Amount on Account of Income or Capital? - Henco Industries

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Henco Industries Ltd v The Queen, 2014 TCC 192

At issue was whether a payment of over $15M by the Ontario Government to Henco was fully taxable as Income or non-taxable as a Capital receipt that was not an eligible capital amount. The character of a few smaller payments were also at issue.

[A very lengthy decision that addressed a number of questions in depth, including: capital vs income; ECE vs other capital expenditure; being in business vs earning income from a business].

FACTS

Henco was in the business of land development and owned three parcels of land in Caledonia, ON. After having done significant work and entering into contract in pursuit of developing these properties, First Nations groups began blockades and occupations of the first property to be developed. Injunctions were issued by the Ontario Courts but the Police did not make any arrests or enforce the injunctions.

The Ontario Government made a $650K payment to Henco, without requiring anything particular to be done or seeking anything in return from Henco. The Ontario Government and Henco, after negotiations, entered into several agreements with respect to the various assets of Henco.

ANALYSIS

The MNR argued that the $650K payment fell squarely within ITA 12(1)(x) and thus included in income as an amount that is a refund, reimbursement, contribution or allowance, or as assistance from government. Henco, relying on *R v Cranswick*, [1982] 1 F.C. 813 (F.C.A.)., argued that the amount is a windfall. The court stated that in order for an amount to fall within paragraph 12(1)(x):

- it must be received by the taxpayer in the year "in the course of earning income from a business or property"
- must be from a government
- must reasonably be considered to be received as assistance in respect of an outlay or expense; and
- must NOT be for the acquisition of the taxpayer's business or property.

The Court pointed out that a taxpayer may be in business, but not be in the course of earning income from a business (as 12(1)(x) requires) and the focus is on the time period when the payment was received (para 121). In this case, when the payment was received, Henco was still in business but not in the course of earning income from that business as it could not access the property, and therefore was cripples and sterilized, rather it was trying to preserve the business (para 125). Additionally, given that there is no evidence of what the payment was received for or used for, and no requirement for accounting for the payment, it cannot be said that the amount was received "as assistance in respect of an outlay or expense" (para 126).

This amount was a windfall and not taxable.

The Court then turned to the question of Capital vs Income on the amounts paid for one property, and referred to the decision in *Canada Safeway Ltd v R*, 2008 FCA 24, where the relevant factors were laid out:

- the boundary between income and capital gains is not easy to draw;
- regard will have to be had to the circumstances and inferences will have to be drawn;
- A primary or secondary intention to sell the property must have been present at the time of purchase so as to constitute an adventure in the nature of trade;
- The intention for resale must be an operating and important consideration in the purchase of the property;

The evidence here did not favour one intention over the other (income over capital), and the taxpayer did not demolish the MNR's assumptions - the court was bound to find that the amount in relation to this one property was on income account.

The second issue, the income or capital nature of the $15M payment was addressed last. The MNR relied on the agreement that stated that the amount was for the sale of land. The Appellant argued that the agreement did not reflect the true nature of the deal between them, and the payment was for the vaporization of Henco's business.

Here, the agreement refereed not to consideration but compensation, and the quantum is determined by reference to a purchased asset (the court held that this was merely a mechanism to determine compensation for something difficult to value) (para 151). The agreement refers to various assets, including intangibles, and to a release of liability (which refers to the full $15M amount as consideration for the release) (paras 154-55). Additionally there were other aspects that point to something more: requirement to cease business, set aside an injunction, and no valuations of assets were done. The court went through a long list of factors (paras 159-60) that showed that the agreement did not reflect the true nature of the deal, and that the payment was not made for the land.

The court, though not required to, asked whether section 23 would apply (ceasing to carry on business), and stated that prior to the payment, by Ontario's actions, the taxpayer did not have a business and was not in business. The land was neither an investment not inventory as it was useless and worthless (para 167).

The payment was therefore not for land but for extinction of the right to sue Ontario - it could only be on Eligible Capital Amount. However, because of the election to have the mirroring rules in 14(5) apply, the payment is not on account of ECP, but a non-taxable nothing. Referring to the decision in *T Eaton Co v R*, 99 D.T.C. 5178 (FCA)., where it was said that payment for damage to income producing assets is on income account while payment for destruction of the income producing asset is on capital account, the payment was held to be on capital account. See also *Pe Ben Industries Co. v R.*, [1988] 2 C.T.C. 120 (F.C.T.D.).; *BP Canada Energy Resources Co. v. R.*, 2002 DTC 2110; and *River Hills Ranch Ltd. v R.*, 2013 TCC 248.

In *Toronto Refiners & Smelters Ltd. v R,* 2002 FCA 476, four factors were set out to determine if an amount is an ECE:

- Was the amount received as a result of a disposition?
- Was the amount received in respect of the business carried on by the recipient of the payment?
- What consideration did the recipient give for the payment?
- If the recipient had made the payment for the same consideration that it had given to the payor (the mirror-imaging test), would that have been an eligible capital expenditure of the recipient?

Here, there was a disposition in respect of a business carried on, and the consideration was for goodwill (what is left over after amounts have been allocated to identifiable assets) (para 194-97). Thus the amount was for ECE, but was non-taxable because of the mirror-imaging rule in 14(5).

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