BETWEEN:

ST. CATHARINES FLYING TRAINING SCHOOL LIMITED ..... APPELLANT;

AND

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

1951
Nov. 28
1953
Nov. 17

Revenue—Income Tax—The Income War Tax Act, R.S.C. 1927, c. 97, ss. 4(e), 4(h)—Construction of exempting provision—Meaning of "non-profitable purposes"—Meaning of "association" in s. 4(h)—Meaning of "inured" in s. 4(h).

The appellant was incorporated under Part I of The Companies Act, 1934 of Canada to operate an elementary flying school for prospective pilots under the British Commonwealth Air Training Plan and entered into a contract with the Canadian Government for the conduct of such a school. It was prohibited by its charter from declaring dividends and from distributing any profits during hostilities or the period of its contract. Except for a small amount its capital was raised by donations. Under a second contract extending the first one it agreed that its surplus should be paid to a flying club approved by the Minister of National Defence or revert to the Crown. Approval was held up at the request of the Department of National Revenue that its interests should be protected. The appellant earned a substantial profit while operating its school and contended that such profit was not liable to taxation under the Income War Tax Act.

Held: That the term "association" in its ordinary meaning is wide enough to include an incorporated company and does not exclude an incorporated company such as the appellant.

2. That the purposes referred to in the term "non-profitable purposes" as used in section 4(*h*) are purposes that are carried out without the motive or intention of making a profit, that is to say, purposes other than that of profit making.

3. That the appellant was an association that was organized and operated solely for non-profitable purposes within the meaning of section 4(*h*).

4. That no part of the appellant's income inured to the benefit of any of its stockholders or members.

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APPEAL under the Income War Tax Act.

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

H. H. Stikeman Q.C. and *A. L. Bissonette* for appellant.

J. Singer Q.C. and *J. D. C. Boland* for respondent.

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

THE PRESIDENT now (November 17, 1953) delivered the following judgment:

The appellant appeals against its income and excess profits tax assessments for the years 1941 to 1945 inclusive, claiming that its income was not liable to taxation under section 4(*h*) or, in the alternative, section 4(*e*) of the Income War Tax Act, R.S.C. 1927, chapter 97, which sections read as follows:

> 4. The following incomes shall not be liable to taxation hereunder:—
> (*h*) The income of clubs, societies and associations organized and operated solely for social welfare, civic improvement, pleasure, recreation or other non-profitable purposes, no part of the income of which inures to the benefit of any stockholder or member;
> (*e*) The income of any religious, charitable, agricultural and educational institution, board of trade and chamber of commerce, no part of the income of which inures to the personal profit of, or is paid or payable to any proprietor thereof or shareholder therein;

The facts are not in dispute. The appellant was incorporated as a private company under Part I of The Companies Act, 1934 of Canada by Letters Patent, dated September 12, 1940. The reason for its incorporation was given by Mr. A. M. Seymour who prior thereto had been the president and later the vice-president of the St. Catharines Flying Club, incorporated under The Companies Act of Ontario, and afterwards the president of the appellant. When war broke out in 1939 some of the flying clubs in Canada were doing pilot training for the Royal Canadian Air Force and when the British Commonwealth Air Training Plan was under consideration the Canadian Flying Clubs Association, of which Mr. Seymour was the president, made representations to the Air Force and the Canadian Government that since the flying clubs were the only bodies that had experience in elementary flying training they should be entrusted with the responsibility of conducting the elementary stage of flying training during the war.

After lengthy negotiations the Government adopted this suggestion and announced its decision to that effect in December of 1939. It was decided that separate corporate entities, to be called schools, should be organized and sponsored by the flying clubs and it was in pursuance of this policy that the St. Catharines Flying Club caused the appellant to be incorporated. The Government also decided that in order that the schools should be able to operate successfully they should have a substantial capital. At first the capital requirement was set at $300,000 but later this was reduced to $35,000. It was intended that this amount should be raised by the sponsoring flying club and the Government felt that this would have to be done through the sale of preferred or common stock. Mr. Seymour, as president of the Canadian Flying Clubs Association, objected to incorporation under Part I of The Companies Act and also took the stand that the necessary capital support should be obtained from the public as a war effort rather than as an investment but the Minister of National Defence insisted on incorporation under Part I and this practice was followed throughout Canada. In the case of the appellant it obtained the necessary capital from donations by industrial and commercial corporations in St. Catharines and vicinity without the issue of any shares except twelve, one to each of the directors who subscribed $5 each. Six of the directors were members of the executive of the St. Catharines Flying Club and six represented the donor companies. Prior to the incorporation of the appellant Mr. Seymour, on behalf of the St. Catharines Flying Club, renewed his representation that the school should be incorporated under Part II of The Companies Act but this was again refused. He then asked for a special provision in the charter to prohibit the declaration of dividends. This was granted in the following terms:

