logging them and not for the purpose of resale at a profit.

In the first instance, the profit realized from the transaction was held to have been made in the course of carrying on a business and taxable, on the ground, I believe, that the company's business was logging and dealing in timber. In the second finding, the profit was not considered taxable, being the sale of a capital asset.

[1] [1956] C.T.C. 15.

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The second case is that of *Gillies Bros. & Co. Ltd.* and *Minister of National Revenue*[1], in which Thurlow J. analyses the difference between the sale of the cutting rights and the sale of the timber itself. This company was upon a Crown land. It logged the trees and sold the timber; it also permitted contract loggers to do the same. The business of the company, however, was established to be of logging and therefore the proceeds were held to be taxable. In his judgment he said (p. 215),

> In this view, the appellant's business included the process of trading in British Columbia timber licences and the profits in question, insofar as they arose from sales of licences made by the appellant, were profits arising from such trading. With respect to them, the basis of the assessments has thus not been demolished. This feature distinguishes the case, so far as the profits from such sales are concerned, from *Sutton Lumber and Trading Company v. M.N.R.* [1953] 2 S.C.R. 77; [1953] C.T.C. 237.

The hereinabove cited decisions demonstrate clearly that a person who owns properties or commodities and deals with them in the same way as a dealer is considered as engaged in trading activities or that his transaction is an adventure or concern in the nature of trade and the profits derived therefrom taxable. If not, they were considered as the sale of a capital asset or disposal of an investment and the profits realized, if any, non taxable. I believe this to be the best test to be applied to the facts and circumstances of each case wherein it must be determined that the result of a transaction is of a capital or income nature. But this must be considered with the test of intention at the time of purchase or acquisition and disposal of the assets, whether property or commodity.

At the time of the purchase of the Dominion Paper Company's assets at Kingsey Falls, the appellant's sole object was to become the owner of a paper mill, because it had a market for its production. It was not in the business of buying or selling wood lands nor trading in timber cutting rights. The evidence clearly establishes that at the time it had no intention of trading in timber rights. True it tried to dispose of the wood lots, but it seems logical to believe that this was to recoup part of the amount invested in the total assets. This brings us to the time of sale. When the appellant realized that the operation of the assets acquired

[1] [1957] C.T.C. 190.

could not be a success, it decided to close the mill and use the machinery and equipment elsewhere. It then got an offer from a paper company to purchase the whole outfit. The price was to be the same as that the appellant had paid. This deal and others did not materialize for the reason explained *supra*.

In 1954 it did sell the cutting rights on the wood lots for a lump sum, but not on a stumpage basis, because the price of $100,000 of the rights was payable, at all events, within a short period of time, though the rights extended to six years.

These facts, to my mind, do not indicate that the appellant dealt with the wood lots in the same way as a trader in timber limits would have proceeded. A trader in timber cutting rights or timber limits does not buy timber limits in a block or bulk sale with a number of assets with the intention of never using or selling the timber. He generally buys something which he intends to deal with commercially. He buys it with the intention of trading in it and thereby realize a profit. He does not buy a timber limit which he does not need because he is intent on getting something else in the deal, and then has to dispose of it because he never wanted it. This would be foreign to any commercial *animus*. The appellant herein forcefully realized that the land on which timber stood had no value. It sold the cutting rights because there was nothing else it could dispose of to save at least some portion of the sum it had paid for the entire assets. It had been forced to buy the wood lots without wanting or needing them and did not sell them for a commercial reason. It succeeded in disposing of the cutting rights after it vainly tried to dispose of the entire assets and had decided to cease its operations. It did continue its operations until the Government of Quebec acquired the balance of the assets for reasons of employment of the local people.

I am of the opinion that the appellant did not deal with the wood lots in the same way as a dealer in timber limits or cutting rights would have or that the transaction was a venture in the nature of trade. The timber formed part of the entire assets purchased by the appellant and the

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money it received was the proceeds of the realization of part of its capital and should not be considered as income but as a capital gain.

For these reasons I would allow the appeal, vary the assessment and refer the matter back to the Minister for reassessment accordingly, with costs to be taxed in the usual way.

Judgment accordingly.