Toward a More Coherent Theory of Dispositions

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PRÉCIS

Les auteurs expriment leur inquiétude du fait que la signification de «disposition» ait été élargie inopportunément dans certaines décisions judiciaires récentes. Par conséquent, les contribuables, dont le placement a changé sans toutefois y mettre fin, sont néanmoins traités comme s’ils avaient effectué la disposition d’un bien assujetti à l’impôt. Les auteurs croient fermement que Revenu Canada et nos tribunaux doivent respecter le choix du Parlement du terme «disposition», dont la signification est limitée : il n’englobe pas toutes les façons dont un particulier peut exploiter son bien. Seules les opérations et les événements desquels il résulte l’élimination complète d’une participation ou d’un droit dans un bien peuvent donner lieu à une disposition de ce bien.

ABSTRACT
An integral aspect of “income” is realization, or a “coming in.” Only realized gains are supposed to be taxed under modern systems of income taxation. In Canada, the Income Tax Act invokes the concept of the “disposition of property” as the basis for taxing gains.

The authors express concern that some recent judicial decisions have extended inappropriately the meaning of “disposition.” The result is that taxpayers whose investment has changed but not terminated are nevertheless treated as having made a disposition of property subject to taxation. The authors emphasize the need for Revenue Canada and the courts to respect Parliament’s selection of the term “disposition,” the meaning of which has limitations: it does not encompass every way in which one can exploit one’s property. Only transactions and events that result in a termination of one’s entire interest or estate in property can result in a disposition of that property.

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INTRODUCTION

Any system of income taxation should strive for at least two objectives: consistency and uniformity. There are many ways of expressing these objectives.\(^1\) We think that the best method is to state that like cases should be treated alike. It is inevitable, however, that modern income tax systems will be challenged by the inherent subjectivity of the most basic concept underlying those systems—the measurement of “income.” It is well documented that the concept of income (or profit, for that matter) is imprecise.\(^2\) Integral to the concept of income is the idea of realization. Indeed, it might be argued that realization is the sine qua non of the constitutional jurisdiction to raise revenues by income taxation. The result

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\(^1\) For example, Jeff Strnad, in “Taxing New Financial Products: A Conceptual Framework” (February 1994), 46 *Stanford Law Review* 569-605, at 572-73, prefaces his analysis as follows:

[T]wo distinct desiderata for a good tax system: universality and consistency. . . .

Universality requires that the tax system specify a tax treatment for every possible transaction. This principle is both attractive as an administrative goal and as an ideal in a system faced with financial innovation. If the tax treatment of particular portfolios of cash flow patterns is unclear, taxpayers and the government both face heightened administrative costs. The government will need to specify rules for ambiguous situations, and, prior to the development of such rules, taxpayers will be unable to predict the tax consequences of holding particular instruments or portfolios.

Even if a tax system is universal, financial innovation poses another set of potential problems. Innovative packaging of a set of cash flows may result in a tax that differs from the tax that would be due if the cash flows were packaged in a more traditional manner. In a tax system where the same patterns of cash flows may have different tax consequences depending on the form chosen for the transaction or portfolio, taxpayers will expend resources searching for the most advantageous form. At the same time, the government will be concerned that many tax treatments will become “elective” for taxpayers who can change these treatments by recasting their transactions or portfolios. Thus, even if the tax system is universal, substantial administrative costs may result if arrangements that are equivalent financially do not have the same tax consequences.

This problem motivates the idea of consistency. A tax system is consistent if and only if every cash flow pattern has a unique tax treatment. In such a system, it is not possible to manipulate tax outcomes by repackaging cash flows into different financial vehicles.

Consistency is an important objective not only because of the administrative costs caused by its absence but also because of its close connection with “tax arbitrage.” Tax arbitrage arises in its purest form when a series of transactions results in no net cash flow but provides tax advantages. . . .

In a consistent tax system, tax arbitrage is not possible. Since tax arbitrage tends to defeat distinctions set up in the tax laws, such as the distinction between capital gain and ordinary income, and tends to produce free money at government expense for well-capitalized taxpayers, the usual presumption is that tax arbitrage is an evil to be controlled.

\(^2\) D.J. Sherbaniuk, in “Receipt and the Time of Recognition of Income: A Historical Conspectus of the Income Tax Laws of the United Kingdom, the United States and Canada” (1963), vol. 15, no. 1 *University of Toronto Law Journal* 62-101, provides a masterly synopsis of the challenge of interpreting the concept of income. Of particular note are the following comments, at 63-64:

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is that modern income tax systems are designed, by and large, to establish liability for taxation in conjunction with the recognition, or realization, of income from specified sources.

The Court of King’s Bench in *The Royal Insurance Co., Ltd. v. Stephen*, when analyzing an exchange by a taxpayer of corporate shares for shares having a reduced value, observed:

> At the bottom of this principle of waiting for a realisation, I think there is this idea: while an investment is going up or down for Income Tax purposes the [taxpayer] cannot take any notice of fluctuations, but it has to take notice of them when all that state of affairs comes to an end, . . . when an investment ceases to figure in the [taxpayer’s] affairs, when it is known exactly what the holding of that investment has meant, plus or minus to the [taxpayer], and then the [taxpayer] starts so far as that portion of its resources is concerned with a new investment. Then one knows where one is and it is no longer a question of paper, it is a question of fact and that is a realisation. . . . [The taxpayer] has done with the investments in the companies. They have disappeared. It is known exactly in money. It is known now exactly what their holding of them has meant to the [taxpayer]. They will never more go up or down. What will go up or down now are the different shares in the new companies, altogether different investments really, and therefore I think that the old investment is closed and realised and a new investment is started.³

The reasons for modern income tax systems linking liability for taxation with “realization” of gain were well summarized in 1963 by Douglas J. Sherbaniuk.

Although the income tax laws of these three countries differ markedly in many material respects, common to all of them is the fundamental principle that only “realized” gains are taxable as income. That is to say that, speaking generally, tax is imposed only on actual gains, and not on deferred or potential or anticipated gains such as an appreciation in value of a taxpayer’s stock-in-trade or his right to receive salary or interest, for example, even though these items enhance his economic worth. As will be explained in detail below, under the early income tax laws of the United Kingdom, the United States and Canada, as a general rule income was regarded as arising when it was received and not before, “receipt” being the fruition or realization in possession of a potential or anticipated gain. This approach contemplated the computation of income on the “cash receipts and disbursements” method of accounting, according to which only amounts actually received and actually paid by the taxpayer are taken into account.

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² Continued . . .

The problem of when income arises to be taxed is, of course, only one facet of the broad and vexed question of what is meant by income, which is the subject of a vast body of literature to which a substantial contribution has been made by economists, especially in the United States. . . .

These and other concepts of income have not played a significant role in the development of income as a legal concept for income tax purposes in the United Kingdom, the United States, or Canada, neither the legislatures nor the courts availing themselves to any appreciable extent of economic theories of income.

³ (1928), 14 TC 22, at 28-29 (KB).
Several reasons may be advanced in support of a proposition that income arises when it is received. For one thing, the idea of a “coming in” or receipt is implicit in the term “income,” and for another, the recognition of income when it is reduced to possession by the taxpayer and is available to satisfy his wants and desires would accord with the layman’s understanding of that word. This is an important practical consideration in view of the fact that most taxpayers compute and report their own income. Applicable equally to the United States and Canada as to the United Kingdom is the statement made recently in the House of Lords that “much of the effective administration of Revenue Collection will continue to depend, as it always has, upon the measure of candour and responsibility that is shown by the individual taxpayer and his professional advisers.” It follows that if a taxpayer can readily determine when his income arises to be taxed by the application of some simple, objective standard such as receipt, as contrasted, say, with having to make complete periodical revaluations of all his property, as Haig would have him do, the more likely is his return to be complete and accurate, and the less burdensome the taxing authority’s task of revenue collection. More important, the imposition of tax only on gains which have been received “does mathematical justice between government and taxpayer” and fairly reconciles their opposing interest in that the latter is spared unnecessary hardship if collection of the tax is postponed until he has received the income out of which to pay it, and the revenue authority is adequately protected if tax is levied at this time when the taxpayer is in funds. Finally, at the time of receipt the uncertainty that amounts due might not be paid is eliminated and the amount of the taxpayer’s gain may be accurately ascertained.4

While many of Sherbaniuk’s comments have been overtaken in Canada by notions of accrual and deemed realization for the purposes of the Income Tax Act, the tenets of the realization-based system remain as applicable today as they were when he described them. (This was recently affirmed by the Supreme Court of Canada in Jake Friesen v. The Queen, as yet unreported.)

In addition to the challenge of interpreting and defining the concepts of income and realization, one of the most serious impediments to the attainment of the goals of uniformity and consistency in most modern systems of income taxation is the distinction between the recognition of fixed amounts and the recognition of contingent amounts. In the simplest sense, fixed amounts are taxed as they accrue or are earned, on the basis that the taxpayer is entitled to enforce the payment of such amounts. Contingent amounts are amounts on which the return is not fixed. These amounts are not recognized or taxed until an event occurs which makes it certain that an amount will be realized (earned). Thus, a gain or loss from acquiring and holding a share of a corporation is not recognized until the gain or loss is realized, usually as a result of a sale or some other method of realization.

In the Canadian context, the Income Tax Act5 relies primarily on the concept of the “disposition of property” as the sine qua non of the taxation

4 See supra footnote 2, at 64-66.
5 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.
of contingent gains or losses on assets. In their attempts to accommodate
the distinction between the recognition of fixed amounts and the recogni-
tion of contingent amounts, however, Revenue Canada and the courts alike
have extended the concept of disposition of property. In so doing, they
have strained two of the most important principles upon which our sys-
tem of income taxation is based:

• taxation is based upon the real or legal rights of the parties to a
  particular transaction or event; and
• property in the real or legal sense is, in most cases, indivisible.

We submit that the effect of these strains may not yet be fully appreci-
ated. In this article we review selected instances in which we believe that
these principles have been strained, and we make a case for rationalizing
the application of the Income Tax Act in the context of dispositions
of property. We submit that this goal may be achieved only when our legis-
lators and judiciary insist upon a more disciplined and consistent approach
to the concepts of “disposition” and “property,” on the assumption that
each of these concepts will remain a cornerstone of our system of income
taxation.

