1938
June 7.

1939
Sept. 29.

BETWEEN:

JULIUS KAYSER & CO. LTD.....APPELLANT;

AND

MINISTER OF NATIONAL REVENUE...RESPONDENT.

Revenue—Income War Tax Act, R.S.C. 1927, c. 97, secs. 9B (ss. 11), 18, 20 & 23A—Money advanced by Canadian company to non-resident parent corporation and remaining outstanding for one year, no interest thereon being paid or credited to the Canadian company—Liability for tax—Appeal dismissed.

Appellant is a limited company incorporated in Canada. All of its outstanding shares, except the directors' qualifying shares, are beneficially owned by a non-resident company. Appellant from time to time made advances of its funds to the parent company. The amount of such advances was shown as outstanding at the end of appellant's financial year, no interest thereon having been paid or credited to appellant. Appellant was assessed for income tax purposes, interest at the rate of 3 per cent on the money advanced to the parent company. This assessment was confirmed by the Minister of National Revenue.

Held: That the money advanced to the parent company by appellant was paid out of undistributed income which the appellant had on hand at the time of such advance.

2 That the appellant having paid out its profits by means of advances to the parent company, rendered itself subject to the provisions of s 23A of the Income War Tax Act and was properly assessed for income tax purposes at the rate of interest determined by the Minister of National Revenue.

APPEAL under the provisions of the Income War Tax Act from the decision of the Minister of National Revenue.

The appeal was heard before the Honourable Mr. Justice Angers, at Ottawa.

A. H. Elder, K.C. for appellant.

J. G. Ahern, K.C. and *A. A. McGrory* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

ANGERS J., now (September 29, 1939) delivered the following judgment:

This is an appeal from an assessment by the Commissioner of Income Tax dated the 30th of October, 1936, affirmed by the Minister of National Revenue on July 26, 1937, under sections 58 and following of the Income War Tax Act.

The appellant is a body corporate and politic, incorporated by letters patent issued in virtue of the Companies Act, 1934 (24-25 Geo. V, chap. 33), having its head office in the City of Sherbrooke, in the Province of Quebec.

By the assessment in question a tax is levied on an additional sum of $12,746.68, not included in the tax-payer's return, representing, in the words of the notice of assessment, "interest on advances to Parent Company outstanding from June 30/34 to June 30/35 $424,889.44 at 3 per cent."

The return, which is for the fiscal year ending June 30, 1935, is dated October 30, 1935, and was presumably delivered to the Minister on that date.

A notice of assessment, altering the amount of the tax as aforesaid, was sent to the appellant on October 30, 1936.

Within the delay mentioned in section 58 of the Act, namely on November 27, 1936, the taxpayer served a notice of appeal upon the Minister.

On July 26, 1937, the Minister rendered his decision affirming the assessment and notified the appellant accordingly.

Within one month from the date of the mailing of the Minister's decision, to wit on August 23, 1937, the appellant sent to the Minister a notice of dissatisfaction in compliance with section 60 of the Act.

The appellant thereupon gave security for the costs of the appeal to the satisfaction of the Minister, as required by section 61 of the Act.

On November 16, 1937, the Minister replied in conformity with section 62, denying the allegations contained in the notice of appeal and the notice of dissatisfaction and confirming the assessment.

Pleadings were filed pursuant to an order directing the parties so to do.

The appellant, in its statement of claim, alleges in substance:

All of its outstanding shares (having under all circumstances full voting rights) are beneficially owned by a non-resident company, viz. Julius Kayser & Co., of New York City, a corporation created under the laws of the State of New York, herein referred to as the parent company;

