

BETWEEN:

EARL B. FINNINGAPPELLANT;

1960
 Apr. 28
 Aug. 16

AND

THE MINISTER OF NATIONAL }
 REVENUE } RESPONDENT.

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 67(1)(3) and 68(1)(a)(c)—Personal corporation—“Does not carry on an active financial, commercial or industrial business”—“Active” the converse of “passive”—Appeal dismissed.

Appellant and his two daughters were, during the taxation years under review, the sole shareholders of Finning Securities Limited. This corporation and one other corporation were set up for the sole purpose of negotiating with the banks all commercial paper, mainly customers' notes received by a mother firm known as Finning Tractor and Equipment Company Limited. These notes usually bore interest at 8½ per centum and were sold to Finning Securities Limited which in turn pledged them to the bank for loans at 6 per cent, profiting by the spread in interest rates. During the taxation years, 1954, 1955 and 1956 Finning Securities Limited handled for the account of Finning Tractor and Equipment Company Limited 863 contracts of this nature with a gross value of over \$5,000,000, making a net profit of over \$50,000 and only 4 contracts for outsiders for a profit of less than \$6,000. Respondent taxed the shareholders of Finning Securities Limited on the basis of it being a personal corporation. Appellant appealed from that decision to this Court.

Held: That Finning Securities Limited was a personal corporation as defined by s. 68 of the *Income Tax Act*, R.S.C. 1952, c. 148.

2. That Finning Securities Limited “did not carry on an active financial, commercial or industrial business” as provided by s. 68(1) of the *Income Tax Act*; it did not advertise its business to the public, it had no telephone listing, it had no office or staff of its own, all its bookkeeping and other activities were carried on for it by Finning Tractor and Equipment Company Limited and by the staff of that company; it acquired only the trade and paper of that company which it discounted immediately at the banks pocketing the profits.
3. That the word “active” is the converse of “passive” which is defined as “suffering action from without . . . acted upon by external force, produced by external energy” and Finning Securities Limited was without any *active* financial, commercial or industrial business and was a personal corporation.

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Vancouver.

William Murphy, Q.C. and *R. J. Harvey* for appellant.

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Miss Mary Southin and T. E. Jackson for respondent.

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

DUMOULIN J. now (August 16, 1961) delivered the following judgment:

This is an appeal from a decision of the Minister of National Revenue, rendered May 25, 1959, rejecting appellant's objection to his re-assessments for income tax in the 1954, 1955 and 1956 taxation years. The appellant, Earl B. Finning was not heard in evidence at trial but had testified on discovery.

In determining Mr. Finning's net taxable income for 1954, the Department of National Revenue added to his income a sum of \$25,747.37 entailing an increase of \$25,225.47 to the tax already owing. In 1955 and 1956 additions of \$26,474.01 and \$21,081.97, respectively, were made, with corresponding raises in the taxes payable of \$30,090.10 and \$26,467.15.

The reason invoked for such drastic revisions appears in para. 8 of the Reply to Notice of Appeal, where one reads that . . . "Respondent included in computing income the respective amounts of \$25,747.37, \$26,474.01 and \$21,081.97 *upon the assumption these amounts were properly deemed as having been distributed to the appellant in those years by a personal corporation called Finning Securities Limited*". (Italics throughout these notes are mine).

The appellant, taking objection to this interpretation, counters that: . . . "in each of the taxation years of the said Finning Securities Ltd., in which income was deemed to be distributed by that Company to the Appellant, *the said Finning Securities Ltd. was not a personal corporation as it carried on in each of such years an active financial business*".

Before passing on to the pertinent law, some explanatory information might be of use.

To start with Finning Securities Limited, during those material years, had, according to my notes, only three shareholders, namely, Earl B. Finning himself and his two daughters, Mrs. Mary Margaret Young and Mrs. Joanne E. Parker.

Two other corporate organisations: Finning Tractor and Equipment Company Ltd., and Tractors Holdings Limited, were, the former, distributors of heavy equipment, earth moving machinery, tractors, etc., the latter, and Finning Securities Ltd., nothing more than financing companies,—or should I say agencies,—set up for the sole purpose of negotiating with the banks all commercial paper, mainly customers' notes, received by the mother firm, Finning Tractor and Equipment Company. Such notes, bearing interest, usually at $8\frac{1}{2}$ per centum, were "sold" by Finning Tractor and Equipment to its handmaid dummy (as it will develop), which, pledging these collaterals with the bank, obtained financing loans at 6 per cent, thereby deriving neat profits through this spread of interest rates.

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Exhibit "6", labelled "Details of all contracts Financed—1954 to 1956 Inc.", reveals that over the aforesaid period Finning Securities Limited did handle, but merely for the account of Finning Tractor and Equipment Company, 863 contracts for a global value of \$5,740,219 at an over-all net profit, taxes deducted, of \$53,777.71.

