BETWEEN:

VIKING FOOD PRODUCTS LTD. .....APPELLANT;

AND

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

Montreal 1967 Feb. 15 Feb. 24

Income tax—Associated companies—Both controlled by same group —Controlling shares of one under option to outsider—Whether actual control thereby divested—Construction of statute—Income Tax Act, R.S.C. 1952, c. 148, s. 139(5d)(b), am. 1953-4, c. 57, s. 31.

In 1963 all of appellant company's issued shares (20) were held by W (10), his son H (9) and the son's wife (1), and all of the issued shares (5,000) of another company were held by W (1,250) and H (3,750). In 1962 appellant's three shareholders had granted M an option to buy all of appellant's issued shares but the option was not exercised until after the expiration of appellant's 1963 taxation year. Appellant was assessed for 1963 at the normal instead of the reduced rate of tax on the ground that appellant and the other company were controlled by the same group in 1963 and were therefore associated companies as provided by s. 39(4)(*b*) of the *Income Tax Act*. Appellant appealed contending that since M by reason of his option to purchase the shares of appellant was deemed by s. 139(5d)(*b*) to have had the same position in relation to the control of appellant during 1963 as if he owned the shares it was a necessary implication of s. 139 (5d)(*b*) that appellant's actual shareholders must be deemed not to have owned those shares and accordingly the two companies were not controlled by the same group and were not associated companies.

Held, having regard to the legislative history and purpose of s. 139(5d)(*b*), *viz* to guard against tax avoidance, the court could not infer that Parliament intended the construction urged by appellant, and the appeal must be dismissed.

Yardley Plastics of Canada, Limited v. M.N.R. [1966] Ex. C.R. 1027 applied.

APPEAL from Tax Appeal Board.

S. Vineberg for appellant.

M. A. Mogan and *P. F. Cumyn* for respondent.

JACKETT P.:—This is an appeal from a judgment of the Income Tax Appeal Board which was set down, and brought on for hearing before me, on a stated case.

The sole question that I have to decide is a question as to the application to the agreed facts of subsection (5d) of section 139 of the *Income Tax Act*, which reads in part as follows:

139. (5d) For the purpose of subsection (5a)

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(b) a person who had a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, shares in a corporation, or to control the voting rights of shares in a corporation, shall, except where the contract provided that the right is not exercisable until the death of an individual designated therein, be deemed to have had the same position in relation to the control of the corporation as if he owned the shares and

. . .

The problem may be explained as follows:

1. The individuals concerned are William Cohen, his son, Harry Cohen, Harry Cohen's wife, Belle Cohen, and Martin Cohen, the son of Harry and Belle Cohen.

2. Throughout the appellant company's taxation year 1963 (12 months ending March 31, 1963), its issued shares were held as follows:

William	10
Harry	9
Belle	1

and during the same period all the issued shares of another company that I may refer to as "Empire" were held as follows:

William	1250
Harry	3750

3. In these circumstances, it is common ground that, if there were no other relevant fact, the appellant and Empire would have been associated companies during the appellant's taxation year 1963 for the purposes of section 39 of the *Income Tax Act*, by virtue of subsection (4) of that section.

4. The other fact, which the appellant says is relevant and the respondent says is not relevant, is that, on February 16, 1962 (i.e., before the commencement of the appellant's 1963 taxation year) William, Harry and Belle executed a document which, it is common ground for the purposes of this appeal, conferred upon Martin "a right under a contract...to acquire"[1]

[1] An argument was put forward that no such right had been created, but that argument was withdrawn by counsel for the Minister during the course of the hearing. After such withdrawal, it was conceded, for the purposes of this appeal, that such a right did exist during the taxation year in question.

all the shares in the appellant company at a specified price, which right was exercisable at Martin's option until December 31, 1964. He did not exercise the right until after the expiration of the appellant's 1963 taxation year.

5. It is common ground, therefore, that, by virtue of the operation of paragraph (*b*) of subsection (5d) of section 139 (*supra*) (which has application in relation to this problem by virtue of subsection (4a) of section 39), Martin must be deemed to have had, during the appellant company's 1963 taxation year, the same position in relation to the control of the appellant company as if he had owned, during that taxation year, all the shares of the appellant company.

6. Where the parties part company is that the appellant says, and the respondent denies, that it also follows, as a necessary implication of paragraph (*b*) of subsection (5d), that, if Martin is deemed to have been in the same position in relation to the control of the appellant *as if he owned* the appellant's shares, William, Harry and Belle must be deemed to have been in the same position in relation to the control of the appellant *as if they did not own* the appellant's shares.

