Date: 20080123

Docket: A-316-06

Citation: 2008 FCA 24

CORAM: LINDEN J.A.
NADON J.A.
PELLETIER J.A.

BETWEEN:

CANADA SAFEWAY LIMITED

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Calgary, Alberta, on October 25, 2007.

Judgment delivered at Ottawa, Ontario, on January 23, 2008.

REASONS FOR JUDGMENT BY: NADON J.A.

CONCURRED IN BY: LINDEN J.A.
CONCURRING REASONS BY: PELLETIER J.A.

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REASONS FOR JUDGMENT

NADON J.A.

[1] This is an appeal from a Judgment of Mr. Justice Beaubier of the Tax Court of Canada, 2006 TCC 345, dated June 19, 2006, which dismissed that part of the appellant's appeal from the Minister of National Revenue's reassessment of its 1996 taxation year pertaining to the sale of its interest in a property situated in South Surrey, British Columbia.

[2] More particularly, the Judge concluded that the disposition of the appellant's interest in the property constituted a gain on income account and not a gain on capital account for the purposes of the *Income Tax Act* (the "Act").

[3] At issue in this appeal is whether the Judge made a palpable and overriding error in holding that the appellant's acquisition and sale of an interest in the property constituted "an adventure or concern in the nature of trade" and thus, that the gain from the sale of that interest is income from a business.

THE FACTS

[4] The relevant facts are not in dispute and a brief review thereof will be useful to a proper understanding of the issue before us.

[5] The appellant operates a retail grocery chain in Canada in a number of locations from Thunder Bay west to Vancouver Island and is a wholly-owned subsidiary of Safeway Inc., a U.S. corporation.

[6] Out of its approximately 31,000 employees, 40 are employed in its Real Estate Department, whose activities are entirely concerned with supporting the appellant's retail stores. Those activities are focused on new store development, remodelling of existing stores and closure of under-performing stores. The appellant's Real Estate Department does not pursue activities pertaining to

real estate development, i.e. for the purposes of making a profit on the purchase and sale of real estate.

[7] In early 1988, Schroeder Properties Ltd. ("Schroeder"), a major land and retail shopping centre development firm with whom the appellant had a history as a tenant in a number of its shopping centres, approached the appellant with a view to having it as an anchor tenant in a future shopping centre.

[8] At the time that Schroeder approached the appellant, the site of the proposed shopping centre, a 20.5-acre parcel of land in South Surrey, British Columbia ("Peninsula Village"), was zoned residential and would have to be rezoned commercial before Schroeder could proceed with construction of the proposed shopping centre.

[9] When the appellant made it known to Schroeder that it was interested in locating a grocery store in the proposed shopping centre, Schroeder was encountering difficulties with respect to the rezoning of the site and informed the appellant that rezoning could take up to two years. I should point out that Schroeder's application for rezoning was filed in September 1987.

[10] Because it did not have the resources to finance the site for up to two years, Schroeder sought a partner to assist it in the financing of its project. Having failed to find such a partner, Schroeder approached the appellant in March 1989 to find out if it would be interested in joining it in the development of the site. Because of its strong view that having one of its grocery stores

located at the proposed site was crucial to its long-term strategy of strengthening its position in the market, the appellant decided to enter into a co-ownership agreement with Schroeder.

[11] More particularly, the appellant entered into the aforesaid agreement because of its view that a store situated in the proposed site would enable it to capture the grocery market in an area of increasing residential growth and that it would prevent competitors from building a grocery store on the site.

[12] At the time that Schroeder approached the appellant with respect to the possibility of its acquiring an interest in Peninsula Village, the zoning of the property, as I have just indicated, was residential. On the assumption that rezoning would eventually occur, Schroeder presented two scenarios to the appellant: the first one was if development commenced by September 1, 1989, there would be a total potential profit of $12,072,890; the second was that if development commenced by September 1, 1991, there would be a total potential profit of $11,462,549.

[13] On the assumption that rezoning would not take place, Schroeder presented a different scenario to the appellant, i.e. a residential contingency plan whereby the land would be sold to a residential developer for the building of condominiums and townhouses. In this scenario, there would be a potential net profit to the joint venture of either $3,039,400 or $1,504,000, depending on whether the sale occurred closer to September 1989 or September 1991.

[14] In the event, the appellant entered into an agreement with Schroeder entitled "Peninsula Village Co-Ownership Agreement" (the "Agreement"), dated April 24, 1989, pursuant to which it acquired a 54% interest in the property. Sections 3.02 and 3.03 of the Agreement set out the purpose thereof and the scope of the parties' activities in entering into it:

> Section 3.02 – Purpose
>
> The purpose of this Agreement is to establish and define the manner in which the Parties intend to develop their respective Co-Ownership Interest in the Property for the limited scope set forth herein. The Parties agree that their relationship is that of co-owners, as tenants-in-common, in respect of the Property and not that of partners, nor is it intended that the relationship of partnership be created between the Parties in respect of the ownership and development of the Property of their respective Co-Ownership Interest in the Property.
>
> Section 3.03 – Scope of the Parties' Activities
>
> The activities of the Parties in relation to the Property by reason of this Agreement shall be limited strictly to:
> (a) acquiring the Property;
> (b) planning for the development of the Property, whether in Phases or otherwise, as a first-class shopping centre, subject to obtaining necessary zoning, as contemplated in the Project Summary;
> (c) development of the Centre including, without limitation, construction, financing and leasing thereof;
> (d) operating, leasing and managing the Property on an ongoing basis as a revenue producing rental property; and
> (e) selling all or a part of the Property in accordance herewith.

