1954
Oct. 7
1956
June 1

BETWEEN:

THE HORSE CO-OPERATIVE MARKETING ASSOCIATION, LIMITED } APPELLANT;

AND

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

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 3(1) —The Co-Operative Marketing Association Act, R.S.S. 1940, c. 180, ss. 4(1), 13, 7(1)(v), 7(1)(w), 10, 43—Quality of income—Substance and reality of transaction to be considered—Appellant machinery established by members—Appellant agent for members.

The appellant was incorporated under The Co-Operative Marketing Association Act, R.S.S. 1940, c. 180. Its members associated themselves together as an incorporated association on a non-profit co-operative plan for the purpose of disposing of their surplus horses by collective and co-operative action. At first the appellant sold live horses but later it processed horse meat and sold it largely in Belgium. The appellant was not in the ordinary business of buying horses. Its members delivered horses to it as instructed and on such delivery received an initial payment per pound, the balance of the payment being dependent on the year's operations. At the end of the year 1947 the appellant credited its members with two amounts, which it styled equalization allotment and further allotment, the totals of which came to $102,917.84 for the former and $742,665.23 for the latter. In assessing the appellant the Minister added these two amounts to the amount of taxable income reported by it. The appellant objected and appealed to the Income Tax Appeal Board which dismissed its appeal and the appellant appealed against this decision.

Held: That the amount of $102,917.84, described as equalization allotment, represents the total of the equalization allowances which were credited to the members' accounts to ensure that all members who had delivered horses in 1947 would receive the same initial payment per pound for the horses delivered by them in that year as if the initial payment per pound had been uniform throughout the year. It was, in a sense, a deferred balance of initial payment per pound credited to those members who had received less than the highest initial payment per pound set for the delivery of horses in 1947.

2. That the amount of $742,665.23, described as further allotment, is the total of the balances due to the members, after the initial payments had been equalized, apportioned out of the net proceeds of the year's operations on the basis of the live weight of the horses delivered during the year, after the results of the year's operations had been ascertained.

3. That the appellant was required to account fully to its members for the proceeds of the sale of horses delivered to it for marketing or processing and the processed products.

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4. That what the members really did in associating themselves together in the appellant association was to establish it as the means or machinery for accomplishing by co-operative action the purpose which they could not achieve individually, namely, the advantageous disposal of their surplus horses. When they delivered their horses to the appellant they did not sell them to the appellant in the ordinary sense but delivered them to it for marketing or processing by it on their behalf and for them.

5. When the appellant received the horses it did so as agent for the members and was accountable to them for the net proceeds from their marketing or the sale of the processed products. The initial payments to the members were really advances to them on account of the total to which they were severally entitled and the surplus of the appellant's receipts over its expenditures did not belong to the appellant as its profits or gains but belonged to the members in their own individual rights and was held by it on their behalf and for them.

6. That, alternatively, the amounts in dispute would be part of the cost of the horses to the appellant and there would be no remaining surplus to constitute profit or gain to it.

APPEAL from decision of Income Tax Appeal Board.

The appeal was heard before the President of the Court at Regina.

W. B. Francis, Q.C. and *R. H. McClelland* for appellant.

J. L. McDougall, Q.C. and *F. J. Cross* for respondent.

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

THE PRESIDENT now (June 1, 1956) delivered the following judgment:

This is an appeal from the decision of the Income Tax Appeal Board (1), dated April 1, 1954, dismissing the appellant's appeal from its income tax assessment for the year 1947.

In its income tax return for the year ending December 31, 1947, the appellant, which had received horses from its members during the year and also purchased horses from non-members and had processed and sold horse meat, included a report from its auditors containing several statements prepared by them, one of which was called its operating statement. This showed, on the one side, the total value of its production for the year as $5,384,552.41 and, on the other, the manner in which this amount was accounted for. The cost of processing and marketing came to $2,752,151.06, the cost of horses was put at $2,578,509.07,

(1) (1954) 10 T.A.B.C. 311.

and the balance of $53,892.28 was described as non-member earnings. This last named amount with the addition of an item of $342.77 for life insurance premiums making a total of $54,235.05 was the only amount which the appellant reported as taxable income from its horse operations. The item of $2,578,509.07 described in the operating statement as "Cost of Horses" was made up as follows:

Initial Payments to Members	1,543,522.43
Full Payment to non-members	189,403.57
Equalization Allotment—Payable	102,917.84
Further Allotment—Payable	742,665.23
	$2,578,509.07

The two last named amounts, namely, $102,917.84 as equalization allotment and $742,665.23 as further allotment, are the amounts in dispute in this appeal. In assessing the appellant the Minister added these amounts to the amount of taxable income reported by it in its return. It objected to the assessment but the Minister confirmed it. The appellant then appealed to the Income Tax Appeal Board which dismissed its appeal. It is from this decision that the present appeal is brought.

The appellant had credited the amounts in dispute to the members in their several accounts under circumstances that will be explained later and the issue is whether they were properly included in the assessment appealed against as items of profit or gain to the appellant and, therefore, taxable income in its hands.

The issue is an important one and it is essential to its determination that the dealings between the appellant and its members should be viewed in the light of their surrounding circumstances so that the true character of the amounts in dispute may be ascertained.

While the questions involved in these proceedings are not free from difficulty I have reached the conclusion without hesitation that the amounts in question were erroneously included in the assessment appealed against and that the appeal herein should be allowed and the assessment set aside. The reasons for my conclusion follow.

