BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

FARB INVESTMENTS LIMITED .....RESPONDENT.

1958
Nov. 27
1959
Jan. 23

Revenue—Income—Income tax—Payment to lessor to accept surrender of lease—Income or capital receipt—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4, 139(1)(e).

The respondent company in March 1954 leased its property to F who operated thereon two businesses, one a service station, the other a car wash. The lease was for five years at a monthly rental of $1,200. and payment of all taxes, as well as insurance premiums on the buildings on the lot. Subsequently an agreement was entered into by the respondent, F and Imperial Oil Ltd. whereby F surrendered his lease to the respondent who thereupon leased the service station to the oil company for a five-year term at an annual rental of $6,000. and the latter thereupon sublet the property to F for the full term less one day at the same rental, the respondent consenting. Pursuant to the agreement, and upon the surrender of the lease by F to the respondent and its acceptance thereof, the oil company paid the respondent $17,000. "as a consideration for such acceptance of surrender". At the same time a new lease for a five-year term was granted by the respondent to F of that part of the property on which he had carried on his car wash business, at a monthly rental of $700. and payment of taxes and insurance premiums thereon.

In re-assessing the respondent for its 1956 taxation year the Minister added $17,000. to its declared income, describing that item as "surrender of lease". The respondent's appeal from the assessment was allowed by the Income Tax Appeal Board and the Minister appealed from its decision.

Held: That by the terms of the lease from the respondent to the oil company, the respondent which had previously not been liable for payment of taxes and insurance premiums on the service station, became obligated to pay them. It could not be assumed that the respondent would voluntarily and without consideration forego the indemnification it previously had in regard thereto, and, in the absence of any explanation, it must be inferred that the $17,000. payment was to take the place of the right surrendered by the respondent. That being so, it was merely receiving in advance taxes and insurance premiums for a period of five years, in effect an additional payment of rent beyond the stipulated annual sum of $6,000., and the sum so received must be brought into account in computing the respondent's taxable income.

APPEAL from a decision of the Income Tax Appeal Board.[1]

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

[1] (1958) 18 Tax A.B.C. 349; 58 D.T.C. 91.

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J. D. C. Boland and *W. R. Latimer* for appellant.

W. D. Goodman for respondent.

CAMERON J. now (January 23, 1959) delivered the following judgment:

In this case, the Minister of National Revenue appeals from a decision of the Income Tax Appeal Board[1] dated January 7, 1958, which decision allowed the respondent's appeal from a re-assessment made upon it for its taxation year ending February 29, 1956 and dated December 20, 1956. In re-assessing the respondent, the Minister added $17,000 to its declared income, describing that item as "surrender of lease". There is no dispute as to the facts, the sole question being whether that sum, which was admittedly received, is or is not taxable income within the meaning of *The Income Tax Act.*

The respondent was incorporated as a private company on December 11, 1953 under the provisions of *The Companies Act* of Ontario. Its provisional directors were Shirley Farb (the wife of Saul Farb) and their three sons Jerome, Stewart and Donald Farb. On February 25, 1954, a certain property located at the corner of King St. West and John St. in the city of Toronto, and owned by the said three Farb brothers, was conveyed to the respondent company subject to an existing lease for five years, dated December 1, 1953, the lessee being Saul Farb, father of the lessors. The lessee operated thereon two businesses, one of which was that of a service station and the other that of a car wash. The evidence indicates that at some earlier date the property had been owned by Saul Farb, who had conveyed it to his three sons. On March 1, 1954, the respondent accepted a surrender of the old lease and granted a new five-year lease to Saul Farb at a monthly rental of $1,200 for the entire property.

Shortly before November 1, 1954, Imperial Oil Co. Ltd. approached the directors of the respondent company with the view of getting a lease on a portion of the property, namely, that on which Saul Farb operated a service station. Apparently, Imperial Oil did not desire to operate the service station but merely to control it in such a way as to

[1] (1958) 18 Tax A.B.C. 349; 58 D.T.C. 91.

ensure that its products would there be sold. It was prepared, if granted a lease, to immediately sublet it to Saul Farb and to pay $17,000 to the respondent if the lease to it could be arranged on the terms proposed.

In the result, after securing the approval of Saul Farb, an agreement was entered into on October 28, 1954 (Exhibit 1) between the respondent company, Saul Farb and Imperial Oil Ltd. Thereby, Saul Farb agreed to surrender his existing lease which the respondent agreed to accept. Upon such surrender, the respondent agreed to lease the service station to Imperial Oil Ltd. for a term of five years from November 1, 1954 at an annual rental of $6,000. Imperial Oil agreed, upon receiving such a lease, to immediately sublet the same property for the full term (less one day) to Saul Farb at the same rental, namely, $6,000 per annum, the respondent agreeing to such sublease. It was further provided by clause 2(*a*) of the said agreement as follows:

> 2.(a) If and when the said Farb surrenders the aforesaid existing lease to the said company, the said company will accept such surrender upon receiving from the said Imperial (which, contemporaneously with such acceptance will pay the said company) the sum of seventeen thousand dollars ($17,000) as a consideration for such acceptance of such surrender.

The terms of this agreement were duly carried into effect on November 1, 1954. Saul Farb surrendered the unexpired term of the old lease (Exhibit 2); the respondent granted a new lease of the service station to Imperial Oil Ltd. (Exhibit 3) which immediately sublet it to Saul Farb (Exhibit 4). A new lease for a five-year term was granted by the respondent to Saul Farb over that portion of the property in which he had carried on his car wash business, at a monthly rental of $700. Then, pursuant to the agreement of October 28, 1954, Imperial Oil Ltd. paid the respondent $17,000 in its 1956 taxation year.

