

event, the requirement of a full disclosure of interest is not subordinate to some other purpose within provincial jurisdiction, as was the case in *Ladore v. Bennett*,¹⁴ but was enacted in and for itself.

The Act, therefore, in pith and substance deals with interest, and is to that extent invalid. It is likely that the whole Act would fall, since the other provisions are inextricably tied up with the interest provisions and are, therefore, not severable.

The Attorney-General of Manitoba is reported in a recent newspaper article to have stated that the object of the legislature in passing the Act was to eliminate the small minority of cases in which consumers are being victimized, and not to make life difficult for reputable companies offering credit facilities. Laudable as this object is, the remedy is clearly one for the federal Parliament.¹⁵

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PARADISE REGAINED:
THE DECLINE AND FALL OF THE SECONDARY
INTENTION THEORY IN DETERMINING
CAPITAL GAINS

Capital gains cases are legion, and trying to derive general principles from cases decided on unique facts is a task fraught with danger. It has often been stated that a case, being authority only for what it actually decides, cannot be quoted for a proposition that may seem to follow logically from it.¹ The cases on capital gains, in particular, constitute "a confused and heterogeneous mass of jurisprudence . . ."²

Nevertheless, certain principles have emerged over the years from cases where the courts have been faced with determining whether a profit is taxable income or a tax-free capital gain. The problem, briefly put, is to decide if the profit has been received by the taxpayer from the operation of a business, or from "an adventure or concern in the nature of trade"³, in which event the gain is considered to be taxable income.⁴ On the other hand, if the gain is in the nature of an enhancement or appreciation of value arising from the realization of a security or investment, it will be, in general, a tax-free capital gain.

In determining whether the taxpayer has been engaged in an adventure or concern in the nature of trade, the court will try to decide if the asset, the realization of which resulted in the profit, was acquired initially as an

14. *Supra*, note 11.

15. Since this note was written the government has announced its intention to make certain changes in the Act. It is doubtful, however, whether they will affect the problem discussed herein.

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1. See *Quinn v. Leatham* (1901) A.C. 495, at p. 506.

2. Note by H. H. Stikeman to *Smith v. M.N.R.* (1960) C.T.C. 392.

3. Income Tax Act, R.S.C. 1952, c. 148, s. 139(1)(e).

4. Income Tax Act, ss. 3 and 4.

investment (connoting a stable, possibly income yielding, security) or as a speculation (involving an element of risk, as likely to produce loss as gain). Disposition of an investment would generally result in a capital gain, while realization of an asset acquired speculatively would generally yield taxable income.

All the facts weigh in the decision of the court: the general course of conduct of the taxpayer, the nature of the item acquired, the declared or apparent intention of the taxpayer on entering into the transaction, and other similar factors. Intention to profit on disposition of the asset, standing alone, is not a sufficient test for determining whether or not a transaction constitutes an adventure in the nature of trade, and, therefore, whether or not the profit therefrom is income.⁵ If there was, however, at the inception of the transaction, an intention on the part of the taxpayer to profit on the ultimate realization of the asset, together with one or more of the other "indicia", or "badges" of trade, the court will in all likelihood find the profit to be taxable income, and not a capital gain.

An examination of cases in this field shows that the courts invariably take into consideration the intention of the taxpayer, and that they are sometimes strongly influenced by it. If the taxpayer's intention on entering into the transaction was to make an "investment" (as opposed to a "speculation"), he could, until recently, feel relatively certain that the profit he realized when he finally disposed of his investment would be deemed to be a capital gain. But as every investor knows, the original intention of purchasing a long-range investment may often be frustrated. Two or three years ago, the courts began to look beyond the taxpayer's original, or primary investment intent, to see if, at the inception of the transaction, he had considered the possible frustration of his investment plans, and had thus formed a secondary, or alternative intention. If he had such an intent, and it was of a speculative nature (such as the intent to dispose of the asset at a profit if his original investment plans failed), then the courts were likely to find that since his secondary intention was one of profit-making, the profit he made was taxable income, notwithstanding the original intention to make an "investment". The doctrine has been expressed by the present chairman of the Tax Appeal Board, Mr. Snyder, in this way:

... an asset may be acquired with an intention to create a capital investment, but where that intention is not carried out there may, depending on the circumstances, be imputed to the taxpayer an overall or alternative intention of turning the asset to account for profit by resale if the preferred capital investment intention is not carried through.⁶

This doctrine of secondary intention considerably muddled the already murky waters of the capital gains well. It was difficult enough for a court to determine a taxpayer's primary intention. How much more challenging a task it was to determine first the existence, and then the nature, of a

5. *Irrigation Industries Ltd. v. M.N.R.* (1962) C.T.C. 215, at p. 223.

