Moncton 1966
June 8, 9
Ottawa July 19

BETWEEN:

M. F. ESSON & SONS LTD. ..... APPELLANT;

AND

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

Income tax—Associated companies—Income Tax Act, s. 35(4)—Control—What constitutes—Overlapping fiscal periods—When control must exist—Casting vote given company president by statute—Whether relevant to control.

Appellant company was assessed to tax for 1963 and 1964 as a company associated with Esson Motors Ltd within the meaning of s. 39 of the *Income Tax Act*. Appellant company's fiscal period comprised the year ending on March 31st in each year whilst the fiscal period of Esson Motors Ltd was the calendar year. All of appellant company's shares were owned by three men who also owned all the shares of Esson Motors Ltd prior to May 9th 1962, on which day they transferred half of their shares to another man pursuant to a *bona fide* contract under which he was to take over the company's management and to have an option to acquire the remaining shares. One of the group of three shareholders was president of Esson Motors Ltd, whose by-laws provided that the president should be chairman at shareholders' meetings. The relevant *Companies Act* provided that the chairman at shareholders' meetings had a casting vote.

Held, the two companies were not associated companies within the definition of s. 39.

1. It was irrelevant that prior to May 9th 1962 all the shares of both companies were owned by the same three men for though the period April 1st to May 9th 1962 fell within appellant company's 1963 taxation year it preceded the other company's 1963 taxation year and the two companies were therefore not controlled by the same group at "any time in the year" within the meaning of s. 39(4).

2. The ownership by the group of three shareholders of half the shares of Esson Motors Ltd coupled with the right of one of them to a casting vote at shareholders' meetings did not constitute control of the company.

Alpine Drywall & Decorating Ltd. v. M.N.R. [1966] Ex. C.R. 1148 followed. *Pender Enterprises Ltd. v. M.N.R.* [1965] C.T.C. 343 at 357, referred to. *Buckerfield's Ltd. v. M.N.R.* [1965] 1 Ex. C.R. 299; *British American Tobacco Co. Ltd. v. I.R.C.* [1943] 1 All E.R. 13; *B. W. Noble Ltd. v. C.I.R.* (1926) 12 T.C. 923; and *C.I.R. v. Monnick Ltd.* (1949) 29 T.C. 379, discussed.

APPEAL from income tax assessments.

George B. Cooper for appellant.

L. R. Olsson for respondent.

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THURLOW J.:—The issue in this appeal, which is from re-assessments of income tax for the years 1963 and 1964, is whether the appellant and Esson Motors Limited were, in the taxation years in question, "associated with each other" for the purpose of section 39 of the *Income Tax Act*.[1] The issue turns on whether at relevant times both corporations were controlled by the same group of persons.[2]

For each of the years in question the appellant's fiscal period ended on March 31, and for it these taxation years accordingly ran from April 1, 1962 to March 31, 1963 and from April 1, 1963 to March 31, 1964. Throughout both periods the whole of the issued share capital of the appellant was owned and registered in the names of Miller F. Esson, Sr., Miller H. Esson, Jr. and John F. Esson, the three of whom admittedly constituted a related group which controlled the company.

From April 1, 1962 to May 9, 1962, that is to say, during part of the 1963 fiscal period of the appellant the same three persons were the registered owners of all the issued shares of Esson Motors Limited. On the latter date, pursuant to a contract dated May 7, 1962 and made between the members of the group and Esson Motors Limited, of the one part, and Edward Earle McKenna, Jr., of the other part, the members of the group transferred to McKenna, who was not related to any of them, 50 per cent of the issued shares of Esson Motors Limited to hold as his own. By the terms of the contract they also gave McKenna an irrevocable option to purchase the remaining issued shares of the company during a period of one year commencing on May 29, 1965 at a price to be determined according to a formula set out in the contract. It was also provided that if McKenna should fail to exercise the option the shares transferred to him should revert to and again become the property of the members of the group.

The object of these arrangements was to induce McKenna to undertake the management of the company. The company had been losing money and by May 1962 was

[1] R S C. 1952, c. 148 as amended by S. of C. 1960, c. 43.

