Privy Council Appeal No. 72 of 1932.

The Minister of National Revenue - - - - - - *Appellant*

v.

Mrs. Catherine Spooner - - - - - - - *Respondent*

FROM

THE SUPREME COURT OF CANADA.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 27TH JULY 1933.

Present at the Hearing:

LORD ATKIN.
LORD TOMLIN.
LORD MACMILLAN.
LORD WRIGHT.
SIR GEORGE LOWNDES.

[*Delivered by* LORD MACMILLAN.]

The respondent, Mrs. Spooner, in the year 1927 received a sum of $9,570.41 in circumstances set out in an agreed statement of facts. The question is whether this sum was "income" of the respondent within the meaning of the Income War Tax Act (Revised Statutes of Canada, 1927, ch. 97).

It appears that the respondent, who was the owner in freehold of a ranch in Alberta, entered into an agreement on 15th April, 1925, with Vulcan Oils Ltd., a company incorporated under the laws of the Province of Alberta, and having for its objects "drilling for and procuring the production and vending of oil." By this agreement the respondent sold to the company all her right, title and interest in and to twenty acres of her land, "subject to the provisos, conditions and royalties hereinafter reserved." "In consideration of the said sale" the company agreed to pay to the respondent the sum of $5,000 in cash on the execution of the agreement, to issue to her 25,000 fully-paid shares of $1 each in the company, and further to deliver to her

order " the royalty hereby reserved . . . namely, ten per cent. of all the petroleum, natural gas and oil produced and saved from the said lands free of costs." The company undertook to deliver this percentage at least once in every 30 days, to keep and make available to the respondent proper books of account showing the quantity of petroleum, natural gas and oil produced from the lands, and to permit the respondent at all times to enter upon and inspect the workings. It was also agreed that the company should forthwith acquire the necessary plant and commence drilling as expeditiously as possible, and upon oil or petroleum being discovered should carry on the operation of pumping or otherwise procuring those products from the lands. " In the event of oil or gas being discovered in commercial quantities on the said lands " the respondent, " as part of the consideration for this agreement " covenanted to transfer to the company in fee simple the 20 acres already mentioned and also 20 additional acres, " reserving always, however, to the vendor the said royalty of 10 per cent. of all petroleum, natural gas and oil in respect to the " first-mentioned 20 acres.

The company duly commenced operations, and in the fall of 1926 struck oil in commercial quantities. In the year 1927 the company did not deliver to the respondent any of the oil produced, but sold the whole of it, and paid over $9,570·41, being 10 per cent. of the gross proceeds, to the appellant, which sum she accepted in satisfaction of the " royalties " reserved to her under the agreement. When the present question arose the respondent had not yet conveyed the lands to the company and the title still remained in her own name.

The respondent in her income tax return for the year 1927 reported no income, but she was subsequently assessed to tax in respect of this sum of $9,570.41 which she had received from the oil company, the amount of the tax being $301.07. The Minister of National Revenue, the present appellant, to whom the respondent appealed, confirmed the assessment subject " to adjustment as to depletion in accordance with Section 4 of Chapter 12 of the Statutes of 1928." The respondent having appealed to the Exchequer Court of Canada her appeal was dismissed by Audette, J. On a further appeal to the Supreme Court of Canada the respondent obtained a unanimous judgment in her favour, setting aside the assessment. From this judgment the Minister of National Revenue has now appealed to His Majesty in Council.

The Income War Tax Act contains the following definition of income :—

> " 3.—(1) For the purposes of this Act ' income ' means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business, as the case may be; and shall include

> the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source; . . ."

The Minister in this appeal maintains that the sum in question comes within the words " annual profit or gain from any other source."

