

BETWEEN:

J. F. M. STEWART & COMPANY } APPELLANT;  
LIMITED, ..... }

1946  
May 9  
Nov. 15

AND

THE MINISTER OF NATIONAL } RESPONDENT.  
REVENUE, ..... }

*Revenue—Income Tax—Income War Tax Act, 1927 R.S.C., chap. 97, secs. 19, 19A—“Absorb”—“Incorporate”—Company—Sale of assets—Issue of no par common shares subsequently converted into redeemable preference shares—Appeal allowed.*

Stewart, Scully Co., Ltd., (Ontario Charter) had on hand an undistributed income at the end of its 1929 taxation period. In 1930 Stewart, Scully Co., Ltd., (Dominion Charter) was incorporated and by an agreement

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dated 1st December 1930 purchased the assets of the Ontario Company for \$5.00 in cash and 7,495 no par common shares in the Dominion Company and assumed the liabilities of the Ontario Company. The Ontario Company was then wound up and the shares in the Dominion Company distributed among the shareholders of the Ontario Company. In 1938 the Dominion Company converted some of the no par common shares into redeemable preference shares and changed its name to that of the appellant. During the years 1939 to 1943 by both purchase and call appellant redeemed such redeemable preference shares for the sum of \$55,075. The respondent assessed the Dominion Company on such redemption under S. 19A of the Income War Tax Act, 1927 R.S.C., chap. 97 and levied a tax of 4 per cent. on the said sum of \$55,075. The appellant appealed to this Court.

*Held:* That "absorb" in S. 19A means to "incorporate" and that in a transaction in which an issue of redeemable shares is given in consideration of the assets of a vendor company which had on hand undistributed income at the end of its 1929 taxation period, the issue of redeemable shares by the purchaser company does absorb the undistributed income of the vendor company.

2. That in this case the issue of no par common shares at the time of the transaction in 1930 by the Dominion Company absorbed the undistributed income in the Ontario Company, and that the subsequent conversion of some of the no par common shares into redeemable preference shares eight years after the Ontario Company had been wound up, did not result in the issue of redeemable shares absorbing such undistributed income because that had already been done by the issue of the no par common shares, and therefore the transaction did not fall within S. 19A of the Act.

APPEAL under the provisions of the Income War Tax Act.

The appeal was heard before the Honourable Mr. Justice O'Connor, at Toronto.

*Wilfred Judson* for the appellant.

*E. C. Bogart, K.C.* and *E. S. MacLachy* for the respondent.

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

O'Connor J., now (November 15, 1946) delivered the following judgment:

This is an appeal from an assessment made under The Income War Tax Act, 1927, R.S.C., chap., 97 as amended.

In 1927 section 19 of this Act read:—

19. On the winding up, discontinuance or reorganization of the business of any incorporated company, the distribution in any form of the property of the company shall be deemed to be the payment of a dividend to the extent that the company has on hand undistributed income.

Stewart, Scully Company Limited (Ontario Charter) had on hand an undistributed income of \$166,138.25 at the end of its 1929 taxation period.

In 1930 section 19 was repealed and re-enacted by adding the words “in the taxation period 1930 and subsequent periods”.

In 1930 Stewart, Scully Company Limited (Dominion Charter) was incorporated and by an agreement dated 1st December, 1930, purchased the assets of the Ontario Company for \$5.00 in cash and 7,495 no par common shares in the Dominion Company and assumed the liabilities of the Ontario Company.

The Ontario Company was then wound up and the shares in the Dominion Company were distributed among the shareholders of the Ontario Company.

In 1933 section 19A was added:—

19A. (1) Where the assets of a company, which had on hand undistributed income at the end of its 1929 taxation period, have been received by another company, either directly or through an intermediary, and whether by the sale of the assets of such first mentioned company to such other company, or through the sale by the shareholders of the shares of such first mentioned company to such other company, and such other company issues or has issued redeemable shares, bonds, notes, or other like instruments in an amount which in whole or in part absorbs the said undistributed income, then on any redemption of such instruments the company redeeming shall pay a tax of four per centum on the amount of such instruments redeemed to the extent of the said undistributed income.

(2) The tax shall be paid to the Receiver General of Canada at the time fixed for redemption or if no date is so fixed, at the time of redemption. Failure to pay the tax within the prescribed time shall render the company liable for interest thereon at the rate of six per centum per annum until paid.

In 1934 section 19 was amended by striking out the words “in the taxation period 1930 and subsequent periods”, leaving the section as it stood in 1927.

In 1938 the Dominion Company passed a by-law which was confirmed by Supplementary Letters Patent which provided that 650 no par common shares which had been

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issued were cancelled and the shareholders received \$12.50 each and of the remaining issued no par common shares, 3,130 were converted into redeemable preference shares of a par value of \$15.00 each.

At the same time the name of the Dominion Company was changed from Stewart, Scully Company Limited to J. F. M. Stewart & Company Limited, the appellant.

In the years 1939 to 1943 the Dominion Company by both purchase and by call redeemed these redeemable preference shares for the sum of \$55,075. This left 3,720 no par common shares still outstanding.

A notice of assessment for 1938 was issued on the basis that the whole of the issue had been redeemed in 1938 at \$55,075 and levying a tax of 4% on this sum viz., \$2,203 and interest, and from this assessment the Appellant appeals.

By agreement the parties have dispensed with new assessments for the years 1939 to 1943.

It was admitted by counsel for the Respondent that the cancellation of the 650 no par common shares does not come within section 19A.

The facts are not in dispute.

The question then to be determined is this: Was the conversion of some of the common shares into redeemable shares by the Dominion Company in 1938 an issue of redeemable shares which, in whole or in part, absorbed the undistributed income which the Ontario Company had on hand at the end of its 1929 taxation period?

The ordinary meaning of the word "absorb" is "to swallow up". The Concise Oxford Dictionary also gives the meaning as "incorporate". The word "absorb" in the section is most inapt.

The section contemplates a transaction in which an issue of redeemable shares is given as consideration for the assets of the vendor company, which company had on hand undistributed income.

Does an issue of redeemable shares in a transaction of this kind incorporate the undistributed income of the vendor company?

I reach the conclusion that it does so, and that this can be best shown by the position after the sale and on the winding up of the vendor company.

The asset side of the balance sheet of the vendor company would show the redeemable shares of the purchaser company in lieu of the assets which it sold. Both before and after the sale the liability side would show the paid up capital and the undistributed income. The undistributed income of the vendor company is then in the form of redeemable shares of the purchaser company and on the winding up when such shares are distributed among its shareholders, the undistributed income is distributed in the form of such shares. So to that extent and in that sense the issue of redeemable shares has incorporated the undistributed income of the vendor company.

Then on the redemption of the shares a tax of 4% is imposed to the extent that the redeemable shares represent the undistributed income.

There must be an issue of redeemable shares in the transaction to come within the section.

In this case, however, an issue of no par common shares was given in consideration of the assets, and the vendor company was then wound up. Eight years later some of the no par common shares were converted into redeemable preference shares and these were subsequently redeemed.

Clearly in this transaction it was an issue of common shares of the Dominion Company that incorporated the undistributed income of the Ontario Company. The conversion of some of the common into redeemable shares eight years after the Ontario Company had been wound up, did not incorporate the undistributed income of the Ontario Company because that had already been done eight years before.

The language of the section does not, in my opinion, reach this transaction.

For the reasons given the appeal must be allowed with costs, with the result that the assessment appealed from will be set aside.

*Judgment accordingly.*

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