[15] Pursuant to section 4.08 of the Agreement, the appellant undertook to execute and deliver the "Safeway Lease". The section provides as follows:

> Section 4.08 – CSL as Tenant
>
> 1. As soon as reasonably practical, and in any event on or prior to completion of installation of a substantial portion of the foundations and footings for the Centre, CSL will execute and deliver the Safeway Lease for execution and delivery by the Nominee Corporation. **For clarity, the obligation of CSL [the appellant] to**

> **<u>execute and deliver the Safeway Lease is independent of the other obligations of CSL hereunder and will survive the termination of this Agreement or completion of the compulsory purchase of the CSL Co-Interest Ownership herein contemplated</u>**.[This is a reference to the option given to the appellant in section 10.11 of the Agreement.]
>
> [Emphasis added]

[16] The Agreement further provided that:

1. Schroeder or its nominee would be appointed project manager, leasing manager and property manager.
2. The appellant had the right to require Schroeder to purchase its co-ownership interest in the property for $2,000,000 over its costs within 60 days after rezoning was achieved (Section 10.11 of the Agreement)
3. If rezoning did not occur within a reasonable period of time, the appellant had the option of purchasing not less than 6 acres of the property, in an area to be agreed upon (Section 10.12 of the Agreement).

[17] The Safeway Lease was executed by the appellant on October 3, 1991, for a 20-year term commencing November 10, 1991 and terminating November 15, 2011.

[18] Following the rezoning of the property to commercial, which occurred prior to August 30, 1990, the appellant did not exercise its rights under section 10.11 of the Agreement. The shopping centre was completed in 1991 and the initial lease-up period was from November 1991 to November1994.

[19] The appellant's interest in the property was listed for sale in January 1993, but was taken off the market in May of that year. Between that time and March 1996, a number of offers were made for the appellant's interest in the property, including one in July 1994 by Schroeder in the sum of $17,375,000. That offer did not succeed because Schroeder was unable to secure adequate financing. However, an offer made by Real Fund in March 1996 was found to be acceptable by the appellant. As a result, the appellant made the following gain:

Proceeds of sale:	$18,021,811
Adjusted cost-base:	$13,462,253
Gain on disposition:	$4,559,558

[20] I should point out that discussions with Schroeder regarding the sale of the appellant's 54% interest in Peninsula Village had commenced in August of 1992.

THE TAX COURT DECISION

[21] The Judge began by first outlining the assumptions on which the Minister relied in reassessing the appellant for the 1996 taxation year. Then, after stating the issue for determination and referring to the relevant provisions of the Act, the Judge indicated which of the Minister's assumptions had either been established by the evidence or had not been refuted by the appellant. He then dealt with the remaining assumptions.

[22] I do not intend to review all of the Judge’s comments and findings in regard to these assumptions. I will, however, emphasize those which, in my view, bear relevance to the determination of the appeal.

[23] First, in respect of assumption 9(g), i.e. that “The area where Peninsula Village is located had speculative potential of which the appellant was aware;”, the Judge made the following remarks:

> 9(g) The area where PeninsulaVillage is located had a critical potential for a large grocery store, in the Appellant's view. Its memos and documents indicate that the Appellant considered that the value of the site would increase in any event resulting in limited risk to the Appellant.

[24] With respect to assumption 9(w), i.e. that “Upon rezoning the Appellant had an option to take a guaranteed profit of two million dollars but the Appellant did not exercise this option and continued to hold its interest and complete the development of Peninsula Village;”, the Judge made the following finding:

> 9(w) Is true. However, this fact supports the Appellant's contention that it entered into the agreements in order to build and operate a store.

[25] With respect to assumption 9(x), i.e. that “The Appellant's intentions upon entering the Agreement were to develop Peninsula Village into a shopping centre and then sell its interest at a profit;”, the Judge found as follows:

> 9(x) **Is questionable, and the subject of this appeal.** The Appellant wanted to build a store. That was its motive for entering into its deal with SPL. The Appellant considered the store site to be ideal and necessary to buy for its own store and to prevent a competitor from

> building on or near that site. **<u>The evidence is that it did not intend to sell at a loss, that it projected a possible sale at a profit greater than what it got on the sale and that it did not expect to sell at a loss.</u>**
>
> [Emphasis added]

[26] With respect to assumption 9(y), i.e that "The Appellant never intended to retain ownership of Peninsula Village and to earn a rental income from it;", the Judge found that that assumption was correct.

[27] With respect to assumption 9(bb), i.e. that "The Appellant intended to wait until a substantial portion of Peninsula Village was leased out and then sell its interest at a profit;", the Judge found that the appellant's intention was to sell its interest in Peninsula Village and not to remain as a long-term landlord. In the Judge's view, the purpose of the joint venture was to enable the appellant to establish its store on the site as advantageously as possible, and that having been accomplished, to sell its interest in the property.

[28] At paragraph 10 of his Reasons, the Judge stated the true question before him: did the appellant enter into a separate adventure in the nature of trade to purchase an interest in Peninsula Village and sell that interest at a profit?

[29] In order to answer that question, the Judge reviewed the Agreement and, more particularly, sections 3.01, 3.02 and 3.03. His review thereof led him to the following finding:

> … The parties' purpose is to rezone the property and develop a shopping centre on the approximately 20 acres with 50-50 voting rights and to sell the property (see paragraph

3.03). **<u>If that zoning is achieved, which is the purpose of the deal</u>**, paragraph 10.11 reads as follows:

> <u>Section 10.11 - Compulsory Purchase of CSL Co-Ownership Interest</u>
>
> 1. Notwithstanding anything to the contrary herein contained, SPL2 and CSL agree that CSL shall have the right, on written notice delivered to SPL2 within 60 days after Rezoning, to require SPL2 to purchase the Co-Ownership Interest of CSL in the Property, for a cash price equivalent to the aggregate of:
> (a) CSL's Proportionate Share of the Development Costs incurred by the Parties to the date of such notice;
> (b) the sum of two million dollars; and
> (c) the Development Costs incurred by CSL, if any, between the date of such notice and the completion of the compulsory purchase.
>
> 2. The compulsory purchase will complete in the offices of SPL2's Vancouver solicitors on the first Business Day which is at least 60 days after delivery of the notice and the provisions of Schedule "E" will apply, mutatis mutandis.

