1929

April 30.
May 20.

GEORGE HOPE.....APPELLANT;

AND

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

Income War Tax Act, 1917—Undistributed Profits—Dividends—Reserve fund—14-15 Geo. V, c. 46, sec. 5, sub-sec. 9.

The H. P. & L. Co. sold to H. & E. M. Co. its entire assets which were composed of shares, plus a "reserve fund," representing an accumulation of undistributed profits and gains from 1917 to 1926, set aside for the exclusive benefit of holders of permanent shares, to be from time to time divided and paid to shareholders. For the purpose of this agreement, the value of a share was fixed at $227, being $100 for the share and $127 being the proportion of the reserve coming to each shareholder per share held, the $100 paid cash, and the reserve was only finally paid after all liabilities had been discharged. The assessment herein was made in respect of the payment of $10,127.95 to the appellment, during the taxation period of 1926, coming to him as a shareholder of H. P. & L. Co., out of the distribution of the proceeds of the said sale of its property and assets, in the form of a dividend, to the extent that the company had on hand undistributed profits. Payment was refused on the ground that this amount was capital, and that even if it was not capital then only that part of the reserve accumulated since 1921 should be taxed.

Held, that by the mere setting of these figures of $227 per share, the company could not change the fact of the existence of a fund which under its by-laws could and would have been distributed as dividends, and that a shareholder receiving this sum must pay income tax on that portion of the price which represents the distribution of the reserve or accumulated profits.

2. That under sec. 5, ss. 9 (14-15 Geo. V, ch. 46), dividends made up of undistributed profits and paid or payable after 1921, whether accrued before 1921 or not, as under the circumstances of this case, are liable to income tax.

1929

GEORGE HOPE
v.
THE MINISTER OF NATIONAL REVENUE.

3. That the reserve fund herein being made up of gains and profits, it would, even prior to the amendment (14-15 Geo. V, c. 46, sec. 5, ss. 9), under secs. 3 and 4 of the Act, be treated as a dividend made up of profits and gains and thereby become liable to the tax. That the said amendment of the Act in 1924 was enacted for the purpose of removing any possible doubt or contention—ex majore cautela. (Re Judges' Salaries (1924) Ex. C.R. 157, referred to.)

APPEAL from the decision of the Minister under The Income War Tax Act, 1917.

The appeal was heard before the Honourable Mr. Justice Audette at Toronto.

N. W. Rowell, K.C. and *Mr. Langford* for appellant.

C. Fraser Elliott, K.C. for respondent.

The facts of the case are stated in the reasons for judgment.

AUDETTE J., now May 20th, 1929, delivered judgment.

This is an appeal, under the provisions of The Income War Tax Act, 1917, and amendments thereto, from the appellant's assessment, for the year ending 31st December, 1926. This assessment was made in respect of a payment of $10,127.95 during the taxation period of 1926, coming to him as a shareholder of The Hamilton Provident and Loan Corporation, out of the distribution of the proceeds of the sale of its property and assets in the form of a "dividend" to the extent that the Company had on hand undistributed income or profits as set forth in exhibit No. 3—14-15 Geo. V, ch. 46, sec. 5, subsec. 9.

This sum of $10,127.95 so paid to the appellant represents an accumulation of undistributed profits and gains from 1917 to 1926, and of which $6,669.25 would be an accumulation of profits from 1917 to 1920, but distributed as part of the $10,127.95 on the 15th July, 1926. This Reserve Fund, under the powers given the directors by by-law 38, consists of profits accumulated for the exclusive benefit of the holders of permanent shares, to be from time to time divided and paid to such holders of permanent shares in proportion to the amount of their shares—in other words to pay a dividend out of this fund of accumulated profits. This fund composed of accumulated profits is therefore quite distinct from the permanent shares of the company which the appellant still holds; and in this sale between

1929

GEORGE HOPE v. THE MINISTER OF NATIONAL REVENUE.

Audette J.

the two companies, the shareholder gets the value of his shares plus the value of this reserve fund made up of profits. The moneys of the shares are alone capital, and under the agreement the moneys representing the reserve are segregated from the capital, and finally paid only after all debts and liabilities are discharged.