6. *No. 674 v. M.N.R.* (1959) 23 Tax A.B.C. 248, at p. 254.

secondary intent. But the doctrine, that "elusive and hypothetical concept"⁷, received judicial approval in the Exchequer Court and in the Supreme Court of Canada. Mr. Justice Thurlow, in two cases⁸ in the Exchequer Court rejected claims of capital gains in circumstances which would previously have been considered consistent with the usual requirements for a successful claim. Excerpts from one case, *Bayridge Estates Ltd. v. M.N.R.*⁹, will suffice to illustrate the basis of his judgments, for both cases were decided on the same principle. The cornerstone of his decision in each case was his finding that there was an alternative intention, if the original investment object failed, ". . . to turn the property to account for profit in some way . . ."¹⁰ In the opinion of Mr. Justice Thurlow:

. . . the sale of the property for profit was one of the several alternative purposes for which the property was acquired, and it was in the carrying out of that alternative purpose, when it became clear that the preferred purpose was unattainable, that the profit in question was made. It was, accordingly, a profit made in an operation of business in carrying out a scheme for profit-making and was properly assessed.¹¹

Shortly after these two cases, the Supreme Court seemed to hammer the final nail into the capital gains coffin with its decision in *Regal Heights Ltd. v. M.N.R.*¹² The appellant company had been formed to develop a shopping centre as an investment, and in accordance with this desire a parcel of land had been acquired. After attempts had been made to find tenants, and after having obtained surveys of the area the promoters decided to abandon the project. A large retail chain had suddenly announced its plans to build a store close to the company's site, and the shopping centre appeared to have become economically unwise. The company sold the land a short time later, at a very large profit. The Supreme Court upheld the judgment of the Exchequer Court that the existence of a primary investment purpose did not rule out the existence of a secondary speculative intent, if the original plans failed. Mr. Justice Judson stated:

These promoters were hopeful of putting the land to one use but that hope was not realized. They then sold at a substantial profit . . . it was not an ordinary investment but an operation of business in carrying out a scheme of profit-making,¹³

and held, therefore, that it was an adventure in the nature of trade, yielding taxable income. The court thus confirmed (albeit tacitly) the secondary intention theory. Not even Mr. Justice Cartwright, who dissented, objected to the doctrine itself; he simply found insufficient facts from which he could recognize the existence of an alternative intent, in the case before him.

7. G. McGregor, "The Puzzle Solved" (1962) 10 *Canadian Tax Journal*, p. 250, at p. 251.

8. *Bayridge Estates Ltd. v. M.N.R.* (1959) C.T.C. 158; *Fogel v. M.N.R.* (1959) C.T.C. 227.

9. *Supra*, note 8.

10. P. 163.

11. P. 165.

12. (1980) C.T.C. 384.

13. P. 390.

The *Regal Heights* decision caused a great furor in tax circles in Canada. One critic (discussing the Exchequer Court decision) said:

This is a new and alarming concept in the capital gains field . . . in short, if this concept is adopted it means that there will be no more capital gains.¹⁴

There seemed to be very real cause for feeling that the prospects of achieving a capital gain had been virtually eliminated, for:

. . . any businessman when purchasing property, has a weather eye cocked on alternative possibilities. It is hard if he is penalized for being practical.¹⁵

A short time before the *Regal Heights* case, the Exchequer Court, in *Sterling Paper Mills Inc. v. M.N.R.*¹⁶, seemed to modify the severity of the secondary intention theory. The appellant company purchased certain assets, and in order to conclude this transaction, it was forced to buy at the same time certain timber rights for which it had no need or desire whatsoever. It immediately tried to sell this unwanted asset, and finally succeeded in doing so, at a profit. Mr. Justice Fournier held that there could be no trade, or adventure in the nature of trade (and, therefore, no taxable income) unless the taxpayer carried out the transaction in the manner of an ordinary trader in the commodity, with the positive intent of realizing a profit. This element of a trading character he called "commercial *animus*". He found this quality lacking in the appellant, notwithstanding its avowed intention to dispose of the asset, because it was trying to sell an asset which had been virtually forced upon it; there was no positive desire to profit by the sale. Commercial *animus* involves an intent to embark on a venture of a commercial nature, not merely a desire to rid oneself of an unwanted asset. Thus, intention to sell (whether primary or secondary) must be accompanied by commercial *animus*, or intent, in order to disqualify a profit from being a capital gain.¹⁷ The appeal by the Crown in *Sterling Paper* has not, at the date of writing (November, 1962) been decided by the Supreme Court.

The most recent decision by the Supreme Court touching this subject is *Irrigation Industries Ltd. v. M.N.R.*¹⁸ The appellant company was incorporated in 1947 to run an alfalfa mill, but the project was abandoned, and the company remained inactive. In 1953 it purchased 4,000 common shares of Brunswick Mining and Smelting Co., a company established to test ore bodies. The shares were paid for by way of an overdraft at a bank. Within three weeks the bank asked for payment of its overdraft, and the company sold the Brunswick shares at a substantial profit. The Supreme Court, by a 3 to 2 decision, reversed the Exchequer Court decision and held the profit to be a tax-free capital gain. The two most important of the general propositions which the judgment established seem to be:

14. G. McGregor, "No More Capital Gains?" (1960) 8 *Canadian Tax Journal*, p. 172.

15. Note by H. H. Stikeman to *Adler v. M.N.R.* (1960) C.T.C. 29.

16. (1960) C.T.C. 215.

