Montreal
1967
May 10
June 7

BETWEEN:

MONART CORPORATION .....APPELLANT;

AND

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

Income tax—Office rental business (Quebec)—Lump sum received by lessor for consenting to cancellation of lease—Whether income a capital receipt—Nature of lessor's right in Quebec.

Appellant company was in the business of renting offices in a large office building which it owned in Montreal. In 1962 appellant received $75,000 for consenting to cancel two leases which had still six years to run in one case and one year in the other and which produced an annual rental of $110,041. The space remained vacant for three months and was then leased for ten years at an annual rental of $105,825.

Held, the $75,000 was chargeable to income tax under both secs. 3 and 4 of the *Income Tax Act* as being in lieu of future rent and also as being in the nature of profit from a property or business of appellant. *Harold F. Puder v. M.N.R.* [1963] C.T.C. 445, distinguished. *M.N.R. v. Farb Investments Ltd.* [1959] Ex. C.R. 113, considered.

The cancelled lease was not a capital asset of appellant: a lessor's right under a lease is a personal right and not a real right. (*Mignault: Traité de droit civil canadien,* tome 7; *Quebec Civil Code,* Art. 1612.)

INCOME TAX APPEAL.

Paul B. Cohen for appellant.

A. Garon and *P. H. Guilbault* for respondent.

DUMOULIN J.:—At all material times and until December 29, 1964, the appellant company was the proprietor of Northern Building, a large office renting edifice situated at 1600 Dorchester Boulevard West, Montreal, Quebec. For the 1962 fiscal year, a tax in the sum of $35,477.44 was levied by the respondent in respect of Monart's income, for reasons to appear below. This appeal is from the Minister's assessment.

In the regular course of its business, the company owning Northern Building had, as lessees of two floors, the sixteenth and seventeenth, Canadian Chemical & Cellulose Company Limited (hereafter shortened to Chemcell), with a ten-year lease (May 1, 1958, until April 30, 1968), at a rental of $97,095 per annum, later increased by supplementary agreement to $110,041. A copy of this lease is included in the transcript of documentary evidence, forming part of the official record. Under the caption of "Other

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Conditions", page 11, clause 1, the lessee is entitled to transfer its right or sublet any portion of the leased premises with the lessor's consent in writing, "which consent shall not unreasonably be withheld"; the lessee, of course, "to remain responsible for the obligations of the Lease including the payment of rental hereunder".

"Late in 1961, Appellant was advised that Chemcell would vacate the leased premises on May 1, 1962", states section 3 of the Notice of Appeal, "and that its obligations for the balance of the term of its lease would be assumed by Dorchester Commerce Realty Limited, owners of the new Canadian-Imperial Bank of Commerce Building which was under construction on Dorchester Boulevard".

Meanwhile certain developments had occurred which, among several others, are set forth in the parties' Agreed Statement of Facts, filed May 1, 1967, and from which I quote the undergoing:

> 16. ...the Appellant received from Dorchester Commerce a letter dated November 1st, 1961, in which the latter made a further offer to pay the sum of $75,000 (two previous offers of, respectively, $50,000 and $55,000 had been refused) if the Appellant would consent to the cancellation of both of the aforementioned leases.

(With the approval of Chemcell, the appellant, on December 19, 1958, leased to Pigott Construction Company Ltd., "a portion of the sixteenth floor, comprising approximately 3,912 square feet in the Northern Building".)

These compensatory terms proving acceptable to the lessor, owner of Northern Building, a Memorandum of Agreement was entered into on April 27, 1962, between Monart Corporation, Dorchester Commerce Realty Ltd., Chemcell and Pigott Construction Company, in virtue whereof "Dorchester Commerce undertook to pay to the Appellant not later than April 30th, 1962, the sum of $75,000.00 in consideration of the termination of both the Chemcell and Pigott leases, effective April 30th, 1962 or on such subsequent date not later than May 6th, 1962 on which the leased premises were actually vacated by the said lessees" (cf. Agreed Statement of Facts, para. 19).

It was further stipulated (para. 20), in order to prevent the loss of any fraction of the rental price, that "...Chemcell and Pigott remained liable for rent for the time they occupied their respective premises beyond April 30th, 1962 but not later than May 6th, 1962, calculated on a *pro rata* basis" (emphasis in text).

