BETWEEN:

ALPINE FURNITURE COMPANY LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT;

AND BETWEEN:

MONTE CARLOS FURNITURE COMPANY LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Toronto 1968 Sept. 16-17 Ottawa Nov. 8

Income tax—Direction that two companies be deemed associated—Onus of proving separate existence not tax reduction—Income Tax Act, secs. 39, 138A(2) and (3).

G and his wife held respectively 53.4% and 26 6% of the issued shares of a company which manufactured modern furniture designed by the husband and fine furniture designed by the wife. The remaining 20% of the company's shares was held by *H*. When the sales of both classes of furniture became approximately equal *G* and his wife, who differed as to the conduct of the business, consulted their accountant, their solicitor, and a tax expert, and on their advice incorporated two new companies on January 28th 1963. *G* held 80% of the issued shares in one of the new companies and his wife held 80% of the issued shares in the other, and *H* held all the remaining shares in both new companies. The new companies acquired the business of the old company and carried it on in equal partnership precisely as before. The old company had earned annual profits ranging from $10,619 in 1960 to $27,635 in 1962 and profits were known to be increasing in 1963 when the new companies were incorporated. The profit of the two new companies' partnership for 1964 was $72,805, i.e. $36,402.50 for each company. In assessing the two new companies for 1964 the Minister invoked s 138A of the *Income Tax Act* and directed that they should be deemed associated with the result that $35,000 of their combined profits instead of $35,000 of each company's profit was taxable at the lower rate.

Held, dismissing the companies' appeals, they had failed to meet the onus on them of establishing that none of the main reasons for their separate existence was to reduce the tax otherwise payable as required by s. 138A(3)(*b*)(ii).

In re C.I.R. v. Brebner [1967] 1 All E.R. 779 distinguished.

1968

ALPINE FURNITURE CO. LTD *et al* *v.* MINISTER OF NATIONAL REVENUE

INCOME TAX APPEAL.

Wolfe D. Goodman for appellants.

Frank L. Dubrule for respondent.

CATTANACH J.:—The appeals of the two appellants named in the above styles of cause against their respective assessments to income tax in respect of their 1964 taxation years were conveniently heard together by consent because both appeals arose from the identical circumstances and transactions which affect both appellants' liability to income tax in an identical manner.

Those circumstances and transactions are accordingly outlined.

Prior to February 1963 a furniture manufacturing business was carried on by Newport Chesterfield Company Limited, a joint stock company incorporated on March 25, 1959.

The voting shares, 500 in number, were held as follows:

Harry Weiner	200	40%
Leo Goldstein	200	40%
Viljo Helin	100	20%

Mr. Weiner was described in evidence as a silent partner by which, I assume, was meant that he did not participate in the actual management of the company in respect of production and sales, but only by way of investment.

Leo Goldstein was a designer of modern furniture and was the managing director and sales manager. The modern furniture designed by Mr. Goldstein was described by him as gimmick furniture and low priced. It was not sold through exclusive retail outlets but rather through discount houses and like outlets and was designed to appeal to purchasers of modest means.

Mr. Helin was an upholsterer and in charge of production, shipping and like duties.

Sarah Goldstein, the wife of Leo Goldstein, was employed by the company as a bookkeeper for which she had special qualifications, and she was responsible for the clerical and office end of the enterprise.

1968

ALPINE FURNITURE CO. LTD *et al* v. MINISTER OF NATIONAL REVENUE

Cattanach J.

However Mrs. Goldstein combined an artistic temperament and ability with her practical attributes. She was a designer of fine furniture particularly in the French Provincial style.

On September 27, 1961, Mr. Weiner's holding of 200 shares in Newport Chesterfield Company Limited was purchased by Mr. and Mrs. Goldstein. Mr. Goldstein purchased 67 shares and Mrs. Goldstein purchased the remaining 133 shares so that from that time forward until February 1, 1963, the outstanding voting shares in the company were held as follows:

Leo Goldstein	267	—	53 4%
Sarah Goldstein (his wife)	133	—	26.6%
Viljo Helin (a stranger in the tax sense)	100	—	20%

Upon her acquisition of the above substantial share interest in the company Mrs. Goldstein's participation in the type of product turned out became greater. Apparently she wished to exploit her talents as a designer of fine and higher priced furniture and to that end to direct the production facilities of the company, in part at least, to the manufacture of this type of furniture rather than exclusively to the production of modern and lower priced furniture designed by her husband.