Apart from this imposing bulk of 863 transactions with the one firm, exhibit "7" lists so few as 4 contracts negotiated with "outsiders" during the same period, to a total of \$20,908.92, practically of negligible proportion when compared to the preceding sum of \$5,740,219.

Such is the outline of this case which squarely raises the issue of what, in the eyes of the law, constitutes a "personal corporation", and, accessorially, the rational meaning attaching to financial business "actively carried on".

As often occurs in statutory texts, the effect or consequence precedes the cause, a probable explanation why s. 67, governing the distribution of a personal corporation's income, comes before s. 68 defining personal corporations.

Section 67, s-ss. (1) and (3) decrees that:

67(1) The income of a personal corporation whether actually distributed or not shall be deemed to have been distributed to, and received by, the shareholders as a dividend on the last day of each taxation year of the corporation.

(3) The part of the income of a personal corporation that shall be deemed under this section, to have been distributed to and received by a shareholder of the corporation, shall be the proportion thereof that the value of all property transferred or loaned to the corporation by

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the shareholder or any person by whom his share was previously owned is of the value of the property so acquired by the corporation from all its shareholders.

At the risk of being repetitious, I would next insert para. 10 of the Reply to Notice of Appeal, since it expounds the Respondent's basic argument.

10. Respondent says that by virtue of subsections (1) and (3) of section 67 of the Income Tax Act the Respondent deemed the amounts concerned to have been distributed by Finning Securities Limited because in the years concerned that company was a personal corporation as defined by section 68 of the said Act.

The afore-mentioned enactment points to the following traits as specifying, in law a "personal corporation":

68(1) In this Act, a "personal corporation" means a corporation that, during the whole of the taxation year in respect of which the expression is being applied,

- (a) was controlled, whether through holding a majority of the shares of the corporation or in any other manner whatsoever, by an individual resident in Canada, *by such an individual and one or more members of his family who were resident in Canada or by any other person on his or their behalf;*
- (c) did not carry on an *active financial, commercial or industrial business.*

This latter requirement, i.e., carrying on in a truly active manner the corporation's alleged line of business constituted the main if not the whole ground of discussion. In other words did those 863 customers' notes taken up, in the material three years, and negotiated by Finning Securities Limited for a single client, Finning Tractor and Equipment Company, qualify with the statutory norms of "active financial business?" The conditions inherent to Finning Securities' trading activities must necessarily shed some revealing light.

On this score, Mr. William Murphy, Q.C., appellant's counsel, contributed a guarded but very useful commentary that I quote as reported at pages 2 and 3 of the official transcript:

Page 2:

We admit, at once, my lord, that Finning Securities Limited met every qualification of a personal corporation set out in Section 68(1) with one single exception, and that is we say it did carry on an active financial business in the three years in question 1954, '55 and '56. The Crown says it did not. And that is the simple point at issue

Page 3:

The evidence we are going to admit is that during these three years Finning Securities Limited did no advertising. It did not have a telephone listing. It had no employee or office of its own. It had an arrangement with an associate company, Finning Tractor and Equipment Company Limited, whereby Finning Tractor and Equipment Company Limited did the necessary clerical help, the necessary managerial assistance, also the use of its offices and so on; and for those services Finning Securities Limited paid in the year 1954 the sum of \$1,000, in 1955 the sum of \$1,000 and in 1956 the sum of \$2,000

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Could one wish for a better description of “inactivity”? Whenever a person, or a body politic as in this instance, retains the remunerated services of someone else to be totally relieved from its normal duties or functions, surely, then, the former party relinquishes its “activity” to the latter.

In a matter of simple common sense were a “man on the street” asked if he considered as active a firm that did not advertise, had no telephone listing, no employee nor any office of its own, but paid another company to conduct its customary tasks, I doubt greatly whether that man would require a dictionary’s assistance to reply promptly in the negative. The most that can be said of the instant set of facts is that Finning Tractor and Equipment Company “actively carried on” the financial affairs of a mere “prête-nom”, Finning Securities Limited.

Here again, the appellant’s counsel, most fairly submitted the issue to the Court in these terms (vide page 15, transcript):

Page 15:

(Mr. Murphy, Q.C.) I do not, my lord, endeavour to suggest to you that these four contracts (referring to exhibit 7) in three years make any difference to whether this company was active or inactive. In other words, if this company, Finning Securities, is not an active financial business on the basis of the business it did with one company, Finning Tractor and Equipment Company Limited, I could not ask your lordship to hold that it was on the basis of these four outside contracts.

Adverting, now, to the only oral evidence heard in Court, that of Mr. Hugh Edwin Hender, internal auditor in the employ of Finning Tractor and Equipment, who also supervised entries and accounting for Finning Securities, it was not of such a nature as to modify the opinion I had otherwise formed of the problem.

