J. DAVID GAGNE........................APPELLANT; 1924 Oct. 25.

AND

THE MINISTER OF FINANCE..........RESPONDENT.

Revenue—Income Tax—Dividends—10-11 Geo. V, ch. 49, sec. 5—Accumulated profits.

A certain company was incorporated in 1911 with a capital stock of $43,500, in shares of $100 each and G. was its manager and also the owner of 11 shares of the capital stock from 1912 until 1920. In 1920 he bought the remaining shares, at prices ranging from $90 to $200 a share. From 1911 to 1920 the profits of the company were allowed to accumulate, and G., upon becoming the owner of all the shares, declared a dividend of 92 per cent, amounting to $40,020, paid out of such accumulated profits. It was contended that this was not income but a return of capital, etc., and not subject to taxation.

Held, that the dividend so declared in 1920 was "income" within the meaning of section 3 of subsection 5 of the Income War Tax Act, 1917, as re-enacted by section 3 of 10-11 Geo. V, c. 49, and was liable to surtax as provided in said Act; but inasmuch as the Crown only claimed taxes on that part of the profits earned during the taxation period, namely from 1916 to 1920, judgment was rendered accordingly.

APPEAL under the provisions of the Income War Tax Act, 1917.

October 9th, 1924.

Appeal heard before the Honourable Mr. Justice Audette at Quebec.

(1) [1864] 10 L.T. 44.

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Jules Poisson for appellant.

Louis A. Talbot, K.C. and *C. F. Elliott* for the respondent.

The facts are stated in the reasons for judgment.

AUDETTE J., now this 25th October, 1924, delivered judgment.

This is an appeal under the provisions of sections 15 *et seq.* of The Income War Tax Act, 1917, and amendments thereto, from the assessment of the appellant's income for the year ending 31st December, 1920, in respect of a dividend of 92 per cent declared and paid to him by the Canadian Rattan Chair Co., Ltd., out of accumulated and undistributed profits since 1911, under the following circumstances.

The Taxing Act was passed in 1917 and counsel for the respondent stated at Bar that while his contention is that the Crown is entitled to tax the income originating as far back as 1911 and distributed only in 1920, yet that the Crown is now only claiming the tax upon profits accumulated since 1916.

The Canadian Rattan Chair Co., Ltd., was incorporated in 1911 with a capital of $43,500 or 435 shares of the par value of $100 each, and the appellant has been its manager since 1912. Up to the year 1920 he held eleven shares of the stock of that company. On the 27th April, 1920, he bought 424 shares at figures running from $90 to $200 a share, or at an average price of $152.52, i.e. the remaining entire issued capital stock of the company, thereby becoming the owner of all the shares of the company, and on the same day the company declared a dividend of 92 per cent payable in the month of May following. This dividend amounted to $40,020. On the portion of the accumulated profits earned since the inception of the Act, namely $18,936.62, the tax was levied but the balance, namely $21,083.38, was not taxed.

This dividend is paid out of the accumulated profits as shewn and detailed in exhibit " D."

Now the appellant contends, as set out at p. 2 of his notice of dissatisfaction, that when he made the purchase of these shares, the taxable profits of the company were

apportioned to the former shareholders in the purchase price paid to them for their stock, and the dividend paid to him represented a return of his capital or a refund of the moneys he had so paid, to purchase with the capital, its inherent proportion of accumulated profits as the value of his investment was, by the payment of the dividend, reduced by the amount it represented and that in the interval of, say, less than 30 days, such investment could not have produced such revenue. It is further contended that this dividend is not revenue but a replacement of capital.

With this extraordinary contention I cannot agree finding myself unable to gauge the logic of such view.

The transaction in question is similar to thousands of such sales occurring daily. The shareholders sold their invested capital and it was bought as such. One buys a share or a number of shares of a company at a large premium, because, rightly or wrongly, he has faith in the company and expects large returns and dividends therefrom; but he gets no benefit from this purchase until the company has seen fit or been able to declare and pay a dividend or until he sells again on a rising market thereby realizing profits. The size of the premium or of the dividend has nothing to do with the merits of question of ownership. Moreover I am not unmindful that in the present case the appellant who was and had been for many years, the manager of the company, was very well aware what his purchase meant.

The dividend before being declared did not exist and it is quite a fallacy to contend that before he purchased the shares and before the company had declared their dividend the latter ever existed, or that in this transaction the vendors were realizing the profits that the company had apportioned to them, and that such profits formed part of the price of the stock. How could that be if the dividend did not exist at that time. How also could that be applied when he purchased for $90 a par value share of $100, thus establishing a discrimination among the old shareholders.

These *a priori* contentions of the appellant rest neither upon law, upon trade customs or upon sound logic. The unsound principles involved therein are subversive to stable and logical structure, and eliminating them is leaving

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the determination of the question at bar a task free from difficulty.

The appellant's contention is neither equitable nor meritorious and seems to challenge common sense.

The dividend paid to the appellant—although of a large percentage—was declared and paid in the usual course in 1920 and I fail to see any reason to distinguish it from the every day business transactions.

I will give effect to the declaration of the Crown and that is to release the accumulated profits during the pre-taxation period, and direct that the taxation shall only bear upon the profits since 1916,—for the year 1917 the year when the Act came into operation.

The revenue taxed comes clearly within the statutory definition of the word "income."

The case does not come within any of the statutory exemptions. It cannot come within the provisions of subsection 5 of section 3 of the statutes of 1919, since the accumulated profits prior to 1st January, 1917, were not large enough to pay such dividend; but the matter comes within the ambit of section 3 of 10-11 Geo. V, ch. 49 (1920) reading as follows:

(5). Dividends declared . . . after 31st December, 1919, shall be taxable income of the taxpayer in the *year in which they are paid or distributed.*

This amendment came into force on the 1st January, 1921, and therefore all dividends declared or voted after the 31st December, 1919, are subject to the tax. See Plaxton & Varcoe's Dominion Income Tax, 166.

Having said so much I gather from what was said by the respective counsel at bar that they will adjust among themselves the figures of the assessment upon the principle disclosed by the judgment. Failing, however, counsel to agree upon this point, leave is reserved to apply for further directions.

The appeal is dismissed with costs and the appellant is declared liable to pay the surtax claimed out of the accumulated profits since 1916, as above set forth.

Judgment accordingly.

Solicitor for appellant: *Jules Poisson.*

Solicitor for respondent: *C. Fraser Elliott.*