On April 30, 1962, Monart Corporation duly received from Dorchester Commerce the sum of $75,000 (para. 21), "in full and final settlement of all claims of the Appellant against Chemcell and Pigott by reason of the termination of their respective leases on or before May 6th, 1962" (para. 18). When thus terminated, "the Chemcell and Pigott leases had approximately 6 years and one year to run. respectively" (para. 22), but with the express reservation that "the premises occupied by Pigott in the Northern Building would have reverted on April 30th, 1963 to Chemcell under the latter's lease with the Appellant until the expiry thereof, on April 30th, 1968" (para. 23).

Subjectively viewed, as of April 27, 1962, date of the cancellation indenture, the situation consequent thereto effectively meant that, in consideration of a $75,000 lump payment, the lessor gave up its right to six annual rentals of $110,041 each, a gross total receipt of $660,246. Objectively, on the other hand, the property owner could let anew those vacated premises, assuming, however, the adverse chances of delays, lower rents and, possibly also, less desirable tenants. Under such conditions, how, then, should this heavy "forfeit" be looked upon in the eyes of our fiscal law? In paragraphs 4 and 5 of its Notice of Appeal, Monart Corporation explains that, in the event of a continuation of the sub-lease by Dorchester Commerce Realty Limited, a competitor,

> 4. Appellant had reason to fear that the premises would either remain vacant or substantially vacant for the balance of the term of the lease or that the premises would be sub-let to small tenants, of any class of business, on short-term leases at inferior rentals inasmuch as any first-class tenants for larger quarters would inevitably be directed by Dorchester Commerce Realty Limited to its own building project.
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> 5. The Appellant was accordingly faced with the prospect of suffering a substantial diminution in the real value of its building as a fixed asset, as well as in the realizable market value of the building as a capital asset.

With, also added, these concluding enunciations of fact and propositions of law outlined in paragraphs 6 and 9 of the Notice of Appeal:

> 6. Upon receipt of an unsolicited offer from Dorchester Commerce Realty Limited, Appellant accepted $75,000.00 in lieu of damages both for the relinquishment of a capital asset (the lease) as well as for the protection of its existing capital assets.

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9. The aggregate of the Appellant's rights in respect of the unexpired term of the lease constituted "property" within the meaning of section 139(1)(*ag*) of the Income Tax Act, and were thus rights of a capital nature.

Previously, the appellant had stated that the compensation received did not constitute additional rental or other income or profit from a business or property within the meaning of sections 3(*a*), 3(*b*) and 4 of the Act, "nor an amount received in substitution for, or in lieu of, such income or profits".

It could go without saying that a diametrically opposite view of the matter was taken by respondent, submitting in his Reply, that the amount of $75,000 "was received ... from Dorchester Commerce Realty Limited as rent or in lieu of rent in respect of the leasing of certain premises in the Northern Building ... and is income from property by virtue of Sections 3 and 4 of the Income Tax Act", and, again, that the amount received by the appellant "is in the nature of profit derived from a property or a business of the Appellant within the purview of Section 4 of the *Income Tax Act*" (paragraphs 10 and 11 of the Reply).

Before dealing with the pertinent law, certain facts should be clarified. Arthur Rudnikoff, President of Monart Corporation in 1962, testified at the trial. After stressing those several fears and apprehensions he entertained as the lessor's chief executive upon cancellation of Chemcell's lease, a practical repetition of paragraphs 4 and 5 of the Notice of Appeal, the deponent ended his testimony by asserting "that, after Chemcell (and Pigott) vacated (their) locals, this space was unoccupied during three months, from May 6 until mid-July; no rent being derived by Northern Building (i.e. Monart Corporation) during that period".

