

1931
Nov. 16.
Nov. 25.

WILLIAM ALLEN BLACK.....APPELLANT;
AND
THE MINISTER OF NATIONAL }
REVENUE } RESPONDENT.

*Revenue—Personal Corporations—Section 21, Income War Tax Act—
Deductions—Shareholder*

Held that section 21 of the Income War Tax Act, dealing with personal corporations, is to be construed as meaning that shareholders are to be assessed upon the company's income according to their several interests therein, and that shareholders of personal corporations thus assessed are entitled to any statutory exemptions or deductions to which ordinarily the corporation, or the shareholder, would be entitled.

APPEAL from the decision of the Minister of National Revenue, affirming an assessment made for the years 1927 and 1928, against the appellant.

The action was heard before the Honourable Mr. Justice Maclean, President of the Court, at Ottawa.

George H. Montgomery, K.C., for appellant.

C. Fraser Elliott, K.C., and *W. S. Fisher* for respondent.

MONTGOMERY, K.C., for appellant argued that the personal corporation amendment was remedial and should receive such fair, large and liberal construction as will best ensure the attainment of the Act according to its true intent, meaning and spirit. He cited *Viscountess Rhondda's Claim* (1922) 2 A.C. 339 at pp. 349, 350 per Viscount Birkenhead, L.C. Maxwell on interpretation of Statutes, 7th Edition, p. 46. The intention was to ignore the corporate entity entirely and treat its income as if it had been received by the individual shareholders. He referred also to the quotation by Lord Halsbury in *Cox v. Hakes*, 15 A.C. 506 at p. 518.

ELLIOTT, K.C., for respondent argued that interest and dividends are income and liable to taxation unless expressly exempted. Dividends received by individuals are taxable in full. You cannot split up a dividend and see what it comes from—per Rowatt, J., in *Gimson v. Commissioners of Inland Revenue* (1930) 2 K.B. 246 at 251 and 252; *McNeil v. Federal Commissioner of Taxation* reported in Ratcliffe and McGrath's *Income Tax Decisions Australasia* p. 35 at p. 37. If the income of a commercial com-

pany be 50 per cent from commercial profits and 50 per cent from Tax Free Bond interest, nevertheless shareholders receiving a dividend from such company are taxable on the whole of the dividend. The words "shall . . . be deemed" "dividend" and "shall . . . constitute taxable income" as used in Section 21, are all imperative. "Deemed" as used in this context means "adjudged and determined"—*Hickey v. Stalker*, 53 O.L.R. 414 at p. 418, per Middleton J. "Deemed" has acquired no technical or peculiar significance when used in legislation but must be interpreted with reference to the whole of the Act. *The Queen v. Freeman* 22 N.S.R. 506 at 513. Subsections 2, 3, 4 and 5 of Section 21, are machinery provisions only and do not alter the principle to be followed when dealing with a dividend. As the text of the Act as passed by Parliament, is clear and unambiguous, the intention as expressed in Hansard Debates, cannot be considered. The statutory dividend from the personal corporation does not come into the hands of the shareholders under any circumstances flowing from the obligation of the Tax Free Bond or its interest, and, therefore, the shareholders cannot claim exemption. *Waterous v. Minister of National Revenue*, (1931) Ex. C.R. 108 at 111. The dividend is not derived from the Tax Free Bond; it is derived from the "income" of the company which the company received from all its sources of income.

The facts involved in this case and the questions of law are stated in the Reasons for Judgment.

THE PRESIDENT, now (November 25, 1931), delivered the following judgment.

This is an appeal from a decision of the Minister of National Revenue, affirming an assessment made for the years 1927 and 1928, against the appellant, a shareholder of a personal corporation, under the Income War Tax Act, Ch. 97, R.S.C., (1927). The appeal was heard upon the pleadings and upon an agreed statement of facts.