[2] Section 39(4). For the purpose of this section, one corporation is associated with another in a taxation year if, at any time in the year,

(*b*) both of the corporations were controlled by the same person or group of persons.

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in poor financial condition. Its property was heavily mortgaged and in addition Miller F. Esson, Sr. had given personal guarantees of its indebtedness to the extent of about $100,000. The contract provided that the company should immediately delegate to McKenna complete and exclusive authority to conduct the affairs of the company (with certain minor exceptions in which the concurrence of McKenna and the Essons was required) during the three year term of the contract. The Essons as shareholders, directors and officers of the company also waived their rights to allowances to be paid by the company by way of salary, bonuses, dividends, directors' fees or otherwise during the term and they further undertook not to cause the issue of any new shares. That the contract was a *bona fide* transaction and that it was carried out in accordance with its terms are not challenged.

Esson Motors Limited had been incorporated in 1953 by letters patent issued under the *Companies Act*[1] of the Province of New Brunswick and its 1963 and 1964 fiscal periods ran in each year from January 1 to December 31. Section 102 of the *Companies Act* provided that:

> In the absence of other provisions in that behalf in the letters patent or by-laws of the company,
>
> (*c*) all questions proposed for the consideration of the shareholders at such meetings shall be determined by the majority of votes, and the chairman presiding at such meetings shall have the casting vote in case of an equality of votes.

The letters patent and by-laws of the company contained no "other provisions in that behalf" but the by-laws did provide that

> The President shall preside at meetings of the board He shall act as Chairman of the Shareholders' meetings if present.

From the time of the making of the contract with McKenna to the end of the period material to these proceedings the three Essons continued to be the directors of the company, the remaining 50 per cent of the issued shares continued to be registered in their names and Miller F. Esson, Sr. continued to be the president of the company, an office to which he had been elected in 1953. It thus appears that Miller F. Esson, Sr., if present, was entitled to act as chairman of any meetings of the shareholders that might be held and that under section 102(*c*) of the Act he was

[1] R.S.N.B. 1952, c. 33.

entitled to exercise a casting vote in case of a tie though he was never at any material time aware that he had a casting vote and he never had occasion to cast one.

As the re-assessments are based solely on section 39(4)(*b*) of the Act the question to be resolved is whether the three Essons, who at all material times controlled the appellant, also controlled Esson Motors Limited at material times. The Minister's case for upholding the re-assessments is that prior to May 9, 1962 Esson Motors Limited was controlled by the three Essons by reason of their holding 100 per cent of the issued shares of the company and that after that time the company was controlled by them by reason of their holding 50 per cent of the issued shares coupled with the power of Miller F. Esson, Sr., as chairman of shareholders' meetings to exercise a casting vote in the case of a tie and that by reason of such control by the Essons of Esson Motors Limited and their admitted control of the appellant the two companies were associated with each other for the purpose of section 39 in both of the taxation years in question. In support of his position counsel for the Minister raised and argued three submissions.

It was said first that the appellant and Esson Motors Limited were associated for the 1963 taxation year by reason of the admitted control of both companies by the Essons during the period from April 1, 1962 to May 9, 1962. Since under section 39(4) of the *Income Tax Act*[1] corporations are "associated with each other" if the appropriate control exists "at any time in the year" this submission is unanswerable if the period from April 1, 1962 to May 9, 1962 was a material time with respect to the 1963 taxation year. Plainly the period was part of the appellant's 1963 fiscal period but it was not part of the 1963 fiscal period of Esson Motors Limited.

What then is the material period? Counsel for the Minister urged that the word "year" in the expression "if at any time in the year" in section 39(4) refers to the expression "taxation year" appearing earlier in the subsection, that the latter expression can refer only to the taxation year of the particular corporation whose taxation is being considered and that it is immaterial whether the period of association is also within the fiscal period of the other

[1] R.S.C. 1952, c. 148 as amended by S. of C. 1960, c. 43, s. 11(1).