[Emphasis added]

[30] At paragraph 12 of his Reasons, the Judge returned to the Agreement and opined that it clearly revealed the intent of the parties thereto which, in his view, was the rezoning of the property for a shopping centre. On that premise, the Judge made the link to clause 10.11 of the Agreement which granted the appellant the right to sell its interest for $2,000,000 over its costs.

[31] On the basis of these findings, the Judge concluded, at paragraph 13 of his Reasons, that the appellant’s intention in acquiring an interest in Peninsula Village was to resell it at a profit. He went

on to state that the appellant had not exercised its rights under section 10.11 because it believed that it could make a greater profit by delaying the sale to a future date.

[32] Consequently, the Judge concluded that the appellant's transaction was an adventure in the nature of trade and that, as a result, the proceeds of the sale constituted a gain on income account.

THE GROUNDS OF APPEAL

[33] The appellant submits that the acquisition of its interest in Peninsula Village and the sale thereof did not constitute an adventure or concern in the nature of trade and that the Judge erred in so concluding. More particularly, the appellant says that in reaching his ultimate conclusion, the Judge made a number of errors.

[34] Firstly, the appellant says that Beaubier J. made a palpable and overriding error in finding that the appellant had not exercised its rights under section 10.11 "because it projected, and upon sale attained, a greater profit" (paragraph 13 of the Judge's Reasons). The appellant argues that the evidence clearly reveals that it did not exercise its rights under section 10.11 because it sought to ensure, by its continued ownership of an interest in the joint venture, that it would obtain a grocery store on the site.

[35] The appellant further says that the Judge made a palpable and overriding error in inferring that, from the outset, it intended to sell its interest in the property at a profit by reason of the fact that pursuant to section 10.11, it could sell its interest for its costs plus $2,000,000. The appellant argues

that, contrary to the Judge’s finding, the inclusion of section 10.11 in the Agreement was made for the purpose of allowing it, if circumstances so warranted, to exit from the Agreement. In the event, it chose not to exercise that option which, in its view, could have jeopardized its ability to locate a store at the site.

[36] Finally, the appellant says that the Judge erred in concluding that the acquisition of its interest in the property was an adventure in the nature of trade. It says that there was no evidence to support the assertion that the lease of the store and the Agreement constituted separate transactions. It also says that it is clear that it did not acquire and deal with its interest in Peninsula Village in a manner in which a developer of shopping centres would have. The fact that it did not intend to keep its interest in the property for a long period is not in itself, according to the appellant, sufficient to lead to the conclusion that there was an adventure in the nature of trade. The plain fact is that it entered into the joint venture for the sole purpose of securing a grocery store on the site and to prevent its competitors from doing so. Consequently, the appellant submits that the transaction cannot be characterized as an adventure in the nature of trade.

[37] The respondent submits that the Judge applied the proper test in determining whether the appellant’s transaction constituted an adventure in the nature of trade and that he came to the correct conclusion. In its view, there was ample and uncontradicted evidence to support the Judge’s finding that the appellant intended, from the outset, to resell its interest for a profit.

ANALYSIS

A. Standard of Review:

[38] The issue before us in the appeal is essentially a factual one. Thus, in order to succeed, the appellant must satisfy us that the Judge made a palpable and overriding error in his assessment of the evidence and, more particularly, with regard to the inferences which he drew from his findings. As the Supreme Court of Canada held in *Housen v. Nikolaisen*, [2002] 2 SCR 235, at paragraph 8:

> If there is no palpable and overriding error with respect to the underlying facts that the trial judge relies on to draw the inference, then it is only where the inference-drawing process itself is palpably in error that an appellate court can interfere with the factual conclusion.

[39] The meaning of the expression "palpable and overriding error" was explained by the Supreme Court of Canada in *H.L. v. Canada (Attorney General)*, [2005] 1 S.C.R. 401, where Fish J., writing for a majority of the Court, said at paragraph 55:

> "Palpable and overriding error" is at once an elegant and expressive description of the entrenched and generally applicable standard of appellate review of the findings of fact at trial. But it should not be thought to displace alternative formulations of the governing standard. In *Housen*, for example, the majority (at para. 22) and the minority (at para. 103) agreed that inferences of fact at trial may be set aside on appeal if they are "clearly wrong". Both expressions encapsulate the same principle: **an appellate court will not interfere with the trial judge's findings of fact unless it can plainly identify the imputed error, and that error is shown to have affected the result.**
>
> [Emphasis added]

B. Adventure in the Nature of Trade;

[40] Although the definition of "business" found in section 248(1) of the Act includes "an adventure or concern in the nature of trade", it does not define that concept. In *Principles of*

Canadian Income Tax Law, 5th ed.(Toronto: Carswell, 2005) at p. 333, the learned authors, Hogg, Magee and Li, explain the concept of an adventure in the nature of trade as follows:

> An adventure or concern in the nature of trade is an isolated transaction (which lacks the frequency or system of a trade) in which the taxpayer buys property with the intention of selling it at a profit and then sells it (normally at a profit, but sometimes at a loss). Accordingly, when a taxpayer enters into an isolated transaction (or only few transactions), he or she is not a trader. But, if the transaction was a speculative one, intended to yield a profit, it is in the name of a business.