The appellant was incorporated on April 6, 1944, under The Co-operative Marketing Associations Act, R.S.S. 1940, Chapter 180, under the name of The Saskatchewan Horse

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Co-Operative Marketing Association, Limited which name was changed on June 11, 1945, to its present one so that farmers from Alberta as well as from Saskatchewan might become members of it. Section 4(1) of the Act provided as follows:

4. (1) Any ten or more persons resident in Saskatchewan who desire to associate themselves together as an incorporated association for the general purpose of marketing products on the non-profit co-operative plan, either with or without a capital divided into shares, shall in the presence of a witness, sign in duplicate and cause to be filed in the office of the registrar a memorandum of association, printed or typewritten (form A), to which shall be attached an affidavit verifying the signatures.

It was under this provision that the appellant was duly incorporated on the filing of the required Memorandum of Association and Organization Bylaws. The capital stock of the appellant consisted of 500,000 shares of one dollar each. Its head office was at Swift Current.

The main object of the appellant, as stated in the Memorandum of Association, was:

4. (*a*) To undertake and carry on all kinds of business or operations connected with the marketing, collecting, receiving, assembling, taking delivery of, buying, slaughtering, processing, transporting, selling, or otherwise handling or disposing of horses produced or delivered to it by its members or by any other persons eligible for admission as members, or the selling or marketing of the by-products thereof;

and I should also refer to the following incidental object:

4. (1) To do all or any of the above things as principals, agents, contractors, trustees or otherwise, and by or through trustees, agents or otherwise, and either alone or in connection with others;

But while the appellant's main object was stated in these general terms the evidence is, in my opinion, conclusive that it was not a trading corporation in the ordinary sense of that term. It was organized for a particular and temporary purpose and its membership was restricted to persons interested in its accomplishment.

The purpose of the members in associating themselves together as an incorporated association on the non-profit co-operative plan, within the meaning of section 4(1) of the Act, is of prime importance. It was carefully and clearly stated by Dr. L. B. Thomson, the president and former acting secretary of the appellant. He was its chief witness. I was favourably impressed with the manner in

which he gave his evidence and I accept it without hesitation. His evidence established that the purpose of the farmers in south-western Saskatchewan in forming the appellant was to find a market for their surplus horses of which there were about 300,000 in Saskatchewan. There were also from 150,000 to 200,000 in Alberta. It was important to dispose of these horses in order to be able to maintain their stock of cattle if there should be a recurrence of drought conditions, but, of course, the farmers desired to realize as much as possible for the horses that they had produced. The only visible means of achieving their purpose was to form an association for the marketing of their horses on a non-profit co-operative plan under the Act and they acted accordingly. The reality was that they decided to do by collective and co-operative action what they could not do individually and they set up the appellant as the necessary machinery for the accomplishment of their collective purpose.

It was originally intended that the appellant should market live horses and some sales of live horses were negotiated. But it was realized at an early date that the processing and sale of horse meat would be necessary if the surplus horses were to be disposed of. There was only a limited market in the United States for horse meat for use as food in fur ranches and for pets but it developed that there was a substantial demand for horse meat in Belgium and, after discussions with the Canadian Government and with guarantees from the Saskatchewan Government, the appellant decided to meet this demand. It really did so at the request of the Canadian Government which had the contract with Belgium. Accordingly, it built two processing plants, one at Swift Current and the other at Edmonton, and sold large quantities of processed meat for use in Belgium. The processing of the meat involved the use of other commodities than meat but the cost of these was less than 2% of the total cost of the output. The supplying of the demand for horse meat in Belgium was the chief means adopted by the appellant for achieving the purpose for which its members had associated themselves together. It was never intended to establish a permanent horse meat processing industry for the farmers knew that over a period of years their surplus of horses would be eliminated and the

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purpose for which the appellant was formed, namely, to dispose of their surplus horses, would be accomplished. Thus the purpose of the appellant and its members was a particular and temporary one. It was, of course, as Dr. Thomson explained, part of this purpose that the appellant should dispose of its members' surplus horses as advantageously as possible for them but the disposal of them was the main consideration. It was not intended that the appellant should embark on a scheme of profit making for itself or to make any profit for itself at the expense of its members.

That the appellant was not in the ordinary business of buying horses is manifest from the restricted nature of its membership and the manner in which it controlled the delivery of horses to it. Section 13 of the Act imposed membership limitations as follows:

13. Only persons who are engaged in the production of products to be handled by or through the association, including tenants of land used for the production of such products, and all landlords who receive as rent all or part of the crop upon premises leased by them, and such other persons as obtain title to or possession of products by due process of law, and associations having as their object or one of their objects the buying and selling or marketing of products on the co-operative plan and which are incorporated or registered under the provisions of *The Co-Operative Associations Act* or this Act or any former Act governing such associations, shall be admitted as members of an association.

And Organization Bylaws 1, 4 and 5 provided:

1. Subject to the approval of the directors, any horse breeder, owner of horses, or person who uses horses in his farming operations, shall be eligible for membership in the Association.

4. Subject to the approval of the directors, an association whose membership is composed of persons qualified for membership under provisions of section 1, hereof, shall be eligible for membership in the Association.

5. Shares in the Association may be allotted by the directors to such persons as meet the requirements of Sections 1 and 4 hereof, but shall include tenants of land used for the production of horses, landlords who receive as rent a share of the proceeds from the sale of horses produced on land leased by them, and such other persons as obtain title to horses by due process of law.

