BETWEEN:

MANITOBA DAIRY & POULTRY CO-OPERATIVE LTD. ..... APPELLANT;

1957
Oct. 7-9
Nov. 6

AND

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

Revenue—Income tax—The Co-Operative Associations Act, S. of M. 1916, c. 23—The Companies Act, S. of M. 1932, c. 5—The Companies Act, R.S.M. 1940, c. 36, s. 123, as amended, S. of M. 1943, c. 6, s. 125, s. 127(3A), as added, S. of M. 1947, c. 7, s. 138—Substance of transaction rather than form to be regarded—Appellant a co-operative marketing association for marketing members' produce—Surplus earned by appellant did not have essential quality of income to it—Surplus earned by appellant not owned by it but held for members.

The appellant was organized as a co-operative association whose membership consisted entirely of producers of poultry, eggs and dairy products who marketed their produce through it. The members were not bound to deliver any products to the association but its by-laws were made binding on it and its members. Article 8A of the by-laws provided that the surplus arising from the yearly business of the association should be credited to the members entitled thereto in proportion to the volume of business respectively done with it and also that the association might borrow from the members for a revolving fund to enable it to carry on business amounts up to their shares of the surplus in consideration of the promise of the association to repay such amounts as soon as monies became available for the purpose. When a member delivered produce to the association to be marketed by it he received

[1] [1932] Ex. C.R. 8. [2] [1956] S.C.R. 49.

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an advance or first payment and awaited final payment. At the end of each year's operation the association made an accounting to its members. At its annual meeting, held soon after the close of its fiscal year, it passed a resolution, pursuant to Article 8A of the by-laws, whereby the surplus for the past year was allocated and credited to the members entitled thereto and the association borrowed from the members a sum equal to the patronage dividends credited to them to be repaid as soon as monies became available for the purpose. The Minister assessed the association to income tax for each of the years from 1948 to 1951 on the surplus in each year on the ground that it had earned the surplus from its business and was entitled to it. The association appealed to the Income Tax Appeal Board which dismissed its appeals and the appellant appealed from its decision to this Court. The issue in the appeal was whether the surplus referred to was taxable income of the association or held by it for its members to whom it must account.

Held: That the case is not essentially different in principle from *The Horse Co-Operative Marketing Association, Limited v. Minister of National Revenue* [1956] Ex. C.R. 393.

2. That regard should be had to the substance of the transaction under consideration rather than its form and that it is the true nature of the transactions between the members and the association that falls to be determined.

3. That when the members delivered their produce to the association they did not sell it to the association but delivered it to the association to be marketed by it for them.

4. That the association was not a trading corporation, in the ordinary sense of the term, and did not purchase its member's produce from them.

5. That the appellant was not engaged in "an operation of business in carrying out a scheme for profit making".

6. That the appellant was a co-operative marketing association for the marketing of its members' produce. It was their marketing agency and the means whereby, in their opinion, they would be able, by co-operation with one another through it, to obtain more for their produce than if they sold it to an outside organization and that when the association received the produce from its members and sold it it did so as the members' marketing agent and held the net proceeds from the sale of the products in that capacity.

7. That the dealings of the members with the association was in their capacity as members acting co-operatively through it as their marketing agent and not in that of patrons doing business with it.

8. That when the association earned a surplus from its business of handling its members' produce for them it did not earn it for itself, but for them and it did not own the surplus.

9. That the surplus did not have the quality of income to the appellant that was essential to its being taxable income in its hands, within the meaning of the test used by Mr. Justice Brandeis in delivering the judgment of the Supreme Court of the United States in *Brown v. Helvering* (1934) 291 U.S. 193, in that its right to the surplus was not absolute and it was not free to dispose of it or to use or enjoy it and that the surplus had to be credited to the members and was held by the association for them and on their behalf.

10. That, in the alternative, if it should be considered that the member's delivery of his produce to the association constituted a sale of it by him to it then the amount credited to him pursuant to Article 8A would be part of the cost of the produce to the Association and there would be nothing left to constitute profit to it.

11. That the appeal from the decision of the Income Tax Appeal Board and from the assessments must be allowed.

APPEAL from decision of the Income Tax Appeal Board.