[41] In *Friesen v. Canada*, [1995] 3 S.C.R. 103, Major J., writing for a majority of the Supreme Court, remarked, at page 115, that the concept of an adventure in the nature of trade is a judicial creation designed to determine which purchase and sale transactions are of a business nature and which are of a capital nature. Major J. then made the point that for a purchase and sale to constitute an adventure in the nature of trade, there had to be a “scheme for profit-making”. In his view, there was a requirement for the taxpayer to have had an intention of gaining a profit from his transaction and, in that regard, he referred to Interpretation Bulletin IT-459: “Adventure or Concern in the Nature of Trade” (Sept. 8, 1980), which sets out the relevant tests found in the case law for a determination of whether a transaction constitutes an adventure in the nature of trade. Paragraph 4 of IT-459 provides as follows:

> In determining whether a particular transaction is an adventure or concern in the nature of trade the Courts have emphasized that all the circumstances of the transaction must be considered and that no single criterion can be formulated. Generally, however, the principal tests that have been applied are as follows:
> (a) whether the taxpayer dealt with the property acquired by him in the same way as a dealer in such property ordinarily would deal with it;
> (b) whether the nature and quantity of the property excludes the possibility that its sale was the realization of an investment or was otherwise of a capital nature, or that it could have been disposed of other than in a transaction of a trading nature; and

(c) whether the taxpayer’s intention, as established or deduced, is consistent with other evidence pointing to a trading motivation.

[42] In Interpretation Bulletin IT-218R can be found a list of factors which courts have used to determine whether a transaction pertaining to real estate is an adventure in the nature of trade:

(a) the taxpayer's intention with respect to the real estate at the time of its purchase;

(b) feasibility of the taxpayer's intention;

(c) geographical location and zoned use of the real estate acquired;

(d) extent to which intention carried out by the taxpayer;

(e) evidence that the taxpayer's intention changed after purchase of the real estate;

(f) the nature of the business, profession, calling or trade of the taxpayer and associates;

(g) the extent to which borrowed money was used to finance the real estate acquisition and the terms of the financing, if any, arranged;

(h) the length of time throughout which the real estate was held by the taxpayer;

(i) the existence of persons other than the taxpayer who share interests in the real estate;

(j) the nature of the occupation of the other persons referred to in (i) above as well as their stated intentions and courses of conduct;

(k) factors which motivated the sale of the real estate;

(l) evidence that the taxpayer and/or associates had dealt extensively in real estate.

None of the factors listed in 3 above are conclusive in themselves for the purpose of determining that a gain arising on the sale of real estate constitutes income or a capital gain. The relevance of any factor to such a determination will vary with the facts of each case.

[43] I agree entirely with the authors of *Principles of Canadian Income Tax Law, supra*, when they say, at page 334, that although the courts have used various factors to determine whether a transaction constituted an adventure in the nature of trade or a capital transaction, namely, those found in IT-218R, the most determinative factor is the intention of the taxpayer at the time of acquiring the property. If that intention reveals a scheme for profit-making, then the Court will conclude that the transaction is an adventure in the nature of trade.

[44] It is clear from his Reasons for Judgment that the Tax Court Judge relied on the third test found in IT-459, i.e. "whether the taxpayer's intention, as established or deduced, is consistent with other evidence pointing to a trading motivation, for his determination that the sale by the appellant of its interest in Peninsula Village constituted an adventure in the nature of trade". The Judge examined the Agreement and concluded that it made clear the intent of both parties thereto. Because of his view that the main purpose of the Agreement was to obtain the rezoning of the property, he found in section 10.11 of the Agreement a clear intent on the part of appellant to sell its interest, from the outset, at a profit. He was reinforced in his view by the fact that the appellant had not exercised its rights under section 10.11 because it hoped to make a greater profit in the future.

[45] Before addressing the criticism directed by the appellant at the Judge's conclusion that the transaction constituted an adventure in the nature of trade, it will be useful to examine some of the decisions which have dealt with this issue.

[46] I begin with the Exchequer Court's decision in *Hazeldean Farm v. Canada (Minister of National Revenue -- M.N.R.)*, [1967] 1 Ex. C.R. 245, in which the Court had to decide whether the proceeds of sale of a property to the National Capital Commission (the "NCC") constituted income or a capital gain. The background to the sale was that in 1944, three promoters bought a 619-acre farm on the outskirts of Ottawa, which they immediately transferred to a company which they incorporated with the declared object of carrying on farming. The company subdivided 67 acres of river frontage into 187 lots. One hundred and twenty of the lots, in addition to other parcels of land totalling approximately 70 acres, were sold to various purchasers over the course of 14 years. The remaining property was leased successively to two farmers for annual rentals until 1959, when it was sold to the NCC.

[47] In addressing the issue before him, Noël J. began, at pages 255 and 256, by emphasizing that the drawing of the line between income and capital gains was a difficult undertaking. He expressed himself as follows:

> Although there have been many decisions as to whether profits on the sale of land are of a capital or income nature, it is still practically impossible to define with certainty the boundary line between income and capital gains. A solution to many of these problems has been found in a combination of factors, such as the intent of the taxpayer, the fact that it was an isolated transaction, the relationship to the taxpayer's ordinary mode of business and the nature of the transaction, each of which alone may not lead to inferences of trade but which, taken together with many other circumstances in their totality, may convince a court that the transaction under investigation is one of a capital nature.

[48] He then went on to express the opinion that in order to determine whether a transaction constituted an adventure in the nature of trade, it was necessary to determine the exclusive purpose

in the taxpayer's mind when he acquired the property. More particularly, the judge stated that he had to determine whether the taxpayer's intention "was to exploit it [the property]" or whether it was acquired **also** with a view to reselling it at a profit depending on the opportunities that would arise" (p. 256 of Reasons).

[49] After stating that there was no doubt that the 67 acres of water frontage, which the taxpayer sold between the time of acquisition and 1959, had been purchased for the purpose of reselling them at a profit, he then opined that the appellant's intention was not so clear in regard to the remainder of the property which had been sold in 1959 to the NCC. Thus, the question to be resolved by the Court was whether the appellant's intention in purchasing the property was for the exclusive purpose of farming the land or whether it had a "**dual intent**" of holding the land and developing it "until it became ripe for profitable disposition and in the interim deriving some income from some farming activities and rental of the property" (p. 256 of the Reasons).