And the share certificates issued to members contained the following restriction:

No person shall have issued to him nor shall any person be entitled to hold shares in this association unless he is engaged in the production of the products handled by the association: and no co-operative association other than those admissible as members are permitted to have issued to them nor to hold shares in this association.

The original Organization Bylaws were consolidated on June 11, 1945, and again on September 26, 1946. Reference will be made to the 1946 consolidation, unless otherwise stated. The bylaws cited above indicate the closed nature of the appellant. It was a horse producers' association. The appellant carefully controlled the delivery of horses to it. For example, Organization Bylaw No. 3 provided:

3. As a further condition of membership, the directors may require each member, or applicant for membership, to furnish annually to the Association a list of horses which he has or expects to have for sale, together with such other information respecting such horses as the directors may require from time to time.

And Organization Bylaw 14 provided for quotas for delivery as follows:

14. To ensure as equitable a service as possible, each member may, from time to time, be assigned a quota of horses to be delivered to the Association from year to year, or for such other period as may be designated, provided however, that the directors may, in the assignment of quotas, give preference to those members who list horses for delivery to the Association within one year from the date of incorporation.

And Organization Bylaw No. 13, which had been No. 12 prior to the 1946 consolidation, provided:

13. Except under such conditions as may be approved by the directors, no member shall deliver a greater number of horses to the Association than were in his possession on the date of his admission to membership, in accordance with these bylaws, and except colts from mares in foal at the date of incorporation of the Association.

The purpose of this bylaw was to prevent members from acquiring horses from others and delivering them to the appellant in large numbers at the expense of other members. It was part of the scheme for the orderly and equitable disposition of the members' surplus horses. Dr. Thomson gave further evidence relating to the regulation of deliveries. It was not open to members to deliver horses as they chose. A delivery date had to be arranged with the appellant and a delivery date permit obtained from it before horses could be shipped to one of its processing plants. Horses were marked as being intended for it and delivered only according to its instructions or subject to a quota set by it.

It is unlikely that the appellant would have regulated deliveries in this manner if its purpose had been the making of profit for itself out of buying horses and processing and selling horsemeat.

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Moreover, the conditions subject to which members delivered horses to the appellant showed that it was not in the business of buying them from the members for a fixed price and making a profit out of its transactions with them. Dr. Thomson explained that from time to time the directors set an initial amount per pound to be paid to the members on the delivery of horses by them. This varied, according to conditions, as will be seen later. The initial payment per pound was made known to the members or intending members in various ways, one of which was by the circulation of a document, similar to Exhibit 23, called "Information for Owners and Shippers". A member or intending member would obtain a delivery date permit from the appellant and deliver his horse or horses to one of its agents for shipment to one of its processing plants. He knew the initial amount per pound that he would receive and that for each horse delivered there would be a deduction of $1 for a share and $3 for the reserve fund, made under the authority of Organization Bylaw No. 15, to which further reference will be made later, but he did not know what amount he would ultimately receive in respect of his delivery. It would be based on the grade and live weight of the horses delivered during the year but the amount to which he was entitled was dependent on the results of the year's operations.

By way of illustration of the manner in which the appellant dealt with its members Dr. Thomson referred to the transactions which it had with two of them, Mr. A. Koehmstedt, a farmer near Kerrobert, and Mr. John Weiman, a farmer near Bruno. I shall deal with the transactions with Mr. Koehmstedt first. On February 14, 1946, he applied for membership in the appellant and delivered a horse to it for which what was called a "Purchase Voucher" was handed to him. This showed the number of head of horses delivered (in this case only one), the grade, weight, the price per pound and the value, in this case $23.88. The voucher also listed the deductions made, namely, 1 share at $1 par value, reserve fund at $3 per horse delivered, freight charges, cleaning and commission, a total of $8.27, which left a balance of $15.61 under the heading of "Pay't herewith—Cheque No." A Bank of Montreal money order for $15.61 was sent to Mr. Koehmstedt with a covering letter, dated February 28, 1946, in which the amount of $15.61,

which had been called simply "Pay't herewith" on the "Purchase Voucher", was correctly described as "initial payment on horses delivered to the Association." Mr. Koehmstedt acknowledged the receipt of the cheque, confirmed the statement set out in the "Purchase Voucher" and signed an application for shares, in this case only one share because only one horse had been delivered. His application was approved by the directors and a share certificate was duly issued to him.

I now refer to his transactions in 1947. On May 29, 1947, he delivered two horses to the appellant and received a "Purchase Voucher" with the same headings as in the previous case except that there was a provision for shrinkage allowance of 100 lbs. per head at 5 cents per pound. The total value for the two horses was put at $57.50. The deductions, including 2 shares at $1 each and reserve fund at $3 per horse delivered, or $6, came to $10.68. The balance of $46.82 was described in the "Purchase Voucher" as "Initial Pay't Herewith" and the total of $57.50 was described as "Total Deductions and Initial Pay't". I should say here that while this "Purchase Voucher", as also the previous one, carried the heading "Price per lb" Dr. Thomson explained that this meant, and should have read, "Initial price per lb", that being the amount which the directors had set as such. I accept his explanation. It is reasonable, consistent with the rest of the document, which should be read as a whole, and in accord with the course of dealing between the members and the appellant. I find as a matter of fact that the term "Price per lb" on the "Purchase Voucher" should have read "Initial price per lb". That would have been a more nearly correct head. On July 17, 1947, Mr. Koehmstedt delivered 2 horses to the appellant and received a similar "Purchase Voucher". Finally, there was a "Purchase Voucher", dated December 11, 1947, on the shipment of 1 horse on that date, but this voucher carried an item of "Deferred Equalization Allowance" of $2\frac{1}{2}$ cents per pound. On this voucher the value of the horse was shown as $25, the deductions at $5 and the initial payment at $20, leaving the deferred equalization allowance of $2.50 under the heading "Balance Due".