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

W. B. Francis, Q.C., and *D. E. Gauley, Q.C.*, for appellant.

F. J. Cross, for respondent.

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

THE PRESIDENT now (November 1957) delivered the following judgment:

This is an appeal from the decision of the Income Tax Appeal Board[1], dated May 25, 1955, dismissing the appellant's appeals from its income tax assessments for the years 1948, 1949, 1950 and 1951.

The appellant, hereinafter usually called the association, was originally incorporated on June 19, 1924, as Manitoba Co-Operative Poultry Marketing Association under *The Co-Operative Associations Act*, Statutes of Manitoba, 1916, Chapter 23, upon the co-operative plan, pursuant to a memorandum of association, dated June 12, 1924. *The Co-Operative Associations Act* was repealed in 1932 by *The Companies Act*, Statutes of Manitoba, 1932, Chapter 5, and co-operatives were brought under Part VI, subsequently Part VII, of the said Act. Section 118 of that Act carried forward into section 123 of *The Companies Act*, R.S.M. 1940, Chapter 36, which, as amended in 1943, Statutes of Manitoba 1943, Chapter 6, provided:

123. This Part shall apply to applications for letters patent for the creation of corporations to be operated on a co-operative basis, and to those corporations when incorporated; and to corporations heretofore incorporated under "The Co-Operative Associations Act" or any Act for which it was substituted in the same manner as if they had been incorporated by letters patent.

[1] (1955) 13 Tax A.B.C. 88.

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Thus the association, which had been incorporated as a memorandum of association company, became, in effect, a letters patent company and stood in the same position as if it had been incorporated under Part VII of *The Companies Act*.

The appellant's capital, which had originally consisted of 20,000 shares of the par value of $1 each, was increased on March 11, 1939, to 40,000 shares of the par value of $1 each and on April 30, 1946, to 200,000 shares of $1 each, the increase in each case being authorized by Supplementary Letters Patent under *The Companies Act*.

Prior to the years in question in this appeal, there was another marketing association operating in Manitoba, known as Manitoba Co-Operative Dairies Ltd., but early in 1947 the appellant took it over by acquiring its shares and assuming its liabilities. Then by Supplementary Letters Patent, dated May 14, 1947, the appellant's capital was further increased to 500,000 shares of $1 each and its name changed to its present one.

The issue in the appeal is a narrow one. It turns on the nature of the transactions between the appellant association and its members and the character of the surplus in its hands at the end of each year of its operations. Was this surplus taxable income of the association or was it held by it for its members to whom it must account?

The association's membership consisted entirely of producers of poultry, eggs and dairy products who marketed their produce through it. This appears from its by-law relating to membership. Article 11(1) provided:

> The term "Member" when used herein shall include "Shareholder" and "Membership Fee" shall include the cost of a share of capital stock.

And Article 11(2)(*a*) read as follows:

> Membership in the Association shall be extended to all persons who market agricultural products through the Association. A formal written application for membership shall not be necessary, but delivery of agricultural products for marketing shall be accepted by the Association as the equivalent of an application for membership.

And Article 11(2)(*b*) should also be considered. It provided:

> There shall be deducted and retained by the Association out of the first and subsequent settlements to any person who has marketed products through the Association, including shareholder members, a total amount equal to the par value of sufficient shares in the capital stock of the

Association to bring such person's holdings up to a total of ten shares of $1.00 each; provided, however, that deductions from members' settlements for the purpose of payment of the purchase price of shares shall, unless the purchasing member directs larger deductions, be limited to the following amounts:

(1) Deductions for purchase of shares of new members shall be limited to $1.00 for the first year, and $2.00 per annum thereafter until paid;

(2) Deductions for purchase of additional shares by members already holding one share shall be limited to $2.00 per annum until paid.

Moreover, it appears to have been intended that the membership should be confined as far as possible to *bona fide* producers. For example, Article 4(1) provided:

The Directors shall have the general management and control of the business of the Association and shall have power:

(a) To allot, and approve the transfer of shares in the capital stock of the Association, but with power to refuse the allotment, or transfer of any of the said shares to anyone other than a bona fide producer of poultry and dairy products.