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from time to time prior to June 30, 1935, appellant had made advances or appropriations of its funds in favour of the said parent company and the amounts thereof were treated by appellant as due by said parent company, the total amount outstanding on June 30, 1935, at the close of appellant's financial year, being $818,767.88, of which an amount of $424,889.44 had been so advanced by appellant to said parent company prior to the beginning of said financial year on July 1, 1934, and had consequently remained outstanding during the said year and no interest thereon had been paid or credited to appellant;

at all times the amounts of loans or advances or appropriation of its funds by appellant in favour of said parent company as a shareholder were less than the amount which appellant had on hand as undistributed income;

the said remittances by appellant to the parent company by way of loans or advances or appropriation of its funds in favour of the latter did not necessarily arise from the carrying on by appellant of its manufacturing business and were not incidental thereto;

the appellant has been assessed in respect of its net taxable income for the year ended June 30, 1935, declared by it under the provisions of the Act, on an additional amount of alleged taxable income in the sum of $12,746.68, as representing interest deemed to have been received by appellant as income at the rate of 3 per cent per annum, from June 30, 1934, to June 30, 1935, on the aforesaid amount of $424,889.44 outstanding during the said period as loans or advances theretofore made by appellant to said parent company;

the appellant objected to the said assessment and appealed therefrom; the respondent rendered a decision affirming the assessment and notified the appellant accordingly; thereupon the appellant mailed to the respondent a notice of dissatisfaction and furnished security for the costs of the appeal; the respondent replied denying the allegations contained in the notice of dissatisfaction and confirming the assessment as having been properly made under section 23a of the Act;

the action of respondent is not justified under section 23a or any other provision of the Act, but on the contrary is in conflict with the provisions of sections 18 and 20 of the Act;

the assessment in question is unfounded and illegal to the extent to which it treats as taxable income of appellant, during the taxation period aforesaid, the amount of $12,746.68.

In his statement of defence the respondent pleads in substance as follows:

He admits that all the appellant's outstanding shares (which have under all circumstances full voting rights) are beneficially owned by a non-resident company, viz. Julius Kayser & Company, of New York City;

he admits that the applicant had made advances to Julius Kayser & Company, a non-resident company, in the amount of $424,889.44 and that these advances had been made prior to the beginning of appellant's fiscal year commencing July 1, 1934, and had remained outstanding during the whole of said fiscal year, without interest thereon having been paid or credited to appellant;

he admits the alleged assessment and appeal therefrom;

he denies the other allegations of the statement of claim;

the appellant, a Canadian company, advanced moneys to a non-resident company and such advances in the amount of $424,889.44 remained outstanding for a period of one year, no interest thereon being paid or credited to the Canadian company;

the Minister of National Revenue, acting within the powers conferred upon him by the Income War Tax Act, particularly section 23a thereof, determined that interest of $12,746.68, being at the rate of 3 per cent on the sum of $424,889.44, shall be deemed to have been received as income of the appellant for the fiscal year commencing July 1, 1934, and therefore taxable under the Act;

the provisions of section 18 of the Act, under which loans or advances by a corporation to its shareholders are deemed to be dividends to the extent indicated therein, are not applicable when determining the income of the corporation subject to taxation, the provisions of said section being applicable only when determining the income of the shareholder;

the provisions of section 18 are not inconsistent with those of section 23a, which specifically applies to the taxation of the appellant.

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The issue was joined by appellant's reply, which prays acte of admissions contained in the statement of defence and denies the other allegations thereof.

Walter Mutchler, general manager of the appellant company, testifying on behalf of his employer, declared that the advances of funds made by the appellant to Julius Kayser & Company, of New York, were in no way incidental to the business of the Canadian company and that they always were much less than its undistributed income on hand.

He stated that the appellant's business could have been carried on without these advances, which, according to him, were not useful to the company's business.

Julius Kayser & Company, of New York, supplies the Canadian company with the raw silk which the latter needs. Asked if the parent company furnished the appellant with any other services, the witness replied: "very little."

The advances made to the parent company by the appellant are entered in the latter's book in a current account in the name of Julius Kayser & Company, New York. It seems to me expedient to cite here a passage from Mutchler's testimony concerning this account:

Q * * * And in that current account Julius Kayser, New York, is credited with the purchase of raw silk made on your behalf?

A. Yes.

Q And it is debited with the advances which you make to it?

A. Yes.

Q. So by looking at the current account it would seem that these advances made by you went in part in payment of the purchase price of the raw silk purchased for your company?

A I would not say that, because there is always enough there to cover our purchases without that amount going in.

Q. Yes, there is always enough, but at first sight that is what the account would appear to show, that part of these advances have been used to pay up the amount you owe the New York company for the purchases made for you?

A Oh, you might say that, and you might say there is a whole lot more left. It is not incidental to the company, I wouldn't say.