In compliance with her desire, one set of French Provincial furniture designed by Mrs. Goldstein was manufactured by the company and shown at a furniture show held in Toronto Ontario in January 1961. This furniture show, which is held at regular intervals, is of paramount importance to furniture manufacturers because prospective purchasers resort to it to see the new lines and to place their orders. This was done before Mrs. Goldstein became a shareholder in the company. Later two more sets of provincial furniture were manufactured.

During the year 1962, presumably at the insistence of Mrs. Goldstein over the opposition of her husband, the manufacture of fine furniture increased while the manufacture of modern furniture decreased comparably. It was estimated by both Mr. and Mrs. Goldstein that in mid 1962, during the months of June, July and August one of the biggest buying times, that the manufacture and sale of fine furniture accounted for approximately 25% of the

1968

ALPINE FURNITURE CO. LTD *et al* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

total volume of the company's sales in terms of dollars, whereas by October 1962 that volume had increased to approximately 50%.

The foregoing estimates of the comparative production of fine furniture and modern furniture were merely estimates by the witnesses because the company kept only one set of books with no breakdown between the two types of furniture produced. While discrepancies occurred between the evidence given by the witnesses on examination for discovery and at trial as to the precise dates of the first manufacture and sale of fine furniture and as to the comparative percentage of the volume of production of the two lines of furniture at particular times, nevertheless, I am prepared to accept the foregoing estimates at the times indicated as being reasonably accurate.

It might well be that the decision to introduce the line of fine furniture designed by Mrs. Goldstein resulted in increased sales and consequent increased profits but in any event the sales and profits of Newport Chesterfield Company Limited showed progressive increases in the years 1960 to 1963 as is demonstrated by the following table extracted from Exhibit "J".

Year Ending	Sales	Gross Trading Profit	Profit Before Income Taxes	Provision for Income Taxes
Mar. 31/60	317,042.14	67,381.81	10,619 09	2,500 00
Mar. 31/61	475,220.40	113,765.98	26,510.51	6,427 46
Mar. 31/62 .. .	557,222 43	118,780.50	27,635 05	6,356 07
Jan. 31/63	635,692 06	162,165 97	47,427.47	15,890 26

Mr. Goldstein testified he knew that profits were increasing but that, as at February 1, 1963, he did not know the precise amount of the profit for the ten month fiscal period ending January 31, 1963, because he did not know the effect of inventory and labour until subsequent to stock taking and completed accounting which ended some time in March, 1963.

There was a definite clash of personalities between Mr. and Mrs. Goldstein resulting from the conduct of the business. Mrs. Goldstein deplored her husband's lack of orderliness including his habit of shaving prices to make a sale without informing the office so that proper billing could be made. Further their conflicting interests in fine furniture

and modern furniture posed a challenge one to the other. Both parties testified that their disagreements reached such proportions that they contemplated separating both in their business and domestic lives.

At this time Mr. Goldstein was in control of the company by reason of his ownership of a clear majority of the voting shares. Mrs. Goldstein insisted that, in fairness, her share holding interest in the business should be equal to that of her husband because, as she put it, her contribution was equal to his.

It was contemplated that Mr. Goldstein should transfer sixty-seven of his shares to Mrs. Goldstein so that each would own 200 shares, but that plan was discarded by both of them, even before they consulted a solicitor, if my recollection of the evidence is correct. The obvious reason for abandoning such method was that in the event of a dispute between Mr. and Mrs. Goldstein relating to the operation of the business, Viljo Helin, by voting his shares in favour of one of the disputants, could carry the issue to the frustration of the other, thereby wielding the balance of power, a circumstance that neither Mr. or Mrs. Goldstein was willing to accept.

