

BETWEEN:

ROBWARAL LIMITEDAPPELLANT;

AND

THE MINISTER OF NATIONAL }
 REVENUE } RESPONDENT.

1959
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 May 25

 1960
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 Jan. 15

Revenue—Income—Income tax—Income Tax Act R.S.C. 1952, c. 148, ss. 6(a)(b)(c), 28(1)(2)(3)(4), 139(5a)—Controlled Corporation—Dealing not at arm’s length—Dividend is income when received not when declared—Declared dividend not payment of debt when received—“Related persons”—Corporation controlled by three brothers and another corporation controlled by their father are related persons and cannot deal at arm’s length—Appeal dismissed.

Appellant company, incorporated on December 14, 1953, is a private company and describes itself as an Investment Holding Company. All its shares are owned by three brothers. On December 18, 1953, appellant purchased from the father of the three brothers 191 shares of the 200 common shares of the capital stock of Parsons-Steiner Limited, a taxable Canadian resident corporation. On December 21, 1953, the directors of Parsons-Steiner Limited declared a dividend of \$1,250 per share on all the issued common shares of its capital stock, payable to shareholders of record as of December 31, 1953. No payable date was specified. The dividend was paid and on January 22, 1954, a cheque in the amount of \$238,750 was drawn by Parsons-Steiner Limited and received by appellant. In the taxation year 1954 the appellant controlled Parsons-Steiner Limited within the meaning of the *Income Tax Act*.

The respondent in reassessing appellant for the 1954 taxation year assumed that the sum of \$129,754.33 being part of the dividend received by it from Parsons-Steiner Limited was paid out of the designated surplus of that company and accordingly added that amount to appellant’s

¹(1909) 12 Can. Ex. C.R. 252. ²(1895) 29 Ir. L.T. 317.
³(1919) 19 Can. Ex. C.R. 1; 47 D.L.R. 437.

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declared income. An appeal from this reassessment was dismissed by the Income Tax Appeal Board and appellant now appeals to this Court.

- Held:* That the dividend was received by appellant in the year 1954 and that Parsons-Steiner Limited was a company controlled by appellant at the time the dividend was received since the 1954 amendments to the provisions of the *Income Tax Act* s. 28 relating to arm's length dealings were applicable to the year 1954 and subsequent taxation years.
2. That the declared dividend did not cease to be a dividend on December 31, 1953 since s. 6(a) of the Act brings into income amounts received as dividends and not amounts receivable as dividends.
 3. That all the appellant had on December 31, 1953 was a right to a dividend which it received in cash in the year 1954 and a right to a dividend is not income until the money is received, the cheque received by appellant on January 22, 1954 from Parsons-Steiner Limited was in payment of the dividend declared on December 31, 1953.
 4. That Parsons-Steiner Limited was a company controlled by appellant within the provisions of s. 28(3) of the Act and as Parsons-Steiner Limited's financial year ran from July 1, 1953 to June 30, 1954 it was a company controlled by appellant when the dividend was declared in December 1953 as well as when it was paid and received in January, 1954.
 5. That appellant corporation controlled by three brothers and Parsons-Steiner Limited another corporation controlled by their father are "related persons" within the meaning of s. 139(5a) of the Act and therefore cannot deal at arm's length.

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Fournier at Toronto.

H. H. Stikeman, Q.C. for appellant.

J. D. C. Boland for respondent.

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

FOURNIER J. now (January 15, 1960) delivered the following judgment:

This is an appeal from the decision of The Income Tax Appeal Board¹ dated January 2, 1958 in respect of the income tax assessment of Robwaral Limited for its taxation year 1954, whereby a tax in the sum of \$57,210.32 was levied on the appellant's income for the above year. The appellant's appeal was dismissed and the relevant assessment was confirmed.

¹18 Tax A.B.C. 363.

I shall summarize the facts of the case which were admitted, agreed to or established before the Court. The appellant, described in its income tax returns as an Investment Holding Company, is a private company having been incorporated on December 14, 1953 under the *Ontario Corporations Act*. Immediately after its incorporation, it commenced business by securing a loan of \$240,000. On December 18, 1953 it purchased 191 common shares of the 200 common shares of the capital stock of Parsons-Steiner Limited, a taxable Canadian resident corporation, for the sum of \$285,650. The shares were purchased from Ernest A. Steiner, father of the three persons who are the sole owners of all the common and preferred shares of Robwaral Limited. The payment for the shares was made in cash.