The members were not bound by contract to deliver any products to the association but its by-laws were made binding on it and its members by subsection (3A) of section 127 of *The Companies Act,* which was added to it in 1947, Statutes of Manitoba, 1947, Chapter 7. This subsection provided as follows:

The by-laws of the corporation shall bind the corporation and its members to the same extent as if they had respectively been signed and sealed by each member, and contained covenants on the part of each member, his heirs, executors and administrators, to observe all the provisions of the said by-laws, subject to the provisions of this Act.

This enactment obviated the necessity or desirability of individual contracts between the association and its members.

One of the association's by-laws, Article 8A, provided for the manner in which the surplus in the appellant's hands at the end of each year of its operations must be dealt with and for the creation of a revolving fund by the association borrowing sums of money from the members and subsequently repaying the borrowed amounts. While this article was passed prior to the enactment of subsection (3A) of section 127 of *The Companies Act* I assume that the subsection gives statutory binding effect to it. Article 8A provided:

(1) After payment of expenses, making proper allowance for depreciation, and after setting aside necessary reserves, the surplus arising from the yearly business of the Association shall be credited to the members

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entitled thereto in proportion to the volume of business which they have respectively done with the Association, with appropriate differences for the different kinds of produce delivered by each.

(2) In consideration of the Association promising to repay to each member, without interest, and as soon as monies become available for that purpose in the revolving fund heretofore established by it, such sums as the Association may borrow hereunder from year to year, each member of the Association agrees to lend to the Association this year, and in each year hereafter upon said terms, a sum of money equal to the amount of the patronage dividends credited to him by the Association, or such part thereof as the Association may desire to borrow, and the Association is by virtue hereof authorized to apply the said dividends of each member on the said loan during such time as he remains a member of the Association.

(3) The Association may repay the said loans, or any part thereof, at any time without notice or bonus.

The association's fiscal year ended on January 31 in each year and its annual meeting was held soon thereafter. At each of the annual meetings held in 1948, 1949, 1950 and 1951 following soon after the close of the fiscal year in such years the following resolution was passed:

BE IT RESOLVED, that pursuant to provisions of Section 8-A of the general By-laws of the Association, the surplus for the past year be allocated and credited to the Members entitled thereto and that the Association do borrow from the said Members a sum equal to the amount of patronage dividends so credited to them to be repaid as soon as monies become available for that purpose.

A description of the organization of the appellant association and the manner in which it operated was given by Mr. J. T. Monkhouse, its president and managing director. The area served by the association was the Province of Manitoba but a few shippers from Saskatchewan used its marketing facilities. The control of the association was vested in its members who were 35,000 in number, distributed among 70 locals divided into 7 districts. The members of each local met at least once a year to elect a delegate or delegates to attend the annual meeting of the association. There were, of course, other meetings of the locals called for the discussion of questions affecting their co-operative. The delegates elected by the locals attended the annual meeting of the association which was held shortly after the end of its fiscal year. At such meeting the delegates received reports from the management on the operation for the fiscal year just concluded and passed a resolution pursuant to Article 8A allocating to the credit of the individual members the surplus in the hands of the association from such

operation. The delegates also elected directors for the current year, one for each of the districts. During the year the members were kept fully informed of the activities of the association.

Mr. Monkhouse then gave a general description of the association's facilities for handling its members' products, consisting principally of poultry, eggs and cream, and of a member's transaction with it. The association had 5 killing plants, 41 egg stations and 9 creameries. If a farmer wished to deliver live poultry, that is to say, turkeys, ducks or fowl, to the association he delivered it to one of the killing stations. There the poultry was killed, packed and sent to a local market or into storage for future sale either in one of the Manitoba cities or outside. On the delivery of the poultry the farmer received an advance payment on the basis of a grade statement handed to him and then awaited final payment in respect of the poultry delivered by him during the year, knowing that the association would make a full accounting to him at the end of the year's operations. If the farmer wished to dress the poultry himself he could deliver his dressed poultry and was dealt with in the same way as if he had delivered live poultry, the only difference being that if he delivered live poultry he was charged with the cost of killing and such cost was deducted from his advance.

