

**CONTINUITY OF BUSINESS AS
AN ALTERNATIVE REQUIREMENT FOR
LOSS CARRYOVERS: THE UNITED STATES,
UNITED KINGDOM, CANADIAN AND
AUSTRALIAN CODES COMPARED**

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Continuity of business is a generally accepted alternative to continuity of ownership in permitting the carryover of net operating losses. This alternative is provided for in slightly varying form, in the four Revenue Codes considered in this paper. None of these Codes attempt to define the concept though the United States Code attempts, in its Regulations, to provide certain guidelines. This lack of definition is due to the imprecision of the concept itself, for ultimately, what constitutes the business of a company is a question of fact.

A business includes several things. Amongst these are its name, location, premises, machinery, stock-in-trade, product, employees, management, shareholders (owners) and its financial standing. The nature of the business (that is hardware, software, merchandise, machinery, service industry and the like), the manner and the method of its conduct (that is retail, wholesale, self-service, etc.), and the goodwill associated with the business generally are also matters to be taken into consideration. Resolving issues in this area, therefore, necessarily involves a consideration of a host of facts — some competing, others complementary — and the resolution of conflicts between them. The requirements under each of the Codes is set down below.

THE STATUTORY PROVISIONS

The United States Internal Revenue Code (1957 Code)

Section 382(a)(1) denies the loss carryover if at the end of the taxable year of the corporation there has been a change in stock ownership of at least 50 percentage points of the total fair market value of the outstanding stock of the corporation amongst any of the ten persons who own the greatest percentage of the stock, AND

“(c) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the

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percentage ownership of the fair market value of such stock." (emphasis added)

The use of the word "substantially" contemplates that some change in the business is permissible. Otherwise, the word "substantially" would not have been used.¹ The business therefore need not be conducted exactly as before. The words contemplate a permissible range of contraction of business activities.² The Regulations further endorse these views. Thus Regulation 1.382(a) — 1(h)(8) states that where after a change in ownership the corporation continues to carry on its prior business activities substantially undiminished, the addition by the corporation of a new trade or business does not constitute a failure to carry on substantially the same trade or business. There will be no substantial continuity of the same business in the following situations:

- (1) Where the corporation is not carrying on an active trade or business at the time of the increase in ownership but is subsequently reactivated in the same line of business as that originally conducted. Reg. 1.382(a) — 1(h)(6).
- (2) Where the corporation discontinues more than a minor portion of its business carried on before such increase. Reg. 1.382(a) — 1(h)(7).
- (3) Where the corporation has changed the location of a major portion of its activities and, as a result of such change in location, the business of the corporation is substantially altered. Reg. 1.382(a) — 1(h)(9).
- (4) Where the corporation is primarily engaged in the rendition of services by a particular individual or individuals and, after the increase in ownership, the corporation is primarily engaged in the rendition of services by different individuals. Reg. 1.382(a) — 1(h)(10).
- (5) Where a change in the trade or business of a corporation is made in contemplation of a change in stock ownership. Reg. 1.382(a) — 1(h)(3).

The United Kingdom Income and Corporation Taxes Act, 1970
Under Section 483, a loss carryover is denied

"(1) If —

- (a) within any period of three years there is both a change in the ownership . . . and . . . a *major change* in the nature or conduct of a trade carried on by the company, or
- (b) at any time after the *scale* of the activities in a trade carried on by a company has become *small or negligible*, and before any *considerable revival of the trade*, there is a change in the ownership of the company . . ." (emphasis added.)

Section 483(1)(a) and (b) spell out the twin perils of Scylla and Charybdis. It denies the benefit where a business which has paled into insignificance is sold before its revival, or where a

1. *Commissioner of Internal Revenue v. Goodwyn Crockery Co.* 315 F.2d. 110

2. *Coast Quality Constructions Corp. v. United States*, 463 F.2d. 503

business that has been acquired undergoes a *major change* in the *nature or conduct* of such trade. Stated differently, the section allows a loss carryover under s.177 even if there has been a change in ownership, if the business had been sold as a going concern and is continued to be carried on without a major change in its trade or in the manner of its conduct. As under s.382(a) of the United States Code, s.483(1) places no reliance on intent or purpose. What constitutes a "major change in the nature or conduct of a trade" is defined in s.483(3). It includes

- "(a) a major change in the type of property dealt in, or services or facilities provided, in the trade, or
- (b) a major change in customers, outlets or markets of the trade..."

This definition in s.483(3) applies even if the change is the result of a gradual process which had begun outside the three year period contemplated in s.483(1).³

The Income Tax Act (Canada), 1974.

Section 111(1) of the Canadian Act permits the carryover of losses. This is subject to s.111(5) which reads as follows:

"Sub-section (1) does not apply to permit a corporation to deduct, for the purpose of computing its taxable income for a taxation year, such portion of its non-capital loss from carrying on *any particular business* if

- (a) control of the corporation has been acquired, before the end of the year, by a person or persons who did not, at the end of that preceding year, control the corporation and the corporation was not, during the year, carrying on *that business*, or
- (b) control of the corporation was acquired, before the end of the year and after the winding up or discontinuance of that business, by a person or persons who did not control the corporation at any time during that preceding year when *that business* was being carried on." (emphasis added).

Two features need particular mention. The first is that the carry-over is available for losses "from carrying on *any particular business*." The second is the reference to carrying on "*that business*". An examination of the section in its historical context assists in its understanding. The original section, s.5(1)(p)(iii) of the Income War Tax Act (Statutes of Canada, 1942-43, Ch. 28), read as follows:

"nothing is deductible in respect of a loss unless the taxpayer carried on *the same business* in the taxation year as he carried on in the year the loss was sustained" (emphasis added).

The section was changed in the 1949 Act, and the new section, s.26(1)(d)(iii) read as follows:

"no amount is deductible in respect of losses from the income of any

3. Section 483(3)

year except to the extent of the lesser of

- (A) the taxpayer's income for the taxation year from *the business* in which the loss was sustained . . ." (emphasis added).

*Minister of National Revenue v. Eastern Textile Products Ltd.*⁴ was concerned with two issues. The taxpayer contended firstly, that the change in the words of the Act from "the same business" to "the business" had resulted in a broadening of the loss carryover benefit. Secondly, it was contended, that the words "the business" in s.26(d) meant essentially the business of the taxpayer as it might be from time to time. The Court rejected the first contention and held the amended legislation to be more restrictive. It pointed out that where a taxpayer carrying on business A in year 1 sustains a business loss, and in year 2 carries on business A and B and makes a profit on business B only, s.5(p) would have entitled the taxpayer to set off the loss from the profits of business B.⁵ Section 26(1)(d), the amended section, did not permit this. Secondly, the Court said that s.3 of the Act contemplated that a taxpayer may carry on more than one business and that concept was embodied in s.26(1)(d). The Court therefore held that any argument that "business" in s.26(1)(d) should mean whatever the company was doing from time to time, would be in conflict with the section, because this would be tantamount to saying that the taxpayer's business would always be the same.

The Australian Income Tax Assessment Act, 1936-1976

The Australian legislation is contained in s.80E. It reads:

"80E (1) Subject to sub-section (2), where —

- (a) the whole or a part of a loss incurred by a taxpayer, being a company, in a year before the year of income would not, but for this section, by reason of a change that has taken place in the beneficial ownership of shares in the company or in any other company, be taken into account for the purposes of section 80 or section 80AA;
- (b) in the first-mentioned company carried on at all times during the year of income and the same business as it carried on immediately before the change referred to in paragraph (a) took place; and
- (c) the first-mentioned company did not, at any time during the year of income derive income from a business of a kind that it did not carry on or from a transaction of a kind that it had not entered into in the course of its business operations, before the change took place,

sections 80A and 80DA do not prevent the whole of the loss being so taken into account.