Statutory References
The Income Tax Act provides expansive definitions of “disposition” in
section 13, which deals with the system of recognizing and recovering the
expense of depreciation of depreciable capital property, and in section 54
of subdivision c of division B, which deals with taxable capital gains and
allowable capital losses. For convenience of reference, these definitions
are reproduced below.

In subsection 13(21),

“disposition of property” includes any transaction or event entitling a tax-
payer to proceeds of disposition of property;

and

“proceeds of disposition” of property includes

(a) the sale price of property that has been sold,
(b) compensation for property unlawfully taken,
(c) compensation for property destroyed and any amount payable under
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6 As noted by Douglas S. Ewens in “When Is a ‘Disposition’?” in Report of Proceed-
ings of the Twenty-Sixth Tax Conference, 1974 Conference Report (Toronto: Canadian Tax
Foundation, 1975), 515-41, at 517, footnote 15: “The number of words and phrases adopted
by the Income Tax Act to denote the passing of property from one taxpayer to another is
remarkable. See for example, para. 7(1)(b) ‘transferred or otherwise disposed of’; para.
7(1)(c) ‘rights of the employee under the agreement have . . . become vested in a person’;
s. 55 ‘one or more sales exchanges, declarations of trust, or other transactions of any kind
whatever’; s. 56(2) ‘payment or transfer of a property’; s. 56(4) ‘transferred or assigned’;
s. 79 ‘transferred or distributed’; and ss. 74 and 75 ‘transferred property . . . by means of
a trust or by any other means whatever.’”

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(d) compensation for property taken under statutory authority or the sale price of property sold to a person by whom notice of an intention to take it under statutory authority was given,

(e) compensation for property injuriously affected, whether lawfully or unlawfully or under statutory authority or otherwise,

(f) compensation for property damaged and any amount payable under a policy of insurance in respect of damage to property, except to the extent that the compensation or amount, as the case may be, has within a reasonable time after the damage been expended on repairing the damage,

(g) an amount by which the liability of a taxpayer to a mortgagee is reduced as a result of the sale of mortgaged property under a provision of the mortgage, plus any amount received by the taxpayer out of the proceeds of the sale, and

(h) any amount included in computing a taxpayer’s proceeds of disposition of the property by virtue of paragraph 79(c).

In section 54, “disposition” of any property, except as expressly otherwise provided, includes

(a) any transaction or event entitling a taxpayer to proceeds of disposition of property,

(b) any transaction or event by which

(i) any property of a taxpayer that is a share, bond, debenture, note, certificate, mortgage, agreement of sale or similar property, or an interest therein, is redeemed in whole or in part or is cancelled,

(ii) any debt owing to a taxpayer or any other right of a taxpayer to receive an amount is settled or cancelled,

(iii) any share owned by a taxpayer is converted by virtue of an amalgamation or merger, or

(iv) any option held by a taxpayer to acquire or dispose of property expires, and

(c) any transfer of property to a trust, or any transfer of property of a trust to any beneficiary under the trust, except as provided in paragraph (e),

but, for greater certainty, does not include

(d) any transfer of property for the purpose only of securing a debt or a loan, or any transfer by a creditor for the purpose only of returning property that had been used as security for a debt or a loan,

(e) any transfer of property by virtue of which there is a change in the legal ownership of the property without any change in the beneficial ownership thereof, other than a transfer by a trust resident in Canada to a trust not resident in Canada or a transfer to a trust governed by

(i) a registered retirement savings plan,

(ii) a deferred profit sharing plan,

(iii) an employees profit sharing plan, or

(iv) a registered retirement income fund

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by a person who is, immediately after the transfer, a beneficiary under the plan or fund, or a transfer by any such trust governed by a plan or fund to a beneficiary thereunder,

(f) any issue by a corporation of a bond, debenture, note, certificate or mortgage of the corporation, or

(g) any issue by a corporation of a share of its capital stock, or any other transaction that, but for this paragraph, would be a disposition by a corporation of a share of its capital stock.

“proceeds of disposition” of property includes,

(a) the sale price of property that has been sold,

(b) compensation for property unlawfully taken,

(c) compensation for property destroyed, and any amount payable under a policy of insurance in respect of loss or destruction of property,

(d) compensation for property taken under statutory authority or the sale price of property sold to a person by whom notice of an intention to take it under statutory authority was given,

(e) compensation for property injuriously affected, whether lawfully or unlawfully or under statutory authority or otherwise,

(f) compensation for property damaged and any amount payable under a policy of insurance in respect of damage to property, except to the extent that such compensation or amount, as the case may be, has within a reasonable time after the damage been expended on repairing the damage,

(g) an amount by which the liability of a taxpayer to a mortgagee is reduced as a result of the sale of mortgaged property under a provision of the mortgage, plus any amount received by the taxpayer out of the proceeds of the sale,

(h) any amount included in computing a taxpayer’s proceeds of disposition of the property by virtue of paragraph 79(c), and

(i) in the case of a share, an amount deemed by subparagraph 88(2)(b)(ii) not to be a dividend on that share,

but notwithstanding any other provision of this Part, does not include

(j) any amount that would otherwise be proceeds of disposition of a share to the extent that the amount is deemed by subsection 84(2) or (3) to be a dividend received and is not deemed by paragraph 55(2)(a) or subparagraph 88(2)(b)(ii) not to be a dividend, or

(k) any amount that would otherwise be proceeds of disposition of property of a taxpayer to the extent that the amount is deemed by subsection 84.1(1) or 212.1(1) to be a dividend paid to the taxpayer.

Some items included in the definitions of “proceeds of disposition” bear some scrutiny.

1) “Compensation for property injuriously affected.” It strikes us that injurious effect falls far short of a “parting with” property.\(^7\)

\(^7\)The term “injuriously affected” describes damages caused to one person’s property by another, usually as a result of the other performing work on his or her own property that (The footnote is continued on the next page.)
2) The receipt of insurance proceeds for damage to property also falls short of a parting with property, in that the owner of the damaged property continues to own it. It would be another matter if the definition were restricted to compensation for property destroyed or taken.

The inclusion of these two items in the definition of “proceeds of disposition” should not affect the interpretation of the definition of “disposition.” The inclusion of compensation for these events that are not actually dispositions does not make either of those events a “disposition.” The reason is that the first branch of the definition of “disposition” in both sections 13 and 54 is “any transaction or event entitling a taxpayer to proceeds of disposition.” Hence, the fact that Parliament has chosen to include in the definition of this latter term proceeds of insurance for damage to property, for example, does not imply any extension of the normal meaning of “disposition” effectively to include the mere occurrence of the damage (being the event that entitles the taxpayer to recover the insurance proceeds).

Jurisprudence
The relevant jurisprudence pertaining to the concept of dispositions was summarized more than 20 years ago in Ewens’s article. It is useful to summarize this jurisprudence and to extend that review to the present.

The leading Canadian decision involving the interpretation of the concept of the disposition of property in the context of the Income Tax Act is The Queen v. Compagnie Immobilière BCN Ltée. In this case, the taxpayer acquired a leasehold interest in, together with a building situate upon, land located in the City of Montreal. One year later, the taxpayer acquired the lessor’s rights under the lease of land (“the acquisition”), thereby becoming the full owner of the land. Immediately after the acquisition, the taxpayer leased several properties (“the latter lease”), including the land on which the building stood, to a third party. Pursuant to the terms of the latter lease, the lessee was obliged to demolish the building and to construct a new office building on the property. The building was established as class 3 depreciable property of the taxpayer under the regulations (that is, property not included in any other class that is a building). The taxpayer’s interest under the original lease was established as class 13 depreciable property (that is, property that is a leasehold interest). The taxpayer claimed depreciation at the appropriate annual rate in respect of the undepreciated capital cost of the class 3 and the class 13 properties. However, in each of the two taxation years in issue (which followed the
date of both the acquisition and the latter lease) the taxpayer did not own any property in either class 3 or class 13. The taxpayer no longer owned the building, since it no longer existed. The leasehold interest had merged in the ownership interest when the taxpayer had acquired it. Nevertheless, the taxpayer did not claim a terminal loss in respect of either class, contending that it had not disposed of its property in either of those classes as the relevant sections of the regulations required. The minister reassessed the two taxation years in issue to deny the taxpayer’s deduction for capital cost allowance.

The taxpayer’s appeal to the Federal Court—Trial Division\textsuperscript{10} was dismissed on the grounds that, first, the right to claim depreciation in respect of property previously acquired depended upon the continued existence of the property, and, second, the property could not longer be said to have been held for the purpose of producing income. The Federal Court of Appeal\textsuperscript{11} allowed the taxpayer’s appeal on the ground that it was not necessary for property to be in existence or used or held for income-producing purposes in order that the cost of the property be included in the relevant undepreciated capital cost pool for depreciation purposes.

At the time, regulation 1100(2) provided:

Where, in a taxation year, otherwise than on death, all property of a prescribed class that had not previously been disposed or transferred to another class has been disposed of or transferred to another class and the taxpayer has no property of that class at the end of the taxation year, the taxpayer is hereby allowed a deduction for the year equal to the amount remaining, if any, after deducting the amounts, determined under sections 1107 and 1110 in respect of the class, from the undepreciated capital cost to him of the property of that class at the expiration of the taxation year [emphasis added].

The issue before the Supreme Court was whether the taxpayer’s interest in the building and its rights under the first lease could be regarded as having been “disposed of” by the taxpayer. In this regard, the minister argued that the Federal Court of Appeal was incorrect in concluding that the expression “disposed of” should be limited to transactions involving any transfer, by way of sale, gift, or otherwise, of the legal title to some other person but not so as to include the destruction or extinguishment of the property. In the minister’s view, the term “disposed of” should be interpreted as broadly as possible. Speaking for the majority of the court, Mr. Justice Pratte noted at the outset that the expression “disposed of,” as found in regulation 1100(2), was not defined in the Act or in the regulations. In view of this, he turned to the comments of Lord Herschell in Colquhoun v. Brooks.\textsuperscript{12}

It is beyond dispute, too, that we are entitled and indeed bound when construing the terms of any provision found in a statute to consider any of the parts of the Act which throw light on the intention of the legislature,

\textsuperscript{10}75 DTC 5198 (FCTD).
\textsuperscript{11}76 DTC 6153 (FCA).
\textsuperscript{12}[1889] 14 AC 493, at 506 (HL).
and may serve to shew that the particular provision ought not to be construed as it would be if considered alone and apart from the rest of the Act.