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company for the same taxation year. While the manner in which section 39(4) is worded lends some colour to the submission, particularly when the subsection is read by itself, in my opinion the submission cannot prevail. In section 39(2) and section 39(3) two or more corporations are referred to and the taxation years of all of them are referred to by the expression "in a taxation year". Two or more corporations as well are involved in the allocations of $35,000 between them contemplated by section 39(3) and section 39(3*a*) for the purpose of fixing the taxation of their incomes for the same taxation year. Two corporations also, not merely one, are referred to by the expression "one corporation is associated with another" in section 39(4) and the taxation of both for the same taxation year is affected thereby. When therefore section 39(4) refers to "any time in the [taxation] year" it is, I think, to be interpreted as referring to any time that is in the taxation year of both corporations and where their fiscal periods do not coincide the subsection can, in my opinion, refer only to a time that is in such portion of the fiscal periods of the two corporations for the taxation year as is common to both.

In my opinion therefore since the period from April 1, 1962 to May 9, 1962 was not within the fiscal period of Esson Motors Limited for the 1963 taxation year the control of both that corporation and the appellant by the Essons during that period is immaterial. The Minister's submission accordingly fails.

The second submission was that the fact that section 139(5*d*)(*b*) might, because of section 39(4*a*)(*c*), be applicable to McKenna so as to cause it to be deemed that he had the same position in relation to the control of Esson Motors Limited as if he owned the shares which he had an option to purchase in the future, could not affect the application of section 39(4) when considering whether the Essons "controlled" Esson Motors Limited for the purpose of section 39. This submission was raised in answer to the main submission of the appellant that the effect of section 39(4*a*)(*c*) coupled with section 139(5*d*)(*b*) was that McKenna must be deemed to have been in control of Esson Motors Limited at all material times from which it followed that the Essons could not be regarded as having

"controlled" the company for the purpose of section 39. I am not persuaded that the appellant's position on this point is sound but in view of the conclusion which I have reached on the first and third submissions, which are sufficient to dispose of the appeal, it is not necessary to decide the point.

The third submission was that the Essons continued to control Esson Motors Limited at all material times after May 9, 1962 by reason of their ownership of 50 per cent of the issued shares and the right of Miller F. Esson, Sr., if present, to preside as chairman of shareholders' meetings which, having regard to section 102(*c*) of the *Companies Act* and to the letters patent and by-laws of the company, conferred on him power to exercise a casting vote in case of a tie.

A similar contention was put forward in this Court in *Pender Enterprises Limited v. M.N.R.*[1] where Noël J., after referring to the judgment of the President of this Court in *Buckerfield's Limited v. M.N.R.*[2] dealt with the point as follows:

> Now although this interpretation was given in connection with Section 39 of the *Income Tax Act*, I can see no reason why it should not apply as well to Section 139(5*a*) of the Act in which case Lee could not have control of the appellant corporation as he held only 50% of its shares and, therefore, could not be said to have a number of shares such that he carries with it the right to a majority of the votes in the election of the board of directors or that his shareholding in the company was such that "he was more powerful than all the other shareholders in the company put together in general meeting" as set down by Cameron J. in *Vancouver Towing Company Limited v. M.N.R.*, [1946] Ex. C.R. 623 at 632; [1947] C.T.C. 18. It indeed appears to be clearly settled that control of a corporation requires at least a bare majority in shareholding and as Lee here has not this majority, he cannot be considered as controlling the appellant and I say this notwithstanding the articles of association adopted by the appellant which gives its president a preponderent vote in the case of an equality of votes at every general meeting of the company. Indeed, such a power given to the president of the present corporation, in view of the particular circumstances of the instant case, could not, in my view, give Lee effective control over the appellant corporation which he would not otherwise have by virtue of his shareholdings because any control he would wish to exercise by virtue of his preponderent vote could not, in practice, be implemented. There being two shareholders only, Lee could not hold a general meeting of the appellant corporation without Wong's consent and as one director cannot constitute a meeting, he could not use his preponderant vote.

[1] [1965] C.T.C. 343 at page 357. [2] [1965] 1 Ex. C.R. 299

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The contention was again raised in the *Aaron cases*[1] where though it was unnecessary to decide the point I expressed a doubt as to its validity.

