1952

June 3, 4

June 5

BETWEEN:

MINISTER OF NATIONAL REVENUE..APPELLANT;

AND

THE LAKEVIEW GOLF CLUB LIMITED..... } RESPONDENT.

Revenue—Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 4(h)—Income Tax Act, S. of C. 1948, c. 52, s. 57(1) (g)—Whether company operating a golf club a non-profit organization—Income derived from a golf club's operations inured to benefit of shareholders thereof although not paid—Estoppels cannot override the law of the land—Crown not bound by errors or omissions of its servants—Appeals from the Income Tax Appeal Board allowed.

Incorporated in 1941 the respondent operates a golf club, the members of which pay an annual fee but are not required to own or purchase shares of the company and have no share in the company or its management by reason of such membership. In the years 1946, 1947, 1948 and 1949 the company made a profit and at the end of the taxation year 1949 had an accumulated surplus of $22,538.62. A by-law of the company provided that the dividends, when earned and declared, shall be paid to the shareholders but no dividends were declared since the incorporation of the company. In 1944 an "understanding" was arrived at between the company and an officer of the Department of National Revenue for the taxation year 1941 and by which the company was exempt under the provisions of s. 4(*h*) of the Income War Tax Act to pay income tax. In 1950 the company was made aware that this "understanding" was no more in effect by receiving notices of assessment for the years 1946, 1947, 1948 and 1949. From these assessments the respondent company appealed to the Income Tax Appeal Board which allowed the appeals and from this decision the Minister now appeals.

The Court on the facts found that the respondent was not a club organized and operated exclusively for recreation or pleasure within the meaning of s. 4(*h*) of the Income War Tax Act and of s. 57(*g*) of the Income Tax Act but was organized and operated for the purpose of profit-making.

Held: That the income derived from the respondent company's operations inured to the benefit of the shareholders or was available for their personal benefit although not, in fact, paid to them. *Moosejaw Flying Club* v. *Minister of National Revenue* (1949) Ex. C.R. 370 referred to.

2. That an estoppel cannot override the law of the land and the Crown is not bound by the errors or omissions of its servants. *Woon* v. *Minister of National Revenue* (1951) Ex. C.R. 18 referred to.

APPEALS from a decision of the Income Tax Appeal Board.

The appeals were heard before the Honourable Mr. Justice Cameron at Toronto.

Geo. B. Bagwell, Q.C. and *I. G. Ross* for appellant.

J. F. Boland, Q.C. for respondent.

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

On the conclusion of the trial Cameron J. (June 5, 1952) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board, dated November 19, 1951, which allowed the appeals of the respondent herein from assessments to income tax made upon it for the taxation years 1946, 1947, 1948 and 1949.

The Income Tax Appeal Board upheld the contention of the company that it was totally exempt from taxation under the provisions of certain sections of The Income War Tax Act applicable in the years 1946, 1947, 1948 and of the Income Tax Act for the year 1949.

For the years 1946, 1947 and 1948, Section 4(*h*) of the Income War Tax Act provided 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.

For the year 1949, Section 57, subsection (1) (*g*) of the Income Tax Act is as follows:

> No tax is payable under this Part upon the taxable income of a person for a period when that person was:—
> (*g*) A club, society or association organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to or was otherwise available for the personal benefit of any proprietor, member or shareholder thereof.

While wording of the two subsections is not precisely the same, I am unable to perceive any essential difference between them so far as this case is concerned.

The respondent was incorporated on March 5, 1941, by a provincial charter with an authorized capital of $100,000 divided into 4,000 shares of a par value of $25 each. At all relevant times the number of issued shares did not exceed 2,505 and the number of shareholders did not exceed 7.

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Following its incorporation the company immediately acquired the assets of The Lakeview Golf Club from five individuals all of whom were among the applicants for incorporation and who became directors of the company. One of such individuals was Harry W. Phelan, who from the time of its incorporation until his death in 1946, held a controlling interest in the company. Another of such directors was A. W. Purtle who, since the sale by the executors of Harry W. Phelan of his stock in 1946 to him, has had the controlling interest in the company, Mr. Purtle and members of his family owning all the issued shares except, perhaps, certain qualifying shares.

It is shown in each of the years 1946, 1947, 1948 and 1949 the company made a profit and that at the end of the taxation year 1949 had an accumulated surplus of $22,538.62.

Bylaw No. 35 of the General Bylaws of the company, which has been in effect throughout the taxation years in question, provided as follows:

> Dividends upon the capital stock of the company when earned and declared shall be paid according to the amount paid up on the shares.

Bylaw No. 33 is as follows:

> Certificates of stock shall be surrendered and cancelled at time of transfer. No transfer of stock shall be made within 10 days next preceding the day appointed for the payment of a dividend or for holding a general meeting of the shareholders of the company.