[50] The Judge then opined, at page 256, that it was not sufficient, in determining whether the taxpayer had a "secondary intention" of reselling the farmland at a profit when circumstances made that desirable,

> … to find merely that, if the purchaser had at the time of a purchase, stopped to think about it, he would have had to admit that, should a sufficiently strong inducement be presented to him at some time after acquisition, he would resell.

[51] Noël J. went on to say, at page 257:

> … **To give a capital acquisition transaction the dual character of being at the same time a venture in the nature of trade, the purchaser must have had at the time of the**

> **acquisition, the possibility of resale in mind as an operating motivation for the acquisition.** As a finding that such motivation existed will have to be based on inferences from the surrounding circumstances rather than direct evidence of what was in the purchaser's mind, the whole course of conduct of the appellant has to be examined and assessed.
>
> [Emphasis added]

[52] The Judge then went on to examine the evidence before him and found that it supported the taxpayer's assertion that its intent, at the time of acquisition, was to use the land for farming purposes. The Judge further opined that there were no surrounding circumstances from which an inference could be drawn that at the time of acquisition, the taxpayer had a secondary motivation, i.e. an intent to purchase the property for the purpose of turning it into a profit.

[53] I now turn to this Court's decision in *Reicher v. R.*, [1975] 12 N.R. 31, wherein the taxpayer had formed a partnership with two other professionals in order to purchase land and to construct an office building thereon to their custom specifications for the lodging of their own businesses. The construction of the building began in May 1968 and was completed in July of that year. Because the taxpayer's financial position took a turn for the worse in July, he offered his share to his partners, in conformity with their agreement, but they were unable to purchase it. As a result, the three partners agreed to sell their office building and lease it back. The transaction, which yielded a substantial profit to the partners, took place in March 1969. The Minister assessed the taxpayer's share of the profits as taxable income from a venture in the nature of trade. The taxpayer's appeal to the Tax Review Board was dismissed. The taxpayer appealed to this Court and was successful.

[54] The issue before the Court was stated succinctly by Jackett C.J. at paragraph 4 of his Reasons:

> *Prima facie* the profit in question arose from the sale of property acquired and used, in part, for the carrying on of the owners' businesses and, as to the rest, for leasing for income-producing purposes; and, as such, was not profit from a business or from a "venture in the nature of trade". **It is common ground, however, that the assessment under attack was made on the assumption that "acquisition of the subject land and the construction of the subject a building was done … with a view to dealing in, trading in, or otherwise turning to account at a profit"** and the appellant accepts it that he had an onus of showing that the possibility of disposing of the property at a profit was not one of the operating motivations in acquiring the land and building the building.
>
> [Emphasis added]

[55] The Chief Justice noted that the taxpayer and his partners had given evidence that in acquiring the property, they had never given any thought to acquiring it for the purpose of selling it at a profit. With respect to this evidence, the Chief Justice indicated that it was obviously not conclusive. In his view, such evidence had to be considered in the light of all the surrounding circumstances from which the Court had to determine, on a balance of probability, whether the possibility of resale at a profit was one of the motivating factors which led them to acquire the property in question. In concluding that the circumstances of the case did not support an inference that the possibility of resale was a motivating consideration in the decision of both the taxpayer and his partners to proceed with the construction of the building, the Chief Justice opined that there was nothing in the evidence, prior to the decision to proceed with the project, which suggested that the partners had ever given "any consideration … to anything other than ownership" (para. 9 of the Reasons).

[56] Mr. Justice Le Dain wrote concurring Reasons. At paragraph 18, he formulated the question before the Court in the following terms:

> **The issue on this appeal is whether at the time they acquired the property the appellant and his partners had a secondary intention, as an operating motivation for such acquisition, to sell the property at a profit should a suitable opportunity present itself.** The evidence is clear and uncontradicted that the appellant and his partners acquired the property with the intention of assuring themselves of suitable accommodation in it for their professional purposes. The building was completed and furnished to their specifications for such purpose. They would have defeated this purpose had they sold it to a third party without satisfactory provision for continued occupancy by themselves on a long-term basis that would accommodate the expanding requirements of their business. Thus the issue is really whether at the time they acquired the property the appellant and his partners had the secondary intention of entering into a sale with leaseback of the property should a suitable opportunity present itself.
>
> [Emphasis added]

[57] Like Jackett C.J., Le Dain J.A. also came to the conclusion that in proceeding with the construction of their building, the taxpayer and his partners did not have, as a motivating reason, the acquisition of the land and the construction of the building for the purpose of selling it at a profit with leaseback or otherwise.

[58] Lastly, in *Hiwako Investments Ltd. v. M.N.R.* (1978), 21 N.R. 220, the issue before this Court was whether a profit of over $1,000,000 on the purchase of an apartment building consisting of eight separate residential apartments and the resale thereof 11 months later, was a profit from a business.

[59] In concluding that the evidence did not persuade him that the sale of the property "completed an adventure or concern in the nature of trade" (para. 6), Jackett C.J. made the following points. First, the fact that the taxpayer had in mind, as a consideration in making the purchase, the prospect of inflation in land values was not "evidence of a purchase for re-sale amounting to the launching of an adventure or concern in the nature of trade". Second, the Chief Justice made the point that the evidence did not support an inference that the prospect of resale at a profit was a motivation for the purchase. In the Chief Justice's view, the findings of fact of the Trial Judge did not amount to more than a finding that the taxpayer had invested in a profit-producing property that would increase in value and that future circumstances might require a change in his investments. Such a finding, opined the Chief Justice, was not a finding from which it could be inferred that there was an adventure in the nature of trade. He said the following at para 8:

> … It amounts to no more than a finding that there was a wise investment appreciation of the facts, *viz*, that the property would be re-sold if and when there were such a change in circumstances as to make such a re-sale the sensible course of action and that, if such re-sale became advisable, the property would have appreciated in value.