Witness said it was his company's custom to send its available cash to the parent company in New York.

Mutchler was asked if the advances in question had been made by appellant to the New York company pursuant to an agreement between the two that the appellant would make them in anticipation of purchase of raw silk or other raw material; the witness replied in the negative

and said that there had never been any agreement to that effect. According to him, when the parent company sees that there is more money on hand in Montreal than is needed, it decides to take some of it down to New York.

Mutchler stated that the appellant company was a wholly owned subsidiary of the New York company.

The moneys that are sent to the parent company are shown in appellant's books as advances made to the former and the amount assessed as aforesaid and with which we are concerned arose in that way.

The appellant rests its claim on sections 18 and 20 of the Income War Tax Act. On the other hand, the respondent submits that the question at issue is governed by section 23a.

The first paragraph of section 18, which is the only one relevant, reads as follows:

> For the purposes of this Act, any loan or advance by a corporation, or appropriation of its funds to a shareholder thereof, other than a loan or advance incidental to the business of the corporation shall be deemed to be a dividend to the extent that such corporation has on hand undistributed income and such dividend shall be deemed to be income received by such shareholders in the year in which made.

Section 20 is in the following terms:

> The undistributed income of a corporation shall, for the purposes of sections fifteen, sixteen, seventeen, eighteen and nineteen, be deemed to be reduced by the amount deemed to be received by the shareholders as a dividend by virtue of the provisions of the said sections fifteen, sixteen, seventeen and eighteen.

Section 23a reads thus:

> Whenever a Canadian company advances or has advanced moneys to a non-resident company and such advances remain outstanding for a period of one year without any interest or a reasonable rate of interest having been paid or credited to the Canadian company, the Minister may for the purposes of this Act, determine the amount of interest on such moneys which shall be deemed to have been received as income by the Canadian company

The evidence shows that the appellant company made advances in the sum of $424,889.44 to Julius Kayser & Company, of New York, which beneficially owns all the issued shares of the capital stock of the appellant company (except the directors' qualifying shares), which have under all circumstances full voting rights.

The proof further discloses that these advances were made prior to July 1, 1934, that the amount thereof

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remained outstanding during the whole of the appellant company's fiscal year ending June 30, 1935, and that no interest was paid thereon.

It seems obvious that these advances were paid out of the undistributed income which the appellant company had on hand at the time they were made.

I do not think that the question at issue comes within the scope of section 18. The object of this section is to create a tax against a shareholder who receives a dividend under the disguise of a loan or advance; it has nothing to do with the corporation which pays it out. I may add that, if I had concluded that the question at issue does come within the scope of section 18, I would have been inclined to believe that the advances in question were incidental to the business of the appellant company.

Had the appellant company wished to declare as dividends the advances made to Julius Kayser & Company it could have done so and the dividends so declared would have been exempt from income tax in virtue of subsection 11 of section 9b, which reads as follows:

> The tax imposed by subsection two hereof shall not apply in the case of dividends paid to a non-resident company by a Canadian company, all of whose shares (less directors' qualifying shares) which have under all circumstances full voting rights are beneficially owned by such non-resident company: Provided that not more than one-quarter of the gross income of the Canadian company is derived from interest and dividends other than interest and dividends received from any wholly owned subsidiary company: Provided further that such non-resident company is not a company incorporated since the 1st April, 1933; but this proviso shall not apply if the Minister is satisfied that such incorporation was not made for the purpose of evading the tax imposed under subsection two of this section.

There is nothing in the evidence to show that these advances were intended as dividends; quite the contrary. In the appellant company's books they are debited to Julius Kayser & Company; had they really been dividends, there is no reason why they should appear in the appellant company's books as a liability or debt of Julius Kayser & Company. Moreover, if these advances were dividends legally declared, the minute book of the appellant company should show it and a copy of the resolutions authorizing their issue should have been produced. The burden of proof was incumbent upon appellant and, in my opinion, it has failed in its task.

The appellant company chose to pay out its profits by means of advances and, in so doing, rendered itself subject to the provisions of section 23a.

For these reasons I have reached the conclusion that the assessment must be maintained and the appeal dismissed.

The respondent will have his costs against the appellant.

Appeal dismissed.