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Mr. Koehmstedt's account was set out in his share ledger sheet. For the year 1946 it showed the delivery of 1 horse weighing 1,365 lbs. Under the heading of "Earnings" there was a credit of $8.20 as an equalization and interim credit and $4.10 as a further credit. Dr. Thomson explained that it was the policy of the directors to make an equalization payment on all horses delivered in 1945 to 1946 and also an interim payment up to April, 1946. The sum of $8.20 was paid to Mr. Koehmstedt by cheque, dated November 24, 1947, on interim and final payment account leaving $4.10 as his credit balance for the horse delivered in 1946. Thus it appears that on February 14, 1946, he was credited with $12.30 over and above the $15.61 which was paid to him on February 28, 1946. This is consistent with Dr. Thomson's statement that the price per pound which was stated on the "Purchase Voucher" at 2½ cents was only an initial payment per pound. For 1947 the share ledger sheet shows that Mr. Koehmstedt delivered 4 horses with a weight of 4,400 lbs., that his equalization and interim credit was $2.50 and his further credit $47.08 and that these two amounts coming to $49.58 stood to his credit along with the $4.10 for 1946 which made his total credit come to $53.68. These credits were over and above the initial payments which had been made to him on the deliveries made by him on the dates mentioned.

I now refer to the transactions of Mr. John Weiman in 1947. These were of the same nature as those of Mr. Koehmstedt except that in the case of the 3 horses which he shipped on February 13, 1947, the price per pound for the 2 Grade A horses was stated as 2 cents and that for the one Grade C horse as 1½ cents. Dr. Thomson explained that these prices were initial payments per pound and that they had been set by the directors. Later in the same year, about June, this initial payment for Grade A horses was raised to 2½ cents per pound and this was the initial payment to Mr. Weiman for 6 Grade A horses shipped on August 21, 1947. Later, he was given an equalization credit of $19.70 in respect of the horses he had delivered on February 13, 1947, made up of an additional ½ per cent per pound for the Grade A horses and ¼ cent per pound for the Grade C one. These items appear on a "Purchase Voucher", dated February 13, 1947, filed as Exhibit 18. On this voucher the item

appears under the heading "Balance Due". While the voucher is dated February 13, 1947, it is obvious that it was issued later and dated back. It is also plain that although the items appear on what was called a "Purchase Voucher" there was no purchase at the time of its issue.

Mr. Weiman's share ledger sheet shows this item of $19.70 under the heading of "Earnings" as an equalization and interim credit. There was also under the same heading a further credit of $129.26 making a total credit of $148.96 over and above the initial payments of $72.05 on February 13, 1947, and $169.06 on August 21, 1947, which Mr. Weiman had received in respect of the horses delivered on the said dates.

The transactions referred to illustrate Dr. Thomson's evidence that the directors set initial payments per pound from time to time and then credited the members who had delivered horses when initial payments per pound were low with equalization allowances so that all members should receive the same initial payment per pound for the horses delivered by them during the year according to their grade, either by way of actual initial payments or by equalization credits.

The amounts in dispute in this appeal may now be explained. The amount of $102,917.84, described as equalization allotment, represents the total of the equalization allowances, such as the $2.50 in the case of Mr. Koehmstedt and the $19.70 in the case of Mr. Weiman, which were credited to the members' accounts to ensure that all members who had delivered horses in 1947 would receive the same initial payment per pound for the horses delivered by them in that year as if the initial payment per pound had been uniform throughout the year. It was, in a sense, a deferred balance of initial payment per pound credited to those members who had received less than the highest initial payment per pound set for the delivery of horses in 1947.

The amount of $742,665.23, described as further allotment, represents the total of such amounts as the $47.08 credited to Mr. Koehmstedt and the $129.26 credited to Mr. Weiman. It was the total of the balances due to the members, after the initial payments had been equalized as

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just explained, apportioned out of the net proceeds of the year's operation on the basis of the live weight of the horses delivered during the year, after the results of the year's operation had been ascertained.

The two amounts totalling $845,583.07 appeared in one of the statements filed with the appellant's income tax return called Statement of Members Equity. The two amounts were not paid to the members but credited to their accounts to be paid later. The credits were made pursuant to a resolution of the directors, dated December 13, 1947, to which further reference will be made.

The appellant did some business with non-members under special circumstances which were explained by Dr. Thomson. In certain months of the year, such as February, March and April, particularly in the hard winter of 1946-1947, horses were not coming in to the appellant in the proper condition to provide meat of the quality required to meet the Belgium contract. It, therefore, became necessary to acquire a limited number of horses in the desired condition and the appellant did so by purchasing them from non-members. An illustrative record of a transaction with a non-member, filed as Exhibit 21, shows that on May 31, 1947, Mr. J. L. Toews shipped 17 horses to the appellant for which he was paid 2·75 cents per pound. This was an outright purchase at that price, the amount of which was paid to Mr. Toews on June 2, 1947. This closed the transaction.