On December 21, 1953, the directors of Parsons-Steiner Limited, at a duly constituted meeting of the board of directors of that company, declared a dividend of \$1,250 per share on all the issued common shares of its capital stock, payable to shareholders of record as of December 31, 1953. On January 22, 1954 a cheque in the amount of \$238,750 was drawn by Parsons-Steiner Limited and received by the appellant. In the taxation year 1954 the appellant controlled Parsons-Steiner Limited within the meaning of the *Income Tax Act*.

The respondent in reassessing the appellant assumed that it had received during its 1954 taxation year, as a dividend from Parsons-Steiner Limited, the sum of \$238,750 and that \$129,754.33 of the said dividend was paid out of the designated surplus of Parsons-Steiner Limited, so it allowed the appellant, for the purpose of determining its taxable income, the amount of \$108,995.67, being the dividend of \$238,750 less \$129,754.33, the portion which was paid out of the designated surplus of Parsons-Steiner Limited at the end of its fiscal period or taxation year 1953. The appellant objected to the reassessment but the respondent confirmed the reassessment. The appellant appealed to the Income Tax Appeal Board, which dismissed the appeal. It is from this decision that the appellant appeals to this Court.

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In this appeal, the appellant submits that it did not receive any dividends in the taxation year 1954. The dividend declared by Parsons-Steiner Limited on December 21, 1953, payable to common shareholders of record December 31, 1953, was for the purposes of Section 28 of the *Income Tax Act* received on December 31, 1953, and not in the taxation year 1954. The declared dividend ceased to be a dividend on December 31, 1953, but became, in fact and in law, a debt due and payable by the company to the appellant on that date and was so recorded in the books of account and in the balance sheet of the appellant as of December 31, 1953. So, it concludes that the payment and receipt of funds on January 1954, in payment of the debt which was due and payable on December 31, 1953, did not result in the payment or receipt of a dividend in 1954.

On the other hand, the respondent contends that the appellant received in 1954 a dividend of \$238,750 from Parsons-Steiner Limited, a company which appellant controlled at the time of the receipt of the dividend. To justify this contention the respondent relies on Section 6(a) and Section 139(5a), paragraph (b). Alternatively, it urges that, if the appellant did not receive a dividend of \$238,750, on account or in lieu of payment of or in satisfaction of a dividend, which it was required by the provisions of section 6 of the Act to include in its income for the 1954 taxation year, it follows that it could not be allowed as a deduction from its income the sum of \$108,995.67 in determining its taxable income pursuant to section 128 of the Act. So the appellant's taxable income for the 1954 taxation year would be in the amount of \$238,750 and not \$129,754.33.

At the hearing, counsel for the appellant admitted that Parsons-Steiner Limited, the payer corporation, had undistributed income on hand and that the sum of \$129,754.33 was the part of the \$238,750 which was paid out of what was known as "designated surplus".

The question to be determined is whether the dividend, in the amount of \$238,750, declared by Parsons-Steiner Limited on December 1953, payable to its shareholders of record at the close of business on December 31, 1953, is includible in the appellant's income for its taxation year

1953 or whether the amount of \$129,754.33, part of the sum of \$238,750 received by the appellant on January 22, 1954, is includible in its 1954 taxation year.

In the *Income Tax Act*, under the heading "Amounts included in computing income", section 6, which deals with dividends and other matters, provides a general rule, namely:

Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year

- (a) *Dividends, Annuities, etc.*—amounts received in the year as, on account or in lieu of payment of, or in satisfaction of
- (i) dividends,

This general rule provides that, to establish a taxpayer's income for a taxation year, amounts received in the year in payment or part payment or in satisfaction of dividends must be included in the income for that year. It is interesting to note that the same rule does not apply to interest or income from a partnership or syndicate. As to the rule relating to interest I quote section 6(b):

Amounts received in the year or receivable in the year (depending upon the method regularly followed by the taxpayer in computing his profit) as interest or on account or in lieu of payment of, or in satisfaction of interest, shall be included in computing the income of a taxpayer for a taxation year.

With regard to income from partnership or syndicate the rule reads:

Sec. 6(c) the taxpayer's income from a partnership or syndicate for the year whether or not he has withdrawn it during the year;

There is a special general rule in each case. Amounts received in the year as dividends shall be included in the taxpayer's income for that taxation year. Amounts received in the year or receivable in the year as interest shall be included in the taxpayer's income for that year, depending on the method followed by the taxpayer in computing his income. A taxpayer's income from a partnership for the year, whether or not he has withdrawn it during the year, shall be included in the taxpayer's income for that year.