The question that I have to decide is therefore a question as to the effect of subsection (5d) of section 139, which may be put in general terms as follows:

> If a person, by virtue of subsection (5d), is "deemed" to have had during a certain period "the same position in relation to...control" of a corporation "as if" he owned certain shares in that corporation, does it follow that the person who during that period actually owned those shares is "deemed" to have had during that period "the same position in relation to...control" of that corporation "as if" he did not own those shares?

As I understand the appellant's contention, it is that, while subsection (5d) does not expressly deem William, Harry and Belle to have been in the same position in the appellant's 1963 taxation year as if they did not own any of its shares, it does so impliedly. The appellant must go so far as to say that, when subsection (5d) expressly enacts that, upon certain facts being established, a person who did not

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own the shares is to be deemed to be in the same position as if he did own them, it impliedly enacts that, upon the same circumstances being established, the person who did own the shares is to be deemed to be in the same position as if he did not own them.

Whether or not such an inference can be read into subsection (5d) is a matter of interpretation, which must be considered in the general context in which subsection (5d) is found. Inasmuch as subsection (5d) is an interpretation provision that may have operative effect in several different parts of the Act, it is not improper to consider first, in general terms (and without intending to express any opinion concerning the precise effect of provisions relating to other problems), the background of the Act as a whole in so far as the concept of "control" of a corporation is concerned.

There are at least three different groups of sections in which it may become relevant to reach a conclusion as to whether a person or a number of persons "control" a corporation:

1. provisions where the legislative intent is expressed by reference to "control" of a corporation or to a corporation being "controlled", e.g., section 27(5) and (5a), section 28(2) and section 68;

2. provisions where the legislative intent is expressed by reference to persons dealing "at arm's length", e.g., section 11(3e) and (15), section 17, section 18, section 20, section 79, section 85, section 85A and section 137(3);

3. section 39, in which, as I have already indicated, we find a definition, for the purposes of that section, of the special statutory concept of one corporation being "associated" with another.

In so far as the simple concept of "control" of a corporation is concerned, there is no special provision in the statute, as far as I am aware, to guide in the determination of what is intended.[1] The meaning of the expression has now

[1] See, however, section 139(1)(*ag*), which defines "subsidiary controlled corporation" to mean, for the purposes of the Act, "a corporation more than 50 per cent of the issued share capital of which (having full voting rights under all circumstances) belongs to the corporation to which it is subsidiary".

been determined, however, by the Supreme Court of Canada in its unreported decision in *The Minister of National Revenue v. Aaron's Ladies Apparel Limited*, (1967), as being, in effect, ownership of shares carrying the right to sufficient votes to determine the election of the Board of Directors.

On the other hand, there are quite complicated provisions to regulate the determination of a question as to whether persons are or were dealing "at arm's length". In so far as relevant to the present purpose these may be summarized as follows: In addition to persons who, in fact, do not deal at arm's length (section 139(5)(*b*)), it is enacted that "related persons" must be "deemed not to deal with each other at arm's length" (section 139(5)); and the statute spells out what it means by "related persons". Individuals connected by blood relationship, marriage or adoption are "related persons" (section 139(5a)(*a*)). A corporation and a person who controls it are "related persons" (section 139(5a)(*b*)(i)). So are a corporation and members of certain kinds of groups by which it is controlled (section 139(5a)(*b*)(ii)) and a corporation and certain persons having a specified relationship to those by whom it is controlled (section 139(5a)(*b*)(iii)). Similarly, two corporations controlled by the same person or group of persons or controlled in other specified ways are "related persons" (section 139(5a)(*c*)).

Subsection (5d) of section 139, the provision that I must interpret, was enacted, in the first instance (section 31 of chapter 57 of 1953-4), as part of the set of provisions to which I have referred concerning the effect to be given to the concept of persons not dealing at arm's length; and it is convenient, at this point, to consider the question that I have to decide as it would have had to be decided if it had arisen immediately after subsection (5d) was enacted in its original form. For that purpose, I here set out sufficient of the provisions then added to section 139 to make it possible to consider what was intended by Parliament at that time.

> (5) For the purposes of this Act,
>
> (*a*) related persons shall be deemed not to deal with each other at arm's length; and
>
> (*b*) it is a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length.

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(5a) For the purpose of subsections (5), (5c) and this subsection, "related persons", or persons related to each other, are

(a) individuals connected by blood relationship, marriage or adoption;

(b) a corporation and

(i) a person who controls the corporation, if it is controlled by one person,

(ii) a person who is a member of a related group that controls the corporation, or

(iii) any person related to a person described by subparagraph (i) or (ii);

(c) any two corporations

(i) if they are controlled by the same person or group of persons,

(ii) if each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,

(iii) if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation,

(iv) if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,

(v) if any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation, or

(vi) if each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation.

. . . .