The transactions of the appellant with Mr. Koehmstedt and Mr. Weiman on the one hand and with Mr. Toews on the other show a fundamental difference between them. In those with a non-member, such as Mr. Toews, the appellant purchased horses from him for a specified price which was paid to him immediately without any deductions for shares or reserve fund. It was an ordinary transaction of purchase and sale at a specified price and when it was paid the transaction was closed. But when a member delivered a horse to the appellant the situation was different. On its delivery he received an initial payment, being the initial payment per pound as set by the directors less the deductions, including $1 for a share and $3 for the reserve fund. The appellant did not purchase the horse at the "price per lb" stated in the "Purchase Voucher". The total amount which the

member was entitled to receive was undetermined and could not be determined until after the results of the year's operations had been ascertained. In the meantime, the initial payment was really an advance on account of the total amount for which the appellant was accountable to the member. The idea of an initial payment on account was taken from other co-operative associations. It is commonly in use where a final payment awaits determination according to future events.

The difference between the results of direct sales by non-members to the appellant, as in the case of Mr. Toews, and deliveries by members to the appellant for co-operative marketing or processing by it, as in the case of Mr. Koehmstedt and Mr. Weiman, is an indication of the wisdom of the members in associating themselves together in the appellant association. The price per pound paid to non-members in 1947 never exceeded 3 cents and the average was 2·88 cents. On the other hand, the amount for which the appellant accounted to its members, including the initial price per pound, came to 3·71 cents per pound.

In addition to the evidence to which I have referred regard must also be had to the provisions of the Act under which the appellant was incorporated and the bylaws by which it and its members were governed. I shall first refer to section 7(1) of the Act and the steps taken under it. The section sets out the matters for which the organization bylaws may provide. Clauses (*v*) and (*w*) set out alternative schemes under which members could market their products. The clauses read as follows:

7. (1) Subject to the other provisions of this Act the organization bylaws may provide for any or all of the following matters:

(*v*) the sale or resale by the association of products delivered to it by its members or other person with or without taking title thereto, and the method, time and manner of the payment over to its members or other persons of the sale or resale price after deducting all necessary selling, overhead and other costs and expenses including reserves for retiring the shares, if any, and other proper reserves including those required for acquiring real or personal property, for the erection of warehouses or other buildings or the acquisition of any mechanical or other facilities connected with the handling, processing, manufacturing and marketing of the products, and interest not exceeding six per cent. per annum on shares and the amounts referred to in any organization bylaw passed under the provisions of section 8;

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(*w*) the purchase and sale or resale by the association of products delivered to it by its members or other persons and the method of apportionment of the surplus arising from the business of the association on a patronage basis among the members, after providing for all the necessary selling, overhead and other costs and expenses, including reserves for retiring shares, if any, and other proper reserves, including those required for acquiring real or personal property, for the erection of warehouses or other buildings or the acquisition of any mechanical or other facilities connected with the handling, processing, manufacturing and marketing of the products, and interest not exceeding six per cent. per annum on shares and the amounts referred to in any organization bylaw passed under the provisions of section 8.

There is a difference between the two schemes. Under the one described in clause (*w*) the association would purchase the members' products and then after marketing or processing them and selling the products would apportion the surplus arising from the business of the association among the members on a patronage basis. But under the scheme set out in clause (*v*) the association would take delivery of the members' products from them, market or process them and account to the members for the proceeds of their sale or processing. The members were free to choose which scheme they would adopt and deliberately adopted the scheme described in clause (*v*) rather than that set out in clause (*w*). This appears from Dr. Thomson's evidence and is established by Organization Bylaw No. 15, which was passed pursuant to section 7(1)(*v*) of the Act. As amended in 1945 and in effect in 1947 it reads as follows:

15. The directors shall provide for the sale or resale or processing of horses delivered to the Association, with or without taking title thereto, and shall determine the method, time and manner of the payment to be made to the members from the sale or resale price, or the proceeds from processing and the sale of any by-products thereof, after deducting all necessary selling, overhead and other costs and expenses, including:

(*a*) An amount equivalent to the unpaid balance on shares subscribed for and corresponding in number to the horses delivered to the Association by the members.

(*b*) For each horse delivered, a special deduction of an amount not exceeding three dollars per head, such deduction being over and above the share subscribed at the time of delivery of each horse, as otherwise provided in these bylaws, this special deduction to be used at such time and in such manner as the directors may determine for acquiring such real or personal property, warehouses, buildings, mechanical or other facilities required for processing horses and the marketing of the products and by-products of such processing.

It was under this Bylaw that the deductions of $1 for a share and $3 for the reserve fund per horse, referred to in the evidence of the transactions by Mr. Koehmstedt and Mr. Weiman, were made.

But no other deductions from the amounts to which the members were entitled were permitted. Section 43 of the Act provided:

> 43. No association incorporated or registered under this Act shall make any deductions from the gross amount received by it from the sale or resale of the products delivered to it by its members or by any other persons who deliver products to it except as provided by subsection (2) of section 11 or by a bylaw passed under clause (*v*) of subsection (1) of section 7 or by a bylaw passed under section 8.