It may be convenient first, to refer to the provisions of the Act pertinent to the issue involved in this appeal. The statute defines a personal corporation as follows:—

S. 2 (i) Personal corporation means a corporation or joint stock company (no matter when or where created) controlled directly or indirectly by one person, who resides in Canada, or by one such person and his wife or any member of his family, or by any combination of them, or by any

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other person or corporation on his or their behalf, whether through holding a majority of the stock of such corporation, or in any other manner whatsoever, the gross revenue of which is to the extent of one quarter or more derived from one or more of the following sources namely:—

(i) From the ownership of or the trading or dealing in bonds, stocks or shares, debentures, mortgages, hypothecs, bills, notes or other similar property;

(ii) From the lending of money with or without security, or by way of rent, annuity, royalty, interest or dividend, or

(iii) From or by virtue of any right, title or interest in or to any estate or trust;

The manner of assessing the income of a personal corporation is defined by s. 21 of the Act, which in part is as follows:—

21. The income of a personal corporation, in lieu of being assessed the tax prescribed by section nine of this Act, shall on the last day of each year be deemed to be distributed as a dividend to the shareholders thereof and shall in their hands constitute taxable income for each year in the proportion hereinafter mentioned, whether actually distributed by way of dividend or not.

(2) Each shareholder's taxable portion of the income of the corporation deemed to be distributed to him as above provided for, shall be such percentage of the income of the corporation, as the value of all property transferred or loaned by such shareholder or his predecessor in title to the corporation is of the total value of all property of the corporation acquired from the shareholders.

(3) The value of the property transferred by each shareholder or his predecessor in title shall be the fair value as at the date of the transfer of such property to the corporation, and the total value of the property of the corporation acquired from its shareholders shall, for the purpose of determining the percentage referred to in the last preceding subsection, be taken as at the date of acquisition thereof by the corporation; and in ascertaining values under this subsection, regard shall be had to all the facts and circumstances, and the decision of the Minister in that regard shall be final and conclusive.

Mr. Elliott, for the respondent suggested that s. 21 of the Act was enacted for the express purpose of circumventing those who might be inclined to escape income tax, by the transfer or loan of securities of one kind or another, to a private investment corporation, in exchange for shares in the corporation, and, who, controlling such a corporation might be willing to accept as annual income, interest or dividend therefrom, a return below what was normal in the ordinary practise of investors, assigning undistributed profits or income to some reserve account, in order to minimise their income which ordinarily would be taxable. With this the appellant's counsel, Mr. Montgomery, agreed. I am not of course accepting this statement of counsel as interpretative of this provision of the Act, though I must say

that the suggested explanation of the origin of this statutory provision respecting personal corporations, seems quite probable if not obvious.

A personal corporation is distinguishable from the ordinary corporation or joint stock company assessable under s. 9, ss. 2 of the Act; in respect of the former corporation special statutory provisions are enacted; its control must be in the hands of a specified class, and its business activities are limited; and special provisions are enacted prescribing how the income of such a corporation is to be assessed, and against whom. By s. 9 of the Act, ordinary corporations or joint stock companies shall pay income tax at the rate and subject to the exemptions set forth in the First Schedule of the Act.

The Dunkeld Securities Company is a company incorporated in the province of Quebec and carrying on business in Canada, and it is agreed between the parties that this company is a personal corporation within the meaning of s. 21 of the Income War Tax Act. The appellant is the holder of 7,850 shares out of an authorized issue of 10,000 shares, the balance, with the exception of 250 shares, being held by members of his family. The income of Dunkeld Securities Company, for 1927, was \$93,154.09 of which \$53,250 was interest derived from tax free bonds of the Dominion of Canada. In 1928, the income of the company was \$107,783.85, of which \$54,901.52 was interest derived from tax free bonds of the Dominion of Canada. The appellant's proportion of interest in the income of the company derived from the Dominion of Canada tax free bonds, under s. 21 of the Act, would be that fraction of the said income that 7,850 shares is of 10,000 shares; it is not necessary to state the result of a calculation upon that basis. The appellant was assessed upon that portion of the income of the company which was deemed to have been distributed to him in the years mentioned, and no deduction was allowed in respect of that portion of such income received by the company from the Dominion of Canada tax free bonds. The respondent claims that the full amount deemed to have been distributed to the appellant, was received by him "as dividend," and as such was liable to income tax. The appellant claims he is not liable to assessment upon that portion of the income of the company, deemed to be

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distributed to him, which was derived from Dominion of Canada tax free bonds. The question for decision therefore is whether income of a personal corporation derived from Dominion of Canada tax free bonds and deemed to be distributed to a shareholder, is subject to income tax.