80E(2) Sub-section (1) does not apply in respect of a loss incurred by a taxpayer being a company in a year before the year of income if —

4. [1957] C.T.C. 48

5. *Id.*, at 56

- (a) before the change took place, the company commenced to carry on a business that it had not previously carried on or entered into, in the course of its business operations, a transaction of a kind that it had not previously entered into; and
- (b) the company commenced to carry on that business or entered into that transaction for the purpose, or for purposes that included the purpose, of enabling the company to take into account, by virtue of sub-section (1), for the purposes of section 80 or section 80AA, a loss that the company had incurred in a year before the first-mentioned year or might incur in the first-mentioned year."

Section 80E(1)(b) requires the taxpayer to have carried on the *same business* during the year of income as it had carried on immediately before the change in ownership took place. Like the provisions under the United States, United Kingdom and Canadian Codes, a claim under this head would only arise if there has been a change in the shareholding. The deduction under this alternative is denied if the company at any time during the year of income derives income from a business that it did not carry on, or from a transaction of a kind that it had not entered into in the course of its business operations before the change took place. The deduction is also to be denied if, before the change in the ownership of the shares in the company, the company had commenced to carry on a business that it had not previously carried on, or entered into a transaction of a kind that it had not previously entered into having as its purpose or as a purpose, the taking advantage of a loss that has been or will be incurred. Its effect, therefore, is to treat such transaction or change in business as having occurred after the change in ownership. But if the transaction entered into or the change in business had not been prompted by tax considerations the loss carryover will be available. Whether mere awareness or knowledge would constitute the requisite purpose is uncertain. Obviously, fine differentiations could arise.

GENERAL COMPARISONS

The requirements under each Code, it would seem, differ. The Canadian Code requires continuity of *the business*, the Australian Code requires continuity of *the same business* and the United States Code requires continuity of *substantially the same business*. The United Kingdom Code denies the deduction where there has been a *major change* in the *nature or conduct of the trade*. *Major change*, as required under the United Kingdom Code, permits some degree of change thus bringing it closer to the United States Code. The requirement of continuity of *the business* under the Canadian Code, has been interpreted to mean *same business*, thus leaning it more towards the requirement under the Australian Code. The reference to trade in the United

Kingdom Code is synonymous with the reference to business in the other Codes except that the notion of business is wider than that of trade.⁶ Two characteristics however, are common and fundamental to all four Codes. The first is that the business must be carried on. Secondly, (though subject to the particular requirements of each Code) the business carried on must be the same business as was carried on during the years of loss. The same two matters also arise for consideration in the business reactivation cases.

THE BUSINESS MUST BE CARRIED ON

Ordinarily, a gain against which the loss can be taken is not realized unless some business is carried on.⁷ In bankruptcy cases, however, the Courts have held that a trader who has put up his shutters and has in fact ceased to trade, is still to be regarded as continuing to carry on business until all trade debts have been paid and all sums due have been collected.⁸ But the Courts have held that this rule applicable to bankruptcy cases does not extend into the field of taxation law.⁹ Furthermore, statements, such as those of Lord Sumner in *South Behar Railway Company Ltd. v. Inland Revenue Commissioners*¹⁰, that business is not confined to being busy, that in many businesses long intervals of inactivity occur, and that the important thing is that the old business still continues getting some return for capital invested,¹¹ would be incorrect as general propositions. Much would depend on the nature and character of the business, as the action of carrying on business would vary with the particular business concerned. The nature or conduct of some business may be such that its carrying on requires little activity. This is evidenced from the facts in the *South Behar Railway Co.* case itself. The question there was whether a railway company receiving annuities (from the sale of a railway to the Crown) and interest from investment in National War Bonds and other sources, and while it distributed annually to its stock holders, was carrying on a business so as to be liable to corpo-

6. In *National Association of Local Government Officers v. Bolton Corporation*, [1943] A.C. 166. Lord Wright speaking on the word "trade" said at 184 (House of Lords) "Indeed, 'trade' is not only in the etymological or dictionary sense, but in legal usage, a term of the widest scope. It is connected originally with the word 'tread' and indicates a way of life or an occupation. In ordinary usage it may mean the occupation of a small shopkeeper equally with that of a commercial magnate. It may also mean a skilled craft . . ."

7. *Commissioner of Internal Revenue v. Barclay Jewellery, Inc.*, 367 F.2d 193, at 196.

8. *Theophile v. The Solicitor General*, [1950] A.C. 186; *In re Bird v. Inland Revenue Commissioners, ex parte The Debtor*, [1962] 1 W.L.R., 686.

9. *Tryka Ltd. v. Newall* (1963), 41 T.C. 146, at 158 (per Wilberforce, J.)
10. [1925] A.C. 476.

11. *Ibid.*, at 488. See also *Commissioners of Inland Revenue v Barr*, 35 T.C. 293; *Hillerns and Fowler v Murray (Inspector of Taxes)*, 17 T.C. 77; *Household Products Co. Ltd. v Minister of National Revenue*, 34 Tax A.B.C. 441..

rations profits tax. The House of Lords held that in the circumstances, the taxpayer was carrying on its business. The point to note is that the Crown always had the option to acquire the railway at any time from the taxpayer, that the railways were actually worked by another company for the Crown, and that the taxpayer had received part of the profits in consideration for having applied the funds and materials for the construction of the railway.

In *Inland Revenue Commissioners v. Korean Syndicate Ltd.*,¹² a syndicate was formed to acquire and work certain concessions and to turn them to account; and to invest and deal with moneys not immediately required. During the relevant years, the syndicate's activities had been confined to receiving the bank interest and royalties which were its only income, in paying the premiums on a sinking fund policy, and in distributing the surplus amongst its shareholders. The Court found the syndicate to be carrying on the business it had been incorporated for — that of acquiring concessions and turning them to account — and that the profit derived therefrom was liable to excess profits duty. It must be noted, that in this case, as in the *Behar Railway Case*, the taxpayers were in receipt of passive income.

In the Australian decision of *Avondale Motors (Parts) Pty. Ltd. v. Federal Commissioner of Taxation*¹³ the taxpayer whose name was C & G Parts Pty. Ltd., had, up to 1966, been in the business of selling and servicing motor vehicles and in selling motor spare parts for vehicles it had franchises on. It suffered losses, and by the end of June 1967, all the four premises at which it had carried on its business were closed down and the employees paid off. By July 1967, it had disposed of all its stock-in-trade and plant and its only office equipment comprised some stationery. From July 1967, till February 1968, the taxpayer's only activity was to pay off debts and receive payments which actually was done by another company acting on behalf of the taxpayer. The taxpayer owed moneys to that other company, and in fact, it later assigned to that other company debts owing to it (the taxpayer). On March 15, 1968, the taxpayer's shareholding was acquired by Avondale Motors Pty. Ltd. It appointed a new Board of Directors and a new Secretary, and changed the taxpayer's name to *Avondale Motors (Parts) Pty. Ltd.* The Commissioner had formed the opinion that prior to March 1968, the taxpayer was not carrying on any business and therefore denied the deduction. The Court in holding for the Commis-

12. [1921] 3 K.B. 258.

13. 71 A.T.C. 4101.

sioner said as follows:

"In some cases the very nature of the business is such that its conduct may require little activity, e.g. the business, considered in *I.R. Commrs. v. Korean Syndicate Limited* [1921] 3 K.B. 258, of acquiring a concession and turning it to financial benefit. However the business of a dealer in Motor Parts and accessories is not one that can be conducted with mere passivity . . . In the present case the taxpayer's activity had ceased completely. The cessation of activity was not due to the nature of the business which the taxpayer carried on, or to some temporary adversity which the taxpayer intended to endeavour to overcome; it was due to a decision to discontinue the business previously carried on because it was unprofitable and there was no intention to resume the conduct of that business."¹⁴

The mere filing of returns and reports will not amount to the carrying on of the business.¹⁵ Nor will a temporary investment in stocks and securities of funds realized from the sale of the taxpayer's assets of a previous business.¹⁶ Looking around for another business after the cessation of the one business will not amount to the carrying on of a business.¹⁷ Where a corporation sells off its capital stock, does no business for two years, and thereafter resumes its former operation, there will be no continuous carrying on of the business.¹⁸

Where a business has been "conclusively terminated" there obviously will be no continuity. Thus in *S.F.H. Inc. v. Commissioner of Internal Revenue*,¹⁹ the taxpayer, a furniture retailer, had sold off its operating assets including accounts receivable for cash on October 27, 1961 (eight months before the end of its taxation year on June 30, 1962), and ceased to carry on any trade or business from that date. The Court held that the taxpayer had "conclusively terminated" its business and as such was not entitled to carry over its losses to its tax year ending June 30, 1962.