We are not here concerned with subsection (2) of section 11, which deals with individual marketing contracts, or with a bylaw passed under section 8, which relates to a scheme for accounting to non-members for products delivered. These provisions have no application to the present case. Thus, the effect of section 43, so far as the appellant is concerned, is to prohibit it from making any deductions from the gross amount received by it from the sale or resale of the products delivered to it by its members except those made pursuant to a bylaw passed under clause (*v*) of subsection (1) of section 7, that is to say, Organization Bylaw No. 15. Thus, the appellant was required to account fully to its members for the proceeds of the sale of the horses delivered to it for marketing or processing and the processed products.

The manner in which the appellant did so may now be described. The original Organization Bylaws included No. 35 which provided:

> 35. All monies received by the Association from the sale of horses delivered to the Association for sale or processing shall, less the deductions, amounts and charges which the Association is entitled to make pursuant to these bylaws, be placed in a separate account and be used exclusively for the purpose of paying to persons delivering the horses to the Association, the monies they are entitled to receive.

In the 1945 consolidation this bylaw became No. 36. In 1945 the members found that in order to operate their association it was necessary to permit it to use on their behalf the proceeds which were to have been set aside in a

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separate account for them, with the result that the 1945 consolidation included Organization Bylaw No. 15 which provided as follows:

15. Subject to the provisions of the other Organization Bylaws of this Association, up to 100 per cent. of any net surplus arising from the business of the Association, and due to members, in accordance with Bylaw No. 14, may be retained in a special revolving reserve account, for the purpose of providing sufficient funds to carry on the operations of the Association in accordance with its objects, and after such amounts so retained have accumulated in an amount deemed sufficient for the operations of the Association, as aforesaid, the directors shall, at such time and in such manner as they may determine, pay to the member the amounts due him from such retention.

(a) The first payment to a member of amounts retained in accordance with the provisions of this Bylaw may be equivalent to the amount considered by the directors as available for payment at the time, and as may be warranted by the financial requirements of the Association, and subsequent payments from this reserve may be in amounts determined likewise by the directors at such future periods as they may decide.

(b) As amounts which have been retained by the Association are paid to a member, additional amounts may be retained from current proceeds due to him, in order that sufficient funds may be maintained to achieve the objects of the Association, provided however that amounts so retained shall in turn be paid to the member, in accordance with the provisions of this Bylaw.

(c) A member shall be entitled to a statement after the end of every fiscal year, showing the amount retained from proceeds due to him, in accordance with the provisions of this Bylaw, together with a statement of any amounts paid to him.

(d) Interest may be payable on any amounts retained for a member in the revolving reserve account.

The reference in this bylaw to Bylaw No. 14 is a reference to Organization Bylaw No. 15, which I have cited, it having become Bylaw No. 14 in the 1945 consolidation. A further change took place when the Organization Bylaws were consolidated in 1946. Bylaw No. 15, which had become No. 14 in the 1945 consolidation, became again No. 15, but Organization Bylaw No. 15 in the 1945 consolidation became subsection 1 of Organization Bylaw No. 16 and subsection (2) was added as follows:

16. (2) The directors may from time to time change the policy of the association as set forth in subsection (1) hereof not inconsistent with the objects of the association; provided the directors shall at the Annual Meeting in 1947 prepare and submit to the Annual Meeting a proposal for the allocation and/or distribution of all surplus proceeds to the end of the then preceeding fiscal year.

Under the circumstances, Organization Bylaw No. 35, which had become No. 36 in the 1945 consolidation, was no longer necessary and was repealed. Dr. Thomson explained that subsection 2 of Organization Bylaw No. 16 was passed so that the appellant might have wider authority to use the moneys standing to the credit of the members in their respective accounts. It should be noted that the directors were trustees for the members and that the bylaws were passed with their full approval.

Pursuant to subsection (2) of Organization Bylaw 16 the directors, on December 13, 1947, passed an important resolution entitled "Resolution Respecting Interim and Final Payment and Non-member Business of the Fiscal year ending December 31, 1947". It read as follows:

WHEREAS Section 16, Subsection (2) of the Organization By-Laws passed by the Delegates in the annual meeting assembled at Swift Current, Saskatchewan, provides that:

> The Directors may, from time to time, change the policy of the Association as set forth in Section 16, subsection (1) of the said By-Laws, not inconsistent with the objects of the Association.

AND WHEREAS it is deemed expedient to provide for the apportioning of the proceeds arising from the operation of the Association in 1947.

BE IT RESOLVED by the DIRECTORS of HORSE CO-OPERATIVE MARKETING ASSOCIATION LIMITED as follows:

1. That portion of the price received by the Association during the fiscal year ending December 31, 1947 from the sale, resale and products of horses delivered by members during the said fiscal year after deducting all necessary selling, overhead and other expenses and other lawful deductions applicable thereto, shall be and hereby directed to be apportioned as follows:

Firstly: To equalize the initial payment to all such members who delivered horses during the said fiscal year.

Secondly: The balance remaining shall then be apportioned *pro rata* according to the number of pounds of live weight of horses delivered by members during the said fiscal year.

2. The amounts apportioned to each member as directed in clause (1) hereof shall be forthwith credited to the account of each member in the records of the Association and such apportioning and crediting shall constitute final payment to each member for each horse delivered by him to the Association during the said fiscal year and such apportioning and crediting shall constitute a binding obligation on the part of the Association to discharge such obligation in cash or specie at such time or times and in such instalment or instalments as the Directors may from time to time determine.