[60] As a result, the Chief Justice concluded that the Tax Review Board had been wrong to dismiss the taxpayer's appeal from the Minister's assessment. In concluding his Reasons, at para. 20, the Chief Justice briefly discussed the concept of "secondary intention":

> I might also add a word with reference to "secondary intention". In my view, this term does no more than refer to a practical approach for determining certain questions that arise in connection with "trading cases" but there is no principle of law that is represented by this tag. The three principal, if not the only, sources of income are businesses, property and offices or employments (section 3). Except in very exceptional cases, a gain on the purchase and re-sale of property must have as its source a "business" within the meaning of that term as extended by section 139. Where property is bought and re- sold at a profit or loss, the

> question whether the profit or loss must be taken into account for tax purposes depends, therefore, generally speaking, on whether
>
> (a) it is a profit or loss from a "business" within the ordinary sense of that term, or
> (b) it is a profit or loss from an undertaking or venture in the nature of trade.
>
> It may be a profit or loss from a "business" in the ordinary sense of that word if the transaction falls within the scope of the business carried on. **<u>If property is acquired when there is no business even though one possibility in the mind of the purchaser is to use the property as the capital asset of a proposed business -- or the purchaser has not considered how he will use it -- a re-sale may be the consummation of a venture in the nature of trade.</u>** Where the subject of the purchase and re-sale is an active profit producing property, it may be more difficult to conceive of its having been acquired both as an investment in the sense of property to be held for the income arising therefrom and as a speculation in the sense of an undertaking or venture in the nature of trade. I am not aware of a clear cut decision with reference to a case of this kind but I do not regard it as theoretically impossible.
>
> [Emphasis added]

[61] A number of principles emerge from these decisions which I believe can be summarized as follows. First, the boundary between income and capital gains cannot easily be drawn and, as a consequence, consideration of various factors, including the taxpayer's intent at the time of acquiring the property at issue, becomes necessary for a proper determination. Second, for the transaction to constitute an adventure in the nature of trade, the possibility of resale, as an operating motivation for the purchase, must have been in the mind of the taxpayer. In order to make that determination, inferences will have to be drawn from all of the circumstances. In other words, the taxpayer's whole course of conduct has to be assessed. Third, with respect to "secondary intention", it also must also have existed at the time of acquisition of the property and it must have been an operating motivation in the acquisition of the property. Fourth, the fact that the taxpayer contemplated the possibility of resale of his or her property is not, in itself, sufficient to conclude in

the existence of an adventure in the nature of trade. In *Principles of Canadian Income Tax Law, supra*, the learned authors, in discussing the applicable test in relation to the existence of a "secondary intention", opine that "the secondary intention doctrine will not be satisfied unless the prospect of resale at a profit was an important consideration in the decision to acquire the property" (see page 337). I agree entirely with that proposition. Fifth, the *viva voce* evidence of the taxpayer with respect to his or her intention is not conclusive and has to be tested in the light of all the surrounding circumstances.

[62] With these principles in mind, I now turn to the appellant's grounds of appeal. First, the appellant says that the Judge made a palpable and overriding error when he concluded that it had not exercised its rights under section 10.11 of the Agreement because it expected to make a greater profit in the future. Second, the appellant says that the Judge also made a palpable and overriding error in inferring by reason of section 10.11 of the Agreement that it intended to resell, from the outset, its interest in Peninsula Village at a profit. It is important to point out that the appellant does not argue that the Judge made any error of law.

[63] Although the Judge appears to have taken a narrow view of the objectives sought by the parties in entering into the Agreement by placing too much emphasis on the rezoning of the property, I am satisfied, after careful consideration of both the evidence and the relevant principles, that the Judge made no palpable and overriding error in concluding that the transaction at issue constituted an adventure in the nature of trade. I am of the opinion that there was sufficient evidence in the record to support his conclusion.

[64] With respect to the appellant's first attack on the Judge's decision, I am of the view that even if the Judge's finding that the appellant had not exercised its rights under section 10.11 of the Agreement because it expected to make a greater profit in the future cannot be supported by the evidence, it does not affect his ultimate conclusion. What the Judge had to decide was whether the appellant intended, upon its acquisition of an interest in Peninsula Village, to resell it at a profit. In other words, was the resale of its interest at a profit an important factor in its decision to acquire a 54% interest in Peninsula Village? In my view, the fact that the appellant did not exercise its option under section 10.11 is, in the end, irrelevant to the determination of its intention at the time of the acquisition.

[65] The appellant's second challenge, however, goes to the heart of the case. The appellant says that there was no basis in the evidence for the Judge's inference that it intended, from the outset, to resell its interest at a profit. In my view, there is ample evidence to support the Judge's inference. As the respondent points out, the finding and inference found in paragraph 13 of the Judge's Reasons cannot be examined in isolation. The Judge's reasoning on the issue is found at paragraphs 9 to 14 of his Reasons, wherein he makes a number of findings which are material to his conclusion. First, the Judge made note of the fact that the only witness heard during the trial, Donald Wright, Senior Vice-President of Real Estate and Engineering for the appellant, testified that the appellant did not intend to remain forever in the joint venture. At paragraph 9 of his Reasons, the Judge finds as follows:

> [9] Mr. Wright testified that when it entered into the joint venture agreement, CSL intended to eventually sell its interest in the joint venture agreement - neither for a profit nor

> a loss. He said that Appellant did not intend to lose money on the eventual sale of its joint venture interest; it hoped or expected to profit from its sale, and it projected a possible profit. Rather, he said it intended to make a profit from the operation of its store. Some of its vetoes in the development of the site reduced the ultimate value of the joint venture to enhance the store's profit. For instance, it chose additional parking over additional store premises and vetoed more profitable leases to stores competitive to Safeway.