They discussed their problems with the auditor of the company, Murray Rumack, whom they knew socially and professionally, several times during the currency of their controversy. Eventually when that dispute had apparently reached a critical stage Mr. Rumack recommended that they should consult a solicitor. They did not seek the advice of their usual solicitor, who was a general practitioner and in their opinion not competent to advise on their particular problem. On the recommendation of Mr. Rumack and, I presume, that of their own solicitor they consulted a solicitor well known for his knowledge of taxation matters. Mr. Goldstein testified that he did not know the reputation of this particular solicitor as a specialist in taxation matters but rather he consulted him because of his knowledge of corporate matters, presumably on the theory that if the business difficulties between him and his wife were resolved their domestic difficulties would also be resolved. At such discussions their own solicitor was present.

As a result of such discussions and upon the advice received Mr. and Mrs. Goldstein instructed the incorpora-

1968

ALPINE FURNITURE CO. LTD *et al* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

tion of two companies, Alpine Furniture Company Limited and Monte Carlos Furniture Company Limited, the appellants herein, to which I shall refer sometimes hereinafter as Alpine and Monte Carlos. The companies were incorporated pursuant to the laws of the Province of Ontario by letters patent both bearing the identical date of January 28, 1963.

In Alpine 100 shares were issued of which Leo Goldstein owned 80 and Viljo Helin owned 20.

Similarly in Monte Carlos 100 shares were issued of which 80 were owned by Mrs. Sarah Goldstein and 20 by Viljo Helin.

Accordingly, Alpine and Monte Carlos were not associated with each other within section 39(4) of the *Income Tax Act*[1].

Alpine and Monte Carlos then entered into a partnership agreement dated February 1, 1963, for the purpose of manufacturing furniture under the firm name and style of Newport Chesterfield Company with both partners investing an equal amount of capital and sharing profits or bearing losses equally. The term of the partnership was to continue until both parties mutually agreed to determine it.

---

[1] 39 (4) For the purpose of this section, one corporation is associated with another in a taxation year if, at any time in the year,

(*a*) one of the corporations controlled the other,

(*b*) both of the corporations were controlled by the same person or group of persons,

(*c*) each of the corporations was controlled by one person and the person who controlled one of the corporations was related to the person who controlled the other, and one of those persons owned directly or indirectly one or more shares of the capital stock of each of the corporations,

(*d*) one of the corporations was controlled by one person and that person was related to each member of a group of persons that controlled the other corporation, and one of those persons owned directly or indirectly one or more shares of the capital stock of each of the corporations, or

(*e*) each of the corporations was controlled by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one of the members of one of the related groups owned directly or indirectly one or more shares of the capital stock of each of the corporations.

By a specific provision in the agreement Leo Goldstein was employed by the partnership as general manager, Viljo Helin as production manager and Sarah Goldstein as bookkeeper, positions similar to those which had been held by those persons in Newport Chesterfield Company Limited.

By an agreement also dated February 1, 1963, between Newport Chesterfield Company Limited and Alpine and Monte Carlos as partners in the partnership known as Newport Chesterfield Company, the company sold and the partnership purchased the business formerly carried on by Newport Chesterfield Company Limited for the price of $210,000.35 by assuming liabilities totalling $114,382.87 and by the partnership giving a promissory note for the balance in the amount of $95,623.48. Specific provision was made in paragraph 4 with respect to the sale of accounts receivable and inventory pursuant to sections 85D and 85E of the *Income Tax Act*.

Mr. Goldstein testified that following the foregoing arrangements the partnership carried on two separate and distinct manufacturing operations on the same premises, one the manufacture of fine furniture under the general direction of Mrs. Goldstein, the other being the manufacture of modern furniture under general direction of himself with Mr. Helin superintending the production of both lines. He also testified that there were two sets of workmen whose work was done on one or other of the lines of furniture with no interchange of workmen whatsoever. He also indicated that the same separation applied to salesmen employed by the partnership. The salesmen of the fine furniture did not sell modern furniture, and the reverse situation applied, because the purchasers differed radically. He also testified that there were in effect two factories in the same premises with a physical separation.