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A few excerpts from this witness' testimony, when cross-examined by one of the respondent's counsel, Miss Mary Southin, do not denote on the part of Finning Securities Ltd., commercial activity nor even a slight degree of correlative initiative and responsibility. I quote some revealing replies appearing on pages 20, 21 and 22 of the proceedings at trial:

Page 20 (Miss Southin)

Q. Now, who determines, and determined in the relevant years, which notes of Finning Tractor were sold to Finning Securities?

A. Well, it was not a question of saying this series of notes or; that series of notes will go either way. The notes were handled by the clerk on the note desk (e.g. an employee of Finning Tractor and Equipment Co.) who was instructed basically to divide them approximately evenly between the two companies (the second one being Tractor Holdings Company).

Q. And this clerk on the note desk was some employee of Finning Tractor and Equipment Limited?

A. Yes.

Q. To the best of your knowledge in these years did Finning Securities Limited ever reject any of the notes that were offered to it by Finning Tractor and Equipment Limited?

A. No, I would not know, but I would doubt it.

By the Court. Q. Were any arrangements or any talks, I should say, had, before Finning Equipment would accept a contract? Would any parley ensue with Finning Securities to see whether Finning Securities approved?

A. No, sir.

Page 21 (Miss Southin)

Q. Well, now, is it correct to say that in these years, Mr. Hender, Finning Securities Limited took no risk except the possible risk that Finning Tractor and Equipment would go broke?

A. I would agree with that.

Q. And is it true to say that on these contracts that Finning Securities gets from Finning Tractor and Equipment Limited the customer is never advised that his paper has been purchased by Finning Securities Limited?

A. I would not want to say that, yes or no to that.

Q. You don't know?

A. He might know, but I would say it was not his concern.

Q. Let me put it this way then: In these years were notices of assignments sent to customers as part of the regular business procedure of the Company, Finning Securities Limited?

A. I would think not.

Q. To whom does the customer pay the instalments? To Finning Securities or Finning Equipment?

A. To Finning Equipment rather than Finning Securities. Finning Equipment handle the notes and they are sold over to the other company (e.g. Finning Securities Ltd.).

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Q. In these years, Mr. Hender, is it true to say that all the decisions that were made as to the purchase of notes by Finning Securities Limited were made not by the shareholders of Finning Securities Limited, but by the employees of Finning Tractor and Equipment Limited in the Finning office?

A. I would say yes.

Q. Finning Securities Limited has no employees of its own?

A. None.

Q. And did not have in the years in question?

A. No.

Dumoulin J.

Once more the same truism obtrudes itself upon one's mind. By what stretch of the imagination could a company without a staff, having no "place of business", whose so-called decisions are perforce the acts of others, be deemed, notwithstanding, to carry on "an active financial, commercial or industrial business?" To put this question is tantamount to answering it, and the situation herein outlined fits to a nicety the definition of the word "passive" in the Shorter Oxford Dictionary 3rd Ed. p. 1444, verbo: passive.

Passive: "*suffering action from without; that is the object, as distinguished from the subject of action; acted upon by external force, produced by external agency.*"

An apt summary of the facts admitted or duly proved was provided by Miss Southin, in these words: (Transcript, p. 37).

This company (Finning Securities Limited) does nothing with its own mind at all. It is, if I may use the phrase, a puppet on the string of Finning Tractor and Equipment Limited and it does in its business what Finning Tractor and Equipment Limited chooses to have it do. Finning Tractor and Equipment Limited supplies it with its business.

In this analysis I thoroughly concur. Pursuant to exhibit "6", labelled: "Finning Securities Ltd., Details of Contracts Financed—1954 to 1956 Inc.", and to exhibit "7", "Details of other Contracts Financed, 1954-1956", I might add as a concluding note, that this company proved itself to be totally "passive" in 863 cases, and relatively "active" in four only. Assuredly, the situation just revealed is of the class which the legislator envisaged when he wrote into the law subsection (c) of section 68(1):

(c) did not carry on an active financial, commercial or industrial business.

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Lastly, other factors mentioned at the beginning of these notes enhance my conviction that Finning Securities was nothing but a "personal corporation" as defined in s. 68 of the *Income Tax Act* (R.S.C. 1952, ch. 148) with all legal implications attaching to the appellant, Earl B. Finning.

Therefore, the Court doth decide and adjudge that Appellant's re-assessment for taxation years 1954, 1955 and 1956, in the sums stated at paragraphs 1, 3 and 5 of the Notice of Appeal, and for the motives set out in paragraphs 2, 4 and 6, are in conformity with the relevant law. The appeal is dismissed; and the Respondent entitled to recover all taxable costs.

Judgment accordingly.