If a farmer delivered eggs to one of the association's egg stations the procedure was similar. He received an advance payment on the basis of a grade statement of the eggs delivered and a final payment later.

When a farmer shipped cream to one of the association's creameries it was graded and he received an advance payment based on its grade and butter-fat content. The creamery then manufactured the cream into butter and this was sold by the association for the best price obtainable. At the end of the year a full accounting was made to the cream shipper on the basis of his total shipments, with a proper deduction for the cost of manufacturing the butter.

There was one creamery, namely, at Brandon, that received milk. The shipper received an advance on the milk delivered by him based on the price fixed by the Milk Control Board. The association pasteurized the milk, bottled it and sold it to residents of Brandon. The final accounting to

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milk shippers was based on the butter-fat content of the milk in the same way as if they had delivered cream. And it should be noted that the milk shippers were all also cream shippers.

At the end of the year's operation there was a final accounting by the association to its members. At the annual meeting called after the close of the fiscal year a resolution was passed whereby, pursuant to Article 8A of the by-laws, an appropriate amount out of the year's surplus was credited to each member by allocating the same to him. But the amount so allocated and credited was not then paid to him but was loaned to the association, also pursuant to a resolution under Article 8A, and the amount of such loan was repaid to the member later.

Mr. Monkhouse also gave particulars of some other matters. In 1949, 1950 and 1951 the association conducted what was called a "Turkey Pool". This was a seasonal activity of short duration. When the shipper delivered his poultry to this pool he received an advance payment at the time of the delivery and his final payment at the end of the year.

There were several activities of the association which Mr. Monkhouse described as incidental. One of these was the operation of hog ranches. Hogs were purchased in order to make use of the buttermilk from the creameries, which would otherwise have had to be hauled away. The hogs were sold and the proceeds of their sale in excess of their cost were considered as a réduction in the cost of butter manufacture. Another auxiliary operation was the renting of cold storage lockers for the use of members living near the creameries at Dauphin and Brandon. This was a service to such members and was rendered at cost. Another incidental operation was that of a subsidiary called Canadian Poultry Sales. The association had originally employed a sales agency to sell its members' products in markets other than its local ones such as in Montreal, Toronto and overseas, but in the years in question it used Canadian Poultry Sales, a subsidiary co-operative established by it in conjunction with the Saskatchewan Co-operative Creameries, to dispose of its members' products in such outside markets. The association paid this sales agency for the service rendered by it. It collected the amounts for which the products had been sold and returned the net proceeds of the sales to the

association thus rebating to it the cost of selling less expenses. The amount thus returned was a reduction in expense and, consequently, entered into the association's surplus. Another small operation, the sale of ice cream, was carried on at one creamery only, namely, at Brandon. It was dealt with in the same way as if butter, instead of ice cream, had been made and sold. Reference was also made to the purchase of some butter from Canadian Government stores but Mr. Monkhouse explained that this had been purchased to meet the association's sales commitments and any earnings from the transaction had been used to reduce selling costs and, consequently, to increase the amount of the association's surplus.

Mr. Monkhouse stated that any member could ship his produce to the association and only a member could do so. All shippers to it became members. The directors fixed the amount of the advance payment from time to time. This was usually less than the market price but might be equal to it. The final payment was by way of an allocation or credit of the appropriate part of the surplus pursuant to Article 8A, as already described.

Mr. Monkhouse gave as an example of a transaction between a member and the association what had happened in his own case. He had shipped poultry, eggs and cream in each of the years in question. On each shipment he received an advance based on a grade statement of the produce delivered. At the end of each year an allocation of the surplus was made to him pursuant to Article 8A. And, to illustrate the conclusion of his transaction, he stated that the amount allocated to his credit in respect of his deliveries in 1948 was finally all repaid to him in 1955.

Three witnesses were called for the appellant to show the course of a transaction between a member and the association from the delivery of the member's produce to the receipt of his final payment, Mr. A. McPhail, a poultry and egg shipper, Mr. A. Guild, a poultry, egg and cream shipper, and Mr. E. S. Jackson, the appellant's secretary-treasurer.