As I have already stated, for the purposes of assessment under the Income War Tax Act, there is a distinction between corporations and joint stock companies, and a personal corporation. The former is assessable and taxable in the manner prescribed by section nine of the Act. Section 21 enacts that the income of a personal corporation "in lieu of being assessed the tax prescribed by section nine of this Act," shall be deemed to be distributed as a dividend to the shareholders thereof, and shall in their hands constitute taxable income, whether actually distributed by way of dividend or not. The evident purpose of this section of the Act was to ignore the personal corporation altogether and to assess the company's income as if in the hands of the shareholders, according to their several interests. In so far as assessable income was concerned, the Dunkeld Securities Company at the end of the calendar year possessed no income; it was deemed to have been distributed among its shareholders, whether in fact it was actually distributed by way of dividend or not; the liability to assessment was legislatively transferred from the company to its shareholders. The assessment was then to be made upon that constructive distribution, designated as a "dividend." I do not think any special significance is, or was intended, to be attached to the word "dividend," it might as well have been "income." It is merely descriptive of the company's income deemed to be distributed to shareholders, and was not intended to mean that the amounts distributed, however denominated, were necessarily taxable dividends or income. The total income of the company was deemed to be distributed to shareholders there to be assessed and taxed as income according to the provisions of the Act; that I think is what the language of section 21 means and what it was intended to mean. The word "dividend" here appears to be surplusage as the section would seem to be as complete and effective without the word as with it. Interest derived from a Dominion of Canada tax free bond is I apprehend a dividend, but is not a taxable dividend, in the hands of

the recipient. Income, under the Act does not necessarily mean "taxable income." S. 3 defines what is "income," and that includes interest received from Dominion of Canada tax free bonds, but such income is exempted from taxation by s. 4 of the Act, and is not therefore taxable income. Such income would not be taxable in the hands of a personal corporation, even if by it received and retained; there is nothing in the statute to indicate that this portion of the company's income was intended to be taxable in the hands of the shareholder to whom it is deemed to have been transferred. That view would accomplish the purpose of the Act as suggested by counsel, which was not, so far as I can see, designed to make taxable, income derived from tax free bonds. The purpose of the legislation was, for income tax purposes, to transfer to shareholders all the income of the personal corporation, so that for such purposes, the situation would be the same as if there never had been any transfer of securities to the corporation by the shareholders, and as if the personal corporation had never existed, and in which circumstances the amounts received as interest from the Dominion of Canada bonds in question would not be taxable, because by statute they were exempt from the income tax. Further, ss. 2 of s. 21 seems, by implication at least, to contemplate that not all the income received by the company and deemed to be distributed to the shareholder was to be taxable, because it expressly declares that "each shareholder's taxable portion of the income of the corporation deemed to be distributed to him," shall be ascertained in the manner prescribed by this subsection. This, I think, implies that it was only the taxable portion of the corporation's income deemed to be distributed to the shareholder that was to be ascertained in the manner prescribed, and for the portion that was non-taxable no method of ascertainment is prescribed, as none was necessary.

I think the proper view of s. 21 of the Act is, that it was the purpose and intention of the legislature to ignore the corporation altogether, so far as income taxation was concerned, and to assess the shareholder upon the company's income according to their several interests, and to grant to the shareholders of personal corporations any statutory exemptions or deductions which ordinarily the corporation, or the shareholder itself, would be entitled to. This interpre-

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tation of s. 21, would, I think, secure the attainment of the purpose and intention of the statute. I am therefore of the opinion that the appeal must be allowed and costs will follow the event.

Judgment accordingly.