Section 5, subsection 9 (14-15 Geo. V, ch. 46), by section 8 of the same Act was

> deemed to be applicable to the income for the taxation period 1921 and subsequent periods.

and the appellant contends that the part of the accumulated profits earned before that date is not subject to such taxation, and moreover contends, in the alternative that the whole of that sum is capital and not subject to taxation.

By the agreement of the 15th July, 1926, exhibit No. 3, above referred to, the Hamilton Provident and Loan Corporation, sold to the Huron and Erie Mortgage Corporation *its entire assets* which are composed of shares and the "reserve fund" in question, and by agreement the measure of payment is determined. Section 2 of the agreement, it is true, provides that "for the purpose of this agreement" the value of the shares is fixed at $227; and that is what gives rise to the appellant's contention that all of the payment of $10,127.95 is capital and part of the value of the share. But in face of the actual facts this contention falls to the ground since it is common ground that besides the shares there was this reserve fund made up of accumulated profits and gain of the company since 1917 under by-law 38. Moreover, by sub-par. (*b*) of the 2nd clause the purchaser pays $100 a share and the reserve is paid in the manner provided further on in the agreement. The purchase price of the segregated assets amounts to the adjusted figure of $227, but does not make the assets capital to that extent, in view of the facts of the case more especially set forth in the agreement. By the mere setting of these figures of $227 the company cannot change the fact of the existence of the fund which could and would under by-law 38, have been distributed as dividend. The company cannot by winding up and discontinuing business, avoid paying tax on this distribution of profits. *Verba fortius accipiuntur contra proferentem.*

The shareholders are not parties to this agreement between the two companies. They remain shareholders

for five years from the date of the agreement or until the reserve fund is adjusted and final payments made, and they receive this payment out of these accumulated profits forming the Reserve, by way of dividend, besides the payment of their shares, but according to the number of their shares, the whole coming from the sale of the assets of the company. It was the capital of these shares that earned by way of profits and gain the accumulated moneys in the Reserve now being paid out by way of dividend and measured by the number of shares. This exhibit No. 3 is nothing but an agreement to sell the assets of the company, confirmed as such by the Attorney General of the Province. The vendors sold the shares and the Reserve, but the transfer of the shares is not to be made until full payment of the Reserve has been made.

In the Annual Reports of the company, exhibit No. 2, the Reserve Fund is always entered as a liability to the shareholders and distinguished from the shares themselves.

It is true that sec. 5, subsec. 9 (14-15 Geo. V, ch. 46) reads as follows:—

> 5. On the winding up, discontinuance or reorganization of the business of any incorporated company the distribution in *any form of the property* of the company shall be deemed to be a payment of a *dividend* to the extent that the company has *on hand* undistributed income.

and that this section came into force for the taxing period of 1921; but it is found that it is the time of payment of such dividend that must govern. That is to say, without any further qualification any such dividend paid in the ordinary course after that date will fall within the ambit of the section. It is a dividend paid in 1926 and which must be paid according to the law in force at that date, which does not require an investigation as to how the company came to pay the dividend.

By sec. 4, subsec. 5 (9-10 Geo. V, ch. 55) 1919, it is further provided that:

> *Dividends* or shareholders' bonuses paid or *credited* to its shareholders by a corporation on or *after the 1st day of January, 1917*, shall be taxable as income of the shareholders *in the year in which the same are received* or credited unless paid *exclusively* out of a surplus or accumulated profits on hand prior to 1st January, 1917.

This section was in force in 1919 and is applicable to the present case and it would result therefrom that the words *accumulated profits on hand* mean those which arose since the passing, in 1917, of The Income War Act.

1929

GEORGE HOPE v. THE MINISTER OF NATIONAL REVENUE.

Audette J.

Dealing with internal Revenue, it was held in the case of *Stoffregen v. Moore* (1) that

> the "income" of a stockholder of a corporation includes dividends received by him during a tax year, although declared and paid in whole or in part from the accumulated surplus of prior years.

See also *Lynch v. Hornby* (2).

