
Calgary 1966 Apr. 5 — Ottawa June 6

BETWEEN:

ALPINE DRYWALL AND DECORATING LTD. ..... APPELLANT;

AND

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

Income—Income Tax Act, R.S.C. 1952, c. 148, Section 39(1)(2)(4)(b)—Associated corporations—Meaning of "control"—Whether corporation is "controlled" by fifty per cent shareholder with casting vote—Effect of casting vote of chairman.

The issue in the disposition of this action was whether the appellant was "controlled", as contended by the Minister, by one of two equal shareholders. The articles of association gave the right to the chairman as president, to exercise a casting vote in case of a tie. If so, the appellant would be "associated" with another corporation which was controlled by the same shareholder and the assessment would be well founded

Held, That while the right to a casting vote residing in the named shareholder by reason of his office as chairman gave control of the appellant to that shareholder for all practical purposes and for the purposes of the relevant companies legislation, it did not follow that it conferred control within the meaning of the *Income Tax Act.*

2. That, as in the *Buckerfield's Ltd. et al* case, rejecting the test of *de facto* control for the purpose of section 39(4) and following
   (a) the implication inherent in the judgment in that case that "controlled" contemplated the right of control that rested in ownership of shares, and
   (b) the dicta of Noël J in the *Pender Enterprises Ltd* case that the power to exercise a casting vote did not constitute "control" within the meaning of section 39.
3. That it followed that the appellant was not controlled by the shareholder in question and was not "associated" with the other corporation.
4. That the appeal be allowed with costs.

APPEAL from assessments of the Minister of National Revenue.

R. A. F. Montgomery for appellant.

Bruce Verchère for respondent.

CATTANACH J.:—These are appeals from the assessments of the appellant under the *Income Tax Act,* R.S.C. 1952, chapter 148 for its taxation years 1961, 1962 and 1963.

The sole question in each of the appeals is whether the appellant was "associated" with another company known as Jager Holdings (Calgary) Ltd. (hereinafter referred to as "Jager Holdings") within the meaning of the word "associated" as used in section 39 of the *Income Tax Act* so as to authorize the Minister to assess the appellant as he did and thereby deprive it of the advantage of the lower rate of tax of 18 percent on the initial $35,000 of its income in each of the taxation years in question as contrasted with a tax at the rate of 47 percent on the appellant's taxable income in each year.

The pertinent provisions of section 39 read as follows:

39. (1) The tax payable by a corporation under this Part upon its taxable income or taxable income earned in Canada as the case may be, (in this section referred to as the "amount taxable") for a taxation year is, except where otherwise provided,

(a) 18% of the amount taxable, if the amount taxable does not exceed $35,000, and

(b) $6,300 plus 47% of the amount by which the amount taxable exceeds $35,000, if the amount taxable exceeds $35,000

(2) Where two or more corporations are associated with each other in a taxation year, the tax payable by each of them under this Part for the year is, except where otherwise provided by another section, 47% of the amount taxable for the year.

It is common ground that the question whether the appellant was associated with Jager Holdings depends upon the

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application, to the relevant facts, of section 39(4)(*b*), which reads as follows:

> 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;
>
> . . .
>
> (*b*) both of the corporations were controlled by the same person...,
>
> . . .

The facts are relatively simple and straight forward.

The appellant was incorporated pursuant to the laws of the Province of Alberta on June 9, 1960 at the instigation of William Jager and Clarence Wagenaar, with head office at Calgary, Alberta. Only 100 shares of the appellant's authorized capital stock had ever been issued at all times material to these appeals, 50 shares belonged to Mr. Wagenaar and 50 shares belonged to Mr. Jager. Each share entitled the holder to one vote at meetings of the company.

Mr. Jager was the managing director of a number of companies carrying on business in various branches of the construction industry in the City of Calgary and the area immediate thereto. One of such companies was Jager Holdings which had issued only 100 shares of which, at all times material hereto, 51 shares were held by Mr. Jager and 49 shares were held by his wife. It is common ground that William Jager controlled Jager Holdings.