The respondent owns no property other than that mentioned and carries on no business other than that connected with such ownership.

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The question as to the taxability of the said receipt of $17,000 is to be determined by a consideration of these facts and the relative provisions of *The Income Tax Act*, which then were:

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

(*a*) businesses,

(*b*) property, and

(*c*) offices and employments.

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

* * *

139.(1) In this Act,

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

Counsel for the respondent submits that this receipt was not on revenue account but was a receipt of capital. It was, he says, a bonus or premium paid for granting the lease. On behalf of the Minister, it is submitted that the receipt was income from the respondent's business or its property. Although the Minister is the appellant in this case, the onus of proving the assessment to be erroneous is on the respondent (*Minister of National Revenue v. Simpsons, Ltd.*[1]).

In support of his contention that the payment of $17,000 was a bonus or premium, counsel for the respondent pointed out that there was no difference in the rentals received prior to and after November 1, 1954. It was suggested, therefore, that the payment could not be in the nature of rent or of income from the business since it could be assumed that the full rental value was that paid by Saul Farb prior to November 1, 1954. There is no evidence as to the manner in which the sum of $17,000 was computed. The only oral evidence at the trial was that of Donald Farb, a director and secretary of the respondent since its incorporation. He said that there was very little discussion about the matter, that the only offer made by Imperial Oil was for that specific sum and that after all the directors had given it consideration, it was accepted.

[1] [1953] Ex.C.R. 93.

In endeavouring to find out the real nature of the payment and while examining the documentary evidence filed, certain facts have come to light which were not mentioned in the evidence of Donald Farb—facts which I think he must have known and should have disclosed. As I listened to the evidence at the trial, I was given the clear impression—although perhaps it was not so stated in express terms—that there was no essential difference so far as the respondent was concerned between that which Saul Farb, the prior tenant, was required to do and pay, and that which under the new arrangements, Imperial Oil and Saul Farb were required to do and pay for the property. True it is that the cash rentals received were the same, but there is a very substantial difference in regard to certain other matters.

By the terms of the lease made by the respondent to Saul Farb on March 1, 1954 (Exhibit 2), the lessee was required to pay a monthly rental of $1,200 for the whole of the property, and, in addition

(*b*) the full amount of all taxes, local improvement rates and building insurance premiums charged against the said lessor in respect of the said demised premises or the buildings standing thereon.

By the terms of the lease from the respondent to Imperial Oil dated November 1, 1954, however, the oil company was required only to pay the agreed cash rental of $6,000 per year and was not required to pay either the taxes on the service station or the building insurance premiums, which taxes and premiums consequently fell to be paid for the full term of five years by the respondent. In the sublease from Imperial Oil and Saul Farb, the latter was again not required to pay such taxes or insurance premiums. However, by the terms of the new lease from the respondent to Saul Farb, on the car wash portion of the property, the lessee was required to pay such taxes and insurance premiums.

As a result of such changes, the respondent, which had previously not been liable for payment of taxes and building insurance premiums on the service station, was now obligated to pay them. There is no evidence before me as to what these would amount to over a period of five years, but there can be no question that they would be

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very substantial. The minute book of the respondent shows that the whole of the property was sold to the respondent in February, 1954 for a consideration of approximately $135,000. The agreed rental of the service station situated on a corner would also indicate that the taxes and insurance premiums would be very large.

Now it cannot be assumed that the respondent would voluntarily and without consideration forego the indemnification which it had previously had in regard to taxes and insurance premiums on the service station. I think there is a clear inference from the terms of the documents that the payment of $17,000 was closely related to the surrender of that right, more particularly as no evidence was given in explanation of why that right was surrendered. It may be true that the payment was made in order to prevail upon the respondent "to accept a surrender of the said existing lease, so as to enable the said lessee to apply for and obtain a lease" (as stated in the preamble of the lease to Imperial Oil), but if so, it was made in order to secure the particular lease that the parties had agreed upon, namely, one in which the tenant was not obligated to pay taxes and building insurance premiums. It is inconceivable that the respondent, in settling the terms of the new lease with Imperial Oil, would not take into consideration the terms of the outstanding lease to Saul Farb which still had over four years to run, or would fail to seek compensation in some manner for the loss of revenue that it would sustain if it did not require Imperial Oil to pay the taxes and insurance premiums. In the absence of any explanation, I must infer that the agreed amount of cash to be paid, namely, $17,000, either in whole or in some unascertained part, took the place of the right which was surrendered by the respondent. That being so, it was merely receiving in advance the amount of taxes and insurance premiums for a period of five years.

In view of that conclusion, it follows, I think, that the sum so received was nothing more than an additional payment of rent beyond the stipulated annual sum of $6,000 and must be brought into account in computing the respondent's taxable income. Even if it be the fact that the total amount of taxes and insurance premiums for a

period of five years were less than $17,000, I would be obliged in the circumstances to find that the respondent had failed to satisfy me that there was error in fact or in law in the assessment, since no evidence was given on that particular matter.

I may add, however, that quite apart from the above considerations, I would have been inclined to the view that the sum received was not a capital receipt. The question to be decided is not whether in some senses or in some contexts such payment might be called a "capital payment", but whether within the terms of ss. 3 and 4 of *The Income Tax Act,* it is the profit arising from the business or property of the respondent. It is not necessary to reach any final conclusion on the mater, but I would point out that the cancellation of the old lease and the giving of a new lease to Imperial Oil in no sense affected the profit-making apparatus of the respondent and its capital structure remained precisely the same as it had previously been.

For these reasons, the appeal of the Minister will be allowed, the decision of the Income Tax Appeal Board set aside, and the re-assessment made upon the respondent affirmed. The appellant is entitled to his costs after taxation.

Judgment accordingly.