The question whether a particular sum received is of the nature of an annual profit or gain or is of a capital nature does not depend upon the language in which the parties have chosen to describe it. It is necessary in each case to examine the circumstances and see what the sum really is, bearing in mind the presumption that " it cannot be taken that the Legislature meant to impose a duty on that which is not profit derived from property, but the price of it " (*per* Hanworth, M.R., in *Perrin* v. *Dickson* [1930], 1 K.B. 107 at p. 119, quoting previous authorities). It may be that ordinary mineral royalties, though not expressly mentioned in the definition section, are taxable income in Canada, subject to an allowance for exhaustion. The term " royalty " occurs in Section 27 of the Act, which provides that any non-resident person who receives a royalty " for anything used or sold in Canada shall be deemed to be carrying on business in Canada and to earn a proportionate part of the income derived therefrom in Canada." This section may have been enacted to obviate the argument that the mere receipt of royalties is not a carrying on of business, as was decided in the excess profits duty cases, *Commissioners of Inland Revenue* v. *Marine Steam Turbine Co.* [1920], 1 K.B. 193, and *Commissioners of Inland Revenue* v. *Korean Syndicate, Ltd.* [1920], 1 K.B. 598. It seems, however, to indicate that some " royalties " at any rate may be taxable income under the Act. But the share which the respondent became entitled to receive of the oil from the land which she had sold to the company was not a royalty in the sense of section 27, or in the ordinary sense familiar in the case of mining leases where the lessor stipulates for payment by his lessee of a fixed rate per ton of the mineral won. Here there is no relation of lessor and lessee. The transaction was one of sale and purchase. It may have taken the form which it did because of the uncertainty whether oil would be found by the purchaser or not; as the value of the land depended on this contingency the price, not unnaturally, was made to depend in part on the event.

The appellant, founding on a passage in the judgment of Audette, J., where that learned judge said: " This royalty mentioned in the agreement is a reservation operating as an exception out of the demise . . . of the profits derived from the working and development of this land," argued that there was really no sale to the company of the oil in the land, but only

a sale of the right to search for oil and reduce it into possession on the terms that a percentage of whatever oil was found should remain the property of the respondent. But this is not really so. The agreement provides for a sale to the company of all the respondent's right, title and interest in the land, which includes the right to any oil which it may contain. The respondent was not in any sense a joint-adventurer with the company in the business of oil prospecting or oil production.

While their Lordships, of course, recognise that a profit or gain may be received in kind as well as in money it is not without some significance that the respondent bargained to receive her share in oil. What she has a right to is so much oil, and the fact that she has accepted a sum of money in the year in question in lieu of her share of oil does not affect the true position, though no doubt if she had taken her share in oil she would have been at the expense of marketing it and might not have received anything like the sum actually paid to her by the company.

Their Lordships have to deal with the transaction as they find it, namely, with a sale of land in consideration of which the purchaser agrees to give the vendor, *inter alia*, a percentage share of the oil to be obtained from the land sold. Capital may, no doubt, be expended in the acquisition of an income which, in the recipient's hands, becomes a proper subject of income tax, as was pointed out in the passage quoted by Newcombe, J., from the judgment of Rowlatt, J., in *Jones* v. *Commissioners of Inland Revenue* [1920], 1K.B. 711 at pp. 714–5. But in the same volume, in a case where the liquidators of a company had sold its assets, including certain patent rights, to a new company for a sum in cash, a block of shares and a royalty on every machine sold, the same learned Judge had characterised the royalties as being " in effect payment by instalments of part of the price of the property which the respondent company had finally disposed of to the new company " (*per* Rowlatt, J., in *Commissioners of Inland Revenue* v. *Marine Steam Turbine Co.*, *cit. sup.*, at p. 203).

Into which category, then, does the present case fall ? Their Lordships agree with Newcombe, J., that " the case is not without its difficulties," as all cases must be which turn upon such fine distinctions, but they are not prepared to differ from the view of the transaction which that eminent Judge took, and with which all his colleagues agreed, namely, that " the respondent has converted the land, which is capital, into money, shares and 10 per cent. of the stipulated minerals which the company may win . . . there is no question of profit or gain, unless it be as to whether she has made an advantageous sale of her property." It was for the Minister to displace this view as being manifestly wrong. In their Lordships' opinion he has failed to do so.

Their Lordships will therefore humbly advise His Majesty that the appeal should be dismissed and the judgment of the Supreme Court affirmed. The respondent will have her costs of the appeal as between solicitor and client.

In the Privy Council.

THE MINISTER OF NATIONAL REVENUE

v.

MRS. CATHERINE SPOONER.

DELIVERED BY LORD MACMILLAN.

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