Mr. Wagenaar came to Canada from Holland in 1950. In 1952 he was employed by a firm of plasterers and decorators specializing in the dry wall method of completing interior walls of buildings. In April 1960 he entered into this type of business on his own behalf. A prospective partnership arrangement was discussed between him and another person, who was a painter and decorator, but this arrangement did not materialize. Meanwhile William Jager had started a dry wall business as part of the construction industry complex in which he was engaged. Because of his other interests he was unable to devote sufficient attention to this phase of his many business interests. For this reason and by reason of the difficulty in obtaining experienced personnel, this dry wall branch of Jager's businesses was not active. Wagenaar, in the course of his work, became known to Jager. It was to their mutual advantage to enter the business of applying this method of finishing walls in buildings. Jager's standing in the industry enabled Wage-

naar to obtain the requisite financing and afforded a voluminous source of work. On the other hand, Wagenaar's experience in this field gave Jager a reliable contractor for this method of construction when he required it. Therefore, the appellant company was formed by them, each of whom contributed an equal amount of capital, and as stated above, 50 shares were issued to each of them.

By agreement of the only shareholders and directors, (Jager & Wagenaar) Jager was elected President of the appellant and as President was entitled to preside as Chairman at all general meetings of the appellant company in accordance with Article 43 of the Articles of Association. Wagenaar was elected secretary-treasurer. This division of offices was agreed upon because of Jager's superior knowledge and familiarity in the conduct of corporate matters. However, Wagenaar was in complete charge of the business operations of the appellant. He solicited work, signed contracts therefor and supervised its completion without direction from Jager.

While the appellant did considerable work for many of Jager's construction companies and purchased supplies from them, the proportion of its total work and purchases represented by such work and purchases varied over the taxation years under review. On the average only 25 percent of the work done by the appellant was done for the Jager companies. The appellant tendered upon work available from the Jager companies and was given that work only when the appellant's bids were competitive. Similarly the appellant purchased supplies from the Jager companies only when their prices were lowest. I am convinced that the appellant, in a business way, conducted its operations quite independently and would so find if it were incumbent upon me to do so, but such finding would not resolve the issue.

The corporate management of the appellant was conducted with a cavalier disregard of the provision of the applicable *Companies Act*. An oranization meeting was held immediately after incorporation at which I would assume that Jager and Wagenaar were elected directors and were elected President and Secretary-Treasurer respectively. Only one annual meeting of shareholders was held during the years 1961 to 1963 inclusive. During those three years there were approximately six casual meetings between Wagenaar and Jager which do not appear to have qualified as either

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director's or shareholders' meetings. Neither Wagenaar nor Jager had read the Articles of Association which governed the internal management of the appellant.

Article 45 of the articles of Association reads as follows:

45. Every question submitted to a meeting shall be decided in the first instance by a show of hands, and in the case of an equality of votes the chairman shall, both on a show of hands and on a poll, have a casting vote in addition to the vote or votes to which he may be entitled as a member.

While neither Wagenaar nor Jager were aware that, by virtue of Article 45, Jager was entitled to a casting vote in the event of an equality of votes, by reason of his office as President, and so Chairman of all meetings, nevertheless, he was so entitled even though he at no time exercised that right.

Wagenaar and Jager are not related.

Counsel for the Minister contends that, by reason of the equal number of shares held in the appellant by Wagenaar and Jager and because Jager's shareholdings were reinforced by the position he held as President, which entitled him to a casting vote at company meetings, it follows that Jager controlled the appellant during the relevant taxation years. If this contention is correct then the appellant was, during these years, associated with Jager Holdings within the meaning of section 39(4)(*b*) in that both corporations, Jager Holdings and the appellant, were controlled by the same person, William Jager, and the Minister would have been right in assessing the appellant as he did.

The solution of the question is dependent upon the meaning to be attributed to the word "controlled" as used in section 39(4)(*b*).

Counsel for the appellant contended that *de jure* control was not vested in Jager but rather in Wagenaar and alternatively that *de facto* control was vested in Wagenaar and not in Jager. At this stage I intimated to Counsel for the appellant that the President of this Court had recent occasion to consider the meaning of the word "control" in *Buckerfield's Limited, et al. v. Minister of National Revenue*[1] where he had this to say:

Many approaches might conceivably be adopted in applying the word "control" in a statute such as the *Income Tax Act* to a corporation. It might, for example, refer to control by "management", where management and the Board of Directors are separate, or it might refer to control by

[1] [1965] 1 Ex. C.R. 299 at p. 302.

the Board of Directors. The kind of control exercised by management officials or the Board of Directors is, however, clearly not intended by section 39 when it contemplates control of one corporation by another as well as control of a corporation by individuals (see subsection (6) of section 39). The word "control" might conceivably refer to *de facto* control by one or more shareholders whether or not they hold a majority of shares. I am of the view, however, that, in section 39 of the *Income Tax Act*, the word "controlled" contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the Board of Directors. See *British American Tobacco Co. v. I. R. C.* ([1943] 1 A.E R. 13) where Viscount Simon L. C., at page 15 says:

> "The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes."