The business carried on must be the same business

Carrying on the business of a brewery is a business different from that of bottling and supplying beer, or the managing of "tied houses". This is evidenced from two United Kingdom decisions. In *Gordon and Blair Ltd. v. Commissioner of Inland Revenue*²⁰ the Court held that a brewery company which had ceased brewing but continued to bottle and sell beer made to its specification by another brewer was not carrying on the same business but had commenced a fresh trade of bottling and selling

14. *Id.*, at 4105.

15. *United States v Fenix and Scisson, Inc.*, 360 F.2d 260.

16. *Exel Corporation v United States*, 451 F.2d 80.

17. *Baldwin Associates Ltd. v Minister of National Revenue* (1951), 3 Tax A.B.C. (Canada) 346.

18. *Barclay Jewellery, Inc. supra*, n. 7.

19. 444 F.2d 139.

20. (1962), 40 T.C. 358.

beer. In *Frederick Smith Ltd. v. Commissioner of Inland Revenue*²¹ the taxpayer, a brewer, bought certain "tied houses" from another. The latter had, up to this time, relied on outside sources of supply for the tied houses. The Court held that the taxpayer had not succeeded to any part of the latter's trade or business *quoad* the tied houses.

Leasing out a garage and operating a garage are different businesses. Thus in the Canadian case of *Bay-Adelaide Garage Limited v. Minister for National Revenue*²² the Court held that the lessor of a garage who commenced the business conducted by the lessee for nearly twenty years had commenced a new business. Similarly in *Case No. 678 v. Minister for National Revenue*²³ the Court held the conversion of a used car sales and service business to a service station business not to be the same business.

A change from manufacturing and selling to selling products manufactured by others would not constitute the same business. In *Minister of National Revenue v. Ottawa Car and Aircraft Limited*²⁴ the taxpayer had, since 1913, carried on the business of manufacturing and selling motor cars and parts, aircraft, aircraft engines and parts, street-cars, and seats for trucks and buses. It also carried on a general metal working business, provided engineering services and acted as agent for other manufacturers of aircraft and aircraft engines, and in addition, received certain rental incomes. It suffered heavy losses in 1946 and 1947, and thereupon ceased its manufacturing operations. It then sold its machinery and leased its premises. By the end of 1949 it had sold eighty percent of its machinery and kept the remainder in storage with another company. On February 1, 1950, it leased most of its property to the government for a period of ten years, by which time, it had ceased its manufacturing business and never resumed it.

Around October 1950, the taxpayer entered into a joint venture for the purchase and resale of aircraft engines, the resale to be done by a third company acting as a commission agent. The taxpayer's head office was moved to another city in 1951. Its employees had been reduced from one hundred and fifty in 1946-47, to three in 1951. It still owned twenty percent of its old machinery but made no use of it and continued receiving rental income. It argued that since, in 1946 and 1947, it had some aircraft parts in stock and had sold them at a loss, and since, in

21. (1950), 29 T.C. 419.

22. (1951), 4 Tax A.B.C. 388.

23. (1959), 23 Tax A.B.C. 267.

24. [1957] C.T.C. 59.

1951, it was engaged in the sale of aircraft parts, it was entitled to set off its previous losses against its 1951 profits. The Court rejected the argument on the ground that the taxpayer's losses had been sustained in the manufacturing business which had since been abandoned, long before 1951.²⁵

In *Diamond Tea Gown Co. of Canada v. Minister of National Revenue*,²⁶ the taxpayer, a manufacturer of women's clothing had with a view to restricting its activities, sold its machinery, leased its premises, and transferred the right to use the name of the company, the contracts for style applications, and all trademarks, registered and unregistered to the purchaser. It also transferred to the purchaser the services of its key employees and made arrangements with a third person whereby the latter, was to look after the cutting, trimming and the making of the garments. The vendor was to continue the business till January 1, 1947, whereafter the vendor was only to purchase piece goods, make patterns and arrange sales. Taxpayer suffered losses in 1947 which it sought to set off against its 1946 income. The Court held that by its sale of October 29, 1946 the taxpayer had sold the business it had carried on till that date and was to continue till January 1, 1947. It found that even though taxpayer had continued to do business in ladies clothing, and continued to design exclusive patterns, purchased piece goods and had them made up, what it was carrying on was a business *similar* to the one it carried on in 1946, and not the *same business* as required under the Act. This decision would be of particular relevance to Australia. The Australian case of *Avondale Motors (Parts) Pty. Ltd. v. Federal Commissioner of Taxation*,²⁷ also has special significance in this area. In considering the question whether the same business had been continued, the Court there said:

"Before 15 March 1968, the taxpayer carried on the business of dealer in motor parts and accessories at three different premises in conjunction with a motor dealer having franchises for certain vehicles. After that date it carried on *the same kind of business* but under a different name, at different places, with different directors and employees, with different stock and plant and in conjunction with a motor dealer having different franchises. The question whether a company has commenced a new business or has continued an old business under different conditions is simply one of fact. In some circumstances a company may expand or contract its activities, it may close an old shop and open a new one, without starting a new business, but the only conclusion that can be drawn from all the circumstances of the present case is that the business of the taxpayer after 15 March 1968 was different from that which it carried on before that date."²⁸ (emphasis

25. See also the United Kingdom decision of *J.G. Ingram and Son Ltd. v Callaghan (Inspector of Taxes)*, [1969] 1 A.E.R. 433, *infra*, n.40. and 61.

26. (1950), 3 Tax A.B.C. 74.

27. For its facts, *supra*, n.13 at p.9

28. *Id.*, at 4105.

added).

Changes in name, location, employees, and customers

A change in location will not in itself constitute a change in the business.²⁹ Nor will a mere change in name amount to a change in the business. But it will be one of the factors that will be taken into consideration. Thus in *Holiday Knitwear Limited v. Minister of National Revenue*³⁰ (Canada) the taxpayer in support of its claim of continuity of the business, argued that it was, as before, carrying on a knitting business, was manufacturing knitted outerwear and fabrics, was selling them to the same class of customers (in many cases to the identical customers), was using the same type of machinery and to a considerable extent the same machinery, the same processes, and the same materials. But the Court found against the taxpayer. It found that by May 31, 1958:

"the name 'Modern Textiles Corporation Limited' had disappeared; the shareholders were all different and so were the directors; all the old employees had been replaced; the business premises were in a new location; and only a small percentage of the machines in use were reminiscent of Modern Textiles and these were being frequently changed."

and concluded:

"On May 31, 1958, it would have been very difficult for the suppliers and creditors of Modern Textiles to see any similarity between that company and Holiday Knitwear Limited. For one thing, they had become very wary in dealing with Modern Textiles . . ."³¹

The change in name might amount to the "last straw". Thus in *Maple Ridge Holdings Limited v. Minister of National Revenue*,³² Maple Ridge Lumber Company Limited had in 1954, sold its sawmill to Maple Ridge Lumber Company 1954 Limited which had been incorporated to acquire all the assets of the former. After the sale, Maple Ridge Lumber Company Limited changed its name to Maple Ridge Holdings Limited. Holdings Limited sought to set off its profits against losses it had suffered when it was Maple Ridge Lumber Company Limited. The Court held that after the sale in 1954, Maple Ridge Lumber Company Limited had ceased to be in the lumbering business and that Maple Ridge Lumber Company Limited and Maple Ridge Hold-

29. In *Martin & Co. (E.P.) Limited v. Minister of National Revenue* (1959), 22 Tax A.B.C. 254 relocation was in the same town; in *Roy Hoffman v. Minister of National Revenue* (1950), 2 Tax A.B.C. 154 relocation was in another city. In *Mendel Farber v. Minister of National Revenue* (1951), 4 Tax A.B.C. 116 the Court said that the taxpayer need not necessarily carry on his business in the same location during the year of profit and year of loss as long as it was in the same business (at 119). But nevertheless the Court held that the taxpayer's second partnership with different partners to the person with whom the taxpayer was in partnership first, and having a somewhat different method of operation at a different location, was not the same business.