On the basis of this reasoning, he concluded that

{quote}
the expressions “disposed of” or “aliénés” as found in Regulation 1100(2) should therefore not be interpreted in the isolated context of the Regulation itself as if it stood alone and independently from the statute under which it was passed. Its true meaning should rather be gathered from the consideration of all relevant statutory or regulatory provisions under which the scheme of capital cost allowances was established and regulated and of which the terminal loss provisions of Regulation 1100(2) are but a part.{/quote}

The court noted the definitions in former subsection 20(5) of the Act, and the fact that those definitions were expressed to have effect for the purposes of section 20 and for the purposes of the “Regulations made under paragraph (a) of subsection (1) of section 11,” which would include regulation 1100(2). The relevant definitions are similar to those in sections 13 and 54 of the current Act. The relevant portions read as follows:

(b) “disposition of any property” includes any transaction or event entitling a taxpayer to proceeds of disposition of property;

(c) “proceeds of disposition” of property include:

(i) the sale price of property that has been sold,

(ii) compensation for property damaged, destroyed, taken or seriously affected, either lawfully or unlawfully, or under statutory authority or otherwise,

(iii) an amount payable under a policy of insurance in respect of loss or destruction of property.

Noting the use of the unlimiting term “includes” in these definitions, the court concluded that the definitions should not be narrowly construed:

In the context of s. 20(5), the definitions of “disposition of property” and “proceeds of disposition” can not be said to be exhaustive; these expressions must bear both their normal meaning and their statutory meaning; it would be wrong to restrict the former because of the latter.

The court concluded that the term “disposed of,” as used in subsection 1100(2), must be used in a sense that conforms with the concepts of “disposition of property” and “proceeds of disposition” in the interpretive sections of the Act. As for the proper interpretation of the phrase, the court reached the following conclusions:

The verb “to dispose” has a very broad meaning; it is defined as follows in the Oxford English Dictionary (see To dispose of):

b. To put or get (anything) off one’s hands; to put away, stow away, put into a settled state or position; to deal with (a thing) definitely; to get rid of; to get done with, settle, finish. In recent use sometimes spec. to do away with, “settle,” or demolish (a claim, argument, opponent, etc.); also humorously, to make away with, consume (food).

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13 Supra footnote 9, at 5071-72.
14 Ibid., at 5072.
The substantive definitions of “disposition of property” and “proceeds of disposition” in s. 20(5)(b) and (c) are a clear indication that the words “disposed of” should be given their broadest possible meaning.

In French, the verb “disposer” would convey the same idea as “to dispose of.” In discussing the jus abutendi which is one of the three main attributes of the right of ownership, Mignault (Droit civil canadien, vol. 2, at p. 477) wrote:

Le jus abutendi, ou droit de disposer, est le droit de faire de la chose un usage définitif, qui ne se renouvelera plus, au moins pour la même personne. Disposer de sa chose, c’est la transformer, la consommer, la détruire, ou enfin l’aliéner, c’est-à-dire la transmettre à un autre.

(TRANSLATION)

The jus abutendi, or right of disposal, is the right to make some final use of the thing, which will not be repeated, at least for the same person. Disposing of a thing means transforming, consuming, destroying or, finally, alienating it, that is, transferring it to another person.15

After noting that the class 13 leasehold interest automatically ceased to exist when the lease under which it was created came to an end upon the acquisition, the court concluded that the taxpayer’s interest in the first lease should be regarded as having been “disposed of” at that time:

As already indicated, the verb “to dispose of,” in its first meaning, encompasses the idea of destruction; one of the meanings of the verb “to destroy” is “to put an end to, to do away with” (Shorter Oxford English Dictionary, see Destroy). The extinction of a right through merger is but one method of “destroying” that right that is putting an end to its existence. In Re Leven, [1954] 3 All ER 81, it was said that the word “disposition” taken by itself and used in its most extended meaning was “wide enough to include the act of extinguishment.”

The acquisition by Respondent of the lessor’s rights under the first lease brought about the automatic termination of leasehold interest; such interest was extinguished, it was destroyed.16

The court similarly regarded the unique nature of the latter lease. The lessee acquired full ownership of the building and undertook to demolish it. The right of ownership in the building was conveyed by the latter lease. In summary:

[T]he second lease did not have the effect of creating a leasehold interest in the Transportation Building; it rather transferred to the Société the full ownership of the building subject to the obligation to proceed with the demolition and the construction of a new office building. Such transfer was a “disposition of property”; such building was therefore “disposed of” within the meaning of Regulation 1100(2).17

15 Ibid., at 5073.
16 Ibid., at 5075.
17 Ibid., at 5074.
The Supreme Court also considered the concept of a disposition in the context of the extinguishment of an interest in property in *The Queen v. Malloney’s Studio Limited.* The court referred to its earlier decision in the BCN case, but it distinguished that case from the circumstances in *Malloney’s Studio* on the basis that in the earlier case the taxpayer conveyed an interest in the building to another party under the latter lease. In *Malloney’s Studio,* the taxpayer contracted to sell land upon which a building was situated, subject to the condition that the building be demolished by the taxpayer before closing. In computing its income for the purposes of the Act, the taxpayer allocated no part of the sale price to the building. The minister assessed the taxpayer on the basis that it had disposed of the building and a portion of the purchase price should be allocated to it. The Tax Appeal Board allowed the taxpayer’s appeal. The Minister’s appeal to the Federal Court—Trial Division was allowed on the basis that a portion of the purchase price constituted compensation for property destroyed. The taxpayer appealed successfully to the Federal Court of Appeal. On appeal to the Supreme Court, the minister argued, and the court held, as follows:

1) The minister contended that the agreement of purchase and sale created an equitable interest in the purchaser in the building, thus necessitating the allocation of a portion of the consideration to such interest. The court found that the building was simply not made a subject of the sale and, accordingly, no equitable interest in it could arise in the purchaser.

2) The minister contended that a portion of the sale price was properly to be regarded as a compensation for property destroyed. The court followed the reasons of the Federal Court of Appeal in concluding that any such compensation must be payable by the person causing the destruction in order to constitute proceeds of disposition. Since this transaction entailed the voluntary destruction of the building by the taxpayer, no portion of the proceeds could be regarded as compensation to it therefor.

3) The minister contended that pursuant to former paragraph 20(6)(g) a portion of the price should reasonably be regarded as being in part the consideration for the disposition of depreciable property and in part something else, and that in accordance with that paragraph the former should be deemed to be the proceeds of disposition of the building class and the capital cost thereof to the purchaser. The court found that there must first be some agreement or determination that the sale involves both a sale of depreciable property and a sale of something else, which was not the case in this situation. In this regard, its reasons are of note:

There are two fatal obstacles to the application of this subsection of s. 20 to the facts of this case. Firstly, it is argued by the appellant that demolition

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18 79 DTC 5124 (SCC).
19 71 DTC 551 (TAB).
20 75 DTC 5377 (FCTD).
21 78 DTC 6287 (FCA).
is equal to disposition and counsel for the respondent accepts this submission. However, that is not the end of the problem. In the opening portions of rule (g), provision is made for the allocation of so much of the consideration as can reasonably be regarded as being in part the consideration for the disposition of depreciable property and for the allocation otherwise of that part of the consideration which can be reasonably regarded as having been paid for “something else.” The rule therefore applies to the situation where the taxpayer has disposed of two types of property, first depreciable property and secondly, something else. When this factual situation occurs, the rule then permits the allocation of that part of the consideration received in the total transaction to depreciable assets as “can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer.” The rule does not permit the Minister to characterize a transaction as one which could reasonably be regarded as being in part the sale of depreciable property and in part the sale of something else. The rule operates only as a second stage, the first stage being the agreement or valid determination that the sale involves both a sale of depreciable property and a sale of something else. Here the contract demonstrably relates only to the sale of vacant land. There is no contractual reference to depreciable property and no bill of sale or other transfer, deed, or assignment was delivered on closing relating to any depreciable asset. Only the deed conveying the land on which no buildings were then located was delivered upon receipt of the consideration of $280,000.

The second obstacle to the applicability of rule (g) when bare demolition occurs with nothing more arises from the portion of the rule appearing after the semicolon, which provides:

|and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property . . . |

Grammatically, the depreciable property there referred to is the same depreciable property as referred to in the opening of rule (g), and the past tense “was disposed of” likewise refers back to the “disposition” mentioned in the second line of the opening part of rule (g). Thus it seems abundantly clear that for the purposes of this invocation of rule (g), the disposition in question must be bilateral and include both a disposer and “the person to whom the depreciable property was disposed of,” whether or not such person may thereupon become entitled to any capital cost allowance under the Act. Here the demolition involved no recipient, at least as regards the hospital. It may conceivably be argued that the taxpayer disposed of the building by selling it to the demolition contractor and the proceeds of sale would at the most be the saving effect by the taxpayer in avoiding the cost of tearing the building down himself. This is rather fanciful, and in any case, would not advance the position of the appellant. In both form and substance, the disposition here, in the bilateral sense, relates only to vacant land.22

Accordingly, the court concluded that the sale of the land by Malloney’s Studio was independent and entirely free from any association with the existence of the building. The agreement accordingly created no interest in the building in the purchaser. As a result, the court concluded that no

22 Supra footnote 18, at 5127.
portion of the sale price should be allocated to the building and accounted for as proceeds of disposition of the building to the taxpayer.