> And it is further ordained and declared that the company shall be prohibited from declaring dividends and shall also be further prohibited from distributing any profits during hostilities or during the period that the company is required to carry on elementary training under the British Commonwealth Air Training Plan.

Mr. Seymour then stated that, since the capital had been donated and the St. Catharines Flying Club was the sponsoring club, it was felt that the directors should make a declaration of trust that the capital should be held in trust

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to be returned to the donor companies without interest or increase and that the shares should be held in trust for the sponsoring St. Catharines Flying Club so that it might be beneficiary of any surplus and this declaration was signed by the twelve directors in November 1940. It shows the names of the donors and the amounts contributed by each, the total amount being $37,850. The donors were allowed to deduct the amounts of their donations from what would otherwise have been their respective taxable incomes. The directors did not receive any remuneration for their services. Mr. Seymour stated that the appellant was not incorporated or organized or operated for the purposes of profit. The Letters Patent describe its purposes and objects as follows:

> To establish, maintain, conduct and operate a school or schools for instruction and training in flying to be operated for the purposes of and in conjunction with the British Commonwealth Air Training Plan.

On its incorporation the appellant entered into a contract with His late Majesty the King, dated September 12, 1940, to carry out the training of Royal Canadian Air Force personnel until March 31, 1943, and this contract was renewed on March 23, 1943, to extend to March 31, 1945. The details of these contracts, the syllabus of training, and the various schedules of payment for services appear in Exhibits 5, 6 and 7. It was provided in the second contract, *inter alia,* that any amounts retained by the appellant should be held by it in a reserve account until the termination of the contract and should then be paid to a flying club approved by the Minister of National Defence, failing which it should revert to the Crown. The St. Catharines Flying Club has not been approved by the Minister of National Defence. It first applied for a uniform charter in 1943 and again in 1946 but its application has been consistently refused on the ground that the Department of National Revenue has requested that its interests should be protected.

On the termination of the second contract the appellant had on hand approximately $83,000 in excess of its subscribed and donated capital. It has not returned any of this money to the Minister of National Defence. There were negotiations between the financial adviser to the Minister of National Defence for Air and the various schools in the course of which he proposed that each school

should surrender to the Government all surpluses earned by it over and above $5,000 per year of operation which it should be able to retain free of income and excess profits tax in return for which certain equipment belonging to the Crown would be turned over to the sponsoring club. All the elementary flying training schools in Canada, except the appellant, accepted this proposal but it refused to do so in the belief that it was not liable to income or excess profits tax and that its sponsoring flying club was entitled to approval.

According to Mr. C. Mapp, the appellant's auditor, the appellant held in its own bank account the sum of $37,910, being the $37,500 donated by the companies referred to, which it intends to return to them, and the $60 subscribed by the twelve shareholders, and its surplus amounting to $83,506.21 has been transferred to trustees under a trust agreement, dated March 7, 1951.

Mr. Seymour admitted on his cross-examination that the payments made by the Government to the schools, including the appellant, were more generous than had been requested and that they were deliberately made generous so that the schools could operate with a surplus that could be used to revive the activities of the sponsoring flying clubs after the war as they were all closed up during the war. Mr. Seymour went even further and admitted that the payments were so generous that if a school had any sort of efficient management there could not be any loss in its operation.

When it became clear that the appellant adhered to its position the taxing authorities took steps to have it assessed for income and excess profits tax. On August 19, 1947, it made a standard profits claim pursuant to section 5 of The Excess Profits Tax, 1940 for a reference to the Board of Referees to determine its standard profits at $25,000. The claim was referred to the Board and on November 18, 1948, the Board, under section 5(3) of the Act, ascertained its yearly standard profits at $20,000 and this decision was duly approved by the Minister. The Minister then assessed the appellant for income and excess profits tax for the years in question. All the necessary steps prior to appeal to this Court have been taken.