30. (1963), 31 Tax A.B.C. 30.

31. *Id.*, at 48.

32. (1963), 33 Tax A.B.C. 381.

ings Limited were not the same entity. The Court said:

"Not only were the losses referred to in the financial statement not sustained in the same business as the one in which the appellant was engaged in 1955, but in addition were sustained by another corporation."³³

The United States decisions take a similar approach. Thus in *Goodwyn Crockery Co. v. Commissioner of Internal Revenue*³⁴ the Court found that:

"While Goodwyn did shift its principal office it remained within the area of its original territory. We do not think selling partially at retail, instead of entirely at wholesale substantially change[d] its business as a merchandiser. Goodwyn retained its corporate name, its real and personal assets and some of its customers . . ."³⁵

Again, in *Euclid-Tennessee v. Commissioner of Internal Revenue*³⁶ the Court said,

"The basic character of the business was also substantially changed by the addition of new employees, new customers, and the new product — heavy equipment and machinery. The charter of the corporation was likewise changed to correspond with that of the old Euclid-Tennessee, Inc. Other prime factors indicating a change in the business are *the change in name* and the change in location. The petitioner immediately took the name of the profitable corporation which was absorbed by it. And it continued to operate from the location of the profitable business and adopted this new address as its business address. These facts point to a substantial change in petitioner's business as contrasted with a continuation of substantially the same business."³⁷ (emphasis added)

Changes In Product

In *Glen Raven Mills Inc. v. Commissioner of Internal Revenue*,³⁸ the taxpayer acquired substantially all of the stock of Asheville Hosiery Co. on May 12, 1964. Asheville had manufactured hosiery on 26 full fashioned knitting machines and 91 seamless knitting machines. Glenraven converted Asheville's full fashioned knitting machines for use in making flat fabric rather than hosiery and used it to make crimped yarn. Asheville continued to make hosiery on its seamless knitting machines until the end of 1965. The Revenue contended that up to the time of the takeover, Asheville manufactured only seamless hosiery and that, although this business was continued in somewhat modified form for about a year after the takeover, it took on an entirely new business after the takeover, namely the manufacture of flat fabric for Glen Raven's knit de knit operations. Additionally, it pointed out that by the end of 1965, Asheville

33. *Id.*, at 383.

34. 315 F.2d 110.

35. *Id.*, at 112.

36. 41 T.C. 752 (affirmed by the Court of Appeals in 352 F.2d 991).

37. 41 T.C. at 760.

38. 59 T.C. 1.

knitted no hosiery at all and that all of the seamless-hosiery knitting equipment had been moved out in order to install machines for knitting double knit fabric.

The taxpayer contended that this description of Asheville's business was too narrow and that at all relevant times Asheville was engaged in the business of knitting yarn into fabric. It relied on the fact that both before and after the acquisition Asheville had used the same machinery and employees to manufacture knitted products and that it was not until 1966 that it began using its new double knit equipment. The Court held for the taxpayer quoting the well-known statement in the *Goodwyn Crockery* case that s.382(a) did not require the corporation to pursue exactly the same business after the acquisition but substantially the same business. The Court said:

"In this case Asheville's existing equipment was quickly converted from making full fashioned hosiery to making flat fabric. Although respondent makes an issue of the fact that flat fabric and hosiery look quite different to an average individual, we believe that to a person in the knitting business they are quite similar. The fact that the two products could be made on the same machine indicates that there was an intrinsic similarity between them."³⁹

But it must be noted that the Court also found that the taxpayer had continued to make seamless hosiery up to the end of 1965 in "quantities which were greater than existed before the acquisition", that these had been continued to be sold through the same broker as before the takeover.

In *J.G. Ingram & Son Ltd v. Callaghan (Inspector of Taxes)*⁴⁰ the taxpayer had substituted plastic for rubber in manufacturing surgical and pharmaceutical goods. The Court held there to have been no change in the product manufactured.

Changes in the manner of conducting the business

In *Island Motor Transport Limited v. Minister of National Revenue*⁴¹ the taxpayer operated a bus route under franchise. In 1951, the taxpayer leased its franchise for a period of ten years to another company also operating a bus route under franchise. Taxpayer sought to set aside its losses incurred prior to 1951 for the rental income derived thereafter on the ground that it was still carrying on the same business. It contended that while formerly it had provided transportation facilities directly by itself, it now provided the same service through an arrangement with the lessee of the franchise. The Court rejected the compa-

39. *Id.*, at pp. 12-13.

40. [1969] 1 A.E.R. 433.

41. (1963), 33 Tax A.B.C. 365.

risson and held the taxpayer not to be carrying on the same business. It said:

"Holding a franchise and the operation of it are two separate things. A franchise confers the right to do something under certain conditions. It is an incorporeal right authorizing something to be done. The operation of a franchise is the carrying on of a business and as such is distinguishable from the simple holding of the franchise."⁴²

A change from a wholesale to an agency commission sales business will result in a change in the business. In *Waldmans Ltd. v. Minister of National Revenue*⁴³ the taxpayer having suffered losses as a wholesaler of ladies clothing, discontinued its business. In the next tax year it bought an agency business in the same line of goods and sold the merchandise purely on a commission basis. The two businesses were held not to be the same on the ground that the first consisted of selling goods that the vendor owned, whilst the second was the sale of goods owned by another. A change from the manufacturing and sale of goods to selling goods manufactured by another to order, amounts to a change in the business.⁴⁴ But a change from the cash sale of goods to a method whereby the purchaser is financed by the supplier does not amount to a change in the business. Thus in *Armand Garand v. Minister of National Revenue*⁴⁵ the taxpayer, a distributor of electrical appliances, incurred a loss in 1956 because it was unable to sell on credit. The suppliers thereafter financed the taxpayer's customers. The Revenue denied a deduction from the 1957 income of losses incurred in 1956 on the ground that the taxpayer had been self-employed in 1956, whereas in 1957, was employed by the supplier. The Court however granted the deduction as it found that the agency had remained the same throughout and that it mattered little how and on what terms the appliances had come to the agency.

Expansion of an existing business

In *Laycock (Inspector of Taxes) v. Freeman, Hardy and Willis Ltd.*⁴⁶ the taxpayer, a wholesaler of shoes, had liquidated two of its subsidiaries and taken over their assets, goodwill and staff. The taxpayer had previously received between twenty to thirty percent of its requirements from these two subsidiaries. There was held to be no continuity in the business of the subsidiaries even though the taxpayer continued to maintain separate books of account for the two subsidiaries. The case of

42. *Id.*, at 373.

43. (1951), 5 Tax A.B.C. 232.

44. *Minister of National Revenue v Eastern Textile Products Ltd.*, [1957] C.T.C. 48; see also *Minister of National Revenue v Ottawa Car and Aircraft Ltd.*, [1957] C.T.C. 59.

45. (1960), 24 Tax A.B.C. 46.

46. [1938] 4 A.E.R. 609.