Regarding a loss of rentals for slightly less than three months, there can be no doubt, which is not at all the case as regards Mr. Rudnikoff's other misgivings; of this, ample proof is forthcoming. In the file of documentary evidence, starting on page 51, appears an indenture of lease, dated May 23, 1962, between Monart Corporation and the Bell Telephone Company of Canada (already an occupier of office space in Northern Building) whereby, and I now revert to paragraph 24 of the Agreed Statement of Facts:

24. ...of the total area of 25,892 square feet (about one-tenth of Northern Building's entire footage) previously occupied by Chem-

cell and Pigott under their respective leases, ... the Appellant leased approximately 24,900 square feet to the Bell Telephone Company of Canada, as follows:

(a) approximately 21,471 square feet ... by Indenture of Lease dated May 23rd, 1962, for a term of 10 years commencing May 1st, 1962, and terminating April 30th, 1972, at an annual rental of $91,251.75; and

(b) approximately 3,429 square feet ... (previously occupied by Pigott) ... for a similar term of 10 years commencing May 1st, 1962, and terminating April 30th, 1972, at an annual rental of $14,573.25.

In the copy of this indenture (cf. file of documentary evidence, page 53), it is agreed that "rental will commence to accrue and be applicable in respect of the premises only from and including the 26th day of July, Nineteen hundred and sixty-two ...". Rudnikoff having testified that the premises, after renovations and repairs, were occupied by the Bell Telephone Company on or about mid-July, 1962, a three-month loss of rent by appellant does not appear exaggerated.

The pecuniary consequences of the latter lease, at an annual rent of $105,825 (i.e. $91,251.75 plus $14,573.25) as against a former yield of $110,041, meant a yearly revenue shrinkage of $4,216 which, repeated during the six remaining years Chemcell's occupation would otherwise have continued, amounted to $25,296. To this income reduction should be joined three months' loss of rent which, computed in accordance with Chemcell's monthly rate of $9,170 ($110,041 ÷ 12), points to a further deficit of $27,510.

That the compensating payment of $75,000 was intended in appellant's mind to take care of such contingencies seems hard to deny and, furthermore, there is of record Rudnikoff's admission to this effect at pages 34 and 35 of his Examination on Discovery, referred to at the hearing by respondent's counsel; quotation:

Page 34:

Mr. GARON, for the Minister:

Q. But, on what basis was this amount of $75,000 computed?

A. We knew that we would have to lose a certain amount of rent because we had no tenant at that particular moment, and we figured how long will it take. And we knew the rent also was approximately $110,000 a year, round figures. Well, during the time when the tenant does move, and we have a certain amount of renovation to do. That would take maybe several months to put into shape again, and we had no tenant at that particular moment, so we just hoped and we took the chance.

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Q. And what was your idea about the amount of rent that you would lose in terms of months?

A. We had figured we would lose between six to nine months ...

At page 61, the deponent asserts: "Yes, it took from three to five months to rent the premises ... this was a normal period under the circumstances".

We saw that on May 23, 1962, new tenants, the Bell Telephone Co. were found for the vacated space, a fortunate result Rudnikoff could, presumably, not foresee when, on April 27, same year, Chemcell's lease was cancelled. The irrebuttable fact remains, however, that this $75,000 indemnity was closely aligned with a possible rental loss of some six to nine months.

Appellant's counsel, both in his written proceedings and plea at trial, insisted that the relinquished lease was a capital asset; "that the aggregate of the Appellant's rights in respect of the unexpired term of the lease constituted 'property' within the meaning of section 139(1)(*ag*) of the Income Tax Act, and were thus rights of a capital nature". Such a proposition of law cannot, I believe, be readily countenanced. The personal nature of a lease *erga* the lessee suffers no doubt in civil law and I was proffered no reason to hold its legal classification differed *erga* the lessor. Albeit commenting more particularly upon article 1612 of the *Civil Code,* Mignault[1] expressly refers to this matter, setting a tenant's right well within the personal category; the authoritative commentator therefore writes (page 255):

> Il faut remarquer que ce n'est là qu'une application de l'article 1065, *car le droit du locataire n'étant que personnel et mobilier, l'action du locataire ne peut avoir un caractère de réalité.*

(Italics mine throughout.)

Next, on page 359, we read:

> et lorsque je dis que le locataire a droit à la possession si son bail a été précédemment enregistré, *je ne veux pas reconnaître qu'il y ait un droit réel, un jus in re* ...

The Court is strongly of the opinion that a deed of lease is not a capital asset or a real right but merely a personal one.

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[1] Mignault: *Traité de droit civil canadien,* tome 7.