(5d) For the purpose of subsection (5a)

(a) where a related group is in a position to control a corporation, it shall be deemed to be a related group that controls the corporation whether or not it is part of a larger group by whom the corporation is in fact controlled; and

(b) a person who had a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, shares in a corporation, or to control the voting rights of shares in a corporation, shall be deemed to have had the same position in relation to the control of the corporation as if he owned the shares.

Generally speaking, it may be said, that the effect of a determination that a corporation does not deal at arm's length with some other person is that either that corporation or someone else is denied an advantage that it or he would otherwise have in the computation of the tax payable under the Act (e.g., it is not permitted to deduct capital cost allowance computed on the actual cost to it of its depreciable assets—section 20(4)), or it is required to compute its profits on a higher basis than is reflected by its

actual transactions (e.g., on the basis of fair market value—section 17).[1] While it is impossible to generalize with any degree of precision, it is probably not too inaccurate to say that, where special rules are made for situations where persons are not dealing at arm's length, the legislative purpose is to guard against tax avoidance, which tax avoidance would put some persons in a specially favoured position with a resultant unfairness to taxpayers not in a position to make similar arrangements.[2] (The attempt to formulate the legislative purpose for this kind of provision is necessary in order to test the appellant's contention that there is an inference in subsection (5d) of section 139 that is not expressed therein.)

Having regard to the general scheme of the provisions in which the concept of not dealing at arm's length was employed, as I understand it, and to the expressed legislative intent that the non-arm's length concept extends not only to any case where parties were not, in fact, dealing at arm's length (subsection (5)(*b*)) but also to a variety of arbitrarily defined circumstances where the parties might, in fact, be dealing at arm's length, it seems improbable that Parliament intended that paragraph (*b*) of subsection (5d) would have the unexpressed effect of artificially deeming a person to have ceased to control a company whose issued shares all belonged to him merely because he had granted an option to someone else to buy such shares.

To test the question further, it seems to me to be appropriate to consider the application of the concept of an arm's length transaction, for the purpose of subsection (4) of section 20, where a corporation bought depreciable property from

(a) the owner of all its shares at a time when he had not granted a right to any other person in respect of such shares,

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[1] In some cases, it is true, the provision containing a "non-arm's length" clause may, incidentally, operate to relieve a taxpayer of a tax liability to which he would otherwise be subject (e.g. section 85A(5)).

[2] The legislative view, presumably, is that, in the particular class of case, persons not dealing at arm's length will be tempted to make arrangements that are not dictated by business considerations but by a desire to minimize tax liability; and that such temptation does not exist where the parties are at arm's length and must therefore heed business considerations ahead of tax considerations.

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(b) the owner of all its shares after he had granted an option to another person to buy the shares and before such option had been exercised, or

(c) a person having an option to buy all its shares.

Clearly the corporation and the owner of its shares, in case No. (a), are related persons by virtue of subsection (5a)(*b*)(i) and, therefore, are deemed "not to deal with each other at arm's length" by subsection (5)(*a*). Similarly, it is clear that in case No. (c), the person who had an option is deemed, by subsection (5d)(*b*), to have had the same position in relation to the control of the corporation as if he owned the shares and he and the corporation are, therefore, related persons by virtue of subsection (5a)(*b*)(i) and are deemed not to deal with each other at arm's length by subsection (5)(*a*). This result clearly follows even if the vendor merely has an option to acquire the shares that he may never be able to exercise (n.b. the words in subsection (5d)(b) "a right . . . either absolutely or contingently"). Parliament seems to have adopted the policy, at least in this case, that, if a person is put in a position where he is entitled, even contingently, to acquire control, the same disadvantages arise as if he actually had control. That being so, it seems quite consistent that Parliament deliberately stopped where it did in subsection (5d)(*b*), it having been intended that, where a situation existed

(i) where one person in fact had control, and

(ii) where another person had a right to acquire control,

each of them should be "deemed" not to deal with the corporation at arm's length. It follows that, in my case No. (b) (*supra*), subsection (4) of section 20 would operate in the case of a purchase by a corporation of depreciable property from a shareholder who had granted an option in respect of its shares to someone else as well as in the case of a purchase from a shareholder who had not granted any such option.

My conclusion is that I cannot infer, in the context of this legislation, from the fact that Parliament cast the net of this class of legislation so as to embrace a somewhat

dubious[1] class of case, that it meant to withdraw its application from the obvious[1] case of the corporation and the person actually owning its shares.

I come now to section 39 of the *Income Tax Act* and its special statutory concept of "associated" companies. That concept is part of a scheme for ensuring that the lower corporate tax rate of 18 per cent provided for by that section is allowed on only one amount of $35,000 where there are a number of companies "associated" with each other within that statutory concept, and is not allowed on $35,000 for each of such companies. As I have already indicated, the present case arises out of a dispute as to whether the appellant is associated with Empire for the purpose of section 39.