As I assess the evidence I cannot see that there was any change in the physical operations as they had been conducted upon the introduction of the manufacture of fine furniture designed by Mrs. Goldstein, and which soon amounted to approximately 50% of the total sales volume by Newport Chesterfield Company Limited, and those that were conducted when the partnership took over on February 1, 1963, with the exception that an efficient system of stock control was introduced by Mrs. Goldstein.

1968

ALPINE FURNITURE CO. LTD *et al* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

Immediately upon the incorporation of Alpine and Monte Carlos the health labels required to be attached to newly manufactured furniture were changed to name either Alpine or Monte Carlos as the manufacturer rather than Newport Chesterfield Company Limited. After a short time these labels were required to be changed from Alpine or Monte Carlos to indicate Newport Chesterfield Company, the partnership, as being the manufacturer to correspond to the fact. Accordingly the name of the manufacturer on the labels was the same as formerly except for the omission of the concluding word "Limited".

The same workmen and salesmen were employed by both the company and the partnership. Mr. and Mrs. Goldstein and Mr. Helin continued to be employed in substantially the same positions in the partnership as they had formerly held in the company and the partnership conducted its business from the same premises as the company had until a later move to better premises. The partnership continued with one set of books, as the company had done, with no breakdown between the two different lines of furniture produced.

The suggestions by the chartered accountant, that the different operations should be conducted by two separate companies rather than by the partnership being superimposed, or that there should be two sets of records for the partnership rather than a common set, were rejected by Mr. and Mrs. Goldstein in the interest of economy. Mrs. Goldstein estimated that keeping of a common set of books resulted in a saving between $8,000 and $10,000. Mr. Goldstein testified that the question of a tax advantage was not discussed when the arrangement was proposed, but he did admit that it was discussed after the arrangement had been implemented on February 1, 1963. In this testimony he was supported by Mrs. Goldstein.

Section 39(1) of the *Income Tax Act* provides that the tax payable by a corporation under Part I thereof is 18% of the first $35,000 of taxable income and 47% of the amount by which the income subject to tax exceeds $35,000. However, subsections (2) and (3) of section 39 provide that when two or more corporations are associated with each other the aggregate of the amount of their incomes taxable at 18% is not to exceed $35,000.

Section 39(4) defines the circumstances under which a corporation is associated with another. As I have previously indicated Alpine and Monte Carlos are not associated within those circumstances and the present appeals were argued upon that basis.

A reference to the information contained in Exhibit "J" shows that until the ten month period ending January 31, 1963, Newport Chesterfield Company Limited never earned a profit in excess of $35,000, but that it earned a profit of $47,427.47 for that period. Mr. Golstein admitted that he knew the profits of that company were increasing in each year and that while he did not know the precise amount of profit for the period ending January 31, 1963, until some three or four months later, nevertheless, he did know that there had been a substantial increase. I think it is reasonable to infer that he knew, or at the very least could have expected that the profit for that period would be in excess of $35,000. Again referring to Exhibit "J" the profit of the partnership comprised of Alpine and Monte Carlos is shown to have been $72,805.24, a still further substantial increase over that of the company, Newport Chesterfield Company Limited, for the immediately preceding financial period.

If Alpine and Monte Carlos were not associated then each would have earned a profit of approximately $36,402 which is an equal share of the $72,805.24 profit of the partnership for its 1964 taxation year. Each such share of the profit is slightly in excess of $35,000. I compute the tax payable by Alpine and Monte Carlos on their respective profits of $36,402 to be $7,971, or a total tax of $15,942.

Assuming that Alpine and Monte Carlos had been associated within section 39(4) then under section 39(1) and (2) I would roughly compute the tax payable upon the partnership profit of $72,805.24 for its 1964 taxation year to have been $26,252.62. (In making such computations I have added the Old Age Security tax at 3% to the percentages of 18% and 47% in section 39(1).)