See also *Minister of National Revenue v. Wrights' Canadian Ropes Ld.* ([1947] A.C. 109) per Lord Greene M.R. at page 118, where it was held that the mere fact that one corporation had less than 50 per cent of the shares of another was "conclusive" that the one corporation was not "controlled" by the other within section 6 of the *Income War Tax Act*.

From the foregoing passage it is quite apparent that the President expressly discarded the test of "*de facto*" control as being the appropriate one to determine the meaning of the word "controlled" as used in section 39.

While I appreciate that the doctrine of *stare decisis* may not have the same application in this Court, which has jurisdiction in the Province of Quebec as well as the common law provinces, as the doctrine does in a common law court, nevertheless, in my view, when a question has been decided by this Court after argument it is in the interest of the certain and orderly administration of justice that the previous decision be followed when the same question subsequently arises in this Court.

I, therefore, stated to Counsel for the appellant that having regard to the view I expressed as above outlined, I proposed to follow the decision rendered by the President in *Buckerfield's Limited, et al v. Minister of National Revenue* (*supra*) to the effect that *de facto* control was not the test and that accordingly he should limit his argument to the question of *de jure* control to which suggestion he readily concurred, on the distinct understanding that his alternative argument on the question of *de facto* control would be properly available to him should the matter come before the Supreme Court of Canada.

As the President has pointed out in the extract from his decision in the *Buckerfield case* (*supra*) quoted above, there are many possible approaches which might be adopted in determining the meaning of the word "controlled" as

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used in section 39 of the *Income Tax Act*. He expressly excludes *de facto* control. While *de facto* control is not susceptible of ready definition, it manifests itself in various forms such as informal agreement, minority control and personal influence. He also excludes control by management or by the Board of Directors and concludes that the word "controlled" in section 39 contemplates:

> The control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the Board of Directors.

In short the ultimate control of a company rests in its shareholders by whose collective will direction or dominion over the affairs of a company is exercised.

The question of whether one corporation was "controlled" by another came before the President in *Dworkin Furs (Pembroke) Limited v. M.N.R.*[1] On the facts of that case it was contended that one corporation controlled a second corporation by holding 50 percent of the shares of the second corporation coupled with circumstance that the directors of the second corporation held their qualifying shares as trustees of the first corporation and were accordingly, in their capacity as directors of the second corporation, subject to the direction of the first corporation, that the first corporation could, by its 50 percent shareholding and by doing nothing, perpetuate the current directors of the second corporation in office and prevent others from being elected and alternatively that this same end could be achieved by a combination of 50 percent of the shares and the fact that a director of the first corporation was the President of the second corporation and thereby had a casting vote.

The person who had the casting vote had that vote by reason of his office as President of the second corporation and in that corporation, but not in the first corporation, alleged to be in control of the second corporation. In the present appeals the question is whether in a specific corporation, i.e. the appellant, where shares are equally held by two persons, a casting vote conferred by the Articles of Association upon one of those persons places the holder thereof in a position to control that very corporation. This is a much different situation from the one which was before the President in the *Dworkin case* (*supra*).

[1] [1965] C.T.C. 465.

The President made no finding as to the correctness of the various propositions so advanced but stated that he doubted that the holding of a veto over the replacement of a particular board of directors constituted control in any of the possible senses in which that word may be used. In his view "control of a corporation" means the power to determine its affairs by positive means and not by negative means. He thereupon reiterated the view he had expressed in the *Buckerfield case* (*supra*) that in section 39 of the *Income Tax Act* the word "controlled" contemplates the right of control that rests in *ownership* of such a number of shares as will carry a decision.

The implications inherent in the view so expressed by the President seems to be that control by reason of the ownership of that number of voting shares as will carry a decision is the only method of control.