17. See, for example, *Essex House v. M.N.R.* (1961) C.T.C. 270.

18. *Supra*, note 5.

firstly, that the fact of entering into a transaction with the intention of disposing of the asset at a profit as soon as there was a reasonable opportunity of so doing is not, of itself, sufficient to constitute the transaction an adventure in the nature of trade; and, secondly, that an accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value. It is clear that what must also be present is the element of commercial *animus*—acting in the manner of a regular trader in the field. In the *Regal Heights* case this element was presumably present, while in the *Sterling* and *Irrigation* cases it was absent (although in the *Irrigation* case the line of distinction is very difficult to discern).

What does this decision do to the secondary intention theory? The facts support the view that this was a case in which that theory could reasonably have been applied. The company had a speculative intent, coupled with a course of conduct consistent with commercial *animus* (having made an isolated speculative purchase of shares, not intending to retain them as an investment, but expecting to dispose of them in the near future at an increased price). Mr. Justice Martland, who delivered the judgment of the majority (himself, Taschereau and Locke, J.J.), makes no mention of the doctrine, and refers to the *Regal Heights* case only in passing. Mr. Justice Cartwright, who dissented (with Judson, J.), found it difficult to avoid the conclusion that the profit was, not an enhancement in price of an ordinary investment, but a gain made in the operation of a business in carrying out a scheme for profit-making:

To hold otherwise would appear to me to be contrary to the reasoning of the majority in the *Regal Heights* case.¹⁹

It is submitted that the *Irrigation* case constitutes a retreat from the Supreme Court's earlier endorsement of the secondary intention theory. The majority decision did not, of course, expressly acknowledge this, but the dissents made it abundantly clear. Moreover, subsequent decisions of lower courts indicate that the secondary intention principle is being invoked much less frequently since the *Irrigation* case. Illustrative of this trend are *Holtzman v. M.N.R.*²⁰, *Lyons v. M.N.R.*²¹, and *Vicross Apts. v. M.N.R.*²² Reference may also be made to *Cosmos Inc. v. M.N.R.*²³ (decided shortly before the *Irrigation* case).

One of the clearest, and most recent examples of the current disaffection for the secondary intention theory is *Wagland v. M.N.R.*²⁴ Mr. Wagland purchased some land in 1955, intending to rent it for car storage purposes to a company with which he was associated. He borrowed by way of a mortgage on the land to pay most of the purchase price, in the expectation that income from the rental of the land would exceed his mortgage payments. It soon became apparent that the company did not

19. P. 230.

20. (1962) 29 Tax A.B.C. 378.

21. (1962) C.T.C. 478.

22. (1962) 30 Tax A.B.C. 61.

23. (1961) 28 Tax A.B.C. 193.

24. (1962) 30 Tax A.B.C. 52.

require the land, and in 1958 Wagland sold it at a profit. The Crown, not unnaturally, argued that at the time of the purchase Wagland had the secondary intention to realize a profit by sale of the land, if it was not leased by the company. The Crown relied for authority on Mr. Justice Thurlow's decisions in the two cases previously noted.²⁵ Wagland candidly admitted that if the company did not require the land he was prepared to sell it, but Mr. Snyder, Chairman of the Tax Appeal Board, nevertheless found his profit to be a capital gain. He found Wagland's course of conduct to be that of a true investor, and not that of a real estate speculator. He stated, in declining to apply the secondary intention theory (and it is interesting to contrast this with his previously noted comment²⁶):

It cannot be found that the appellant's admission that he hoped to realize a profit on the sale of the property if it could not be rented . . . stamps the transaction now considered with speculative imprint . . . the hope of realizing a profit is surely in the mind of all investors. Few investments would be made if the purchaser anticipated a loss on disposing of the asset . . .²⁷

So we are brought back to the realities of practical life by some eminently reasonable decisions. Since intention is always one of the factors determining taxability, the presence of a secondary profit-making motive may still be considered, but only as one (preferably a minor one) of the "badges" of trade. Courts in the future will not place nearly so much reliance on secondary intention as they have in the recent past. The taxpayer will still escape with his capital gain intact, notwithstanding the existence of a secondary profit-making intention, if he acted without commercial *animus*. It now appears that the practical investor whose mind considered more than one possibility, *ex abundanti cautela*, will no longer be penalized by the application of the secondary intention theory, with all its pitfalls and subjective probings.²⁸ It is certainly to be hoped that this harsh and unwieldy doctrine has been given a premanent burial.

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"THE ANCIENT BUT IMAGINARY RIGHT TO GO ROUND AND ROUND FROM JUDGE TO JUDGE"

The Criminal Law Section of the Canadian Bar Association, at the 1961 Annual Meeting in Winnipeg, considered a resolution recommending to the Parliament of Canada that the Criminal Code be amended to permit an appeal from the refusal of an application for a writ of *habeas corpus* in a criminal proceeding. The resolution was defeated because it was felt that the applicant has a sufficient remedy: the right to make successive applica-

25. *Supra*, note 8.

26. *Supra*, note 6.

27. P. 56.

28. *St. Aubin v. M.N.R.* (1962) C.T.C. 520, indicates that the doctrine may to some extent be rearing its ugly head once more.

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