3. Each member whose account according to the records of the Association has been credited as hereinbefore directed, shall as soon after the 31st day of December, 1947 as possible, be sent a statement showing:

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(a) The number of horses delivered by him to the Association during the said fiscal year, and the number of pounds of live weight of horses so delivered;

(b) The amounts so apportioned and credited to such member for such fiscal year;

(c) The amounts standing to the credit of each member in respect to any preceding fiscal year.

4. That portion of the price received by the Association during the fiscal year ending December 31, 1947, from the sale, resale and products of horses delivered to the Association during the said fiscal year by persons, other than members, after deducting therefrom portion of selling overhead and other costs and expenses and other lawful deductions applicable thereto, shall, after payment of income tax, if any, payable thereon, be transferred to a special account to be used for such purposes of the Association as the Directors may from time to time determine.

5. The Treasurer shall, at the first meeting of the Directors after January, 1948, report in writing:

(a) The amount realized during the said fiscal year ending December 31, 1947 after deducting selling overhead and other expenses.

(b) The net amount apportioned and credited to members:

(i) To equalize initial payments

(ii) By way of final payment on each horse delivered during the said fiscal year, and the amount per pound of live weight or horse so apportioned and credited.

(c) The net amount realized from business with persons other than members during such fiscal year.

It was under the authority of this resolution that the amounts in dispute in this appeal were credited to the members' accounts after the results of the year's operations had been ascertained, with a binding obligation on the part of the appellant to pay them.

With this review of the facts, the relevant provisions of the Act under which the appellant was incorporated and the governing organization bylaws I come to the conclusions to be drawn. In my opinion, they are clear.

The appellant would be taxable in respect of the amounts in dispute only if they constituted net profits or gain to it from a trade or business within the meaning of section 3(1) of the *Income War Tax Act*, R.S.C. 1927, Chapter 97, the relevant portion of which reads as follows:

3. (1) For the purposes of this Act "income" means the annual net profits or gain or gratuity, ... as being profits from a trade or commercial or financial or other business ....., directly or indirectly received by a person from ..... any trade, manufacture or business, ...

In my opinion, the amounts do not come within this definition of taxable income. There are two aspects from which the question may be viewed. In the first place, they did

not constitute profits or gains to the appellant from a trade, manufacture or business, and, secondly, they did not have the necessary quality of income to render them taxable in its hands.

The appellant was not engaged in "an operation of business in carrying out a scheme for profit making" for itself, within the meaning of the test laid down by the Lord Justice Clerk in *Californian Copper Syndicate v. Harris* (1) and, apart from its profit on its non-member business, did not make any profit or gain for itself that would render it subject to tax. I have already referred to the purpose for which the appellant was incorporated, namely, to dispose of its members' surplus horses as advantageously for them as possible. They associated themselves together for this purpose on a non-profit co-operative plan under section 4(1) of the Act and it was not intended that the appellant should make a profit for itself. While I agree that the presence or absence of an intention to make a profit is not conclusive of taxability or otherwise, the absence of an intention to make a profit is a factor to be taken into account. Nor does the mere fact that the word "Co-operative" is part of the appellant's name indicate absence of tax liability in respect of its activities. The important thing to determine is the true character of the amounts in dispute.

As I view the facts, they did not have the quality of income to the appellant that was essential to their being taxable income in its hands. In *Robertson Limited v. Minister of National Revenue* (2) I applied a test of the quality of income which had been used by Mr. Justice Brandeis in delivering the judgment of the Supreme Court of the United States in *Brown v. Helvering* (3). In that case the question was whether certain overriding commissions in respect of which the taxpayer had sought to deduct certain reserves for contingent obligations to return part of the commissions were income and Mr. Justice Brandeis held that they were. At page 199, he said of the commissions:

> The overriding commissions were gross income of the year in which they were receivable. As to each such commission there arose the obligation—a contingent liability—to return a proportionate part in case of

(1) (1904) 5 T.C. 159 at 165 (2) [1944] Ex. C.R. 170.
(3) (1934) 291 U.S. 193.

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cancellation. But the mere fact that some portion of it might have to be refunded in some future year in the event of cancellation or reinsurance did not affect its quality of income.

And he put the test of such quality in these words:

> When received, the general agents' right to it was absolute. It was under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

In the *Robertson* case (*supra*), at page 182, I adopted this test of whether an amount received by a taxpayer has the quality of income such as to make it taxable in his hands and put it in the form of a question as follows:

> Is his right to it absolute and under no restriction, contractual or otherwise, as to its disposition, use or enjoyment?

This test was also applied in *Canadian Fruit Distributors Limited v. Minister of National Revenue* (1). The amounts in dispute in this appeal cannot meet this test. The appellant's right to them was not absolute and it was not free to dispose of them or use or enjoy them. In fact, it did not own them at all. It was obliged as a matter of law to account to the members for them and it held them for the members. They belonged to the members in their own individual rights. It was definitely not a case of the amounts belonging to the appellant as its profits and the members becoming entitled to participate in such profits either as patronage dividends or as dividends on their shares in their capacity as shareholders of the appellant. The provisions of the Income War Tax Act relating to patronage dividends have no bearing in this case. And the corporate set-up of the appellant did not permit any declaration of dividends in respect of its transactions with its members. That was foreign to the principle which governed the association of the members together. They were entitled to the amounts credited to them in their own individual rights under the conditions subject to which they had delivered their horses to the appellant for co-operative marketing or processing by it.

The correctness of this conclusion is not affected by the fact that there were no individual contracts between the appellant and its members on which they could sue the appellant for the amounts to which they were entitled. They did not need contracts in order to become so entitled.