*Briton Ferry Steel Company Ltd v. Barry (Inspector of Taxes)*⁴⁷ involved a merger between a parent and its subsidiary. The taxpayer there manufactured steel bar and sold some of it to a subsidiary which used it to manufacture tinplate. The subsidiary was later wound up and its assets and undertaking transferred to the taxpayer. The taxpayer was found to have succeeded to the part of the trade previously carried on by its subsidiary and was held liable for tax to that part of the profits of the subsidiary's business. The Court found that the distinguishing feature between this case and *Freeman, Hardy and Willis* was that in *Freeman, Hardy and Willis* the essential activity of the subsidiary companies had disappeared altogether, after the amalgamation — that essential activity being the wholesaling of goods manufactured by it. All that was left of the activity of the subsidiary companies was the actual manufacturing, a thing which, by itself, produced no profits.

Two other United Kingdom decisions are also in point. In *James Shipstone and Sons Limited v. Harris (Inspector of Taxes)*⁴⁸, the taxpayer, a brewery, acquired by a share exchange, control over the Beeston Brewery Company. The taxpayer purchased the stock and loose effects of the Beeston Company and leased for itself, the brewery and tied houses of the Beeston Company. It subsequently purchased the brewery at a valuation. All this happened within a period of eighteen months. The Court found that the taxpayer had succeeded to the business of the Beeston Company. In *Bell (Surveyor of Taxes) v. National Provincial Bank of England Limited*,⁴⁹ the taxpayer, a bank with several branches, bought the business, the premises, and assets, of a small provincial bank and thereafter converted it into one of its branches. It continued to retain the existing manager and staff. The Court found the taxpayer to be continuing its business along with the business it had acquired. Finally, the United States Case of *Commissioner of Internal Revenue v. Goodwyn Crockery Co.*⁵⁰ must once again be noted. Before being acquired by another company the taxpayer had been engaged in the selling of housewares at wholesale; after its acquisition, a new business of selling dry goods at retail was added on to it. The Tax Court held that the taxpayer had continued to carry on the business of selling housewares at wholesale and that the change in place of business and customers was only minor. Upon appeal, the decision was affirmed by the Sixth Circuit. However, it expressly indicated that it would have decided differently had

47. [1939] 4 A.E.R. 541.

48. (1929), 14 T.C. 413.

49. [1904] 1 K.B. 149.

50. 315 F.2d 110; supra n.34 and 39.

it decided the case originally.

As the Australian and Canadian Assessment Acts require continuity of the same business, the decision in *Goodwyn Crockery Co.* and *Briton Ferry Steel Co.* would be decided differently in these two jurisdictions. The degree of expansion permissible under the Assessment Act would be limited to the same line of business and will not extend to the addition of a new line of business. In other words, only horizontal and not vertical expansion would, if at all, be permissible.

Reactivating inactive businesses

The business reactivation cases can be grouped into three categories. The first is where an inactive business is reactivated, the ownership remaining the same throughout. The second is where an inactive business changes ownership and is subsequently reactivated by the new owners. The third situation is where an active business changes ownership, becomes inactive, and is subsequently reactivated.

Reactivating inactive businesses in circumstances where ownership has remained the same.

Two United Kingdom and two Canadian decisions are directly in point. In the United Kingdom decision of *The Merchiston Steamship Co. Limited v. Turner (Surveyor of Taxes)*⁵¹ the Memorandum of Association permitted the company to own only one ship at any one time but was empowered on the loss or disposal of such ship to acquire and trade with another ship. The "Merchiston", the only ship owned by the company, was lost in April 1906, and in the following month an order was given for another ship, the "Veraston", which commenced her first voyage in October, 1906. The Court held that the business of the company was continuous. In *Aviation and Shipping Co. Ltd. v. Murray (Inspector of Taxes)*⁵² the taxpayer had, in 1947, acquired two ships by exercising an option given by a third person to its subsidiary. On 30 December, 1954, the taxpayer took over the two ships of its subsidiary company, and there was thereupon a discontinuance of the trade of the subsidiary company and a succession to that trade by the taxpayer company. In March, 1955, taxpayer sold these two and another ship of its own as they had become "old, slow and obsolete", and it bought 3 modern, faster vessels. The Court held that there had been no disconti-

51. [1910] 2 K.B. 923.

52. [1961] 2 A.E.R. 805.

nuance of the trade by the sale and replacement of the ships in 1955, as the taxpayer was only replacing its stock-in-trade, and that the trade itself was an organized enterprise seeking profits by the use of the ships.⁵³

In both *Roy Hoffman v. The Minister of National Revenue*⁵⁴ and *Martin and Company (E.P.) Limited v. Minister of National Revenue*⁵⁵ the taxpayer's premises had been destroyed by fire. In the *Hoffman* case the taxpayer was a retailer of hardware who subsequently relocated his business in another city; in *Martin's* case the taxpayer was a retailer of clothing who subsequently bought another clothing outlet in the same city. In both instances the Court held for the taxpayer finding there to be a continuity of the business. In both cases the period of discontinuity was for less than one year, and in both cases the temporary discontinuance of the business had been forced upon them by circumstances which were not the doing of the taxpayers.⁵⁶

Reactivating inactive businesses after a change in ownership.

With few exceptions, the courts have tended to construct this situation against the taxpayer. In the Canadian case of *Roscommon Builders Limited v. Minister for National Revenue*⁵⁷ the taxpayer company after incorporation in 1955, had built 10 houses during the taxable years 1956 and 1957. It suffered losses of over \$10,000 when compelled to rebuild to comply with the health and building regulations. The taxpayer remained idle in 1958. Taxpayer was entitled to get 25 National Housing Act mortgages, and in view of this asset, the taxpayer was sold in 1958 for \$3,500. The new owners sought to deduct the losses incurred in 1956-1957. The Court denied the deduction. It found that:

"there was no continuity of the appellant's business when Roscommon Builders Limited recommenced activities after it was taken over by the Wingold Brothers in July of 1958. The purchasers . . . took over no assets whatsoever other than a right or privilege to obtain mortgage monies from the National Housing Act Authority by reason of the company's previous activities in its housebuilding operations in previous years. Nor did they take over any of the liabilities of the company to its previous shareholders at the time the change of ownership took place . . . It is true that subsequent to July 1958 the appellant was carrying on the same type of business as had been carried on by the company in 1956 and 1957, but, in my opinion, it cannot be said that the business carried on in . . . [1959] was the business which had been carried on under the name of Roscommon Builders Limited in 1956 and 1957."⁵⁸

53. But note that in both instances it was the taxpayer who contended that there was no continuity in order to avoid paying "supertax".

54. (1950), 2 Tax A.B.C. 154.

55. (1959), 22 Tax A.B.C. 254.

56. See also the United Kingdom decision of *Wild v Madam Tussaud's (1926), Ltd.* (1932) 17 T.C. 127.

57. (1963) 34 Tax A.B.C. 121.

58. *Id.*, at 132.