More recently in *Alpine Drywall & Decorating Ltd. v. M.N.R.*[2] (Cattanach, J., while expressing doubt that there was any basic distinction between the case before him and that of *B. W. Noble Ltd. v. C.I.R.*[3], held the contention invalid on the basis of the earlier expressions of opinion in this Court, including that of the President in the *Buckerfields'* case as to the meaning of "controlled" in section 39(4) of the Act. In view of the decision of Cattanach J., and in the absence of any expression of opinion to the contrary by the Supreme Court I think that in this Court the matter should be taken as decided but it may be useful nevertheless to make some further comment on the point.

The meaning of "controlled" in section 39(4) of the *Income Tax Act* was considered in *Buckerfield's Limited v. M.N.R.*[4] where the President of this Court said at page 302:

> Many approaches might conceivably be adopted in applying the word "control" in a statute such as the *Income Tax Act* to a corporation. It might, for example, refer to control by "management", where management and the Board of Directors are separate, or it might refer to control by the Board of Directors. The kind of control exercised by management officials or the Board of Directors is, however, clearly not intended by section 39 when it contemplates control of one corporation by another as well as control of a corporation by individuals (see subsection (6) of section 39) The word "control" might conceivably refer to *de facto* control by one or more shareholders whether or not they hold a majority of shares. I am of the view, however, that, in section 39 of the *Income Tax Act*, the word "controlled" contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the Board of Directors. See *British American Tobacco Co. v. I.R.C.* [1943] 1 A E R. 13 where Viscount Simon L C., at page 15, says:
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> > The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes.
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> See also *Minister of National Revenue v. Wrights' Canadian Ropes Ltd.* [1947] A.C. 109 per Lord Greene M.R. at page 118, where it was held that the mere fact that one corporation had less than 50 per cent of the shares of another was "conclusive" that the one corporation was not "controlled" by the other within section 6 of the *Income War Tax Act*.
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> Where, in the application of section 39(4) a single person does not own sufficient shares to have control in the sense to which I have just referred, it becomes a question of fact as to whether any "group of persons" does own such a number of shares.

[1] [1966] C.T.C. 330.
[2] [1966] Ex. C.R. 1148.
[3] (1926) 12 T.C. 923.
[4] [1965] 1 Ex. C.R. 299.

The definition of control as that arising from shareholding is supported by the opinion of the House of Lords in *British American Tobacco Co. Ltd. v. I.R.C.*[1], a decision which has on several occasions been referred to and applied in decisions of this Court[2] both in cases arising under the *Income War Tax Act* and in cases arising under the *Income Tax Act*. In the *British American Tobacco* case Lord *Simon*, L.C. in considering the meaning of "controlling interest" said at page 15:

> It is true that in such circumstances company No. 1 owns none of the assets of company No 2, and *a fortiori* owns none of the assets of company No. 3, and that in that sense neither owns, nor has an interest in, company No 3 But that is to treat the phrase "controlling interest" as capable of connoting only a proprietary right, that is, an interest in the nature of ownership The word "interest", however, as pointed out by *Lawrence* J, is a word of wide connotation, and I think the conception of "controlling interest" may well cover the relationship of one company towards another, the requisite majority of whose shares are, as regards their voting power, subject, whether directly or indirectly to the will and ordering of the first-mentioned company. If, for example, the appellant company owns one-third of the shares in company X, and the remaining two-thirds are owned by company Y, the appellant company will none the less have a controlling interest in company X if it owns enough shares in company Y to control the latter.
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> In my opinion this is the meaning of the word "interest" in the enactment under consideration, and, where one company stands in such a relationship to another, the former can properly be said to have a controlling interest in the latter. This view appears to me to agree with the object of the enactment as it appears on the face of the Act. I find it impossible to adopt the view that a person who, by having the requisite voting power in a company subject to his will and ordering, can make the ultimate decision as to where and how the business of the company shall be carried on, and who thus has, in fact, control of the company's affairs, is a person of whom it can be said that he has not in this connection got a controlling interest in the company.
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> As to what may be the requisite proportion of voting power, I think a bare majority is sufficient. The appellant company has, in respect of each of the foreign companies referred to in the case, the control of the majority vote. I agree with the interpretation of "controlling interest" adopted by *Rowlatt* J, in *Noble v. Commissioners of Inland Revenue* when construing that phrase in the Finance Act, 1920, s. 53(2)(*c*). He said at p. 926, that the phrase had a well-known meaning and referred to the situation of a man
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> . . . whose shareholding in the company is such that he is more powerful than all the other shareholders put together in general meeting.
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> The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes.