I shall deal first with the evidence of Mr. McPhail. He had been a member of the appellant association since 1926 and had shipped poultry and eggs to it. He participated in the Turkey Pool of 1948. On December 11, 1948, he delivered poultry to the association's local agent at Rossburn and

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received a grade statement showing the number of birds, the number of pounds of each and the amount to his credit, together with a cheque for $34.92. He considered this to be a first payment on his poultry. On March 1, 1949, he received another statement showing the grade of the poultry delivered by him, the number of pounds, the price, and the value, which came to $38.55. From this amount the advance of $34.92 had been deducted leaving a balance of $3.63 and a cash ticket for this amount was attached to the statement. This closed his 1948 Turkey Pool transaction.

I now turn to his deliveries other than as a participant in a Turkey Pool. For example, on July 28, 1948, he delivered poultry to the association's shipping point at Brandon and received a grade statement, called a dressed poultry produce voucher, showing number of birds, grade, number of pounds, price and value coming to a total of $68.37, less processing and transportation charges of $9.49, and received a cheque for $58.88. This was a sample transaction. Similarly, on December 4, 1948, he delivered eggs to the association and received a statement, called a produce record, showing the grade of the eggs, the number of dozens, the rate and the amount coming to a total of $5.49 and a cheque for that amount. This was another sample transaction. Mr. McPhail stated that he had made other shipments of poultry and eggs to the association in each of the years in question and that when he made deliveries he received statements from the association similar to the ones referred to. Subsequently, he received statements showing the amounts of the additional payments that had been allocated to him. These are, in my opinion, important. I set out the statement regarding his poultry shipments as follows:

MANITOBA DAIRY & POULTRY CO-OPERATIVE LTD.
Owned and Operated By Over 30,000 Farmers—1950

A. McPhail,

Vista, Man.

Dear Member:

Your association being a co-operative finances on a revolving surplus fund. This means that your savings are not immediately payable in cash, but are allocated each year and then borrowed from the members to provide the necessary finances for carrying on the business.

At this time we are pleased to advise you that your additional payments based on the savings realized by your Association are as follows:

Lbs. of Poultry	shipped in	1947	@ 2.52%	$ 8.97
" " "	"	1948	@ 4.94%	$18.46
" " "	"	1949	@ 1.24%	$ 5.57

These will be paid out in accordance with our By-laws, subject to the approval of our members at each General Annual Meeting. On this basis 1947 savings—less deductions for shares—must be paid in full before any additional earnings for 1948, or later years, can be made.

This statement was filed as Exhibit 12. There were similar statements regarding his additional payments in respect of eggs, filed as Exhibits 15 and 16. Exhibits 12, 15, and 16 show the totals of the amounts of his additional payments as follows: for 1947, $8.97 for poultry and $8.61 for eggs, or a total of $17.58; for 1948, $18.46 for poultry and $1.43 for eggs, or a total of $19.89; and for 1949, $5.57 for poultry and $6.98 for eggs, or a total of $12.55. On June 15, 1951, Mr. McPhail received $4.31 on account of his $8.61 for eggs and on September 1951 $4.49 on account of his $8.97 for poultry. In each case he received a statement with his cheque showing for the year ending January 31, 1948, his share of the surplus at $8.61 for eggs and $8.97 for poultry. These statements were filed as Exhibits 17 and 13 respectively.

I now turn to Mr. Jackson's evidence to show what finally happened in Mr. McPhail's case. He stated that there was a list showing what produce each member had delivered. This list was compiled by stations and he had gone through the lists that would include Mr. McPhail's name and verified the amounts of his deliveries of poultry and eggs. Mr. Jackson then produced a statement, called Patronage Dividend Record, filed as Exhibit 22. This showed the total allocations to Mr. McPhail of $17.58 for 1947, $19.89 for 1948 and $12.53 for 1949. The record showed that these amounts were all borrowed by the association and that the amounts so borrowed were repaid later. For example, the amount of $17.58 was repaid by $8.80 in 1951, corresponding with the amounts of the cheques for $4.31 and $4.49 received with the statements, Exhibits 17 and 13, and the balance of $8.78 in 1953; the amount of $19.89 for 1948 was repaid in 1954 and the amount of $12.53 for 1948 in 1956.