[66] The Judge then canvassed the various sections of the Agreement which made clear the object thereof and the scope of the parties' activities in entering into the Agreement. It is in that context that he noted the appellant's rights to sell its interest for a profit upon the rezoning of Peninsula Village. On the basis of these findings, he found that the appellant intended, from the time of its acquisition of an interest in the property, to resell it at a profit.

[67] In reaching his ultimate conclusion, the Judge limited his review of the evidence to the testimony of Mr. Wright, to the Agreement itself and, more particularly, to section 10.11 thereof. However, as I have already indicated, there was ample evidence in the record to support his conclusion. In that regard, I wish to point to the following:

- March 3, 1989 memo (Appeal Book, Vol. II, p. 146):

  > … Given that the strategic significance of this site will increase as South Surrey continues to expand, we feel this site will increase in value even if we are not successful in rezoning. In this regard, purchasing this site represents only limited risk.

- March 30, 1989, Supplemental comments (Appeal Book, Vol. II, p. 175):

  > … Acquiring the site through Joint Venture presents opportunities, the most important of which is to – hold the site for future rezoning thus securing a fine store site. The worst scenario is that if rezoning cannot be obtained, then we will still have an excellent real estate asset in a growing area with

> increasing land values thereby protecting the downside risk of carrying the site.

- Inter-Office Communication, April 4, 1989 (Appeal Book, Vol. II, p. 186):

> While the zoning application has not yet been approved, I believe we should approve the submittal and secure our position in any future development on this very strategic development in White Rock.

- Testimony of the appellant's officer, Donald Peter Wright (Appeal Book, Vol. II, pp. 120-121), where he agreed that it was always the Appellant's intention to sell its interest in the joint venture after the shopping centre was established.

- Inter-Office Communication, April 5, 1989 (Appeal Book, Vol. II, p. 189):

> Participation in this joint venture ensures that we will have a new store at this location as soon as the political climate favouring new commercial development in this area improves. Furthermore, and as the Division points out, it is likely that only one shopping centre site will be approved in the future. It is acknowledged that this site has the best potential as a shopping centre and would stand the most likely opportunity to proceed. **We believe that the downside risk to our company in acquiring an interest in this site is minimal and the upside potential in the profits generated from a new store together with the real estate development opportunity, are truly outstanding.** [Emphasis added]

[68] To the above I would add section 10.11 of the Agreement, which entitled the appellant to make $2,000,000 in profit within 60 days of the rezoning process, and the fact that when Schroeder's proposal was put to the appellant's Real Estate Committee for approval, it included the scenario outlined in paragraph 12 of these Reasons that there was a considerable profit potential, on the resale of Peninsula Village, in the order of $11,000,000 to $12,000,000, of which the appellant would receive 54%.

[69] That scenario, in my view, helps to understand the words of the writer of the inter-office communication of April 5, 1989, Donald Wright, who wrote "… We believe that the downside risk to our company in acquiring this site is minimal and the upside potential in the profits generated from a new store **together with their real estate development opportunity** are truly outstanding" (Emphasis added).

[70] It is clear from the jurisprudence that the fact that a taxpayer eventually intended to sell his or her interest in a property and thereby expected to sell it at a profit is not, in and of itself, sufficient to lead to the conclusion that there is an adventure in the nature of trade. However, in the present matter, the evidence clearly supports the view that the appellant did not simply view its acquisition of an interest in Peninsula Village as an investment that it would eventually sell at a profit. The evidence supports the inference that, from the beginning, the appellant did not want to keep its interest in the joint venture for a long period and that it intended to resell it at a profit. Consequently, section 10.11 of the Agreement reinforces that view.

[71] Although I accept without any hesitation that the appellant entered into the Agreement with Schroeder in order to secure its opportunity to locate a store in Peninsula Village, I must conclude that the evidence supports the view that the appellant had a secondary intention when it entered into the Agreement, namely, to profit from the sale of its interest. The appellant's secondary intention can be understood as a dual intention, as opposed to an alternative intention. In my view, the appellant's intention to have a profitable store co-existed with the operating motivation of reselling

its interest in Peninsula Village at a profit. Unlike the cases where the sale of the property is triggered by unexpected circumstances, such as financial difficulties or non-solicited offers to purchase, the evidence herein supports the view that the appellant always intended to resell its interest at a profit. Thus, the conclusion reached by the Judge that the sale of the appellant's interest in Peninsula Village was an adventure in the nature of trade was clearly open to him.

DISPOSITION

[72] For these reasons, I would therefore dismiss the appeal with costs.

"M. Nadon"
J.A.

"I agree.
A.M. Linden J.A."

<u>PELLETIER J.A. (CONCURRING)</u>

[73] I would dispose of this appeal as proposed by my colleague Nadon J.A. but for somewhat different reasons.

[74] The question as to whether Canada Safeway's foray into real estate development was an adventure in the nature of trade resolves itself into a question as to the nature of its co-ownership interest. There are only two choices:

> "The Act defines two types of property, one of which applies to each of these sources of revenue. Capital property (as defined in s. 54(b)) creates a capital gain or loss upon disposition. Inventory is property the cost or value of which is relevant to the computation of business income. The Act thus creates a simple system which recognizes only two broad categories of property. The characterization of an item of property as inventory or capital property is based primarily on the type of income that the property will produce."
>
> *Friesen v. Canada* [1995] 3 S.C.R. 103 per Major J. at paragraph 28

[75] Since there are only two choices, the demonstration that a given property is inventory is necessarily proof that it is not a capital property and vice versa. In some cases, it may be easier to show what a property is and in others it may be easier to show what it is not. In either case, the result is the same. For the purpose of determining whether a transaction with respect to a property is an adventure in the nature of trade, that property must be either inventory or capital property.