To appreciate the breadth of the concept of a disposition of property in the Act, one need look no further than the decision of the Federal Court—Trial Division in *Olympia & York Developments Ltd. v. The Queen.* In that case, the taxpayer agreed to sell an apartment complex but retained title to the building pending the payment of the balance of the purchase price, which was not due until an agreed-upon future time. Under the terms of the agreement, however, the taxpayer completely divested itself of all the duties, responsibilities, and charges of ownership together with all the profits, benefits, and incidents of ownership, except legal title. Upon examining the civil law of Quebec relating to real property, the court concluded that even though the transfer of all the benefits and charges of ownership to a purchaser in possession amounted to something “equivalent” to a sale, it still did not constitute a sale at law.

Notwithstanding this finding, however, the court proceeded to determine that in the circumstances of the case there was a “disposition” of the complex within the meaning of former section 20 of the Act (now section 13). The court noted that pursuant to paragraph 20(5)(c), “disposition” included sale and several types of payment, such as compensation for damage and amounts payable under a policy of insurance. It also noted that the “disposition of a property” in paragraph 20(5)(b) included any transaction or event entitling a taxpayer to proceeds of disposition of property. It concluded as follows:

Section 20(5)(c) states that “disposition” includes sale and several other types of payment such as compensation for damage, amounts payable under a policy of insurance, etc., but does not purport to be exhaustive of the definition of “disposition” contained in section 20(5)(b) which I have quoted. In fact, section 20(5)(b) itself, which uses the word “includes,” is not itself an exhaustive or restrictive definition. In this respect, in delivering judgement on behalf of the Supreme Court of Canada, Pratte, J. in *Her Majesty the Queen v. Compagnie Immobilière BCN Limitée* [1979] 1 SCR 865 stated at page 876:

The substantive definitions of “dispositions of property” and “proceeds of disposition” in s. 20(5)(b) and (c) are a clear indication that the words “disposed of” should be given their broadest possible meaning.

An earlier Canadian case in which the concept of disposition was considered for the purposes of the Income Tax Act is *Victory Hotels Ltd. v. MNR.* In that case, the taxpayer agreed to sell certain property pursuant to an agreement executed in December 1954. The downpayment was received in trust, and the purchaser was not entitled to take possession until

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23 80 DTC 6184 (FCTD).
24 Ibid., at 6193.
25 62 DTC 1378 (Ex. Ct.).
January 3, 1955. The agreement further provided that the contract would be void if the property was destroyed by fire or if the purchaser was refused a liquor licence prior to January 3, 1955. The taxpayer submitted that no disposition of the property had taken place in 1954. The minister assessed the taxpayer on the basis that a disposition did occur in 1954 and the taxpayer must include in its income for that year recaptured capital cost allowance. After a thorough examination of the interpretation of the word “disposed,” the definition of “disposition of property” in former paragraph 20(5)(b) and of “proceeds of disposition” in former paragraph 20(5)(c), and the circumstances of the agreement, the court concluded that the properties were not disposed of in 1954. Mr. Justice Noel noted the following in his decision:

The words “disposed of” in s. 20 of the Income Tax Act are of the widest meaning and should, in my opinion, be given their widest ordinary or popular meaning bearing in mind, however, that they are being used in a taxation statute, in a matter where the properties which are to be “disposed of” are the assets used to earn the very income from which, according to specified rates, depreciation can be charged off. Let me add that they may even be given in an appropriate context a wider meaning than their normal meaning, unless of course, the Income Tax Act has restricted this meaning.

Indeed, in the context of s. 20 of the Income Tax Act it is not unreasonable to give the words “disposed of” their widest meaning which would be “to part with,” “to pass over the control of the thing to someone else” so that the person disposing no longer has the use of the property. Indeed, Bell in the South African Legal Dictionary, at p. 182, defines “disposed of” as follows:

To part with; to pass over the control of a thing to someone else.

The expressions “disposed of,” “lost” or “destroyed” were dealt with in the Australian case of Henty House P.T.V. Ltd. v. Federal Commissioner of Taxation, 88 C.L.R. 151, and from that decision it will be seen the words “disposed of” are given a very wide meaning. May I add that the section of the Australian Income Tax Act in which these expressions were found is very similar to our s. 20. It was therein stated that:

The entitled expression “disposed of,” “lost” or “destroyed” is apt to embrace every event by which property ceases to be available to the taxpayer for use in producing assessable income, either because it ceases to be his, or because it ceases to be physically accessible to him, or because it ceases to exist.

and at p. 156 of this same decision (supra) it is stated:

The idea of ordering, managing, controlling, arranging, the idea of the exercise of an existing power over a thing is generally inherent in the word “disposed” itself and that essential idea is not lost when the word is used as a preposition to denote an act of alienation or creation of a new interest in property.

The evidence also discloses here that the taxpayer was not only selling land and chattels and buildings, but what he was doing mainly was selling a business as a going concern. There is no doubt that had this hotel not have been a going concern, the sale would not have taken place, at least not for the price that was paid. Indeed, the importance attached to the transfer
of the liquor licence for instance making a *sine qua non* condition to a deal establishes without doubt that the purchaser was buying a business.  

Perhaps the broadest expression of the meaning of “disposition” is found in the early English decision of *Carter v. Carter*. Mr. Justice Stirling observed that

> [t]he words “dispose” and “disposition” in the Fines and Recoveries Act are not technical words, but ordinary English words of wide meaning; and where not limited by the context those words are sufficient to extend to all acts by which a new interest (legal or equitable) in the property is effectually created.

A declaration of trust on the part of a femme sole, whereby she effectually parts with the entire equitable interest in property of which she remains legal owner, certainly appears to me to be a disposition in equity of that property.

**Commentaries**

In 1980, Revenue Canada issued *Interpretation Bulletin* IT-448. As noted in the opening paragraph of the bulletin,

Alterations made in the rights, preferences, terms, conditions, restrictions or limitations attaching to shares, bonds, debentures, notes, certificates, mortgages, hypothecs, agreements of sale or similar obligations (hereinafter referred to as “changes in securities”) frequently do not fall clearly within the limits of inclusions in, or exclusions from, the meaning of the term “disposition” contained in paragraph 54(c). The purpose of this bulletin is to discuss the factors that the Department considers in determining whether or not a disposition has taken place in such circumstances.

Elsewhere in the bulletin, Revenue Canada notes as follows:

By virtue of clause 54(c)(ii)(A), any transaction or event that involves the redemption in whole or in part or the cancellation of a security necessarily results in its disposition in the hands of the holder, even though the result achieved could have been accomplished by a change in terms.

As a general rule, and subject to the first sentence in 2 above, the Department examines the effect achieved by a particular set of changes, rather than the method adopted to accomplish it.

In considering a particular fact situation, the Department endeavours to establish whether or not it is reasonable to regard the amended security as being the same property as that which underwent the change.

This bulletin distinguishes between changes in the attributes of debt securities on the one hand and equity securities on the other. The underlying “principle” to be used in determining whether any change to the terms of a debt obligation constitutes a disposition of the obligation appears to be that unless the change occurs pursuant to a provision in the original

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26 Ibid., at 1385.
27 [1896] 1 Ch. 62 (Ch. D.).
28 Ibid., at 67.
30 Ibid., at paragraphs 2, 3, and 4.
terms of the debt obligation, the change will be considered to result in the
disposition of the debt obligation if it affects the owner’s fundamental
economic interest in the property. In this vein, Revenue Canada cites the
following as events that “almost invariably” precipitate a disposition:

- a change to interest-bearing from interest-free or vice versa;
- a change in a repayment schedule or maturity date;
- an increase or decrease in the principal amount;
- the addition, alteration, or elimination of a premium payable upon
  retirement;
- a change in debtor; and
  the conversion of a fixed interest bond to a bond in respect of which
  interest is payable only to the extent that the debtor has made profit, or
  vice versa.

With respect to changes in the terms of shares, Revenue Canada notes
(again, subject to an exception where the terms and conditions of a par-
ticular share themselves contemplate an amendment to those terms and
conditions) that any change will be regarded as a disposition if it is of
“sufficient substance.” Revenue Canada then cites a number of situations
in which a disposition would be considered to arise. These include:

- a change in voting rights attached to shares that effects a change in
  the voting control of the corporation;
- a change in a defined entitlement (for example, a change in par
  value) to share in the assets of a corporation upon dissolution (preferred
  shares only); and
  the addition or deletion of a right attaching to a class of share that
  provides for participation in dividend entitlements beyond a fixed prefer-
  ential rate or amount.31

Several examples are cited of changes which, taken singly, Revenue
Canada does not regard as a disposition. These include:

- the addition of a right to elect a majority of the directors of the
  corporation if, at that time, the shareholders of that class are already in a
  position to control the election of directors;
- a change in the number of votes per share if the ability of any one
  shareholder to influence the day-to-day affairs of the corporation is nei-
  ther enhanced nor impaired thereby; and
  the addition or removal of restrictions concerning the transfer of shares.32

31 Other changes cited by Revenue Canada as events constituting a disposition include
the giving up or the addition of a priority right to share in the distribution of assets of the
 corporation upon dissolution, and a change from a cumulative to a non-cumulative right to
dividends or vice-versa.

32 Other examples of changes that would not, taken alone, constitute a disposition are
the giving up of contingent voting rights that would not affect the control of the affairs of
(The footnote is continued on the next page.)
As noted, however, the foregoing changes might, in combination and in the appropriate circumstances, be considered by Revenue Canada to constitute a disposition.