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On the facts which I have stated it was contended for the appellant that it was entitled to the benefit of the exemption conferred by section 4(*h*) or, alternatively, section 4(*e*) of the Income War Tax Act and that its income was not liable to taxation under it.

The manner in which an exempting provision of the Income War Tax Act should be construed has been discussed in several cases, including *Lumbers* v. *Minister of National Revenue* (1). There I put the rule as follows:

> a taxpayer cannot succeed in claiming an exemption from income tax unless his claim comes clearly within the provisions of some exempting section of the Income War Tax Act: he must show that every constituent element necessary to the exemption is present in his case and that every condition required by the exempting section has been complied with.

Consequently, unless the appellant can bring its claim for exemption squarely within one of the sections relied upon it is not entitled to it.

It is also clear that if the appellant is within the ambit of section 4(*h*) then section 4(*e*) does not have to be dealt with. It is only if section 4(*h*) is not applicable that section 4(*e*) need be considered.

To succeed in its claim under section 4(*h*) the appellant must show, first, that it was an association that was organized and operated solely for non-profitable purposes within the meaning of the section and, secondly, that no part of its income inured to the benefit of any stockholder or member. Counsel for the appellant realized this and contended that both of these constituent elements existed in the appellant's case and that all the conditions required by the section had been complied with.

I shall deal first with the question whether the appellant was an association that was organized and operated solely for non-profitable purposes within the meaning of the section. Counsel for the appellant argued that it was. He contended that the term "non-profitable purposes" meant the same as "non-commercial purposes", that Parliament intended to make the non-commercial profits of organizations of the kinds referred to in the section non-taxable and that the purpose of the appellant in operating a school for the elementary flying training of prospective pilots under the British Commonwealth Air Training Plan pursuant to its contract with the Government was a non-commercial

(1) [1943] Ex. C.R. 202 at 211.

purpose and, therefore, a non-profitable one within the meaning of the section. It was also contended that before it could properly be said that an organization was organized and operated for profitable purposes it must appear that such profit as it made was a profit to it which it could keep or dispose of as it saw fit and that since the appellant was prohibited by its Letters Patent from declaring dividends or distributing profits and was required by its contract to pay its profits to a club approved by the Minister of National Defence or to the Minister it never really owned its profit in the true sense. The essence of the submission was that the test of whether an organization was organized and operated for profitable purposes was whether its profits were such that it could keep and enjoy them or pass them on as it chose, that this test could not be met in the appellant's case and that the fact that it could never keep its profits or distribute them as it chose showed conclusively that it was not organized and operated for profitable purposes from which it followed that it was organized and operated for non-profitable purposes within the meaning of the section. It was also submitted that Mr. Seymour's statement that the appellant was not incorporated or organized or operated for the purposes of profit and the facts that it did not pay any salaries or declare any dividends or distribute any profits supported the view that it was organized and operated solely for non-profitable purposes.

One of the contentions of counsel for the respondent was that section 4(*h*) did not apply to the appellant at all, the submission being that it was not a club or a society and that the term association excluded a company incorporated, as the appellant was, under Part I of The Companies Act, 1934. This submission cannot be accepted. The term "association" in its ordinary meaning is wide enough to include an incorporated company. Moreover, the reference in the latter part of the section to "any stockholder or member" clearly indicates that it was contemplated that the term "association" might include an incorporated company and I cannot find any indication that it was intended that it should exclude companies such as the appellant because of their incorporation under Part I of The Companies Act, 1934. I am, therefore, of the opinion that the term association in section 4(*h*) does not exclude an incorporated company such as the appellant.

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The other contentions for the respondent present more difficulty. It was submitted that the appellant, being incorporated under the same part of The Companies Act, 1934 as ordinary commercial companies, was organized in the same way as they were, that the Letters Patent and the contract with the Government assumed that the appellant would make a profit and that it did in fact make a profit. Moreover, it had ancillary powers so that it was not confined to the purpose of conducting an elementary flying training school but could avail itself of its ancillary powers and, being a Letters Patent company, could do anything that a natural person could do. These facts, it was urged, indicated that the appellant was not organized and operated for non-profitable purposes.