The evidence of Mr. A. Guild was of a similar nature. He shipped cream as well as poultry and eggs. With each shipment he received a grade statement and a cheque for the

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amount shown on it. Later, he received statements similar to Exhibits 12, 15 and 16 and then statements similar to Exhibits 13 and 17 and with them a cheque for the amount of the payment shown on them. His Patronage Dividend Record, filed as Exhibit 23, showed that his total allocations came to $112.53 for 1947, $73.44 for 1948 and $92.14 for 1949. The Record also showed that $2.00 was deducted for shares from the amount of $112.53 for 1947 and that the balance of $110.53, all of which was loaned to the association, was repaid to him by $57.03 in 1951 and $53.50 in 1953, that the amount of $73.44 for 1948 was repaid in 1954 and that of $92.14 for 1949 in 1956.

Mr. McPhail, whose evidence impressed me favorably, explained that he could have delivered his produce to organizations other than the appellant association but made his deliveries to it because, to use his words, "we had formed a local to handle our own products, poultry and eggs, and we believed we could obtain a better price than we could obtain from other organizations". The association told its members in advance what they were to get. In most cases it was equal to the price quoted by competitors but in some cases it could be less. The members expected that the association would sell their produce to the best advantage and anticipated that it might be shipped and sold at outside points or stores until prices might be higher. Mr. McPhail was familiar with Article 8A of the by-laws and it was his understanding of the reference in it to the term "the surplus arising from the yearly business of the Association" that the association was carrying on a business and that a surplus would arise from it. In his view, the business consisted of "the handling of our produce until it reached the consumer" and he considered that a surplus would arise on the sale of the products in various markets for a price that would allow a surplus, meaning thereby an excess of receipts over expenses and the advance payments that had been made. By "our produce" Mr. McPhail meant his own produce and that of his neighbors who were members of the association and, while he had no contract whereby the property in his produce continued to be his and expected only money in return for it, he considered that the net proceeds of its sale was his.

Mr. Guild's evidence was essentially to the same effect although on his cross-examination he was confused in some

of his statements, but I am satisfied that this confusion was one of terminology and not of substance.

Mr. Guild was not alone in his confusion of terminology. It showed on the forms used by the association. But the confusion was substantially cleared away by Mr. Jackson. He stated that the amount received by a member on the delivery of his produce to the association was a first payment or an advance. Its amount was determined by the management on a day to day basis and approximated the price paid by competitors. When a member delivered his produce to the association it did not purchase the produce from him and Mr. Guild's statement that it did so was erroneous. The use of the term "purchase" to describe the association's receipt of its members' produce was erroneous and such terms as "price" and "value" appearing on the statement, called dressed poultry produce voucher, were inaccurate. The term "price" should have been read as meaning "initial payment" or "advance".

Then Mr. Jackson explained the so-called final payments. The member's entitlement to his share of the surplus was that it was his portion of the proceeds from the sale of his produce after deducting the expense of selling it and the advances or first payments that had been made to him. In that view, there were errors in the headings used in such statements as Exhibit 17 and 13 which Mr. McPhail received. For example, Exhibit 13 showed certain headings, one of which was "your share of surplus", under which the sum of $8.61 appeared, which, as I have stated, was Mr. McPhail's allotment of surplus for eggs delivered in the year ending January 31, 1948. This statement was accurate. The other headings were "Credit to Share Acc't", $4.30 and "Patronage Dividend", $4.31. "Credit to Share Acc't", according to Mr. Jackson, was not a correct heading. It should have been called "Balance Still to be Paid", for that is what it really was. I agree with this view. The amount of $4.30 was never credited to Mr. McPhail's share account. The heading "Patronage Dividend" $4.31 was, likewise, not accurate. Actually, it was part of the sum of $8.80 shown as Exhibit 22 as a loan repayment made to Mr. McPhail in 1951. And the said sum of $8.80 was a part repayment of the loan of $17.58 which Mr. McPhail had made to the association of the amount of the total allocation to his credit out of the surplus for the year ending January 31, 1948, for

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his deliveries of poultry and eggs during that fiscal year. And the heading "Patronage Dividend Record" on Exhibits 22 and 23 was not an accurate one. It should have been simply "Credit Record" or something of that sort for what the statement recorded was the amount of the allocation out of surplus and what was done with it, such as allocation in payment of shares and allocation to loan account, and then the statement recorded the repayments of the loans and the balance of loans remaining unpaid. This closes the statement of the facts.