Appellant's learned counsel attached special insistence, as an applicable precedent, to the case of *Harold F. Puder v. Minister of National Revenue*[2], the salient facts of which are thus summarized by Mr. Justice Thurlow: "The issue in the appeal is the liability of the appellant for income tax in respect of a sum of $4,161.15 received by him (the mortgagee) in addition to the principal sum on the release before maturity of a mortgage which he held". This mortgage, with many years to go before its terminal date, nevertheless provided for an option of repayment after three years of the balance of principal and interest to date together with a bonus of 3 months' interest.

When the mortgage had run but 15 months (instead of 36) "the mortgagor on arranging a sale of the ... property requested a release of the mortgage". This was acceded to on condition that he should pay "the unearned interest for that portion of the three year period remaining as a bonus, plus a further bonus of three months interest", amounting to $4,161.15 and $516.99 respectively.

To the learned judge, the above prepayments appeared:

> to have been simply a sum received in respect of the relinquishment by the appellant of his right to insist on payment of the mortgage according to its tenor which, in my opinion, was not a right of an income nature ... Moreover, I do not think that the fact that the appellant exacted the amount in question as a condition of giving up his right can affect the amount with an income quality or serve to characterize it as anything more than an amount received in exchange for a right of a capital nature *by one not engaged in a business of making investments for the purpose of securing amounts of that kind.*

For the present requirements, I need retain only the italicized observation *that Harold F. Puder was not engaged in the business of mortgage investments,* while the actual appellant is a corporation whose "raison d'être", and sole pursuit, consist in *the business* of renting office accommodation; an essential difference due to which the aforementioned precedent does not apply.

The case of *The Minister of National Revenue v. Farb Investments Limited*[3], decided by Mr. Justice Cameron, formerly of our Court, and relied upon by respondent's able counsel, bears much closer resemblance to the instant suit. Since the material factors in *re Farb Investments* are

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[2] [1963] C.T.C. 445.

[3] [1959] Ex. C.R. 113 at 117 and 118.

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rather involved, being a repetition of those lease-juggling acts, between an oil company and one of its thinly masked service station owners and clients or, more exactly, quasi-agents, I had better cite them at length:

> 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.
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> 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.

I now turn to Mr. Justice Cameron's textual pronouncement at page 117:

> 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
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> (*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.
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> 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.
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> 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 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.

For the reasons preceding, the eminent jurist held that:

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.

The appeal was consequently allowed by Mr. Justice Cameron.

The logical divergence is slight between "an additional payment of rent beyond the stipulated annual sum of $6,000" in view of future taxes and insurance premiums on commercial premises, and a compensation of $75,000 in lieu of eventual loss of rents also in connection with commercially exploited premises.

I believe the points at issue in the cause were correctly set down by Mr. Guilbault, one of the respondent's attorneys, who submitted that:

...in the present case, it is our contention that:

Firstly, the amount received by the Appellant was paid to it for damages suffered or to be suffered as the result of the premature termination of the lease, and that the termination can be considered as a normal incident in the activities of a landlord renting properties.

Secondly, that the rights or benefits surrendered by the Appellant do not represent a loss of an enduring asset, and that its structure (namely, Monart Corporation's mode of conducting business) was so fashioned as to absorb the shock (bearing upon only one tenth of its rentable space) as one of the normal incidents to be looked for, and ... it must be noted that in the lease there was a clause where a lessee could leave the premises, and it was stated by Mr. Rudnikoff that he could not oppose to that. This is one of the things that the corporation had looked for.

Thirdly, that the compensation received (is in substitution for) future profits surrendered. (cf. Argument for Respondent—Partial Transcript, pages 3 and 4.)

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Irrefutable evidence indicates that Monart Corporation, owner of an extensive office-renting property, as said above, was uniquely engaged in carrying on the business inherent to these pursuits and, inasmuch, cannot escape the purview of sections 3, 4 and 139, subsections (1)(*e*), (1)(*ac*), (1)(*ag*) and (1)(*av*) of the *Income Tax Act*, all of them so well known texts it would be superfluous to quote them. I must therefore conclude that the respondent's assessment of the appellant's income for the 1962 taxation year was levied according to law, since the sum of $75,000 paid to appellant by Dorchester Commerce Realty Company was in lieu of future rent in respect of the demised premises in Northern Building, and was also in the nature of profit derived from a property or a business of the appellant.

Consequently this appeal is dismissed and the respondent entitled to his costs after taxation.