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[1] [1943] 1 All E.R. 13.

[2] *Vancouver Towing Company Limited v. M.N.R.* [1946] Ex. C.R. 623. *Sheldon's Engineering Limited v. M.N.R.* [1954] Ex C.R. 507. *Vineland Quarries and Crushed Stone Ltd. v. M.N.R.* [1966] C.T.C. 69.

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The definition of "controlling interest" as referring to the man whose shareholding is such that he is more powerful than all the other shareholders put together in general meeting seems to me to coincide precisely with the definition of "controlled" formulated by the President of this Court in the *Buckerfield's* case and to be inapt to describe the position of the Essons as a group with respect to Esson Motors Limited during the material period. Their *shareholding* plainly was not such that they were more powerful than McKenna in general meetings. Moreover, Viscount Simon's expression "the *owners* of the majority of the voting power" also seems inappropriate to characterize the casting vote of a chairman since it is not a subject of ownership at all but is, as I view it, a mere adjunct of the office exercisable, not as his personal interest alone may dictate, but *bona fide* in the interest of the company as a whole. Its nature is also such that it is exercisable by whoever happens to occupy the chair at a meeting when the occasion to exercise such a vote arises and it is then exercisable only by the person himself and not by anyone on his behalf. I do not think it was intended by Parliament to make the taxation of corporations vary according to exigencies of that nature and reading the provisions of section 39 and giving the word "controlled" in section 39(4) what appears to me to be its ordinary meaning I do not think that anything but a sufficient number of votes arising from shareholding to dictate decisions to be taken by the company can be regarded as within the generally understood meaning of control in the sense in which the word "controlled" is used in the statute. Moreover, even if the matter were regarded as doubtful in the sense that the word used in the statute was such that it might or might not have been intended to cover a case of this kind the situation would seem to me to be one for the application of the principle that clear words are required to authorize taxation and that any doubt as to the meaning of the expression used should be resolved in favor of the taxpayer.

The principal case relied on by the Minister in support of his position was that of *B. W. Noble Limited v. C.I.R.*[1], a

[1] (1926) 12 T.C. 923.

decision of Rowlatt J., rendered in 1926 on the meaning of "controlling interest" in section 53 of the *Finance Act*, 1920. In that case the appellant company had been formed to acquire and operate an insurance business carried on by Noble. Half of the company's voting shares were held by Noble and the remainder by two others but, under a contract made at the time when the company was organized and to which all three shareholders and the company itself were parties, Noble was entitled as against the other shareholders and the company itself to be chairman of shareholders' meetings and thus under the articles of the company to a casting vote in case of a tie. Rowlatt J., said:[1]

> It seems to me that "controlling interest" is a phrase that has a certain well known meaning; it means the man whose shareholding in the Company is such that he is the shareholder who is more powerful than all the other shareholders put together in General Meeting. That is really what it comes to. Now, this gentleman has just half the number of shares, but those shares, in the circumstances of this case, are reinforced by the position that he occupies of Chairman, a position which he occupies not merely by the votes of the other shareholders or of his Directors elected by the shareholders but by contract; and, so reinforced, inasmuch as he has a casting vote, he does control the General Meetings—there is no question about that—and inasmuch as he does possess at least half of the shares he can prevent any modifications taking place in the constitution of the Company which would undermine his position as Chairman.
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> Therefore, on the whole, giving what I think is the most obvious meaning to these words in the Sub-section and having regard to the object of the Section, I think the contention of the Crown is right,...

