

JAMES GOODFELLOW ROBSON }  
 (APPELLANT) ..... } APPELLANT;

1952  
 \*Feb. 20, 21  
 \*April 22

AND

THE MINISTER OF NATIONAL }  
 REVENUE (RESPONDENT) ..... } RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA.

*Taxation—Revenue—Income Tax—Shareholder—Distribution of profits in form of stock in another company—Capital or Income—Liability of shareholder to Income Tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 3(1).*

The appellant was the president and principal shareholder of the Timberland Lumber Co. which in 1938 purchased from funds representing accumulated profits, shares of the Salmon River Logging Co. at \$100 per share. The latter company accumulated substantial profits from the date of purchase until 1944 when Timberland sold the shares to its own shareholders in proportion to their holdings at \$100 per share. In 1945 the shareholders disposed of the shares at \$750 each. The appellant having been assessed for the year 1944 on the estimated market value of the Salmon River Logging Co. shares, less the cost of the shares to him, as a dividend deemed to have been received from Timberland, appealed to the Exchequer Court of Canada which affirmed the assessment.

*Held:* 1. The difference between the price paid to Timberland by its shareholders for the Salmon River shares and their true value was an annual net profit or gain in the sense of being a dividend or profit directly received from stocks within the meaning of s. 3(1) of the *Income War Tax Act*.

2. The shares sold were not an accretion of capital but a dividend paid in money's worth and represented taxable income. *Pool v. The Guardian Investment Trust Co.* [1922] A.C. 347, approved in *Commissioners of Inland Revenue v. Fisher's Executors*, [1926] A.C. 395 at 403; *Weight v. Salmon*, 19 T.C. 174 at 193, 194.

3. It was a profit in 1944 when the money's worth was received and not in 1945 when the shares were sold. It was an immediate distribution of profits and not a declaration of a distribution payable at some subsequent time.

4. On all the evidence the value of \$600 per share as found by the trial judge was a fair and just figure.

Judgment of the Exchequer Court of Canada [1951] Ex. C.R. 201, affirmed.

APPEAL from the judgment of the Exchequer Court of Canada (1) Sidney Smith J., Deputy Judge, affirming an assessment made against the appellant under the *Income War Tax Act* for the year 1944.

\*PRESENT: Rinfret C.J. and Kerwin, Taschereau, Rand and Fauteux JJ.

(1) [1951] Ex. C.R. 201.

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*J. L. Lawrence* for the appellant. The 580 shares did not have a value in excess of \$580,000 but if so the excess value was not a dividend or deemed to be a dividend under the *Income War Tax Act*. Such excess value was not income of the appellant under s. 3 of the Act or under any other provision of the Act and in any event no income in respect thereto was received by the appellant in 1944. The object of the sale by Timberland was to secure needed funds and not to distribute profits and was a bona fide sale. None of the reasons given by the appellant for the sale to its shareholders were contradicted in evidence and the trial judge made no finding of fraud or dishonesty. The Court should not submit its judgment for the judgment of businessmen in business matters. *Hirsche v. Sims* (1). Timberland is a separate legal entity from its shareholders and the sale should be considered as a contract between independent parties. *Salomon v. Salomon & Co.* (2); *Pioneer Laundry and Dry Cleaners Ltd. v. Minister of National Revenue* (3).

The shares of Salmon River held by Timberland were a capital asset of Timberland. The shares were purchased to give an enduring benefit to Timberland. Any profit made on the sale of the shares would not be income of Timberland. *British Insulated & Helsby Cables v. Atherton* (4); *Minister National Revenue v. Dominion Natural Gas Co. Ltd.* (5); *Southern v. Borax Consolidated Ltd.* (6).

Capital is not defined in the *Income War Tax Act* but if an asset does not come under the head of inventory, that is the property in which a company trades, then for all the purposes of the Act it should be treated as capital. In England capital invested in inventory is called circulating capital as opposed to fixed capital. Shaw and Baker "The law of Income Tax" 1937, p. 154; *Inland Revenue Commrs. v. Blott* (7). The attitude of Parliament towards the sale by a company of its assets to its shareholders is shown in s. 32B of the *Income War Tax Act*. The respondent has made no attempt to rely on this section and the reason is obvious because the sale of the shares of Salmon River by

(1) [1894] A.C. 654.

(2) [1897] A.C. 22.

(3) [1940] A.C. 127.

(4) [1926] A.C. 205.

(5) [1941] S.C.R. 19.

(6) [1940] 4 All E.R. 412.

(7) [1920] 1 K.B. 114;

[1920] A.C. 171 at 194.

Timberland would not create income of Timberland. If s. 3 is to be interpreted as found by the trial judge then s. 32B is unnecessary and that would not logically follow since Parliament is presumed to know the law. *Queen v. Walford* (1); *Young & Co. v. Mayor of Royal Leamington Spa* (2). The inclusion in s. 32B of the words "which assets if sold at the market price would create income of the corporation within the meaning of this Act" clearly indicate that only where a corporation receives or would receive income can a shareholder be deemed to receive a dividend. This is a step beyond the provisions of s. 3 and obviously it is as far as Parliament intended to go. The trial judge has gone far beyond s. 32B in holding that similar provisions should apply in every sale by a corporation of assets to its shareholders whether or not such sale would create income of the corporation.