In *Goff (Inspector of Taxes) v. Osborne and Co. (Sheffield) Ltd.*,⁵⁹ premises of the taxpayer at which it had carried on an electro-plating business and other allied activities were compulsorily taken over for slum clearance in 1939. It ceased business thereafter and its registered office was moved to its accountant's office which was "equivalent to putting it on the shelf", from where nothing in the way of trading could be done. The taxpayer's shares were sold in 1944. The new owner transferred a brass casting and plating business together with the premises to the taxpayer company. The Court found the events between 1939 and 1944 to have completely destroyed the identity of the former trade. "It did not merely suspend it, but it put an end to it." Vaisey J. said:

"I have not only to look at the continuity or the correct historical origin, but I have to find if those two trades are the same trades and for that I think there is no justification of the facts as found by the Commissioners. Obviously there was a complete cessation, on the evidence, of this trade when it sold its book debts and reported that it was going out of business to the local tax authorities. I should have thought that it is obvious that there was no continuity between the business now carried on and the other one, whether it was a case of succession or a new business . . ."⁶⁰

*J.G. Ingram and Son Ltd. v. Callaghan (Inspector of Taxes)*⁶¹ is another instance where the Court held there to be no continuity of business. The taxpayer had, from its incorporation in 1916 to September 1961, carried on the trade of manufacturing and selling pharmaceutical rubber goods. From 1955 it began to suffer heavy losses owing to the substitution of plastic for rubber by its competitors which was cheaper and longer lasting. In 1960 a receiver was appointed who sold off the company's factory but not its machinery. In the same year Redland Holdings (another subsidiary of the taxpayer's parent company) acquired the taxpayer's shares and machinery, and conducted the taxpayer's business from Hainault, where Redland Holdings was located. In May 1961, the taxpayer ceased its manufacturing operations. It sold off its stock and paid off its staff. In September 1961, it closed its factory. For nine months thereafter, the products made of plastic by another subsidiary of Redland Holdings called Martindill Ltd. were sold under the taxpayer company's name and to the company's old customers at prices fixed by the company's old contracts. This did not prove to be too successful and in June 1962, Redland Holdings sold the machine and the materials and goods of Martindill Ltd. to Plastage (Sussex) Ltd. and transferred to it the issued shares of the

59. (1953), 34 T.C. 441.

60. *Id.*, at 446.

61. [1969] 1 A.E.R. 433; *supra*, n.40 and 25.

taxpayer company. Plastage moved the machine and materials bought from Martindill, to another factory owned by Plastage and sold them to the taxpayer company which thereafter commenced business again. The question at issue was whether the taxpayer had permanently discontinued its trade in September 1961, and commenced a new trade in June 1962. The taxpayer contended that it had continued the same business throughout — that of selling — as this was what had produced the profits. Accordingly, it argued, that it was immaterial that in one period it had itself made the goods whereas in the other, it had purchased them already made. The end remained the same, that of achieving a profitable sale. The Court rejected the contention, Donovan L.J. saying,

“I doubt if one can, as a rule, segregate the various activities involved in carrying on a trade, select one of them as being of the essence, and then designate the one selected as being the real trade. There is, I think, an organic unity about a trade which invalidates this sort of dissection; and I think that Rowlatt J. was saying much the same thing, though more incisively, when he remarked in *Graham v. Green (Inspector of Taxes)* [1925] A.E.R. 690 that a trade differs from the individual acts which go to make it up, just as a bundle differs from odd sticks. If the taxpayer company had been asked in period number one what its trade was, it would have replied: ‘Making and selling surgical products’ — not merely ‘Selling surgical products’. And in period number two, if asked the same question, I think the company would have replied, and properly replied, ‘we have changed over now simply to selling’ . . .”⁶²

The United States decisions are governed by Regulation 1.382(a) — 1(h)(6) of the Internal Revenue Code. The regulation in effect provides that where the taxpayer corporation is not carrying on an active trade or business at the time of the change in ownership but is subsequently reactivated in the same line of business, it had originally conducted, the corporation has not continued to carry on a trade or business substantially the same as that conducted before such change in ownership. Thus in *Fawn Fashions, Inc. v. Commissioner of Internal Revenue*⁶³ the taxpayer, a wholesaler of infants clothing, had incurred substantial losses during the first one and a half years of its operations and ceased operations in December 1955. In April 1956, after the taxpayer had been placed in receivership, its assets were sold. More than a year later, taxpayer’s franchise, corporate name, and other rights were purchased by a manufacturing and sales corporation which put the taxpayer through Federal bankruptcy proceedings and, in early 1958, transferred its sales activities to the taxpayer. The Court held that the taxpayer was not carrying on any active trade or business, within the meaning

62. *Id.*, at 436.

63. 41 T.C. 205.

of that section at the time of its acquisition. *Glover Packing Company of Texas v. United States*⁶⁴ was decided on similar lines. The taxpayer had commenced to carry on an abattoir and a meat packing business in 1950. Having suffered large losses, it ceased operations in May 1952, and did not resume the abattoir business until January 1957. In the meanwhile, the taxpayer had unsuccessfully attempted to recruit a new manager, and thereafter, leased the premises at a low rental. Upon the termination of the lease, the shareholders sold the taxpayer company to Mr. Glover, an experienced meat packer, who took over the management of the company and resumed operations in the abattoir. The Court found that the taxpayer's activities after the Glover acquisition were substantially the same operation as it had carried on prior to May 1952. But the Court denied the loss carryover deduction on the ground that the taxpayer had not suspended the operations but had discontinued them "without any firm purpose to resume them in the future". The Court said:

"But after the cessation of operations in May of 1952 plaintiff did not actively engage in the slaughterhouse business until after nearly 5 years had passed. During the interval, it bought no animals, dressed no carcasses, and, with the exception of an inventory liquidation, sold no meat. It had no operating employees, and completely discontinued the operation of an abattoir. During the 5 year period its activities consisted of leasing its plant to the Air Force . . . and to a local slaughterer . . . and to a large meat packer . . ."⁶⁵

*United States v. Fenix and Scisson, Inc.*⁶⁶ was another instance where the Court found that there was no continuity. The facts were that, from the time of its inception in 1936 until around 1948-49, Oronogo mined lead, zinc and ore until poor economic conditions forced it to abandon this, though it continued to sell quantities of ore up to 1951. From 1949 Oronogo had started quarrying for gravel. In 1953, only sales of gravel and chat were reported. From 1952 onwards, Oronogo systematically set about to sell off its assets including the equipment used in its coal mining operations through another company. On August 12, 1953, the Directors resolved to dissolve the company and on September 25, 1953, the Articles of Dissolution were filed. On October 11, 1955, the Directors rescinded the dissolution. Three days later the stockholders of Oronogo sold their stock to the taxpayer. The taxpayer retained Oronogo as a wholly owned subsidiary until October 31, 1957, when it liquidated Oronogo. In 1958 the taxpayer claimed to deduct the losses incurred by Oronogo in 1953, 1954 and 1955. The Court denied the deduction holding that the fact that the company was incurring some fixed

64. 328 F.2d 342.

65. *Id.*, at 347.

66. 360 F.2d 260.

expenses and filing tax returns did not mean it engaged in a trade or business. Most of the expense was to preserve the remaining equipment until it could be disposed of. The Court said:

"In any event, Oronogo's attempt to sell nearly all of its equipment is incompatible with the idea that it was merely standing by intending to resume operations should business factors improve. Had they been completely successful in selling equipment, they would have been unable to resume operations short of repurchasing necessary equipment."⁶⁷

These three cases are distinguishable from the subsequently decided cases of *H.F. Ramsey Co., Inc. v. Commissioner of Internal Revenue*⁶⁸ and *Clarksdale Rubber Manufacturing Company v. Commissioner of Internal Revenue*.⁶⁹ In *Ramsey's* case, the taxpayer corporation had been in the road construction business and had suffered losses up to 1956. Due to its precarious financial situation, and also in order to meet the requirements of the company to which it was bonded, it decided to limit its activities to completing projects on hand until it could see its way clear to take on more work if it desired to do so. Taxpayer found it necessary to sell most of its equipment as well as pay out all of its obligations, but there was no evidence that it had been intended at any time, to terminate the taxpayer's activities permanently. The taxpayer's stock changed hands in December 1957, and the new owners, who were also in the construction business, continued to carry on the business that the taxpayer corporation had carried on prior to the change in ownership. The Court held that there had been no break in the continuity of the taxpayer's business⁷⁰ but nevertheless denied the deduction under s269 of the Internal Revenue Code on the ground that the taxpayer had been acquired for the purpose of taking advantage of the tax benefit.