In *Pender Enterprises Limited v. M.N.R.*,[1] Noël J. in considering whether a disposition or sale was not at arm's length within section 139(5a) had this to say at page 357:

> ...It indeed appears to be clearly settled that control of a corporation requires at least a bare majority in shareholding and as Lee here has not this majority, he cannot be considered as controlling the appellant and I say this notwithstanding the articles of association adopted by the appellant which gives its president a preponderant vote in the case of an equality of votes at every general meeting of the company. Indeed, such a power given to the president of the present corporation, in view of the particular circumstances of the instant case, could not, in my view, give Lee effective control over the appellant corporation which he would not otherwise have by virtue of his shareholdings because any control he would wish to exercise by virtue of his preponderant vote could not, in practice, be implemented. There being two shareholders only, Lee could not hold a general meeting of the appellant corporation without Wong's consent and as one director cannot constitute a meeting he could not use his preponderant vote.

It seems clear that in the opinion of my brother Noël, control of a company requires at least a bare majority in shareholding. Since the party with whom he was concerned held only 50 percent of the shares he concluded that that party could not be considered as controlling the company "notwithstanding the articles of association adopted by the appellant which gives its President a preponderant vote in the case of the equality of votes at every general meeting of the company". Moreover, in the particular circumstances of

[1] [1965] C.T.C. 343.

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the facts before him he concluded that the casting vote could not be implemented in practice because there were only two shareholders, one of whom could render abortive any duly called meeting of shareholders by the simple expedient of not attending. As I read his opinion he was prepared to decide that appeal as he did without reference to this latter consideration and it was probably, therefore, not a necessary part of the reasoning by which he decided that appeal.

On the facts before me in the present appeals I do not think I am entitled to speculate upon the eventuality of the holder of 50 percent of the shares, in whom the casting vote is not vested, namely Wagenaar, not attending a duly called meeting even though, in such event, there were devices readily available to the shareholder, Jager, whereby a meeting could be validly constituted and conducted in the absence of Wagenaar.

In *Aaron's (Prince Albert) Limited v. M.N.R.* recently decided by Thurlow J. and as yet unreported he had this to say:

> In the remaining three particular issues defined in the order the question of control turns on whether the person named in the issue, in addition to the votes to which he was entitled as shareholder, had the right to control the company by the exercise of a casting vote in the case of an equality of the other votes. In each of the three companies the votes of a majority were, under the articles, sufficient to carry an ordinary resolution of shareholders and in each case the articles provided for a casting vote exercisable by the chairman of the meeting in the case of a tie. While this is a point on which opinion may differ, offhand I should have doubted that control arising in that way, if it can be considered to be control at all, was within the meaning of the word "controlled" in section 39(4) of the *Income Tax Act*[1] since the situation seems not to be one of the kind at which I think the provision is aimed and since the casting vote, unlike the votes arising from shareholding, which are exercisable without responsibility to the company or to other shareholders, is, in my opinion, not the property of the holder, but is an adjunct of an office. However, in view of the conclusion which I have reached on the facts respecting the three issues it is not necessary for me to reach a concluded opinion on the question.

[1] *Vide* Jackett P., in *Buckerfield's Ltd. v. M.N.R.* [1965] 1 Ex. C.R. 299 at 303: "I am of the view, however, that, in section 39 of the *Income Tax Act*, the word 'controlled' contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the Board of Directors".

While my brother Thurlow readily conceded that on the question of a casting vote in the event of an equality of votes opinions might differ, nevertheless, he has expressed strong doubts that a casting vote can be considered control at all and even if it could, that it can be considered within the meaning of the word "controlled" in section 39 of the *Income Tax Act*.

In the statutes governing the incorporation and regulation of companies in most of the jurisdictions throughout Canada there is almost invariably a provision that at all meetings of shareholders questions proposed for consideration thereat shall be determined by a majority of the votes cast and that in the event of an equality of votes, the Chairman shall have a casting vote. These provisions are subject to other provisions in the respective statutes that certain matters shall be approved by a greater preponderance of the votes cast than a bare majority. Further it is usually provided that the application of the above provisions may be waived by by-law or by embodiment of an appropriate provision in the Articles of Association. Such a provision is contained in the *Alberta Companies Act* under which the present appellant was incorporated.

While such statutory provisions were undoubtedly intended to ensure that, in the event of a tie vote at a meeting of a company, the Chairman's second or casting vote would resolve the deadlock, nevertheless, in the circumstances such as in the present case, where all shares are held equally by two persons, it does in fact result in the Chairman being in a position to determine the result of all questions that arise at general meetings as long as he continues as Chairman. The power of exercising the casting vote resides in the Chairman, not by reason of the ownership of a share, but by virtue of his position as Chairman and the privileges and rights bestowed on that office by the Articles of Association. While these circumstances would vest control in Jager over the appellant for all practical corporate purposes and for the purposes of the Alberta companies legislation, it does not necessarily follow that it confers control within the meaning of the *Income Tax Act*.