Then in 1920, by 10-11 Geo. V, ch. 49, sec. 3, it was enacted that:

> Dividends declared or shareholders' bonuses voted after the 31st December, 1919, shall be taxable income of the taxpayer *in the year in which they are paid or distributed.*

See *Gagné* v. *The Minister of Finance* (3); *Smith* v. *Attorney General of Canada* (4); Plaxton and Varcoe, Dominion Income Tax, 166. See also sec. 8 (8), (9), (10), (11) and (12) of the Act of 1926.

The plain intention of this section 5, subsec. 9 (14-15 Geo. V, ch. 46) is that dividends made up of undistributed profits and paid or payable after 1921 as under the circumstances of the case, are liable to tax. The Act primarily imposes a tax upon all incomes made up of profits and gain and that is intended to be taxed in this case. And failing to come within any of the statutory exemptions, the appellant must pay. The wording of subsec. 9 of sec. 5 is clear and unambiguous in its grammatical meaning and that should be adhered to. Clear language would have to be found to support the contention that—notwithstanding the dividend is paid in 1926 when the section is in full force and effect—the section would not apply because some of the moneys forming part of that dividend were earned before that date and should be exempted. In so finding one would have to add or to distort the plain meaning of the section. There is no reason and no right to assume that there is any governing object which the taxing Act is intended to attain other than that which it has expressed. *Tennant* v. *Smith* (5).

We have a clear and unambiguous section in the Act summarizing all the exemptions and it does not cover the present case or the appellant's contention, while the respondent brings the appellant within the letter of the law.

(1) (1920) 264 Fed. R. 232.
(2) (1918) 247 U.S.R. 339.
(3) (1925) Ex. C.R. 19, at p. 22.
(4) (1924) Ex. C.R. 193, at p. 195.
(5) (1892) A.C. 150, at p. 154.

This finding is moreover supported by sec. 4, subsec. 5 (9-10 Geo. V, ch. 55) passed in 1919 and hereabove recited, declaring that dividends are taxable as income of shareholders in the year in which the same are received or credited. Furthermore sec. 3 of 10-11 Geo. V, ch. 49, enacts that dividends declared after the 31st December, 1919, shall be taxable in the year in which they are paid or distributed. Section 8, subsecs. (8), (9), (10), (11) and (12) of the Act of 1926 go also to support and bear that meaning and contention. A Taxing Act must be read as a whole, and any particular section must be read in conjunction with the meaning of the words used in the context.

On the whole I fail to see any ground upon which the appellant should be treated in any more favourable way than the other citizens or public of Canada in relation to liability for a tax of the nature here in question. See *Hollinshead* v. *Hazelton* (1).

Moreover, I must find that this amendment of the Act in 1924 (sec. 5, subsec. 9) was enacted for the purpose of removing any possible doubt or contention—*ex majore cautela*—because the reserve fund in question in this case, made up of gain and profits, would, prior to such amendment, under secs. 3 and 4 of the Act, be treated as a dividend made up of profits and gains and thereby become liable. The amendment is of the same nature as the one made with respect to the Judges' salaries. See In re Judges' Salaries (2), confirmed on appeal to the Supreme Court of Canada.

Indeed, by The Interpretation Act, ch. 1, R.S.C. 1927, sec. 21, it is provided that the amendment of an Act shall not be deemed to be or to involve any declaration whatsoever as to the previous state of the law, and it shall not be deemed to be or to involve a declaration that the law under such Act was, or was considered by Parliament, to have been different from the law as it has become under such Act as so amended.

For the reasons above mentioned I feel myself unable to follow the decision in re *Anderson* (3), with respect to the tax as between a life tenant of share and remainderman,

(1) (1916) 1 A.C. 428 at 436 & 461. (2) (1924) Ex. C.R. 157.
(3) (1925) 4 D.L.R. 116.

1929

GEORGE HOPE
v.
THE MINISTER OF NATIONAL REVENUE.

Audette J.

and moreover because of by-law 38 of the Company which qualifies and determines the fund in question in this case.

A number of English cases were cited at trial; but I find that the laws in England with respect to winding up and the circumstances of this case are entirely different from our Canadian Taxing Act.

There will be judgment dismissing the appeal with costs.

Judgment accordingly.