A company is not competent to declare a dividend except in accordance with its authorized procedure. *Bouch v. Sproule* (3). The extract from the Articles of Association as filed requires a recommendation by the directors and a declaration by the company in general meeting in order to declare a dividend. This was not done. What the company declares a certain translation to be that it is; if it declares it to be a dividend then it is a dividend; if it declares it to be a sale it is a sale and not a dividend. *Commsr. of Inland Revenue v. Blott* (4); *Commsr. of Inland Revenue v. Fishers Executors* (5).

The resolutions of Timberland were for a sale only and were approved by Salmon River and by Green Point only on that basis. The real and only purpose was to effect a sale and this would be so even though the shares were sold at an under-valuation and even though the shareholders contemplated a benefit to themselves as well as Timberland.

S. 3 must be strictly construed. The relevant words apply to a dividend not to a sale. If Parliament had intended s. 3 to apply to a transaction such as this it would have enacted legislation such as is found in s. 8 (1). Under that section the sale might attract taxation yet that section does not declare the transaction to be a dividend or even

(1) (1846) 9 Q.B. 626 at 635.

(3) (1887) 12 A.C. 385.

(2) [1883] App. Cas. 517 at 526.

(4) [1920] 2 K.B. 657.

(5) [1926] A.C. 395.

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presumed to be a dividend. No such words appear in the Act as it existed in 1944 and should not be read into the Act. *Parkington v. A.-G.* (1); *Brooks v. Commsr. of Inland Revenue* (2); *Canadian Eagle Oil Co. v. The King* (3); *Taplin v. Commsr. of Internal Revenue* (4).

*W. R. Jackett Q.C.* and *F. J. Cross* for the respondent.

The appellant received the profit arising from the purchase of the Salmon River shares as a shareholder of Timberland and as a profit from his Timberland shares even though the profit arose out of a sale transaction and was received as a free distribution. *Weight v. Salmon* (5); *Ede v. Wilson and Cornwall* (6). He received the profits arising from the purchase in the year he purchased the shares. *Gold Coast Selection Trust v. Humphrey* (7).

The profit received by the appellant was properly included in computing his income for the 1944 taxation year by virtue of s. 3 as being a dividend or profit directly or indirectly received in the year from stocks or other investments, *Commsr. of Inland Revenue v. Blott* (8), and the amount of the profit as fixed by the Minister and trial judge is justified on the evidence.

The judgment of the Chief Justice, Kerwin, Taschereau and Fauteux, JJ. was delivered by:—

KERWIN J.:—This appeal is concerned with the assessment to income tax of the appellant under the *Income War Tax Act* in the year 1944. I agree with the reasons for judgment of the trial judge except that I find no occasion to consider any of the decisions in the Courts of the United States referred to by him.

His findings of fact are the only possible ones on the evidence. The appellant was the President and Managing Director of Timberland Lumber Co. Ltd., and its principal shareholder. That company had obtained 100 shares, at \$100 each, of Salmon River Logging Company Limited, which latter had profits after payment of taxes in each of the years 1938 to 1943 inclusive, of various amounts ranging from about \$65,000 to about \$126,000. Timber-

(1) (1869) L.R. 4 H.L. 100.

(2) (1914) 7 T.C. 236.

(3) (1946) 27 T.C. 205 at 208.

(4) (1930) 41 Fed. R. 2d 454.

(5) (1934) 19 T.C. 174.

(6) [1945] 1 All E.R. 367.

(7) [1948] A.C. 459 at 469.

(8) [1921] A.C. 171 at 194, 196.

land held earned profits and the object of its shareholders, including the appellant, was to distribute those profits. This is made quite clear from the company's annual statements and the letters to the Income Tax Inspector from the firm that acted as auditors of that company and also of the Salmon River Company. These letters also show that originally it was the intention to declare a dividend of the Salmon River shares to the shareholders of Timberland. What was finally done was that Timberland sold to its shareholders, in proportion to their holdings, the Salmon River shares at \$100 per share. The shareholders, including the appellant, thus secured shares that represented profits and which profits had never been capitalized by Timberland.

Upon these facts the case falls within subsection 1 of s. 3 of the *Income War Tax Act* because the difference between the price paid to Timberland by its shareholders of \$100 for each share of the Salmon River Company and the true value was an annual net profit or gain in the sense of being a dividend or profit directly or indirectly received from stocks within that part of subsection 1 of s. 3 of the Act, reading as follows:—

and shall include the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security, or from stocks, or from any other investment, and, whether such gains or profits are divided or distributed or not, and also the annual profit or gain from any other source.