[76] The type of income produced by inventory is business income. Inventory produces business income by being turned over, that is, by being sold in the market. If inventory is not sold at a profit, the business soon ceases to be a business but inventory does not lose its character as inventory by being sold at a loss.

[77] The definition of a capital property as property whose disposition gives rise to a capital gain or loss is not particularly useful as a device for identifying capital property. Since property which

produces income by being turned over is inventory, capital property must necessarily produce income by being held. Without excluding other possibilities, property which produces income by being held can either produce a revenue stream on its own, i.e a revenue property, or be used in the conduct of a business but without being part of the inventory (the trading stock) of that business. So, for example, real property can be inventory in the hands of a property developer but is capital property to a grocery store operator who uses it to house its grocery business.

[78] The essence of the distinction between inventory and capital property, for purposes of the question of adventure in the nature of trade is one of intention at the time the property is acquired. See *Hazeldean Farm v. Canada (Minister of National Revenue -- M.N.R.)*, [1967] 1 Ex. C.R. 245 at p. 257. I suggest that the test is whether the property is acquired with the intention of being held for the purpose of producing income (or being used in the production of income), in which case it is capital property. If it is acquired for the purpose of being turned over, it is inventory.

[79] Because an adventure in the nature of trade produces business income, the analysis is often approached on the basis of whether the evidence discloses “a profit making scheme” or whether the property was acquired with the intention of being sold at a profit. This analysis has yielded a rich and sophisticated jurisprudence, an excellent example of which is found in the reasons of Campbell J. in *Corvalan v. Canada* 2006 TCC 200. To the extent that these cases focus on the intention of profit as a factor in the analysis, they are subject to being misinterpreted.

[80] In the case of inventory, it is the taxpayer's intention to turn over the property which is determinative, not the taxpayer's calculation that it can be done at a profit. There are few, if any, cases in the jurisprudence where the taxpayer intended to turn the property over at a loss simply because a transaction which is likely to produce a loss is not likely to proceed. But if such a case were to surface, property acquired with the intention of being turned over, even at a loss, would not cease to be inventory because of the absence of the element of profit. It would merely be unprofitable inventory.

[81] Applying this analysis to the facts of this case, it seems to me to be easier to show what Canada Safeway's co-ownership interest in the shopping centre was not than what it was. It is clear that Canada Safeway did not acquire its co-ownership interest with the intention of producing income from that interest. In other words, Canada Safeway did not acquire that interest with a view to generating rental income. Nor was the co-ownership interest to be used in the conduct of Canada Safeway's grocery business. Canada Safeway's intention at the time it acquired the property was not to hold the property as a source of income; as a result, its co-ownership interest in the shopping centre must necessarily be inventory. Since the transaction was an isolated one, it amounts to an adventure in the nature of trade.

[82] The fact that Canada Safeway did not acquire its co-ownership interest with the intention of holding it to produce income is apparent from the trial judge's finding of fact. In dealing with the Minister's assumptions of fact, the trial judge first stated the relevant assumptions and his conclusions with respect to those assumptions:

> 3. In so assessing and reassessing the Appellant for the 1996 taxation year the Minister relied on the following assumptions of fact:
> …
> (y) The Appellant never intended to retain ownership of Peninsula Village and to earn a rental income from it;
> …
> bb) The Appellant intended to wait until a substantial portion of Peninsula Village was leased out and then sell its interest at a profit;
>
> 5 Respecting the remaining assumptions, by subparagraph:
> ….
> (y) Is correct. The Appellant intended to be in the grocery business and to have its store on the site.
> …
> (bb) The Appellant intended to sell its interest in the joint venture and *not to become a long term landlord when it entered into the joint venture.* The Appellant intended to establish its store on the site in the most advantageous way possible and to prevent a competitor from doing so there, or in a nearby location. Once that was accomplished, it would sell its interest in the joint venture. Whether its intent at the outset was to sell at a profit will be analyzed later. [Emphasis added]

[83] The conclusion that Canada Safeway never intended to hold its co-ownership interest and to earn rental income from it is, to my mind, fatal to any suggestion that the co-ownership interest was a capital property. This is not a case where there is evidence of mixed motives. Canada Safeway was crystal clear in its objectives which was to participate in the co-ownership venture long enough to assure the construction of its store and then to sell its co-ownership interest. The evidence of that single intention does away with any need to refer to secondary intention.

[84] The trial judge's final comment in the passage cited above, that the analysis of whether Canada Safeway's intent "at the outset was to sell at a profit" would follow, is a nice illustration of misplaced reliance on the profit motive. Once it was clear that Canada Safeway never intended to hold its interest longer than necessary to ensure the construction of its store, the question of sale at a

profit became redundant. The trial judge's comment leaves open the possibility that, had a loss been anticipated, the transaction would not have qualified as an adventure in the nature of trade. Property which is not acquired with the intention of being held for the purpose of producing income is necessarily inventory, even if it is unprofitable inventory, since there are only two classes of property for these purposes.

[85] As a result, I would dismiss the appeal with costs.

"J.D. Denis Pelletier"

J.A.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-316-06

(APPEAL FROM A JUDGMENT OF THE TAX COURT OF CANADA, 2006 TCC 345, DATED JUNE 19, 2006)

STYLE OF CAUSE:	CANADA SAFEWAY LTD. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Calgary, AB
DATE OF HEARING:	October 25, 2007
REASONS FOR JUDGMENT BY:	Nadon J.A.
CONCURRED IN BY:	Linden J.A.
CONCURRING REASONS BY:	Pelletier J.A.
DATED:	January 23, 2008

APPEARANCES:

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