Not surprisingly, Revenue Canada’s views have not been accepted universally. Most recently, the Tax Court of Canada in *Quincaillerie Laberge Inc. v. The Queen*\(^{33}\) considered the effect of an amendment to a debt obligation to extend the term of the repayment obligation. The issue was whether the extension constituted a disposition of the debt by the creditor. The facts were relatively simple. The taxpayer lent money to another to enable the borrower to acquire certain real property and buildings near Montreal. The borrowed money was required to be repaid slightly more than one year later. The loan agreement further provided a mortgage to secure the performance of the agreement, as well as a “giving in payment clause” that allowed the taxpayer to demand immediate possession of the property in the event of default in the performance of certain specified obligations or as a result of the occurrence of certain other events. As the due date approached, a lien was placed on the property by another creditor of the borrower. The taxpayer advised the borrower that it proposed to exercise its rights under the giving-in-payment clause. This severely limited the prospect of the borrower’s refinancing the properties by the due date. In order to avoid losing the properties, the borrower negotiated two agreements with the taxpayer in 1987. Under the first, the borrower agreed to pay the sum of $575,000 in consideration of the taxpayer’s agreeing to extend the due date of the loan. Under the second, it was agreed that the loan would be fully paid upon the earliest of three dates or events specified therein. Several months later, the borrower placed an additional mortgage on the properties for the amount of the extension payment and certain other costs. Several months thereafter, in 1988, the borrower paid the sum of $575,000 together with the balance of the loan. The taxpayer treated the sum of $575,000, which was received in 1988, as a capital gain arising from the disposition of property constituting its original right to repayment of the loan. The minister reassessed the taxpayer on the basis that this sum was received as an inducement payment in order to persuade the taxpayer to defer its rights of action under the original loan agreement and to extend the time limit for repayment. Therefore, the minister argued, this amount should be included in computing the taxpayer’s income pursuant to paragraph 12(1)(x) of the Act, and the postponement and waiver of the due date of the loan did not constitute a disposition of an interest in the loan.

\(^{32}\) Continued . . .

the corporation, the addition of a right of redemption in favour of the corporation, stock splits or consolidations, changes from par value to no par value or vice-versa (provided that no change in any entitlement to dividends or distribution of assets upon dissolution occurs), a change in ranking concerning preferences, and an increase or decrease in the amount or rate of a fixed dividend entitlement.

\(^{33}\) 95 DTC 155 (TCC).
The court examined the nature of the original loan agreement and the effect of the amending agreements. It concluded that the term of the loan was itself a condition of the obligation and that the amendments concerned only the extension of the term of the loan. They did not go so far as to extinguish the obligation. The court stated:

If one considers the question from the creditor’s standpoint, the appellants’s right to claim the amount of $10,500,000.00 was not extinguished. None of the methods of extinguishing obligations (articles 1139 and following of the Civil Code of Lower Canada) can apply here. The due date of this claim was extended by a maximum of one year. The right of claim continued to exist. The same is true of the types of action which could be exercised in case of default in the obligation to repay the loan by the new time limit provided by the agreement of December 18, 1987 to extend the time limit. . . .

It is therefore my view that there was no disposition of an interest under domestic law, the civil law applicable in the province of Quebec, pursuant to the two agreements of December 18, 1987. 34

After having examined the impact of the amendments under the domestic law, however, the court proceeded to consider whether the two agreements constituted a disposition under the Income Tax Act, because, according to the appellant, if there had been a disposition of property, it would follow that the appellant would have realized a capital gain. In other words, the nature of operation must be analyzed in tax terms. More precisely, was this a “disposition of property” within the meaning of section 54, appearing in Subdivision c respecting taxable capital gains and allowable taxable losses.35

The court examined the definition of “disposition” in paragraph 54(c) and the definition of “property” in subsection 248(1) of the Act. It then concluded:

I see nothing in the Income Tax Act, particularly in the definitions of the word “property” at subsection 248(1) of that Act and in the definitions of the expressions of “disposition of property” and “proceeds of disposition” appearing in section 54 of that same legislation, which would make it possible to state that the two agreements of December 18, 1987 considered comprehensively in their results or effects gave rise to a disposition of property in the context of this legislation. The concept of “disposition of property” does not seem to me more comprehensive or more extensive than that pertaining to the disposition of an interest; it is perhaps even more restrictive and narrower in certain circumstances. The comments which I made in considering the question of whether, having regard to the facts of this case, there was a disposition of an interest by the appellant in Mr. Turenne’s favour therefore generally apply to the question whether there was a disposition of property between the same parties in the circumstances of the instant case.36

34 Ibid., at 160-61.
35 Ibid., at 161.
36 Ibid., at 162.
It is interesting to note the court’s analysis of the relevance of the BCN case, as follows:

In that judgement, the highest court of the land had to consider the scope of the terms “disposed,” “alienated,” “disposition of property,” “proceeds of disposition” and “proceeds of an alienation” in the context of the system of depreciation established by certain provisions of the Income Tax Act and Income Tax Regulations applicable to the taxation years in issue, 1967 and 1968. That context was quite different from that which currently concerns us, that of capital gains. In addition, the definition of the expression “disposition of property” appearing at section 54 of the Act, the key expression in the context of the instant case, scarcely resembles the definition of that same expression which is now subsection 13(21) of the Act. The definitions in this latter subsection apply to all elements of the depreciation systems established by the Income Tax Act and the Income Tax Regulations. This decision by the Supreme Court of Canada appears to me to be of little use in the circumstances. 37

Revenue Canada’s comments in IT-448 were the subject of an extensive review by Brian Arnold and David Ward in an article published shortly after the release of the bulletin. 38 The authors submitted that Revenue Canada’s position with respect to alterations in the terms of shares and debt obligations was untenable in law and could act as a trap for unwary taxpayers where no rollover provisions were available to shield the taxpayer from the tax consequences that would otherwise obtain upon a disposition. In support of their submission, the authors provided a brief review of the relevant jurisprudence. On the basis of this review, they submitted as follows:

Even with this broad approach to the interpretation of the term “disposition,” the fundamental requirement is that there must be a cessation, divestiture, alienation, or transfer of the incidents of ownership of property. In other words, the taxpayer’s interest in the property must be substantially, even if not completely, terminated whether or not such interest is acquired by any other person. 39

They canvassed Revenue Canada’s positions in relation to alterations in the terms of debt obligations in share conditions. In the context of the former, they observed that

since a debt obligation is in legal terms a contract between the debtor and the creditor, whether the alteration in the terms of the debt is in substance an exchange of one property for another property should be resolved by reference to the applicable contract law. If, in accordance with the relevant contract law, the changes in the terms of the original debt obligation have resulted in the discharge of that obligation and substitution of a new obligation, it is probably appropriate to review the original obligation as having been disposed of for income tax purposes. 40

37 Ibid.
39 Ibid., at 561.
40 Ibid., at 567.
However, upon examining Revenue Canada’s position, they concluded that it is not based upon an analysis of legal relationships between the parties,

but, rather, seems to be based upon an analysis of the creditor’s economic interest in the property. In our view, this test for determining when a disposition of a debt obligation has occurred is unjustified. It is clear from the jurisprudence concerning the term “disposition” that a disposition of property must involve the alienation or extinguishment of the property. There is no notion of alienation or extinguishment in Revenue Canada’s concept that a disposition occurs whenever there is a substantial change in the holder’s economic interest in the property. 41

Arnold and Ward agreed generally with the analysis of a share as a “bundle of rights.” They acknowledged that specific kinds of alterations in shares, such as complete or partial redemptions and cancellations, by definition constitute a disposition. 42 They asserted, however, that Revenue Canada is incorrect in stating that alterations in the attributes of shares could amount to a disposition of more than a part of the bundle of rights—that is, the part that is altered. They pointed out that such an approach would create a nightmare of administrative complexity in terms of measuring both the cost base of the part disposed of and the market value of the portion of the “new share” acquired in exchange for that part.

The authors suggested that Revenue Canada’s policy objective for their stated positions was less than clear. They noted that the events that Revenue Canada views as triggering a disposition have the effect of shifting some value or voting control from one taxpayer to another. In outlining their tax policy objections to Revenue Canada’s approach, Arnold and Ward noted:

The concept of a disposition is the statutory description of the realization requirement for income tax purposes. As stated earlier, it is a fundamental principle of income tax law that income must be “realized” before it is subject to tax. If property increases in value, the amount of the increase is not subject to tax until it is realized by the means of a sale or some other similar transaction. 43

We turn now to the concept of consistency. Indeed, Sherbaniuk’s observation that a common thread woven through British, American, and Canadian income tax systems is the fundamental principle that only “realized” gains are taxable was prophetic, to say the least, in the light of the recent American tax literature regarding complex financial instruments. 44 In a similar vein, Arnold and Ward predicted an extension of Revenue Canada’s approach in respect of types of property other than shares and debt obligations.

41 Ibid., at 569.
42 Subparagraph (b)(i) of the definition of “disposition” in section 54.
43 Supra footnote 38, at 576.
44 Supra footnote 2.
Perhaps the most striking aspect of Interpretation Bulletin IT-448 is the fact that the principles [on] which Revenue Canada relies with respect to shares and debt obligations can be extended to many other types of property.45 For example, any significant variation in the terms of such intangible property as a licence agreement, a franchise agreement, a partnership agreement or other contract will appear to result in a disposition not just of the particular varied rights under the contract but also perhaps of the entire bundle of contractual rights. Similarly, the principles in the bulletin could be extended to tangible property. The granting of the lease, for example, or the variation of rent or the term of an existing lease could be considered as modifications of the bundle of rights of both the fee simple owner and the tenant and could result in the disposition of the underlying property by the lessor and the disposition of leaseholder interest by the tenant.46

OUR CRITIQUE OF THE TOUGH CASES

The Stursberg Case

It is submitted that the decision of the Federal Court of Appeal in Stursberg v. The Queen47 illustrates the serious challenge faced by income tax legislation that is based on realization in which the timing of taxation may depend upon whether the taxpayer’s return is contingent as opposed to fixed. It also illustrates the spectre that Arnold and Ward foresaw in the conclusion of their commentary on IT-448. In the Stursberg case, the taxpayer reduced his partnership interest in a general professional partnership from 40 percent to 15 percent, coincidental with an increase in the interest in the same partnership of a corporation related to the taxpayer from 10 percent to 35 percent. In conjunction with these changes, the related corporation paid $162,500 to the partnership; this same amount, in turn, was paid to the taxpayer. At the same time, 25/40 of the taxpayer’s 40 percent of the partnership losses was transferred from the taxpayer to the related corporation in the partnership’s records. This change apparently also affected the partners’ respective percentage participation rights and voting rights in the partnership. The minister assessed the taxpayer on the basis that the sum of $162,500 must be characterized as proceeds of disposition of property—specifically, a portion of the taxpayer’s partnership interest. The taxpayer appealed to the Tax Court of Canada48 on the basis that the payment received by him was a distribution of his share of the partnership capital within the meaning of subparagraph 53(2)(c)(v) of the Income Tax Act.49

45 Arnold and Ward, supra footnote 38, at 584, inserted the following footnote at this point: “It is thought that Revenue Canada did not consider this matter and may not intend at this time to extend the principles of IT-448 to property other than shares or debt obligations. However, it is difficult to distinguish shares and debt obligations from other contractual rights or other intangible property for these purposes.”