The general rule applicable to dividends, read by itself, is simple enough, but it has to be interpreted in the light of other provisions of the Act to determine if the facts of this litigation fall within the ambit of the general rule or are covered by exceptions to this rule.

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But before considering the modifications or the exceptions to section 6 of the Act, the section should be read solely, having regard to dividends as amounts to be included in computing taxable income. Its meaning would be that the amounts received in the year as dividends shall be included in computing the income of a taxpayer for a taxation year. This section of the *Income Tax Act* may not be in accord with the provisions of company laws, which provide for the setting up of the balance sheet of the operations of companies; nevertheless, it indicates that amounts of dividends received in a year by a taxpayer are includible in that taxpayer's income for that year. This charging section is sweeping and does not distinguish between corporation or individual taxpayers.

This being said, I propose to examine the provisions of section 28 of the Act, which are relevant to this dispute and identical in wording with section 27(1) of the 1949 *Income Tax Act* and amendments. It creates a modification to the general rule of the charging section and applies to dividends received by a corporation. These provisions read as follows:

Sec. 28(1) Where a corporation in a taxation year received a dividend from a corporation that

(a) was resident in Canada in the year and was not, by virtue of a statutory provision, exempt from tax under this Part for the year,

* * *

an amount equal to the dividend minus any amount deducted under subsection (2) of section 11 in computing the receiving corporation's income may be deducted from the income of that corporation for the year for the purpose of determining its taxable income.

This section reads: "Where a corporation in a taxation year received a dividend . . .", while section 6 is thus worded: "Amounts received in the year as dividends". In both sections there is a question of dividends received or amounts received as dividends. So section 28(1) enacts that in certain instances dividends received by a corporation may be in part deducted in computing the corporation's income, whereas section 28(2) provides that when the facts therein described are applicable the provisions of section 28(1) have no effect. The section reads:

Sec. 28(2) Notwithstanding subsection (1), where

(a) a dividend was paid by a corporation that was resident in Canada and was controlled by the receiving corporation, and

(b) the payer corporation had undistributed income on hand at the end of its last complete taxation year before the control was acquired (which undistributed income is hereinafter referred to as the "designated surplus"),

if the dividend was paid out of designated surplus, no amount is deductible under subsection (1), and, if a portion of the dividend was paid out of designated surplus, the amount deductible under subsection (1) is the dividend minus the aggregate of

(c) the portion of the dividend that was paid out of designated surplus, and

(d) the part of any amount deductible under subsection (2) of section 11 in computing the receiving corporation's income reasonably attributable to the portion of the dividend that was not paid out of designated surplus.

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The provisions of this subsection, as to the deductibility or non-deductibility of dividends paid out of, or a portion of, its designated surplus by a corporation resident in Canada and not exempt from tax to be applicable only if it is established that the payer corporation was, at the relevant time, controlled by the receiving corporation. In this case it has been admitted that the payer corporation Parsons-Steiner Limited was a resident of Canada not exempt from tax and had undistributed income on hand at June 30, 1953. Now, if the payer corporation was controlled by the receiving corporation at the relevant time, it is obvious that that should be the "control period" defined in section 28(4).

Sec. 28(4) In this section, "control period" means the period from the commencement of the payer corporation's taxation year in which the control was acquired to the end of the taxation year in which the dividend was paid.

In the present instance, the Parsons-Steiner Limited was the payer corporation. Its financial statement for the year ended June 30, 1954 is included in the record before this Court. "Fiscal period", under section 139(1)(r) of the Act, means the period for which the accounts of the business of the taxpayer have been ordinarily made up and accepted for purposes of assessment; and, in the absence of an established practice, the fiscal period is that adopted by the taxpayer. In the case of a corporation, no fiscal period may exceed 53 weeks. The financial statement shows that the fiscal period of Parsons-Steiner Limited is the period from July 1 to June 30 of the following year. It follows that its taxation year commenced on July 1, 1953 and ended on

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June 30, 1954. It is during that taxation year that on December 21, 1953 it declared a dividend of \$1,250 per share on the issued common shares of its capital stock. The financial statement declares that the above dividend was paid in cash. The payment was made on January 22, 1954 during the payer corporation's taxation year 1953-1954.