It is common ground that since the incorporation of the company no dividends have been declared.

Membership in and use of the facilities of the club are acquired by payment of an annual fee, but such members are not required to own or purchase shares of the company and have no share in the company or its management by reason of such membership.

The contention of the respondent is that it is a club organized for recreation or pleasure and is a non-profit organization. The purposes and objects of the company are set forth in the Charter, and are as follows:

> (a) To purchase or otherwise acquire and to hold lands and buildings or any interest therein for the purposes of golf, sport, recreation, amusement and entertainment or for any other purpose and to sell, lease, exchange, mortgage or otherwise dispose of the whole or any portion thereof or all or any buildings that are now or may hereafter be erected thereon;

(*b*) To erect buildings on such lands or any part thereof for golf, riding, polo, skating, curling, hockey and other amusements and for the purpose of entertainment or for occupation as dwellings or for any other purpose; to equip the same with all necessary apparatus and to use, convert, adapt and maintain all or any of such lands, buildings or premises for the purposes aforesaid or any of them with their usual and necessary adjuncts;

(*c*) To conduct, hold and promote golf, polo, horticultural, agricultural and other exhibitions; and to give and contribute towards prizes, cups, stakes and other awards;

(*d*) To serve refreshments of all kinds to its shareholders, members, patrons and their friends; and

(*e*) To take or hold mortgages for any unpaid balance of the purchase money on any of the lands or buildings sold by the Company and to sell, mortgage or otherwise dispose of such mortgages;

It is doubtless true that those who become members of the club upon payment of an annual fee do so for purposes of personal recreation and pleasure. So also do those who by payment of an annual fee acquire the right to bowl in a privately owned rollodrome operated for profit, or to skate in a privately owned skating rink operated for profit.

The question to be determined, however, is not whether those using the facilities of the club do so for recreation or pleasure, but whether, to use the words of Section 4, subsection (*h*) (*supra*), it is a club organized and operated solely for pleasure or recreation or other non-profitable purposes, no part of the income of which enures to the benefit of any stockholder or members, or in the words of Section 57, subsection (1) (*g*) (*supra*), it is a club organized and operated exclusively for pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to or was otherwise available for the personal benefit of any proprietor, member or shareholder thereof.

Mr. Purtle, president and general manager of the respondent company was called as a witness on behalf of the appellant, and gave his evidence in a very frank manner. As general manager he receives an annual salary of $7,000. The incorporators had in mind the provision of golfing facilities for those who could not afford to belong to the more expensive clubs. About 100 members pay an annual fee of $90 and have the full use of the club facilities, arrange their own tournaments and the like, but are not required to acquire stock in the club, and in fact, do not

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do so, and consequently, have no voice in the election of the directors or control of company matters. Some 800 or 900 associate members pay a nominal annual fee of $5 plus a green fee on each occasion when playing golf, but have nothing to do with the conduct of the company's business. Casual visitors may play golf at any time on payment of a somewhat larger green fee than is paid by the associate members. Neither the Charter of the company nor its bylaws (as they were in effect in the years in question) contain any suggestion that the company was organized for non-profitable purposes. On the contrary, Bylaw No. 35, which I have quoted above, provides that the dividends, when earned and declared, *shall* be paid to the shareholders. That is the clearest possible evidence that the directors and shareholders contemplated the possibility of profits being earned and that in such a case they would be available, when declared, to the shareholders.

As I have stated above, the company, in each of the years in question earned profits which constituted taxable income unless the total exemptions now claimed are available to it. They are as follows:—

1946—$2,840.54
1947—$3,143.02
1948—$12,870.30
1949—$9,211.27.

At the end of the fiscal year in 1949 the company had a total surplus on hand and in cash of $22,538.62. While that amount was not distributed to the shareholders, it was at all times possible for the directors to declare dividends to the shareholders to such extent as they had profits on hand. The value of the shares increased to the extent of such income was earned and, therefore, in my opinion such income inured to the benefit of the shareholders or was available for the personal benefit of the shareholders although not, in fact, paid to them.

In this connection reference will be made to *Moose Jaw Flying Club* v. *The Minister of National Revenue* (1).

Mr. Purtle's statement that one of the purposes of building up and maintaining the surplus was to provide funds for improvements to the club property. He instanced his

(1) (1949) C.T.C. 281.

intention of constructing a fence around the property at a probable cost of $15,000. The property has had no such fence since the company came into existence, and Mr. Purtle frankly admitted that if constructed, it would undoubtedly enhance the value of the club, and thereby increase the value of the shares.

In my opinion, therefore, the facts established in evidence show:

1. That the company was not a club organized and operated exclusively for recreation or pleasure within the meaning of the exempting sections but, on the contrary, was organized and operated for the purpose of profit-making and did, in fact, make a profit during each of the relevant years.

2. That the income derived from such operations enured to the benefit of the stockholders and was available for the personal benefit of such shareholders.