46 Ibid., at 584.

47 93 DTC 5271 (FCA).

48 90 DTC 1159 (TCC).

49 “In computing the adjusted cost base to a taxpayer of property at any time, there shall be deducted such of the following amounts in respect of the property as are applicable . . .

(The footnote is continued on the next page.)
The minister contended that the taxpayer disposed of a portion of his interest in the partnership, thus giving rise to a capital gain computed in accordance with subsection 100(2) of the Income Tax Act. The taxpayer’s appeals to the Tax Court and the Federal Court—Trial Division were dismissed.

On appeal to the Federal Court of Appeal, that court too dismissed the taxpayer’s appeal. The court reviewed the decisions of Judge Mogan of the Tax Court and Madam Justice Reed of the Federal Court—Trial Division.

At the Tax Court, Judge Mogan determined that the substance of the transaction was the sale of a portion of the taxpayer’s partnership interest in which the partnership was effectively used as a conduit to facilitate the sale. At the Federal Court—Trial Division, Madam Justice Reed focused particularly upon the interpretation of subparagraph 53(2)(c)(v) and suggested that while as a general rule gains should be taxed in the year in which they are realized, this subparagraph accommodated the conventional fluidity of partnership status by permitting new partners to enter without necessarily having to consider the existing partners of a partnership to have disposed of their partnership interest. She distinguished the comments of the minister of national revenue in former Interpretation Bulletin IT-338, dated August 23, 1976, from the circumstances of this case on the basis that the minister’s comments in the bulletin did not extend to a situation where one partner withdraws funds either immediately or within a short time after the admission of a new partner with a coincidental capital contribution. She also referred to the analysis of Larry Eddy in the 1981 conference report of the Canadian Tax Foundation. In his article, Eddy commented on the situation in which a new partner is admitted and makes a contribution of capital to the partnership. He did not consider that this should constitute a disposition of a part of the former partner’s partnership interest, even though their profit-sharing ratio would change. He reasoned that they would simply “now have a smaller portion of a larger pie.” On the other hand, Eddy speculated that where the funds contributed by the new partner were not left within the partnership but were withdrawn immediately by one or more of the existing partners, it would be inappropriate to treat such a transaction as something other than a sale of a part of the partnership interest by one or more

49 Continued . . .

(c) where the property as an interest in a partnership, . . .

(v) any amount received by the taxpayer under 1971 and before that time as, on account or in lieu of payment of, or in satisfaction of, a distribution of the taxpayer’s share (other than a share under an agreement referred to in subsection 96(1.1)) of the partnership profits or partnership capital.”

50 91 DTC 5607 (FCTD).


52 Ibid., at 532.
existing partners to the newly admitted partner. While a mere book entry crediting a partner’s capital account does not necessarily represent proceeds of disposition to the partner, a transaction in which a new partner’s capital contribution is immediately paid to one or more existing partners should be treated as a partial disposition of a partnership interest rather than a capital distribution.

The reason this type of transaction might appear to work is to be found in the fact that a partnership interest is the one item of capital property for which the adjusted cost base can go into negative balance without triggering the deemed realization of a capital gain. However, I believe, if challenged, the courts might well find that the passing of the funds through the partnership was merely a sham intended to convert what was really a direct sale of a part interest into some other type of transaction to defer the recognition of any capital gain for income tax purposes.53

Madam Justice Reed concluded:

A distinction must be drawn between a disposition of a partnership interest and a distribution of partnership capital or income covered by subparagraph 53(2)(c)(v). And, as counsel for the defendant argues, this distinction should be assessed in the context of the Act as a whole and by reference to the principles on which it is based. One of those principles is that gains should normally be taxed in the year in which they are made. Subparagraph 53(2)(c)(v) is an exemption relating to negative adjusted cost base calculations that operates within the parameters of the other provisions of the Act and general principles on which it is based.54

On behalf of the Federal Court of Appeal, Mr. Justice Hugessen concluded that he would have great difficulty accepting Judge Mogan’s finding that the substance of the transaction was a sale in the light of the provisions of the partnership agreement and the fact that real rights and obligations were created by the transaction, both as between the appellant and the partnership on the one hand and as between the partnership and the related corporation on the other. He examined Judge Mogan’s reasons for concluding that paragraph 53(2)(c) did not apply, and concluded that although Judge Mogan did not put it in those terms, he really analyzed whether what took place was a disposition or a distribution of the appellant’s “share.” Mr. Justice Hugessen considered it “wholly irrelevant” that the appellant had surrendered or transferred a substantial portion (25/40 or 5/8) of his partnership interest. He then summarized his analysis in the following passage:

In my view, and although I am in disagreement with certain relatively minor parts of what each of them said, I think that the two learned Judges below reached the correct conclusion and for what are generally the right reasons. The common thread running through both decisions is the unchanged nature of the capital structure of the partnership before and after the transaction. What follows is a restatement in my own words of what I take to be the essence of their reasons.

53 Ibid.
54 Supra footnote 50, at 5610.

(1995), Vol. 43, No. 5 / n° 5
In the first place, it should be recalled that we are dealing here solely with an alleged distribution of capital. The partnership in question did not have any profits and it may be that somewhat different considerations would apply in determining whether or not a payment represented a distribution of profit.

Second, it seems to me that a distribution of capital, whether it be proportionate sharing out among many or a single or periodic payment to one recipient, necessarily results in a change in the residue of what has been distributed either by reducing it or by otherwise altering its structure; it implies a division or redivision of that which is distributed. Accordingly, a distribution of capital will always result in an alteration of the corpus from which it is made, whether that corpus be the capital structure of a partnership, an estate, a trust or anything else.

Finally, in order to trigger the application of subparagraph 53(2)(c)(v), the payment made to the appellant must not only be a “distribution” it must also be “of his share... of the... partnership capital.” On February 7, 1983, 25/40 of the appellant’s share of the partnership capital had a value of $162,500. If that amount had been paid to him on that day and the partnership capital had been reduced accordingly, the appellant would have received a distribution of his share of the partnership capital. But that is not what happened since the partnership capital was not reduced by $162,500 or at all; its structure remained quite unchanged. The latter’s share of the capital is accordingly reduced but only to the extent that a portion of it is acquired by the new partner; there is no distribution because there is no change whatever in the corpus of the partnership capital or in the relative interests therein of any of the other partners.

Since it is not disputed that if what took place on February 7, 1983 was not a distribution of a part of the share of the appellant in the partnership capital, it was necessarily a disposition by him of a part of such share within the meaning of paragraph 54(c) and was appropriately assessed as such by the Minister, I would dismiss the appeal with costs.55

While Madam Justice Reed acknowledged that a disposition may occur without a sale, Mr. Justice Hugessen’s apparent disagreement with Judge Mogan’s conclusion that the appellant surrendered or transferred a portion of his partnership interest leaves one wondering what, in fact, the act of disposition was in this case. Was it the act of dilution? Was it the act of receiving a sum of money which the court implicitly characterized as proceeds of disposition? Was it the fact that there was a coincidental acquisition of property by the related corporation? Unfortunately, we are left to speculate on this matter, since the court did not dwell upon the incidents of a disposition that it felt obtained in these circumstances. However, it is submitted that the decision poses considerable difficulty to taxpayers owing to its failure to identify the criteria upon which the finding of “disposition” rests.

Not surprisingly, Revenue Canada has revised its Interpretation Bulletin IT-338, referred to in Eddy’s article.56 Paragraph 3 of the previous bulletin provided that

55 Supra footnote 47, at 5275.

56 Supra footnote 51.
[if] the incoming partner makes a contribution of capital to the partnership, there is no disposition of the existing partners’ partnership interests nor is there any adjustment to the ACB of these interests. This will be so even if part of the contribution made by the incoming partner is credited to the existing partners’ capital accounts for accounting purposes.

Paragraph 2 of Interpretation Bulletin IT-338R2, dated July 10, 1995, now provides that

[if]urthermore, there may be a disposition of all or part of a partnership interest when the capital contribution by a new partner (or by an existing partner wanting an increased partnership interest) is not left within the partnership and is withdrawn by one or more of the existing partners. See Richard K.G. Stursberg v. The Queen, [1993] 2 CTC 76, 93 DTC 5271 (FCA), in which the Court concluded that there was a disposition of part of a partner’s partnership interest in a transaction when the reduction in that partner’s partnership interest was followed by a corresponding increase in another partner’s partnership interest. In this decision, the reduction in the partner’s partnership interest was found to be a disposition, and not a distribution of partnership capital under subparagraph 53(2)(c)(v), because there was no change in the overall capital of the partnership. . . . There will not be a disposition by the existing partners of a part of their partnership interest or an adjustment to the ACB of their interests when a new partner’s capital contribution to the partnership is credited to that partner’s capital account.