The question arising is: how and when was control of the payer corporation acquired by the receiving corporation, the appellant in this case? Evidently, when the appellant purchased the common shares of Parsons-Steiner Limited and Parsons-Steiner Limited declared and paid the above dividend. The Act defines a controlled corporation as follows:

Sec. 28(3) For the purpose of subsection (2), one corporation is controlled by another corporation if more than 50% of its issued share capital (having full voting rights under all circumstances) belongs to the other corporation or to the other corporation and persons with whom the other corporation does not deal at arm's length.

There is no doubt in my mind that when the three Steiner brothers had the appellant company (Robwaral Limited) incorporated and became the owners of all the shares of its capital stock and purchased 191 common shares of the 200 shares issued of Parsons-Steiner Limited, a company controlled by their father, the above definition of a controlled corporation could not apply to their case. The definition did not make one company controlled by a father and another company controlled by his sons related companies or controlled companies for the purposes of section 28(2). Had this situation prevailed until after June 30, 1954, I believe this dispute would not have arisen, but the statute was amended before that date.

Section 139(5) was amended by section 31(1), Statutes of Canada 1954, Chap. 57, by adding subsection 5(a) to section 139, to be applicable to the 1954 and subsequent taxation years. It reads:

Sec. 139(5a) *Relationship defined.* For the purpose of subsection (5), (5c) and this subsection, "related persons", or persons related to each other, are

- (a) individuals connected by blood relationship, marriage or adoption;
- (b) a corporation and
 - (i) a person who controls the corporation, if it is controlled by one person,

- (ii) a person who is a member of a related group that controls the corporation, or
- (iii) any person related to a person described by subparagraph (i) or (ii);
- (c) any two corporations
 - (iii) if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation,
 - (iv) if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,

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These two subsections, which are applicable to the taxation year 1953-1954 of Parsons-Steiner Limited and the taxation year 1954 of the appellant, have the effect of making Mr. Steiner and his three sons a related group who between them control both Parsons-Steiner Ltd. and Robwaral Ltd., the appellant. Hence during the taxation year of Parsons-Steiner Limited, pursuant to the above provisions the corporations became related persons which were deemed not to deal with each other at arm's length.

By virtue of the amendment the father and the three sons fell in the group of persons who together rendered the Parsons-Steiner Limited controlled by the appellant, Robwaral Limited.

Following the reasoning that the amendment had the effect of giving Robwaral Limited control of Parsons-Steiner Limited pursuant to section 28(4) of the Act, the control of Parsons-Steiner Limited commenced with its taxation year and continued to the end at least of the same taxation year in which the dividend was paid. The appellant acquired control during Parsons-Steiner's taxation year 1953-1954. The dividend was declared on December 21, 1953 and paid on January 22, 1954, during that same year in which it was controlled by the appellant.

The dividend in question was declared by a resolution of the directors of the payer corporation which reads:

Upon motion duly made, seconded and unanimously carried, it was resolved that a dividend of \$1,250 per share on the outstanding common shares of the Company be and the same is hereby declared payable to the shareholders of record at the close of business on the 31st day of December, 1953.

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The motion states that the amount of the dividend will be a sum of money of \$1,250 per share and that the shareholders of record on the date *supra* will be entitled to receive the said sum of money on every common share they own. So, the word "amount" here means money and no other right of thing; in other words, a dividend is a right that qualifies shareholders to share in the profits of an undertaking whenever a distribution of profits is decided upon. When the distribution of the profits is expressed in terms of a sum of money, I do not believe it necessary to give the word "amount" any other meaning.

It is agreed that a shareholder entitled to receive a dividend expressed in terms of a sum of money has a right to sue for payment for the amount of the dividend if the company declaring same fails to meet its undertaking. This general rule is applicable when the facts indicate that there was failure on the part of the debtor and that a proper defence could not be made. I do not think that it can be said that the right to sue arises out of the declaration of a dividend. The recourse to justice flows from the fact of the non-payment of the sum of money which is the amount of the dividend.