Accordingly if Alpine and Monte Carlos were associated the tax payable would have been approximately $26,-252.62, whereas if they were not associated the tax payable by each of them would have been $7,971 or a total of

1968

ALPINE FURNITURE CO. LTD *et al* *v.* MINISTER OF NATIONAL REVENUE

Cattanach J.

approximately $15,942. Therefore if the appellants were not associated there would be a tax reduction of approximately $10,310.62.

Section 138A(2) which is applicable to the 1964 and subsequent taxation years reads as follows:

> 138A ...
>
> (2) Where, in the case of two or more corporations, the Minister is satisfied
>
> (*a*) that the separate existence of those corporations in a taxation year is not solely for the purpose of carrying out the business of those corporations in the most effective manner, and
>
> (*b*) that one of the main reasons for such separate existence in the year is to reduce the amount of taxes that would otherwise be payable under this Act
>
> the two or more corporations shall, if the Minister so directs, be deemed to be associated with each other in the year.

Pursuant to the provisions of section 138A(2) the Minister directed that Alpine and Monte Carlos were deemed to be associated companies for the purposes of section 39 for the 1964 taxation years and assessed the appellants accordingly.

An appeal from an assessment made pursuant to a direction by the Minister under section 138A(2) is provided in subsection (3) which reads in the relevant part thereof as follows:

> 138A. . .
>
> (3) On an appeal from an assessment made pursuant to a direction under this section, the Tax Appeal Board or the Exchequer Court may
>
> (*a*) confirm the direction;
>
> (*b*) vacate the direction if
>
> . . .
>
> (ii) in the case of a direction under subsection (2), it determines that none of the main reasons for the separate existence of the two or more corporations is to reduce the amount of tax that would otherwise be payable under this Act; or
>
> (*c*) vary the direction and refer the matter back to the Minister for reassessment.

Under this subsection this court is given the power to make an independent determination of the main reasons for the separate creation of the two appellant companies which the Minister has directed should be taxed as associated corporations.

Under section 138A(2) the justification required for the exercise of the Minister's direction is that (1) the separate existence of the appellants herein is not solely for the

purpose of carrying on the business of those corporations in the most effective manner and (2) one of the main reasons for their separate existence is the reduction of taxes which appears to presuppose two conditions precedent to the exercise of the discretion by the Minister.

However under section 138A(3)(*b*)(ii) this court may vacate the direction made by the Minister under subsection (2) if it determines that "none of the main reasons" for the separate existence of the two or more corporations is to reduce the amount of the tax payable and this court is not authorized by section 138A(3) to substitute its finding for that of the Minister under section 138A(2)(*a*) that the separate existence of two or more corporations is not solely for carrying on the business in the most effective manner. It would seem to me that the findings of the Minister under paragraphs (*a*) and (*b*) of section 138A(2) are, in reality, only one finding to the effect that the separate existence of two corporations is not solely for business purposes and is to reduce taxes for which reason reference is made to section 138A(2)(*b*) in section 138A(3)(*b*)(ii) and no reference is made therein to section 138A(2)(*a*).

By section 138A(3) this court is authorized on appeal from an assessment resulting from a direction by the Minister to (*a*) confirm the direction of the Minister, (*b*) vacate that direction, or (*c*) vary the direction which is comparable to the court's power on appeals from assessments to income tax under section 100(5) of the Act. Notwithstanding the difference in language an appeal under section 138A(3) is made in the same manner as an appeal under section 100(5) and is subject to the same principles paramount among which is that the onus is on the taxpayer "to demolish the basic fact on which the taxation rested".

Thus the issue that emerges for determination is that none of the main reasons or the separate existence of Alpine and Monte Carlos was to reduce the amount of taxes that otherwise would have been payable.

Counsel for the appellants contended that the sole motivating reason for the implementation of the arrangement described above was that it offered a clear and realistic solution to the business problems faced by Mr. and Mrs. Goldstein in a sensible manner. He pointed out that this

1968

ALPINE FURNITURE CO. LTD *et al* v. MINISTER OF NATIONAL REVENUE

Cattanach J.

arrangement ensured that Mr. and Mrs. Goldstein would participate equally in the business of the partnership and the control thereof through the instrumentality of Alpine and Monte Carlos and that in the event of a dispute between them Mr. Helin, by virtue of his share ownership, would not have the balance of power as was formerly the case. He added that the arrangement would facilitate splitting the business into two parts, the fine furniture business going to Monte Carlos and the modern furniture business going to Alpine, controlled respectively by Sarah and Leo Goldstein, upon the dissolution of the partnership in the event of an insoluble dispute between them.