We submit, with great respect, that the courts in the Stursberg case extended inappropriately the meaning of “disposition.” In our view, the more appropriate reasoning is that because the taxpayer’s interest in the partnership had not completely or substantially terminated, he had not disposed of all or part of it. The analysis that the capital of the partnership had undergone no change overlooks the reality that the amount of capital distributed by the partnership to the taxpayer was replaced by an equivalent amount contributed to the partnership by the corporation—a relatively common practice in many different types of partnerships, particularly professional ones. More important, we are concerned that the result reached by the courts in Stursberg fails to give due weight to the very specific and deliberate scheme for taxing members of partnerships that is set forth in the Act. This scheme recognizes that in law a partnership is simply a relationship among persons carrying on business in common, rather than a separate legal person as a corporation or trust is. Although the income of members of a partnership is computed as if the partnership were a separate person resident in Canada, the scheme for dealing with contributions made by a member of a partnership to the partnership and distributions of profits and capital made by a partnership to its members contemplates that such transactions will affect only the determination of the member’s cost base of his partnership interest, not the amount of his income, loss, or capital gain. An integral aspect of

57 The taxpayer’s partnership interest had reduced from 40 to 15 percent, and the related corporation’s partnership interest had increased from 10 to 35 percent.
58 Subsection 96(1).
59 Paragraphs 53(1)(e) and 53(2)(c) and subsection 40(3).
this statutory scheme is the exclusion of partnership interests from subsection 40(3), which deems a disposition of property to occur where the cost base of a capital property would become a negative amount. The proceeds of this disposition are deemed to be the amount by which the cost base would be negative. This statutory scheme simply does not envision splitting a partnership interest into “parts,” with the cost base of one part not excluded from this “negative gain” provision. By declining to follow this deliberate statutory scheme, the courts, in our respectful view, arrived at an inappropriate conclusion in *Stursberg*.61

Even if the taxpayer’s interest in the partnership had reduced to a nominal level, we believe that the approach adopted by the courts in *Stursberg* would not have been warranted. Although the taxpayer’s interest in the partnership would have reduced substantially, he would continue to have real rights and obligations as a partner under the partnership agreement. Consequently, in our view, he would not have made a disposition of even part of his partnership interest for proceeds equal to the amount received on the distribution. Even on facts as extreme as these, in view of the specific statutory scheme applicable to members of partnerships with respect to distributions of partnership profits and capital, we believe it is not appropriate to conclude that the amount distributed to the taxpayer by the partnership amounted to proceeds of disposition by reason of its being the “sale price of property that has been sold.”62 The true legal effect is, we believe, a “distribution of the taxpayer’s share... of... partnership capital.”63

**The Kieboom Case**

A case of similar import is the decision of the Federal Court of Appeal in *The Queen v. Kieboom*.64 This case involved an analysis of the application of subsection 74(1) of the Act.65 The taxpayer, formerly the owner of 90 percent of the common shares of a corporation, implemented successive

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60 It is significant that *only* partnership interests are excluded from this deemed realization of gain provision.

61 Amendments proposed in September 1994 further support this view. Proposed subsections 40(3.1) through (3.9) limit the application of subsection 40(3) such that a negative cost base of a partnership interest owned by someone who is a limited or passive partner would be deemed to be a capital gain. See Canada, Department of Finance, *Release*, no. 94-084, September 27, 1994.

62 Paragraph (a) of the definition “proceeds of disposition” in section 54.

63 Subparagraph 53(2)(c)(v).

64 92 DTC 6382 (FCA).

65 Former subsection 74(1) read as follows: “Where a person has, on or after August 1, 1917, transferred property either directly or indirectly by means of a trust or by any other means whatever to his spouse, or a person who has since become his spouse, any income or loss, as the case may be, for a taxation year from the property or from property substituted therefore shall, during the lifetime of the transferor while he is resident in Canada and the transferee is his spouse, be deemed to be income or a loss, as the case may be, of the transferor and not of the transferee.”
corporate transactions in which his wife subscribed for nominal consideration for sufficient additional shares to increase her shareholding to the same level as that of the taxpayer. Thereafter, additional shares were issued to each of the taxpayer’s minor children, again for nominal consideration. The minister assessed the taxpayer, partly on the ground that a capital gain was deemed to have been received by his wife by virtue of her deemed disposition of a portion of her shares to her children, and that this gain was attributable to the taxpayer on the basis that it constituted income from property transferred to his wife. To so conclude, it was necessary to determine that the first reorganization was an event in which property was transferred by the taxpayer to his wife. It was argued that the taxpayer transferred property to his wife by virtue of giving a portion of his ownership of the equity in his company to his wife. The court agreed:

In my view, the phrase “transfer of property” is used in this provision in a rather broad sense. Both of the nouns in the phrase are general and non-technical. As for the word transfer, Lord Justice James in *Gathercole v. Smith* (1980-1981), 17 Ch. D. 1 stated at p. 7 that the noun transfer was “one of the widest terms which can be used.” Lord Justice Lush stated that the word “transferable” includes “every means by which the property may be passed from one person to another . . .”

In this case, therefore, the taxpayer transferred property to his wife, that is, he gave a portion of his ownership of the equity in his company to his wife. The 40% capital interest in his company which he gave to his wife was clearly property. His beneficial interest in the property was reduced by 40% and hers was increased by 40%. The fact that this transfer of property was accomplished through causing his company to issue shares makes no difference. Subsection 74(1) covers transfers that are made “directly or indirectly” and “by any other means whatever.” The transfer, which in this case was indirect, in that the taxpayer arranged for his company to issue shares to his wife, is nevertheless a transfer from the husband to the wife. There is no need for shares to be transferred in order to trigger this provision of the Act, as was erroneously concluded by the Tax Court judge. By this transfer of property to his wife, he divested himself of certain rights to receive dividends should they be declared. Hence, when the dividends were paid to the wife in 1982, that was income from the transferred property and was rightly attributable to the taxpayer.

In addition, the property transferred to Mrs. Kieboom in 1980 was a portion of his ownership equity. As a result of the transfer, the taxpayer’s entitlement of 40% was transferred to Mrs. Kieboom. Moreover, the shares which Mrs. Kieboom acquired are also taxable as “substituted property” pursuant to subsection 248(5), as it may be said that she substituted the shares she purchased for the property she received from her husband. . . . Mrs. Kieboom disposed of part of that interest when she transferred a part of that equity to children.66

Once again, with respect, we believe that the court enlarged inappropriately the meaning of “disposition.” In addition, in this case we think

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66 Supra footnote 64, at 6386-87.
the court also expanded the meaning of “property” beyond the bounds contemplated by Parliament. We recognize that in this case the court had a degree of interpretive latitude because of the inclusion in subsection 74(1) of the reference to transfers of property made “directly or indirectly.” Nevertheless, we simply see no termination, substantial or otherwise, of the taxpayer’s shares of the corporation that warrants a conclusion that he made a disposition of property, directly or otherwise. The court’s equation of the taxpayer’s “property” and his “ownership equity,” followed shortly by the court’s distinction between the taxpayer’s “shares” (which clearly are property) and his “ownership equity,” seems to involve inconsistent results.

In our respectful view, the taxpayer in Kieboom did not make a disposition of property. We believe that a more appropriate finding might have been that the taxpayer was required to include the dividends received by his wife and children in computing his own income as an indirect benefit, based on a combination of subsections 15(1) and 56(2).

The Wiebe Case
In Wiebe et al. v. The Queen, the Federal Court of Appeal held that certain amendments to a stock option agreement so radically changed the terms of the original stock option agreement that new stock options were created.

When the two taxpayers were hired, each was given an option to purchase five shares in the capital of their employer for $1 per share. The options placed no restrictions on the use that could be made of the shares by the employees. Several years later, the employer required the taxpayers to sign a buy-sell agreement with respect to the shares, which would become operative upon a termination of their employment. The employer also required that the employees guarantee the indebtedness of the employer to the extent of $20,000 each. After the taxpayers had exercised their stock options, Revenue Canada assessed them on the basis that they had received taxable benefits. The taxpayers’ position was that the changes made to their stock option agreements, as described above, were so fundamental as to result in the creation of new agreements that were entered into at the time the changes were made. Between the time the original stock option agreements were entered into and the time the changes were made, the Income Tax Act had been amended to afford improved tax treatment to holders of stock options in Canadian-controlled private corporations. The court found in favour of the taxpayers:

What is important is that these were new conditions which attached to the appellants’ becoming shareholders of the company at the time they acquired

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67 87 DTC 5068 (FCA).

68 Specifically, subsection 7(1.1) had come into effect, applicable to stock option agreements entered into after March 31, 1977. Under that new subsection, benefits resulting from the exercise of qualifying stock options were not required to be included in the income of an optionee until the time at which the shares acquired upon the exercise of the stock option had been disposed of.
their shares. They were conditions which substantially affected the “basic elements” of any earlier purported stock option agreement. In particular, they affected the consideration to be paid by adding the important requirement of a personal guarantee with the bank to the extent of $20,000; they also drastically affected the terms upon which each appellant became a shareholder by requiring the concurrent execution of a buy-back agreement. Changes as fundamental as this are inconsistent with the continuing existence of the alleged prior stock option agreement; rather they represent a whole new agreement. Since it is common ground that the changes came into being after 31 March 1977, the appellants’ acquisition of shares in Mitchell was made under an agreement entered into after that date.69

In our respectful view, it would have been more appropriate to determine whether the parties intended the amendment of the original stock option agreement to effect a novation—that is, the creation of an entirely new option—or merely to modify the terms of the original agreement. If the former finding prevailed, then by virtue of paragraph 7(1)(b)70 the taxpayer would have suffered an income inclusion in the year in which the novation occurred, but would have been subject to subsection 7(1.1) when he exercised the new option. If the latter finding prevailed, the taxpayer would not have been subject to subsection 7(1.1) when he exercised his option.

A RETURN TO PRINCIPLES
Legal Rights and Obligations
Notwithstanding several recent attempts to establish liability for income taxation on the basis of the “substance” of a transaction as compared to its form, it is submitted that the principle continues to exist in Canada that liability for income tax is based on the true legal relationships between parties to a particular transaction. In such a system, it follows that the essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name. It is the true legal relationship, not the nomenclature that governs. The Minister, conversely, may not say that to the taxpayer “you used one legal structure but you achieved the same economic result as that which you would have had if you used a different one. Therefore I shall ignore the structure you used and treat you as if you had used the other one.”71

69 Supra footnote 67, at 5070. The Wiebe case was distinguished in the Tax Court’s judgment in Amirault v. MNR, 90 DTC 1330, which considered the effect of a retroactive amendment of a stock option agreement to increase the exercise price. The Tax Court adopted the approach that the determination whether a subsequent agreement has the effect of rescinding or merely amending an earlier one depends upon the intentions of the parties.