Prior to 1960, the definition of "associated" company in section 39 made use of the "arm's length" concept. Any reference to that concept was, however, dropped when section 39 was amended in 1960. The following provisions were, at that time, enacted as part of section 39 (section 11 of chapter 43 of 1960):

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,

(*a*) one of the corporations controlled the other,

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

(*c*) each of the corporations was controlled by one person and the person who controlled one of the corporations was related to the person who controlled the other, and one of those persons owned directly or indirectly one or more shares of the capital stock of each of the corporations,

(*d*) one of the corporations was controlled by one person and that person was related to each member of a group of persons that controlled the other corporation, and one of those persons owned directly or indirectly one or more shares of the capital stock of each of the corporations, or

(*e*) each of the corporations was controlled by a related group and each of the members of one of the related groups was related to all of

[1] I use "dubious" here in the sense that it is doubtful that persons in such a class would have been in fact persons who did "not deal with each other at arm's length"; and "obvious" in the sense that it is probable that persons in such a class did, in fact, "not deal with each other at arm's length".

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the members of the other related group, and one of the members of one of the related groups owned directly or indirectly one or more shares of the capital stock of each of the corporations.

(4a) For the purpose of subsection (4),

(*a*) one person is related to another person if they are "related persons" or persons related to each other within the meaning of subsection (5a) of section 139;

(*b*) "related group" has the meaning given that expression in subsection (5c) of section 139; and

(*c*) subsection (5d) of section 139 is applicable *mutatis mutandis*.

In my view, the meaning to be given to subsection (5d) of section 139 must be determined in the light of the context in which it was when it was first enacted; and, when it was incorporated by cross reference in section 39, its meaning for the purpose of that section was precisely the same, subject only to necessary verbal variations, as it had previously been.

Changes have been made in subsection (5d) since that time, but, in my view, they do not affect the question that I have to decide.

I have set out the reasons for my conclusion in my own words and at some length out of deference to the submission of counsel for the appellant that the question that I have to decide is quite different in principle from that which my brother Noël had to decide in *Yardley Plastics of Canada Limited v. The Minister of National Revenue*[1]. While the problem that arose in that case had to do with a similar contention concerning the effect of paragraph (*a*) of subsection (5d) rather than paragraph (*b*) thereof, in my view, the two paragraphs cannot be given a different effect, as far as the present problem is concerned. I therefore apply, as I think I ought, the conclusion expressed in the following sentence in Noël J.'s judgment:

> The appellant has not, however, succeeded in this regard because although section 139(5d) and its subsections directly affect section 39(4) in extending the meaning of control therein, they do not restrict its meaning.

I am, moreover, in complete agreement with that conclusion, which is expressed by Noël J. much more succinctly than I have found it possible to do.

The appeal is dismissed with costs.

[1] [1966] C.T.C. 215.

APPENDIX

After the above reasons were prepared, counsel for the appellant filed written submissions with regard to *Yardley Plastics of Canada, Limited v. Minister of National Revenue,* in which the following passage appears:

> The depths of absurdity reached by any other construction are well illustrated by the example adduced at the hearing by Mr. Mogan, counsel for the Respondent. Suppose Eatons had a wholly owned subsidiary, all of the shares of which were optioned to Simpsons. Suppose further that the total number of shares issued and outstanding are one hundred shares. Under the construction which Mr. Mogan advanced, Eatons, Simpsons and the subsidiary would all be associated with each other. Under the construction for which I argued, Simpsons and the subsidiary would alone be associated. Eatons would not be associated with the subsidiary or with Simpsons.
>
> If the artificial concept of ownership dictated by Section 139(5d)(*b*) is not exclusive it would necessarily follow that none of the companies would be associated! If Simpsons, because of its option, is deemed to have had the same position in relationship to control of the corporation as if it owned a hundred shares and if, notwithstanding the foregoing, Eatons is regarded as being still the owner of a hundred shares, then the subsidiary is not associated with Eatons and it is not associated with Simpsons. If you add to the artificial deemed to be shareholdings of Simpsons the one hundred shares actually owned by Eatons, there emerges a company in which, in relation to control, Eatons and Simpsons each own or is deemed to own one hundred shares. As the number of shares balance each other and neither of the two companies in relationship to control has more than fifty per cent of the total share issue and deemed to be share issue, there will be no association, and the formerly associated subsidiary would become disassociated from anybody by the option itself.

In my view, this *reductio ad absurdum* argument is based upon an incorrect reading of subsection (5d). That subsection applies, when the question arises as to whether the owner of a "right" controlled the corporation and it directs that he should be deemed to have had the same position in relation to control of the corporation "as if" he owned "*the* shares". When the question arises as to whether the real owner of the shares controlled the corporation, there is no occasion to apply the deeming provision in subsection (5d). There is no possible justification for reading the provision as deeming the existence of two sets of shares in place of the one set that actually existed.