The fact that Mr. Jager has had no occasion to exercise the casting vote vested in him as Chairman, or has not

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chosen to do so, is immaterial. The right was there at all times and might have been exercised at any time. It is a matter of the power and right to do so and not the actual exercise thereof.

Thurlow J. acknowledges that the question of a casting vote conferring control within the meaning of section 39 of the *Income Tax Act* is one upon which opinions may differ.

The contrary line of reasoning was adopted by the Vice-Chairman of the Tax Appeal Board in *Dealers Acceptance Corporation Ltd. v. M.N.R.*[1]. There the shares of the appellant were evenly divided between two groups which had orally agreed to maintain this balance of power. It was held that, in the case of an equality of shareholdings, the right to a casting vote gives its holder control of the corporation concerned.

This decision was followed by another member of the Tax Appeal Board in *Dominion Fibre Drum Corporation v. M.N.R.*[2]. A provision for a casting vote was contained in the *Quebec Corporations Act* and unlike similar provisions in other jurisdictions the casting vote could not be excluded by a by-law to the contrary. The statute in question has been subsequently amended to so provide.

The word "control" is nowhere comprehensively defined in the *Canadian Income Tax Act*. Accordingly the English decisions, which result from an interpretation of definitions in the *Finance Act* and the *Income Tax Act* are not of particular assistance nor are they applicable in the facts of the present appeals. For the purposes of the *United Kingdom Income Tax Act* control, in relation to a company, has been defined by the statute to mean the power to secure by shareholding or voting power, or powers conferred by the Articles of Association or other document regulating any company, that the affairs of the company are conducted in accordance with the wishes of the person concerned.

Before that definition was introduced into the English legislation, Rowlatt J. in *B. W. Noble, Ltd. v. I.R.C.*[3] in considering the meaning of the words "controlling inter-

[1] 37 Tax A.B.C. 33. [2] 40 Tax A.B.C. 79.
[3] 12 T.C. 911.

est", which words, when not expressly defined in a statute, have been held to have essentially the same meaning as "control", said:

...It seems to me that "controlling interest" is a phrase that has a certain well known meaning; it means the man whose shareholding in the Company is such that he is the shareholder who is more powerful than all the other shareholders put together in General Meeting. That is really what it comes to. Now, this gentleman has just half the number of shares, but those shares, in the circumstances of this case, are reinforced by the position that he occupies of Chairman, a position which he occupies not merely by the votes of the other shareholders or of his Directors elected by the shareholders but by contract; and, so reinforced, inasmuch as he has a casting vote, he does control the General Meetings—there is no question about that—...

In the *Noble case* (*supra*) there was an agreement between the Company, Major Noble, and all the other shareholders that all the natural parties thereto should be directors, that Major Noble should be managing director and chairman and upon an equal division of opinion among shareholders he should have a casting or deciding vote. It will be noted that Major Noble had his 50 percent holding of shares reinforced by the casting vote he had as Chairman and that he occupied the position of chairman by virtue of a contract.

For my part I am unable to perceive any basic distinction between occupying the position of chairman, with a casting vote attached to that office, by virtue of a contract as in the *Noble case* (*supra*) and merely being elected to that position, to which a casting vote attaches by reason of the Articles of Association. The Articles of Association bind the shareholders *inter se* with contractual effect. Section 28(1) of the *Alberta Companies Act* provides:

The memorandum and articles, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member, his heirs, executors, and administrators, and in the case of a corporation, its successors, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act.

However, I feel constrained to follow the implication which I consider to be inherent in the decision of the President in *Buckerfield's Ltd. v. M.N.R.* (*supra*), that the word "controlled" in section 39 of the *Income Tax Act*

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contemplates the right of control that rests in ownership of shares and the *dicta* of Noël J. and Thurlow J. that a casting vote arising from the Articles of Association in the case of equality of the other votes does not constitute control within the meaning of section 39.

Therefore, it follows that Jager Holdings and the appellant were not controlled by the same person, William Jager, and accordingly the appellant was not associated with Jager Holdings.

The appeals herein are, therefore, allowed with costs.