Ramsey's case was followed in *Clarksdale Rubber Company v. Commissioner of Internal Revenue*.⁷¹ The taxpayer had been incorporated in 1946 under the name of Dismuke Tyre and Rubber Co., Inc., and was engaged in the manufacture of rubber products for the automotive industry. Because of financial difficulties, taxpayer suspended its manufacturing operations

67. *Id.*, at 268.

68. 43 T.C. 500.

69. 45 T.C. 234.

70. In holding that the taxpayer had continued to carry on the same business the Tax Court placed considerable emphasis on the particular circumstances of the case. Thus the Court said at p. 515. "Here petitioner was required by its circumstances, its bonding company, and Ramsey's desire to assure that no outsiders suffered in their dealings with petitioner, to curtail its operations until it could see its way clear to take on more work if Ramsey desired to do so. While it took on no new projects after July 1956, it did complete the several projects then in progress. It was not until this became certain that petitioner could be in a position to take on new business . . ."

71. *Supra*, n.69

in March 1955 and leased its premises. In August 1955, the premises were sold to Cooper Tyre and Rubber Company, which, in turn, leased it to one of its subsidiaries, the Clarksdale Rubber Manufacturing Company. The latter used the premises to manufacture rubber goods for the automotive industry under its own name, till on April 30, 1958, it changed the taxpayer's name to Clarksdale Rubber Manufacturing Company. The Court held the taxpayer to have continued to carry on the same business. As the Court found:

"... the petitioner did not sell its assets. It retained its plant and equipment and leased them to a sister corporation under an agreement giving petitioner a share of the profits to be carried by the manufacture and sale of rubber products. Throughout the two year period from April 1956 to April 1958, petitioner negotiated with its creditors, defended its assets in law suits, sued to collect amounts receivable, and, in general, attempted to recover its financial health.

The substance of these transactions indicates that [Cooper] purchased a corporation engaged in the manufacture and sale of rubber products and continued thereafter to successfully operate it by temporarily segregating the income producing activities from the financial pressures brought to bear on petitioners' assets by its creditors."⁷²

Commenting on these two decisions the Court of Appeals in *Coast Quality Construction Corporation v. United States*⁷³ said:

"Our analysis of the suspension cases is consistent with an exception carved out by the Tax Court in *Clarksdale Rubber Co.*, 45 T.C. 234 (1965) and *H.F. Ramsey Co.*, 43 T.C. 500 (1965). In those cases where business was suspended because of economic circumstances and at all times it was intended that business would resume when conditions permitted, never fully divorced themselves from one endeavour."⁷⁴

What was to be established then is that at all times it was intended that the business be continued and that it was never intended that it be discontinued, though circumstances may have forced its contraction. *Goff (Inspector of Taxes) v. Osborne and Co. (Sheffield)*⁷⁵, it would seem, would have been decided differently if it had been established that immediately upon acquisition the taxpayer had set about looking for new business premises in which to resume business within a reasonable period of time.

The Australian decision of *A.G.C. (Advances) Ltd v. Commissioner of Taxation*⁷⁶ must next be considered. The taxpayer, a subsidiary of Master Butchers Ltd., had suffered losses in its business as a financier. Its operations were suspended in December 1968, after investigation by Inspectors appointed under the South Australian Companies Act. A scheme of com-

72. *Id.*, at 246.

73. 463 F.2d 503.

74. *Id.*, at 510 (footnote 5).

75. (1953), 34 T.C. 441; *supra*, n. 59.

76. 49 A.L.J.R. 105.

promise effective from March 17, 1969, was thereafter approved by the South Australian Supreme Court with regard to the taxpayer, Master Butchers Ltd., and one other. The scheme was for a period of five years and was in the nature of a creditor moratorium. A special manager was appointed under the scheme as agent of each company vested with the power to carry on the business of each company "in any way he should deem most advantageous and beneficial to the interests of members and scheme creditors", to wind up their affairs and to realize the assets, and "to sell the undertaking . . . the losses and structure" of the companies. Large sums were owing to the appellant for moneys lent and for sales on hire-purchase.

On December 23, 1969, the Australian Guarantee Corporation acquired the shareholding of Master Butchers Ltd. in the taxpayer. In release of its debts to Master Butchers, taxpayer was to transfer all its assets and net amounts received by it by way of collections of the debts due to it up to an amount of \$2,750,000. On April 17, 1970, taxpayer appointed Master Butchers Ltd. as its agent for a period of five years to collect and receive in trust and deliver all sums received in respect of debts owing to the taxpayer at that date and authorized it to commence proceedings for the recovery of such debts. The transfer of shares by Master Butchers Ltd. to Australian Guarantee Corporation was completed on the same date and taxpayer resumed its business as a financier. On May 8, 1970, the taxpayer's name was changed to its present name. On a preliminary point, the Court unanimously agreed that the debts continued to remain in the legal and equitable ownership of the taxpayer company and that there had been no assignment of the debts by the taxpayer. The real question in issue was whether the amounts that could not be written off under s.63 could be deducted under s.51(1). In the course of deciding this question the Court also had to decide whether the same business had been carried on during the year when the instalment credits were given and the year when the debts were written off under S.51(1). Gibbs, J., dissenting held that there had been no continuity as there had been a complete cessation of the income producing operations out of which the necessity to make the outgoings arose. His Honour said,

"The question whether the business carried on by the appellant since about 3rd June, 1970, is the same as that which it carried on before 2nd December, 1968, is one of fact . . . It does appear that after 3rd June, 1970, the appellant entered into transactions of the same general nature — namely, hire purchase and money lending transactions — as those that had been carried on before its activities ceased on 2nd December, 1968. However, the appellant was then trading under a *different name* and had a *different place of business*. There was a *complete change in the*

shareholding so that the appellant was under *completely different control*. The case does not state that the later transactions had any connexion with earlier ones and in particular it does not reveal whether it was still true that the appellant made most of its hire purchase agreements with *customers of a particular group of companies* which manufactured or dealt in small domestic appliances. The case does not state whether, in other respects, the appellant's manner of trading was the same as, or different from, that of the earlier period . . ."⁷⁷ (emphasis added)

Barwick, C.J. and Mason, J. found that there was a continuity of the same business during the years before and after the change in ownership. According to Mason, J., there was no indication that the character of the business changed in any respect. His Honour said:

"That there was a change in the personality of the shareholders and of the clients with whom the appellant did business is immaterial to the question whether a different business came into existence, *so long as the character of the business remained unaltered* . . . It may be acknowledged that there was a cessation in the day to day business activities of the appellant when it encountered financial difficulties, but as I read the facts *the cessation was intended to be temporary, not permanent*."⁷⁸ (emphasis added)

Barwick, C.J., found there to be no change in the nature of the business at all and that in point of fact, it was the same business which was being carried on after a break — the break being not for the purpose of abandoning the business, but to enable its continuance.⁷⁹ According to his Honour, there would be a break in the continuity ". . . if a long period of years separated the two events and meantime the company had started a different business or become an investment company as in *Amalgamated Zinc (DeBavay's) Ltd v. Federal Commissioner of Taxation* . . ."⁸⁰

As stated earlier, the question whether the taxpayer was carrying on the same business arose here in the context of s.51(1) which requires that the loss or outgoing be incurred in gaining or producing *the assessable income*. The expression "*a continuing business*" was used in *De Bavay's* case to qualify the occasion when an expenditure, not precisely related to the assessable income of a particular year, was an allowable deduction.⁸¹ These circumstances then are completely different to those arising under s.80E, with its very specific requirement of continuity of the *same business*. The decision of the Court in the *A.G.C. (Advances)* therefore has no bearing on s.80E. That Gibbs, J. found there to be no continuity, whilst Barwick, C.J. and Mason, J. found to the contrary, only means that their Honours

77. *Id.*, at 114.

78. *Id.*, at 116.

79. *Id.*, at 111.

80. *Id.*, at 111.