It will be observed that Rowlatt J., did not hold that as a general proposition half the shares of a company plus the right to be chairman and to exercise a casting vote in case of a tie, would give a "controlling interest" in the company. What he appears to me to have said is that half the shares plus the right arising *by contract* with both the company itself and the other shareholders to be chairman and thus to exercise a casting vote in case of a tie *in the circumstances* enabled Noble to control general meetings of the company, that in the circumstances he was, because of his shareholding, in a position to prevent constitutional changes that might undermine his position and that *on the whole* and *having regard to the object of the section* under consideration he was of the opinion that Noble had a "controlling interest" in the company.

[1] (1926) 12 T.C. at 926.

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The statement of Rowlatt J., with respect to the meaning of "controlling interest" was approved by the House of Lords in the *British American Tobacco* case[1] already referred to but so far as I am aware his application of it to the facts of the particular case has not been discussed in any higher Court. It does seem to me that after stating the meaning of "controlling interest" by reference to shareholding Rowlatt J., proceeded to his conclusion by taking into account additional facts chief among which was that of the contract between Noble and the company and the other shareholders under which Noble was entitled to be chairman of the company and thus to exercise a casting vote. As I view the matter it is not necessary to decide in the present case whether it is permissible in cases arising under section 39 of the *Income Tax Act* to take into account the casting vote of a chairman where the chairman is entitled by contract to exercise such a vote because here there was no contract giving Miller F. Esson, Sr., any such right. However, if the implication of the decision on its particular facts of the *Noble* case is that a casting vote is to be taken into account and I am thus faced with a choice between the decision in the *Noble* case and the principles to which I have referred including those which have been established by this Court and by the House of Lords since the decision in the *Noble* case I think the principles so established should be followed rather than the implication from a decision on its own particular facts.[2]

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[1] See also the judgment of Viscount Simonds in *Barclays Bank Ltd. v. I.R.C.* [1960] 2 All E.R. 817 at 820.

[2] If, however, I am wrong in this view and additional facts with respect to the situation in the particular company may be taken into account in determining control, as was done in the *Noble* case, it would appear to me that the contract between McKenna and the Essons to which the company was itself also a party tended to restrict rather than to reinforce the rights of the Essons to dictate decisions to be made by the company. I would infer that at least one of the purposes of transferring 50% of the shares to McKenna was to ensure that his voice in the company's decisions would thereafter be as strong as that of the Essons and in view of both the authority conferred upon him and of the restrictions upon the powers of the Essons I do not think either that the voting rights of the Essons were exercisable to override the will of McKenna in order to dictate decisions to which he was opposed or that the casting vote in these circumstances could be regarded as a reinforcement of the Essons' shareholding so as to put them in control of the company as it was held to be of Noble's shareholding because of the contract in the *Noble* case.

Another case relied on was *C.I.R. v. Monnick Ltd.*[1] where in the course of holding on particular facts that the respondent company was not one the directors whereof had a controlling interest therein, though two persons who for the purpose of the statute under consideration were to be regarded as directors held half the shares, Croom-Johnson J., said at page 385:

> It is perfectly true that if this Company had a board of directors—and it has not—and if that board of directors had appointed a chairman, and if that chairman had happened to be Mr. Mark Monnickendam, the result would no doubt have been that he would have been in control. I do not shut my eyes to that as a possibility.

To my mind this was no more than a description for purposes of illustration of a possible situation which was not then before the Court and though the learned Judge at one point used the expression "no doubt" it is noticeable that he also referred to "a possibility". Accordingly, apart from the statement being *obiter*, I do not think that it should be regarded as expressing a concluded opinion on the point.

I am accordingly of the opinion that the proposition that the casting vote of the chairman in a situation such as the present confers control of the company is not sustainable as a general proposition in view of the principles which have been established for determining control in cases arising under section 39 of the *Income Tax Act* and that the shareholding of the Essons, upon which control for the purpose of section 39 depended, was not such as to afford them control of Esson Motors Limited at any time material to these proceedings. The Minister's submission therefore fails.

The appeal will be allowed with costs and the re-assessment will be referred back to the Minister for re-assessment on the basis that the appellant and Esson Motors Limited were not "associated" for the purpose of section 39 of the Act in either of the taxation years in question in the appeal.

[1] (1949) 29 T C. 379.