Each dispute having to be decided on its own facts, I shall state the appellant's declaration as to why it did not receive the dividend on December 31, 1953. In its objection to the Minister's reassessment for the year 1954, it is stated that it was entitled to receive \$238,750 of the dividend on December 31, 1953. On that date, it set up this amount of dividend as being receivable upon its books of account as at December 31, 1953. As it had no need to collect the sum payable to it by Parsons-Steiner Limited as of December 31, 1953, they did not request the payment of the amount until January 22, 1954. On that day a cheque was issued by Parsons-Steiner Limited payable for an amount of \$238,750. This would be far from showing that the payer corporation was in default or had failed to meet its obligation. The amount covered by the cheque was not in payment of a debt which Parsons-Steiner Limited refused or was not in a position to pay. To my mind this would be incredible,

knowing that in its financial statement for the fiscal period July 1, 1953 to June 30, 1954 (page 3), Parsons-Steiner Limited declare the following earned surplus, viz.:

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| Cash dividends paid— | |
| 6% on first preferred stock | \$ 1,020.00 |
| \$1,250 per share on common stock | \$250,000.00 |

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It is clear that the cheque of \$238,750 which the appellant received on January 22, 1954 from the payer corporation was in payment of the dividend declared on December 21, 1953, and not in payment of a debt arising out of the non-receipt of the amount of the dividend in question.

Ignoring for the moment the provisions of section 28 of the Act, but keeping in mind the above facts, I believe the charging section 6, as applicable to the appellant, can logically be paraphrased as follows:

There shall be included in computing the income of the appellant taxpayer for its taxation year 1954 the amount of \$238,750 received in the year as a dividend or in satisfaction of a dividend.

It is admitted that the appellant did not receive the dividend declared by the payer corporation in 1953. All it had was a right to a dividend payable, which was not paid in cash until the year 1954. Section 6 clearly states "Amounts received" and not "Amounts receivable". I was referred to a rule laid down in the case of *Leigh v. The Commissioners of Inland Revenue*¹, where arrears of interest were paid in a lump sum, and it was contended without success that the sum should be apportioned over the period in which the arrears accumulated. Mr. Justice Rowlatt said (p. 595, *in fine*):

. . . receivability without receipt for the purpose of Income Tax is nothing at all. There is no Income Tax or Super-tax upon a good debt or upon the value of a moderate debt. I am not speaking, of course, of mercantile accounts where these things are brought in, or anything of that sort; but there is no such thing as Income Tax upon a debt until it is paid. . . .

True this rule may be subject to exceptions, but the exceptions must be clearly expressed in the statute. Both sections 6(a) and 28 deal with "amounts received as dividends" and not "amounts receivable as dividends".

Taking for granted that the appellant was entitled to the payment on December 31, 1953, it appears from the evidence that it was not paid until January 22, 1954, date on

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which it was received by the appellant. When the section says "received" I do not believe that it means "receivable". I would say that a right to a dividend in an amount of money is not income until received.

To conclude this point, I shall quote what Lord Greene, M.R., said in the case of *Johnson (H. M. Inspector of Taxes) v. W. S. Try, Ltd.*¹ at page 181:

... It should be noted that in general tax is calculated on the basis of the receipts of a business. There is one notable exception to that and that is the case of trade debts. ...

Dividends in the present case are not trade debts but the right to a sum of money as a dividend and the statute says that amounts received as dividends are includible in the taxpayer's income for the year in which the amount of the dividend was received.

Within the meaning of section 6(a)(i) I find that as a general rule dividends expressed in terms of a sum of money are to be included in computing the income of a taxpayer, whether an individual or a corporation, in the taxpayer's taxation year in which it was received.

I also find that, by virtue of the amendment of June 1954 to section 139(5a) of the *Income Tax Act*, a corporation controlled by three brothers and another corporation controlled by their father are "related persons" and therefore cannot deal at arms' length. The effect of the amendment was to render Parsons-Steiner Limited controlled by the appellant Robwaral Limited during the period between the date the appellant acquired the shares of Parsons-Steiner Limited and the end of the latter's taxation year 1953-1954, in which the dividend in question was declared and paid.

When the respondent reassessed the appellant's income, he assumed that the dividend in the sum of \$238,750 was paid in cash by the payer corporation on January 22, 1954, as it appears in the latter's financial statement for its taxation year 1953-1954. He also assumed that it was paid in part out of its designated surplus in the amount of \$129,754.33. It was incumbent upon the appellant to prove that these assumptions were erroneous in fact and in law; it failed to do so.

Having found that the payer corporation was controlled by the appellant at the relevant time, to wit at the time of the declaration of the dividend and of its payment and receipt, and that it was paid in part out of the designated surplus of the payer corporation, I now find that the sum of \$129,754.33 paid as a dividend to the appellant is includible in the appellant's taxation year 1954 as taxable income.

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Therefore the appeal is dismissed with costs.

Judgment accordingly.