It might also have been contended, on the basis of the admissions made by Mr. Seymour on his cross-examination, to which I have referred in my statement of the facts, that it was intended by the Government, in its insistence on incorporation under Part I of The Companies Act, 1934 that the appellant should operate in the same way as a commercial company, that it was also intended by the Government by its generous payments that the appellant should operate at a profit so that after the war this might be turned over to its sponsoring flying club to revive its activities, that the appellant concurred in the Government's intentions and operated as intended by the Government and that it could not, therefore, be said that it was organized and operated for non-profitable purposes.

My first inclination was towards the view that the appellant was not organized and operated solely for non-profitable purposes and, therefore, not entitled to the benefit of the exemption conferred by the section but on further consideration I have reached a different conclusion. The fact that the Letters Patent and the contract with the Government assumed that the appellant would make profits and that it did so has little, if any, bearing on the question whether it was an association that was organized and operated for non-profitable purposes. It is quite possible for such an association to make profits. The fact of profits is, therefore, not the test. Indeed, section 4(*h*) assumes that the organizations referred to in it will have incomes, within the meaning of section 3 of the Act, which could include profits, that would be taxable under the Act except for the

exemption conferred by it, for otherwise there would be no need for the section. It does not follow, therefore, from the fact that the appellant made profits that it was not organized and operated for non-profitable purposes. The enquiry must go further.

For a similar reason the term "non-profitable purposes", which is not as precise as would be desirable, cannot mean that the purposes must be such that profit does not result from carrying them out, for the section assumes the possibility of making profits in the course of carrying out non-profitable purposes. The term must, therefore, mean something other than purposes from the carrying out of which profit might possibly result.

In my judgment, the purposes referred to must be purposes that are carried out without the motive or intention of making a profit, that is to say, purposes other than that of profit making. That being the meaning of the term, I am satisfied that the appellant was organized and operated solely for non-profitable purposes. Its purpose was the conduct of a school for the elementary flying training of prospective pilots under the British Commonwealth Air Training Plan. It was organized and operated for that purpose and it had no other purpose. It was not part of its purpose to make profits and it operated without any profit making motive or intention. Mr. Seymour's evidence to that effect was clear. Moreover, it is supported by the fact that the appellant could never keep any of its profits or distribute them to its stockholders or members. How could it properly be said that it was in the business of conducting its school for the purpose of making a profit when it was quite impossible for it to keep or distribute any profit that might come to it in the course of carrying out the purpose for which it was organized and operated? The question answers itself.

Nor does the fact that the Government deliberately made generous payments to the appellant so that with any sort of efficient management it could not sustain a loss have any bearing on the question. The reason for the generous treatment can be found in the Government's stated concern that the appellant should be able to conduct its school successfully.

Under all the circumstances I am satisfied that the plaintiff was not in the business of conducting its school for profit

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even although it actually did make profits. Consequently, I find that the appellant was an association that was organized and operated solely for non-profitable purposes within the meaning of section 4(*h*): *vide* in this connection the decision of the Saskatchewan Court of Appeal in *In re Regina Elementary Flying School Limited* and *City of Regina* (1).

There remains the second question under section 4(*h*), namely, whether any part of the appellant's income inured to the benefit of any stockholder or member. This presents no difficulty. It was not intended that any of the appellant's stockholders or members, of whom there were only twelve, should ever receive any portion of the appellant's income or any benefit from it and it was impossible that they should ever do so. It is true that six of them represented or were members of the St. Catharines Flying Club, the appellant's sponsoring club, and it was submitted that if the appellant's surplus should go to its sponsoring club these six members would benefit thereby and that, consequently, part of the appellant's income inured to their benefit. I am unable to agree with this submission. That is not the kind of benefit contemplated by the section. Moreover, there is no evidence that any of the six representatives or members would ever derive any personal benefit even if the appellant's surplus should be turned over to the sponsoring club for the purpose of doing so would be to revive its activities. I find, therefore, that no part of the appellant's income inured to the benefit of any of its stockholders or members.

The result is that the constituent elements necessary to the exemption conferred by section 4(*h*) are present in the appellant's case and it is entitled to the benefits of the section.

Since the appellant's claim for exemption falls within the ambit of section 4(*h*) there is no need to consider whether section 4(*e*) is applicable.

It follows that the appellant's income for the years in question is not liable to income or excess profits tax and its appeal against the assessments for 1941, 1942, 1943, 1944 and 1945 must be allowed with costs.

Judgment accordingly.

(1) (1944) 3 W.W.R. 479.