(1) [1954] Ex. C.R. 551 at 559.

The difficulties involved in having individual contracts had been realized in connection with the Wheat Pools and it was provided for by section 10 of the Act which provided:

> 10. The memorandum of association and the organization bylaws and amendments thereto shall, when registered, bind the association and the members thereof and the other persons who deliver products to the association, to the same extent as if they had respectively been signed and sealed by each member and by each such person and contained covenants on the part of each member and each such person, his heirs, executors and administrators to observe all the provisions thereof subject to the provisions of this Act.

Thus the members were entitled in their own rights to the amounts credited to them pursuant to Organization Bylaws No. 15 and No. 16 and to the resolution of December 13, 1947, as effectively and completely as if they had become entitled to them under contracts between them and the appellant.

The fact that the moneys to which the members were entitled were not actually paid to them is immaterial. The effect of what the appellant did was exactly the same as if it had paid the members the amounts to which they were severally entitled and then borrowed such amounts from them.

It is essential to the determination of the character of the amounts in dispute that the dealings between the members and the appellant should be properly ascertained. It does not follow from the fact that members received a document called a "Purchase Voucher" when they delivered horses to the appellant that they sold them to the appellant for the "price per lb" stated in it. Such a conclusion would be contrary to the evidence as a whole. The document must be read as a whole and also looked at in the light of the surrounding circumstances. It is the substance and reality of the transaction that should be considered, rather than the form in which it was expressed. In my view, it would be erroneous to conclude that the members sold their horses to the appellant for the specified "price per lb" stated in the so-called "Purchase Voucher". Such a conclusion would attribute an intention to them that was foreign to the basic purpose for which they became associated together and contrary to fact. Indeed, in my opinion, the transactions between the members and the appellant were really not transactions of sales in the ordinary sense at all. They were of a different nature.

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What the members really did in associating themselves together in the appellant association was to establish it as the means or machinery for accomplishing by co-operative action the purpose which they could not achieve individually, namely, the advantageous disposal of their surplus horses. When they delivered their horses to the appellant under the scheme described in paragraph 7(1)(*v*) of the Act they did not sell them to the appellant in the ordinary sense but delivered them to it for marketing or processing by it on their behalf and for them. In that view, it is not important that the document handed to the members on the delivery of horses by them was called a "Purchase Voucher". It might just as well have been called a receipt for that, in effect, is what it was. When the appellant received the horses it did so as agent for the members and was accountable to them for the net proceeds from their marketing or the sale of the processed products. The initial payments to the members were really advances to them on account of the total to which they were severally entitled. Thus, the surplus of the appellant's receipts over its expenditures did not belong to the appellant as its profits or gains but belonged to the members in their own individual rights and was held by it on their behalf and for them.

That being so, the appellant had no independent right to the amounts in dispute. Consequently, they did not constitute profits or gain to it and were not subject to tax in its hands.

While this finding disposes of the matter there are some further observations to make.

This case is distinguishable from *Commissioners of Inland Revenue v. Sparkford Vale Co-operative Society Limited* (1), for there the company bought milk from its own members and sold it to the public on its own account thereby making a profit for itself. And it is also distinguishable from *Fraser Valley Milk Producers' Association v. Minister of National Revenue* (2) on the facts of that case for there the members received dividends on their shares in their capacity as shareholders and these could come only out of the association's profits.

(1) (1925) 12 T.C. 891. (2) [1929] S.C.R. 435.

The conclusion that the members established the appellant as the means or machinery for accomplishing their purpose of disposing of their surplus horses is not affected by the fact that it is a corporation: *vide New York Life Insurance Company v. Styles* (1).

Nor is it material that the appellant processed the members' horses and sold the processed products. The object was to dispose of the horses as advantageously for the members as possible and it did not matter what means the appellant took to accomplish the desired purpose. Whatever it did with the horses it did for and on behalf of the members as its agent.

Nor is the correctness of the conclusion in this case affected by the fact that the appellant did some business with non-members: *vide Municipal Mutual Insurance Limited v. Hills* (2). It dealt with them in a very different manner from that in which it dealt with its members and the fact that it made taxable profits as a result of its business with non-members did not make it taxable for amounts which it received for and on behalf of its members and for which it was accountable to them as stated.

There is an alternative ground for finding that the assessment was erroneous. In a sense, it is immaterial whether the transactions between the members and the appellant were sales and purchases of the horses delivered by them or not. If they were to be regarded as sales and purchases then the purchase price would certainly not be at the rate of the "price per lb" stated in the "Purchase Voucher". That would only be an advance on the purchase price, it being understood that the balance would be a proportionate part, according to the live weight and grade of the horses delivered, of the surplus of the appellant's receipts over its expenditures during the year in which the horses were delivered. In that view, the amounts in dispute would be part of the cost of the horses to the appellant and there would be no remaining surplus to constitute profit or gain to it.

In any event, the item of $102,917.84 for equalization allotment would not be properly assessable against the appellant even if it were held that it was in business on its

(1) (1889) 14 A.C. 381 at 407. (2) (1931) 16 T.C. 430.

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own account for this was merely for the equalization of the prices per pound payable to the members on the delivery of their horses.

For the reasons given, I have no hesitation in finding that the amounts in dispute were erroneously included in the assessment appealed against and that the appeal herein should be allowed with costs and the assessment set aside.

Judgment accordingly.