Mr. Lawrence suggested that this should be read:—  
 “The interest \* \* \* received from money at interest upon any security or without security \* \* \* dividends from stocks \* \* \* profits from any other investment.” This, however, is not the correct interpretation as what is included is: (a) the interest, dividends or profits directly or indirectly received from money at interest upon any security or without security: and (b) the interest, dividends or profits directly or indirectly received from stocks or from any other investment. The same construction results from a consideration of the French version of the text:—

et doit comprendre l'intérêt, les dividendes ou profits directement ou indirectement reçus de fonds placés à intérêt sur toutes valeurs ou sans garantie, ou d'actions, ou de tout autre placement, et, que ces gains ou profits soient partagés ou distribués ou non, et aussi les profits ou gains annuels dérivés de toute autre source, y compris.

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The distribution of the shares by Timberland was not a distribution of capital of that company. As the correspondence and the balance sheets of Timberland show, those shares were not an accretion of capital but were a dividend paid in money's worth and represented taxable income: *Pool v. The Guardian Investment Trust Co.* (1), a decision of Sankey J., as he then was, approved, although distinguished, in *Commissioners of Inland Revenue v. Fisher's Executors* (2), by Viscount Cave, at 403, with the concurrence of Lord Atkinson. Here, as in the *Pool* case, the distributing company distributed, not shares in its own stock, but shares in the stock of another company. The fact that the shares were not freely distributed but were purchased at \$100 per share means only that each shareholder, including the appellant, was receiving a profit to the extent of the difference between the price he could get for it and the price he had actually paid: *Weight v. Salmon* (3), at pp. 193, 194, per Lord Atkin, with whom all the other peers agreed. Furthermore, it was a profit in 1944 when the money's worth was received and not in 1945 when each share was sold for \$750. It was an immediate distribution of profits and not a declaration of a distribution payable at some subsequent time such as was found in *Associated Insulation Products Ltd. v. Golder* (4).

On the evidence the true value was properly fixed by the trial judge at \$600 per share in 1944. The appellant called as a witness Mr. J. C. Wilson, a member of the firm of auditors that acted for both companies. He fixed the value at \$113 per share but, as the trial judge points out, the letter of June 20, 1944, from Mr. Wilson's firm to the Income Tax Inspector disagrees with his view at the trial that in 1944 the outlook for Salmon River was a poor one, since that letter states: "It appears that Salmon River will accumulate funds fairly rapidly from now on." The trial judge, therefore, declined to accept Mr. Wilson's estimate and with that conclusion I agree. Mr. Beer, called on behalf of the respondent, put the book value at approximately \$400 with the value computed on earnings at something more, and he testified that in arriving at that figure

(1) [1922] 1 K.B. 347.

(2) [1926] A.C. 395.

(3) (1935) 19 T.C. 174;

51 T.L.R. 333.

(4) [1944] 2 All E.R. 203.

he had made no allowance for wartime appreciation in fixed assets due to rising prices. On all the evidence \$600 per share is a fair and just figure and the appellant is liable to income tax imposed upon the difference between that amount and the sum of \$100 paid by the appellant on his purchase from Timberland of each share of Salmon River.

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In this view of the matter, I find it unnecessary to deal with the respondent's contention that section 18 of the Act also applies. The appeal should be dismissed with costs.

RAND J.:—The investment by the Timberland Company in the Salmon River Company was made from funds representing accumulated profits; and if the shares so obtained had been distributed among the shareholders of Timberland there can be no doubt that they would have been income within the meaning of s. 3 of *The Income War Tax Act* as "dividends or profits directly or indirectly received . . . . from stocks". In *Pool v. The Guardian Inv. Company* (1), such a distribution took place and the judgment of Sankey J. (as he was) was approved by Cave L.C. in *I.R. v. Fisher's Ex.* (2); and *I.R.C. v. Reid's Trustees* (3), shows that "dividends" are taxable regardless of the nature of the fund out of which they are paid.

But such a distribution can be made under the guise of a sale, and here Smith J. has found that to have taken place. Shares purchased originally by Timberland for \$100 each were, seven years later, made the subject of an agreement purporting to sell them to the shareholders of Timberland for the same price. One year still later, they were disposed of by the shareholders for \$750 each. Those striking facts were buttressed by the frank disclosure of the desire to make a distribution of the shares, as to the mode of which the advice of the Income Department was sought; and I agree with Smith J. that the form adopted was simply what was thought to be a means of avoiding the taxation consequences of declaring a dividend.

(1) [1922] 1 K.B. 347.

(2) [1926] A.C. 395.

(3) [1949] 1 All E.R. 354.

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The remaining question is of the value of the shares found, namely, \$600 when they were received. In this, Smith J. has, I think, dealt carefully and thoroughly with all relevant factors, and I am quite unable to say that his conclusion was unwarranted or indeed that it was not dictated by what was before him.

I would therefore dismiss the appeal with costs.

*Appeal dismissed with costs.*

Solicitor for the appellant: *J. L. Lawrence.*

Solicitor for the respondent: *F. J. Cross.*

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