I now come to the conclusion to be drawn from the facts. Counsel for the appellant relied strongly on the decision of this Court in *The Horse Co-Operative Marketing Association Limited v. Minister of National Revenue*[1]. But before I deal with its applicability I should refer to counsel for the respondent's admission regarding the appellant association's Turkey Pool operations and his argument in support of the assessments.

During the course of the hearing he stated that the amounts of the final payments made to members in respect of the Turkey Pools operated in 1949, 1950 and 1951 were not taxable income to the appellant association and that it had been improperly assessed in respect of them. I agree. It follows that to the extent that such amounts were included in the assessments the appeals against them must be allowed. Here I must say that I do not see any fundamental difference between the association's Turkey Pool operations and its ordinary ones. The only difference appears to have been that a member who participated in a Turkey Pool received his final payment at the end of the appellant's fiscal year instead of lending it to the association and waiting for the repayment of the loan.

I now set out counsel for the respondent's argument in support of the assessments, as I understood it to be. He confined it to his interpretation of the meaning and effect of subsection (3A) of section 127 of *The Companies Act* and Article 8A(1) of the appellant association's by-laws. His submission was that the members of the association contemplated that it would carry on a business from which a surplus would arise and that such surplus as had arisen had been earned by it from its business and belonged to it.

[1] [1956] Ex. C.R. 393.

This was not a case, so the argument went, where the association was required to account to its members for the portion of the surplus that belonged to them but rather one where they contracted for a portion of such surplus after it had been earned by the association and it was urged that what was to happen to it after it had been earned could not alter the fact that since it had been earned by the association from its business it belonged to it and was taxable income in its hands. It was also submitted that this case differed from the *Horse Co-Operative* case (*supra*) in that there was no by-law in this case similar to By-law No. 15 in that case, but that, on the contrary, Article 8A of the by-laws of the appellant association was quite different from By-law No. 15 in the case referred to.

I am unable to accept counsel's submissions in support of the assessments and have come to the conclusion that this case is not, in reality, essentially different in principle from the *Horse Co-Operative* case (*supra*). There are several reasons for this conclusion.

It is, I think, clear that the appellant association was a true co-operative within the meaning of section 125 of *The Companies Act* which provided:

> 125. A corporation hereafter incorporated shall be deemed to be operated on a co-operative basis, if provision is made in its letters patent or by-laws,
>
> (*a*) that no member have more than one vote;
>
> (*b*) that no member, other than a corporation member, vote by proxy; and
>
> (*c*) that the surplus funds arising from the business be distributed wholly or in part among the members or amongst members and patrons, in proportion to the volume of business which they have done with or through the corporation.

I am also of the view that Article 8A of the appellant association's by-laws was within the ambit of section 138(1) of *The Companies Act* which provided:

> 138. (1) A corporation may, subject to its letters patent and memorandum of agreement, enter into any contract or arrangement with its members or patrons for or incidental to dealing with commodities of the kinds the corporation may lawfully deal in and for carrying out the objects and purposes of the corporation, and may advance money to its members or patrons as part payment for commodities delivered or agreed to be delivered to it.

and that the appellant association operated under this section rather than under section 139.

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It is essential in a case such as this that regard should be had to the substance of the transaction under consideration rather than its form: *vide Inland Revenue Commissioners v. Eccentric Club Ltd.*[1]. Thus, it is the true nature of the transactions between the members and the appellant association that falls to be determined.