81. *Id.*, at 110 (Barwick C.J.).

differed on a finding of fact. As has been pointed out, in the context of s.80E, a change in the personality of the shareholders and of the clients with whom the taxpayer had done business, are relevant considerations in deciding the question whether the same business has been continued. Similarly, in deciding the question whether a business has been terminated and a new business begun, the period of inactivity need not be long, and a new business need not have been started. What is important is whether the same business had been continued to be carried on in the period in between.⁸²

Where an active business changes hands, becomes inactive, and is subsequently reactivated

Cases under this heading would be rare as they would generally fall under the first heading, that is the reactivation of an active business. Those that would come under this head would be cases where the business ceases to be continued immediately upon acquisition as in *Commissioner of Internal Revenue v. Barclay Jewellery, Inc.*⁸³ The facts here were that up to 1958 all of the stock of Barclay Co. and Barclay Jewellery, Inc. (the taxpayer) was owned by Mr. Rice. Barclay Co. manufactured costume jewelry, and the taxpayer wholesaled them. In 1958, S. & S. bought all the stock in both the taxpayer and Barclay Co. S. & S. thereafter sold the Barclay products through their existing agency and continued to hold on to nearly ninety percent of taxpayer's customers, using to some extent, the Barclay name. Although taxpayer's corporate existence was continued, it did no business, and attempted none. In January 1960, the taxpayer was reactivated to sell jewelry as before. It sought to set off the profits of that year against its losses in 1958. The Court denied the deduction. It said that the Statute intended to provide the benefit only to those persons "who purchase *with the intention of carrying on the business*". Congress, according to the Court, required the purchaser "to demonstrate his intent by *actually continuing the business.*"⁸⁴

As the discussion in the preceding pages shows, the question for determination in the temporary suspension cases is not whether the taxpayer corporation conducted the same business before and after the period of inactivity, but whether the period of inactivity itself caused the taxpayer's resumption of activities to amount to the conduct of a new business. In *Barclay Jewellery, Inc.*, the Court indicated that there were two matters to be considered in resolving this issue. The first was the

82. *Infra*, p. 29.

83. 387 F.2d 193.

84. *Id.*, at 196.

question of intent, and the second, demonstrable proof of that intent by actual continuation of that business. These are, of course, questions of fact.

Good reasons exist for subjecting the temporary suspension cases to the test of continuity of business even in instances where ownership has remained the same. The rationale, as has been stated so very well by the United States Court of Appeals in *Coast Quality Construction Corporation v. United States*,⁸⁵ is that,

"... profits arising from the resuscitated corporation do not fall on the same cyclical curve with losses identifiable with its former self, because even if the taxpayer cultivates the same customers and employs the same location, and in the same type of business as before it does so as part of a new endeavour. In effect, it has taken its losses, given up, had a change of mind, and begun afresh."⁸⁶

Conclusion

As the preceding discussion indicates, the question whether the business carried on after the change in ownership is the same as the business carried on before the change is essentially a question of fact, the ultimate resolution of which involves a consideration of a host of facts. Against this, what the same business test requires in essence is a *freezing* of the business carried on at the date of the change in ownership for comparison with the relevant later time. The Canadian and the Australian Codes do not provide the degree of latitude provided for by the United States and United Kingdom Codes. Some degree of minor change is however inevitable. As stated by Gibbs J. in the *Avondale Motors (Parts) Pty. Ltd.* case

"It does not, of course, follow that a business will not be the same because there have been some changes *in the way* in which the business was carried on; some questions under s.80E may give rise to questions of degree . . ." (emphasis added).⁸⁷

Difficulties however lie in determining what his Honour meant by changes in *the way* the business was carried on and the sort of changes his Honour had in mind. Given the context of s.80E, and the tenor of his Honour's judgment, it would seem that the changes the section could accommodate are only as to the method of carrying on the business, such as, for instance, the extension of credit in a business previously conducted only for cash, some measure of wholesaling by a business which had previously only retailed, or, some measure of self service by a

85. 463 F.2d 503.

86. *Id.*, at 510.

87. *Supra*, n.13 at 4106

business which had previously sold by customer service only.

Because of the recent origins of the United Kingdom provisions there is little by way of case law as to the judicial acceptance of these provisions. The United States Courts seem to have construed this exception rather narrowly. This is evidenced in the Regulations accompanying the United States Code and in the cases discussed in the body of this paper. There is good reason for this. The nebulous nature of the requirement is one reason. More important, and what should be borne in mind, is the fact that the same business exception is an alternative to the same ownership requirement, which exception is the subject of very close statutory supervision under all four Revenue Codes.⁸⁸ Furthermore, the purpose in permitting loss carryovers is not to provide for a tax holiday but to enable the particular business activity or its shareholders to set off lean years against lush years⁸⁹ and average their income over several years.

All four Codes do contain statutory safeguards against the possible abuse of the same business exception. The Revenue's protection in these circumstances has generally been to deny the deduction where there has been either a contraction or expansion in the loss company's business prior to the change in its ownership. Section 483(1)(b) of the United Kingdom Code,⁹⁰ Regulations 1.382(a)-(h)(6) and (7) of the United States Code,⁹¹ and s.111(5)(b) of the Canadian Code⁹² are evidence of the former. However, none of the three Revenue Codes contain any statutory protection against an expansion of the loss company's business in anticipation of the change in ownership. The Australian Code in sections 80E(1)(c) and 80E(2)(a) seeks to prevent the abuse of the benefit by the latter method — expansion in anticipation —

88. In the United States, s172 of the Internal Revenue Code is the general provision permitting loss relief. Section 382(a) denies corporate loss carryovers where there has been a change in continuity of ownership and continuity of business. Section 382(b) regulates loss carryovers where there has been a corporate reorganization of a s368(a)(1)(A), (C), (D), or (P) type. Section 381(b) determines the scope of the carryover in (A), (C) and (D) type reorganizations. Additionally, s269 acts as a general anti-avoidance provision. Section 269 denies the deduction if the "principal purpose" of acquiring the loss corporation was motivated by the tax avoidance. There is also a possible further limitation contained in the so called *Libson Shops* doctrine. The above limitations also apply to loss carryovers between affiliated corporations filing consolidated returns. In addition, there applies s482. In the United Kingdom, s177 of the Income and corporation Taxes Act, 1970, is the general loss deduction provision. Section 178 provides for "terminal losses", and s252 for loss carryovers uniting in corporate reconstructions. Provisions for Group Relief are contained in s258. Section 483 (of the 1970 Act) and sections 28 and 29 of the 1973 Act, seek to prevent the abuse of the benefits. In Australia, s80 is the general loss carryover provision. Extensive anti-avoidance legislation is contained in sections 80A, 80B, and 80DA. There is also a general anti-avoidance provision contained in the Act namely, s260. The safeguard under the Canadian Income Tax Act is found in its undefined requirement of "control" in s111(5). In addition there is the general anti-avoidance provision, namely, s246.

89. *Libson Shops Inc. v Koehler, District Director of Internal Revenue*, 353 U.S. 382, at 386.

90. *Supra*, p3.

91. *Supra*, p2.

92. *Supra*, p4.

but contains no statutory safeguards regarding the former. It would therefore be of mutual benefit to adopt the opposite restriction not already found in the respective Codes. As no definition of the same business is possible, the only manner of ensuring that the benefit is not abused is to contain the benefit by express legislation. There is one further matter the legislature should do. It should provide both the taxpayer and the Courts with basic ground rules for the working of the exception. Guidelines modelled on the Regulations contained in the United States Code provide a good start. Additionally, the legislature should spell out that matters such as name, location, premises, stock-in-trade, manufactured product, type of service rendered, management and employees are also factors that will be taken into account in determining the sameness of the business being carried on. This would prevent Courts from making bland statements that matters such as name, location and the like bear no significance.⁹³

93. See for instance, Barwick C.J. in the Australian case of *A.G.C. (Advances) Ltd. v Commissioner of Taxation*, 49 A.L.J.R. 105, at 111.