The same results could have been achieved by a variety of other means such as the continuation of Newport Chesterfield Company Limited with Mr. and Mrs. Goldstein holding an equal number of shares and by Mr. Helin entering into a voting agreement amongst other arrangements but from which no tax advantage would result.

It was established in evidence that it was suggested that the business of Newport Chesterfield Company Limited should be divided along the lines of fine and modern furniture to be carried on by Monte Carlos and Alpine respectively without the superimposition of the partnership but that such suggestion was rejected by Mr. and Mrs. Goldstein in the interest of the saving effected by keeping a common set of books for the partnership. It follows that they were anxious to carry on the partnership business in a most efficient and economic manner and were conscious of the savings to be effected thereby.

The fact that there may be two ways to carry out a *bona fide* commercial transaction, one of which would result in the imposition of a maximum tax and the other would result in the imposition of much less tax, does not make it a necessary consequence to draw the inference that in adopting the latter course one of the main objects is the avoidance of tax. (See *In re Commissioner of Inland Revenue v. Brebner*[2], Lord Upjohn at page 784). However, the foregoing proposition contemplates that the sole purpose to be accomplished is the *bona fide* commercial transaction.

[2] [1967] 1 A11 E.R. 779.

In the course of his remarks counsel for the appellants readily admitted that a substantial tax reduction would be effected but he contended that the tax advantage was incidental to the pursuit of a genuine business advantage and therefore irrelevant.

In the light of the remarks of Lord Upjohn (*supra*) I would agree with his contention assuming I were convinced that the business advantage was the sole motivating reason for entering into the arrangement here adopted.

Thus the question for determination again stands out in sharp relief and, which I repeat, is that none of the main reasons for the separate existence of Alpine and Monte Carlos was to reduce the amount of tax.

That question is one of fact to be decided upon the evidence adduced and the proper inferences to be drawn from that evidence and the onus of establishing that the sole main reason was that of business consideration falls upon the appellants. In my view the appellants have failed to discharge that onus. The actual physical business operations were carried on precisely as they were before under Newport Chesterfield Company Limited. Both Mr. and Mrs. Goldstein were desirous of effecting savings in bookkeeping for which reason the partnership was formed and one set of books kept rather than separate businesses being conducted by each appellant, a suggestion which had been made but rejected by them. They were not unaware of the incidence of income tax. Newport Chesterfield Company Limited had paid substantial income tax by way of instalments. The partnership agreement made specific provision for the treatment of accounts receivable and inventory for income tax purposes. Mr. and Mrs. Goldstein sought and obtained professional advice from specialists in the income tax field. It was known prior to February 1, 1963, that the profits of the company would likely be in excess of $35,000, although the precise amount was not known.

It is inconceivable to me in this day when the incidence of tax is always present that persons with the business experience and acumen which Mr. and Mrs. Goldstein possessed would have been oblivious of the tax advantage that might result from the arrangement adopted and it is even more inconceivable that the incidence of tax was not

1968

ALPINE FURNITURE CO. LTD *et al* v. MINISTER OF NATIONAL REVENUE

Cattanach J.

raised and discussed with them by the specialists whom they consulted. I say this despite the fact that Mr. Goldstein testified that the question of income tax was not discussed with their professional advisers prior to February 1, 1963, when present arrangement was implemented, although he admitted that it was discussed subsequent to that date. I think that I must infer from the nature of the plan adopted and the circumstances proceeding its adoption that the probability of a reduction in the amount of income tax payable was one of the main reasons for the adoption of the arrangement even though Mr. Goldstein gave evidence to the contrary.

For the foregoing reasons I confirm the direction of the Minister and dismiss the appeals with costs.