70 This provision requires that if a taxpayer disposes at arm’s length of “rights under [a stock option] agreement,” he must include in income the “value of the consideration for the disposition.” It appears that under this finding the taxpayer’s rights under the new stock option agreement will be the consideration for the disposition. This finding would necessitate a determination of the value, if any, of those rights at the time the novation occurred.

71 See Continental Bank of Canada et al. v. The Queen, 94 DTC 1858, at 1871 (TCC).
The principle of assessing taxpayers on the basis of the true nature of the legal rights and obligations among them is well summarized in the UK decision *In re Hinckes, Dashwood v. Hinckes*,\(^{72}\) which is cited by Lord Tomlin in the *Duke of Westminster*'s case:

“It is said we must go behind the form and look at the substance . . . but, in order to ascertain the substance, I must look at the legal effect of the bargain which the parties have entered into.” So here the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles.\(^{73}\)

### The Elements of Property

The relevance of dispositions in the context of the Act is to transactions in a taxpayer’s “property.” In other words, all situations in which a disposition is relevant to the computation of a taxpayer’s income under the Act involve dispositions of property.

The concept of property enjoys remarkable breadth under the Act. In subsection 248(1) “property” is defined to mean property of any kind whatever whether real or personal or corporeal or incorporeal and, *without restricting the generality of the foregoing*, includes:

(a) a right of any kind whatever, a share or a chose in action,

(b) unless a contrary intention is evident, money,

(c) a timber resource property, and

(d) the work in progress of a business that is a profession [emphasis added].

Paragraph (a) of this definition introduces the “bundle of rights” theory of “property” into all types of property. When one owns a hammer, for example, one has numerous different property rights in it:

Ownership consists of innumerable rights over property, for example, the rights of exclusive enjoyment, of destruction, alteration and alienation, and of maintaining and recovering possession of the property from all other persons. Such rights are conceived not as separately existing, but as merged in one general right of ownership. . . .

Ownership is nevertheless divisible to some extent. For example, one or more of the collection of rights constituting ownership may be detached. Thus prima facie an owner is entitled to possession or to recover possession of his goods against all the world, a right which a dispossessed owner may exercise by peaceable retaking. He may, however, voluntarily or involuntarily part with possession, for example, by pledging, lending, hiring out, bailment, theft or loss of his goods, in any of which cases he is left with a right of ownership without possession, accompanied or not accompanied, as the case may be, by the right to possess.\(^{74}\)

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\(^{72}\) [1921] 1 Ch. 475, at 489 (CA).


As noted by Mr. Justice Linden:

Lord Langdale once stated that the word property is the “most comprehensive of all the terms which can be used inasmuch as it is indicative and descriptive of every possible interest which the party can have.”

Notwithstanding such unlimited expressions, it is clear that for the purposes of the Act, some things are not “property.” For example, before 1988, section 68 contemplated the prospect of an amount’s being regarded as in part the consideration for the disposition of any property of a taxpayer and in part the consideration for something else. As noted by the Supreme Court of Canada in relation to the statutory definition of “property” in the Income Tax Act,

This extremely broad definition of property leaves very little in the “non-property” classification. It would appear to include a contract right and might in some circumstances include a right to assert a covenant by a vendor to deliver “know-how.” It may be thought that “services” would be “something else.” Consideration paid for “services” will in most, if not all, cases fall within the basic income tax provisions in Div. B, including s. 12. Thus, if “something else” is interpreted to refer only to non-property items, the result would be the confinement of s. 68 to at most a minuscule part of commercial transactions.

As to what is or is not property, it is interesting to note the comments of Chief Justice Latham of the Australian High Court in Federal Commissioner of Taxation v. United Aircraft Corporation in relation to the transfer of know-how:

Knowledge is valuable, but knowledge is neither real nor personal property. A man with a richly stored mind is not for that reason a man of property. Authorities which relate to property and compositions etc., belong to the law of copyright and have no bearing upon the question whether knowledge or information, as such, is property. It is only in a loose metaphorical sense that any knowledge as such can be said to be property. Either all knowledge is property, so that the teaching of, for example, mathematics involves a transfer of property, or only some knowledge is property. If only some knowledge is property then it must be possible to state a criterion which will distinguish between that knowledge which is property and that knowledge which is not property. The only criterion which is being suggested is the secrecy of the knowledge—it is said that the fact that the knowledge is secret in some way creates a proprietary right to that knowledge. I confess myself unable to appreciate this proposition as a legal statement. It is obvious that a monopoly of knowledge may be valuable, whether it be knowledge of a place where a person has discovered gold or knowledge of a method of making a machine or a chemical product, or of a means of deciphering cryptograms but is such knowledge property only so long as it is secret?

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75 Supra footnote 64, at 6386, quoting from Jones v. Skinner (1836), 5 LJ (NS) ch. 87, at 90 (HL).
76 The Queen v. Golden et al., 86 DTC 6138, at 6140 (SCC).
77 (1943), 68 CLR 525, at 534-35 (HC).
Without purporting to have a monopoly on all knowledge in relation to the concept of “property” (a higher aim that we will leave to others), we submit that the following maxims may be stated in relation to the concept of property in the context of the Act.

1) A person’s “property” is a reference to the person’s estate or interest in relation to a particular person, right, or thing, rather than to the person, right, or thing itself. In other words, more than one taxpayer may have property in relation to a hammer. The owner of the hammer may lease it to another for his use in the process of earning income from a business or property. The lessee has a leasehold interest in the hammer that originates in the agreement between the owner and the lessee and from the common law rights of landlord and tenant. The owner has a reversionary right and rights in respect of the possession, use, and replacement of the hammer that derive from the agreement and the common law.

2) A person’s “property” in relation to many rights or things is indivisible, in the sense that the enjoyment or opportunity for enjoyment of one or more aspects of the person’s estate or interest cannot be separated from the totality of those rights or interests.78

3) In contrast to the foregoing, there is a burgeoning body of rights and interests in relation to which the collective bundle of rights is divisible. For example, certain forms of intellectual property such as patents and copyrights may be assigned absolutely or for a limited period or in respect of a particular geographic area.

THESIS

For the purposes of the Act, except where otherwise specifically provided, a disposition of property must entail a termination of the taxpayer’s entire estate or interest in it, even in the case of property that is divisible. If it were otherwise, then every relinquishment of an interest in property would be a disposition because it results in the suspension or termination of that particular interest or right. Thus, the grant of a lease of equipment for a limited term would coincide with the loss to the owner of the opportunity to let that property to anyone else for that term. It would be extraordinary, to say the least, to suggest that the lease and the coincidental loss of opportunity to enter into another lease for that term could be considered a disposition of the lessor’s interest in the equipment.79

78 See *Min. of Rev. (Ont.) v. McCreath*, [1976] CTC 178 (SCC), in relation to property in shares. An argument that a right to income from the shares for a period of time could be settled upon a trust distinct from a settlement of the “corpus” was dismissed.

79 On April 9, 1974, the government of Ontario introduced The Land Speculation Tax Act, 1974, SO 1974, c. 17, which since has been repealed by SO 1978, c. 63. It imposed a tax of 50 percent on so-called speculative gains from sales of Ontario land. Also announced on the same date was an amendment to The Land Transfer Tax that imposed a 20 percent tax on the purchase by non-residents of certain Ontario land. These statutes included in their concepts of “dispositions” and “conveyances” of land the grant of a long-term (The footnote is continued on the next page.)
As hard as one might try to give the terms “disposed of” and “disposition of property” their broadest possible meanings, as the Supreme Court of Canada stated in the BCN case, it is clear that Parliament did not intend to invoke terms or concepts of unlimited breadth in using such language. To provide some context for this point, we have examined Canada’s “universal” tax system, the goods and services tax (GST). The basic charging provision in that legislation is as follows:

Subject to this Part, every recipient of a taxable supply made in Canada shall pay to Her Majesty in right of Canada a tax in respect of the supply equal to 7% of the value of the consideration for the supply. 80

Upon exploring the interpretation provisions in subsection 123(1) of the Excise Tax Act, however, we note that

“supply” means, subject to sections 133 and 134, the provision of property or a service in any manner, including sale, transfer, barter, exchange, licence, rental, lease, gift or disposition;

“property” means any property, whether real or personal, movable or immovable, tangible or intangible, corporeal or incorporeal and includes a right or interest of any kind, a share and a chose in action, but does not include money;

and that

“service” means anything other than

(a) property;
(b) money; and
(c) anything that is supplied to an employer by a person who is or agrees to become an employee of the employer in the course of or in relation to the office or employment of that person [emphasis added].

Clearly, anything that is not property, money, or that which is provided in the course of the relationship of employment is a “service” for the purposes of the GST. By way of corollary, “service” is “everything” that is not property, money, etc. The licence to use a term such as “anything” in drafting any legal instrument would make even the most confident draftsman envious of the ability to be comprehensive!

While many terms in the definition of “supply” might be considered analogous or even overlapping, there can be no doubt that the ordinary interpretation of the concept of providing property and everything else there is encompasses more than the mere concept of disposing of one’s property. We submit that it is appropriate to take note of the expressions Parliament has used in the GST legislation to define the true meaning of disposition—a related, though not identical, concept used in the Income Tax Act.

79 Continued . . .

lease. While it is obviously possible to achieve that result through a statutory definition, it is submitted that in the absence of that kind of specificity a disposition would not include the granting of a lease.

Therefore, in order to make sense of the concept of the “disposition of property” and maintain the distinction between the realization of fixed amounts and the realization of and contingent amounts under the Income Tax Act, it is necessary to recognize that the concept of a “disposition of property” does not encompass every transaction or event in relation to property. In fact, it is unnecessary to go any further than to recognize the distinction that is commonly accepted in relation to intellectual property between a sale or disposition of such property on the one hand, and the exploitation of one or more aspects of such property on the other. We submit that the problem with the decisions of the Federal Court of Appeal in *Stursberg, Kieboom*, and *Wiebe* and with Revenue Canada's approach to dispositions in the context of the variation of the terms or conditions of debt and share instruments lies in the theory that all property is divisible and that any exploitation of property can result in a disposition of such property. In our view, only those transactions or events that result in the termination of a person’s entire estate or interest can properly be considered a disposition of property under the Income Tax Act.