As I see it, it would be contrary to the fact to say that when the members delivered their produce to the association they sold it for the amount received by them on their delivery of it. They did not. The evidence is conclusive to that effect. The members delivered their produce to the association to be marketed by it for them. That was the reason for the association's existence. It had been formed so that the members could co-operate with one another through it in the marketing of their produce, and the fact is that they did market their produce through it. That it was intended that they should do so appears clearly from the provision in Article 11(2)(*a*) of the by-laws that "Membership in the Association shall be extended to all persons who market agricultural products through the Association". Membership in the association implied of necessity marketing through it. The evidence of Mr. McPhail is to the same effect. Conversely, and notwithstanding the terms used in some of the documents referred to, the association did not purchase its members' produce from them. It was not a trading corporation, in the ordinary sense of the term, engaged in the buying and selling of poultry, eggs, and dairy products for its own profit. If it had been its members would have been entitled to participate in such profit by receiving dividends in their capacity as shareholders. But their rights to an appropriate portion of the association's surplus did not depend on their shareholdings. That had nothing to do with the matter. The fact is that the appellant association was a co-operative marketing association for the marketing of its members' produce, and when it earned a surplus from its business of handling its members' produce for them it did not earn it for itself, but for them. In my opinion, it is clear beyond dispute that the appellant association was not engaged in "an operation of business in carrying out a scheme for profit making" for itself, within the meaning of the test laid down by Lord

[1] [1924] 1 K.B. 390 at 414.

Justice Clerk Macdonald in *Californian Copper Syndicate v. Harris*[1]. On that ground alone it would not be subject to tax on its surplus.

Nor can it be said that the members were entitled to their appropriate portion of the appellant's surplus as patronage dividends. Their dealings with the association were in their capacity as members acting co-operatively through it as their marketing agent and not in that of patrons doing business with it. I make this statement without hesitation and notwithstanding the use of the term patronage dividend in article 8A(2) of the by-laws and Exhibits 13, 17, 22 and 23. The term was misdescriptive and its use erroneous.

The fact of the matter is that when the members delivered their produce to the association they did so in order that it should market their produce for them and on their behalf. It was their marketing agency and the means whereby, in their opinion, they would be able, by co-operation with one another through it, to obtain more for their produce than if they sold it to an outside organization. And when the association received the produce from its members and sold it it did so as the members' marketing agent and held the net proceeds from the sale of the produce in that capacity.

Moreover, I find, as I did in the *Horse Co-Operative* case (*supra*), that while it may be conceded that the appellant association had earned the surplus referred to it did not own it. The surplus did not have the quality of income to the appellant that was essential to its being taxable income in its hands, within the meaning of the test used by Mr. Justice Brandeis in delivering the judgment of the Supreme Court of the United States in *Brown v. Helvering*[2], to which I referred in the *Horse Co-Operative* case (*supra*). The appellant's right to the surplus was not absolute and it was not free to dispose of it or to use or enjoy it. In view of the Article 8A of the by-laws there was only one thing that could be done with it. It had to be credited to the members in the manner specified by the article and the association had no option in the matter. Article 8A is confirmatory of the fact that the appellant did not own the surplus but held it for its members and on their behalf.

[1] (1904) 5 T.C. 159 at 165. [2] (1934) 291 U.S. 193.

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In the alternative, as in the *Horse Co-Operative* case (*supra*), if it should be considered that the member's delivery of his produce to the association constituted a sale of it by him to it it is manifest that it was a condition of such sale that the amount paid on the delivery of the produce was only a first payment on account and that the balance was to be paid after the close of the year's operations, as specified in Article 8A. In that view of the transaction between the members and the association the amounts credited to the members pursuant to Article 8A would be part of the cost of the produce to the appellant association and there would not be anything left to constitute profit to it or taxable income in its hands.

Only one other matter requires comment. It was intimated to the appellant association that it might be subject to income tax on its surplus and it set aside a portion of it as a contingency reserve to pay it and paid it under protest on the understanding that if it should be held that it is not subject to tax the amount paid will be refunded to it and the amount so refunded will be credited to the members pursuant to Article 8A of the by-laws in the same manner as the rest of the surplus.

It follows from what I have said that the appeal from the decision of the Income Tax Appeal Board and the appeals from the assessments must be allowed and the assessments set aside. The appellant is also entitled to costs to be taxed in the usual way.

Judgment accordingly.