I have not overlooked the further submission by counsel for the respondent. The evidence indicates that in its initial year of operation, that is 1941, the company showed a small operating profit in its income tax return. When that return and those for 1942 and 1943 were under consideration in 1944 an assessor of the department apparently reached the conclusion that the company was exempt under the provision of Section 4, subsection (*h*). That conclusion was arrived at after he had received a copy of the resolution of the directors dated October 23, 1944, Exhibit A-10, the essential part of which was as follows:—

> It was moved by the secretary, seconded by Joseph B. Cherrier, and duly carried that the treasurer be and he is hereby authorized to complete for the Income Tax Department Form T2 showing that the club is a non-profit sharing association, and that any earned surplus is to be used to make repairs or improvements or supply necessary equipment required by the club in its operation.

Accordingly, the company was not assessed to tax for the year 1941. For the years 1942, 1943 and 1945 the company had operating losses. In 1944 it had an operating profit of $160.24 and was not assessed to tax. It does not clearly appear whether in that year exemption was granted under Section 4, subsection (*h*), or whether it was found that after taking into consideration the previous years' losses, there was no taxable income.

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The returns for 1946, 1947, 1948 and 1949 were not processed until 1950, and it was not until that year that the company was made aware that the "understanding" arrived at in 1944 for the year 1941 was no longer available to it. That resolution, Exhibit A-10, merely authorizing the treasurer to make representations to the department that the company was "a non-profit sharing association." It was not binding in any sense and could have been altered at any time. It specifically provides for the possibility of making "improvements" to the club, a step which would have enhanced the value of the shares.

I cannot agree that such an "understanding",—to use the word of Exhibit A-5—can be of any assistance to the respondent, and an estoppel cannot override the law of the land, and the Crown is not bound by the errors or omissions of its servants.

In the case of *Woon* v. *The Minister of National Revenue* (1). I had to consider a similar submission to that made here. It is not necessary to refer to more than a few extracts from that case commencing at page 24. There I referred to Phipson on Evidence, 8th Edition, 667, where it is stated:

> Estoppels of all kinds, however, are subject to one general rule: they cannot override the law of the land. Thus, where a particular formality is required by statute, no estoppel will cure the defect.

I then refer to *Maritime Electric Company Limited* v. *General Dairies Limited* (2) in which it was held:

> That the appellants were not estopped from recovering the sum claimed. The duty imposed by The Public Utilities Act on the appellants to charge, and on the respondents to pay, at scheduled rates, for all the electric current supplied by the one and used by the other could not be defeated or avoided by a mere mistake in the computation of accounts. The relevant sections of the Act were enacted for the benefit of a section of the public, and in such a case where the statute imposed a duty of a positive kind, it was not open to the respondents to set up an estoppel to prevent it.
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> An estoppel is only a rule of evidence, and could not avail to release the appellants from an obligation to obey the statute, nor could it enable the respondents to escape from the statutory obligation to pay at the scheduled rates. The duty of each party was to obey the law.

(1) (1951) Ex. C.R. 18. (2) (1937) A.C. 610.

I then refer to the judgment of Lord Maugham in that case where at page 620 he said:

. . . The court should first of all determine the nature of the obligation imposed by the statute, and then consider whether the admission of an estoppel would nullify the statutory provisions . . .

Then in the "*Woon* case," I stated as follows at p. 25:

It was therefore the duty of the taxing authority to apply the provisions of the section to the case of any taxpayer falling within its terms and it was the duty of such taxpayer to pay such tax as might properly be payable thereunder. It was the duty of both to obey the law.

I think it is quite clear that the "ruling" said to have been made in this case, was made without authority and was not in any way binding upon the Crown. There is nothing in the section itself which confers any sort of discretionary powers on the Minister or his officials. Parliament has said that under certain circumstances certain things are deemed to be dividends and manifestly the Commissioner of Taxation had no power to declare otherwise or to settle the limit of taxation thereunder, other than according to the statute itself.

In the same case I referred to *Anderton and Halstead Limited* v. *Birrell* (1), in which the Inspector of Taxes after full disclosure of all the facts had agreed in writing to the writing down for two years successively of a doubtful debt. Subsequently, by an assessment, the writing down of the doubtful debt was disallowed on certain grounds.

In considering an appeal from the Commissioners of Inland Revenue, Rowlatt J. said at page 279:

In order to clear the ground, I may point out at once that there is no question of the Crown having been bound by the first action of the inspector by way of mere contract. No officer has power to do that.

In the result, the appeals will be allowed. The decision of the Income Tax Appeal Board will be set aside and the assessments made by the Minister for each of the years in question are affirmed.

The appellant is entitled to be paid his costs after taxation, and there will be judgment accordingly.

Judgment accordingly.

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(1) (1932) 1 K.B.D. 271.