THE PALMOLIVE MANUFACTURING COMPANY (ONTARIO) LIMITED (DEFENDANT) ..... APPELLANT;

AND

HIS MAJESTY THE KING ON THE INFORMATION OF THE ATTORNEY GENERAL OF CANADA (PLAINTIFF)..... RESPONDENT;

AND

COLGATE-PALMOLIVE-PEET COMPANY, LIMITED (DEFENDANT).

1932
*Nov. 28.
1933
*Feb. 7.

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COLGATE-PALMOLIVE-PEET COMPANY, LIMITED (DEFENDANT).... RESPONDENT;

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THE PALMOLIVE MANUFACTURING COMPANY (ONTARIO) LIMITED (DEFENDANT).

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Revenue—Sales tax—Special War Revenue Act, 1915, s. 19BBB (1), as amended by 13-14 Geo. V, c. 70, s. 6 (1)—Manufacturing company and selling company and control by foreign parent company—Relationship of the companies and mode of business—Sales by manufacturing company to selling company and by latter to public—"Sale price" for basis of the tax.

*PRESENT:—Rinfret, Lamont, Smith, Cannon and Crocket JJ.

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P. Co. (an Ontario company), incorporated January 17, 1924, manufactured (*inter alia*) certain kinds of toilet articles, which they sold only (and were, by arrangement, allowed to sell only) to C. Co. (a Dominion company, which, prior to incorporation of P. Co., was engaged in the manufacture and sale of such articles) which sold them to the trade. Both companies had the same president, and the same vice-president and general manager. All the capital stock of both companies, except qualifying shares, was owned by a foreign parent company, which fixed from time to time the percentage over cost to be allowed P. Co., on figures furnished by department heads. The quantity of goods to be produced by P. Co. was prescribed by C. Co., which controlled the formulæ. The Crown claimed that the sales (from January 17, 1924, to April 13, 1927) made by C. Co. to the trade were chargeable with sales tax, under s. 19BBB (1) of the *Special War Revenue Act, 1915,* as amended by 13-14 Geo. V, c. 70, s. 6 (1). The companies claimed that the price at which P. Co. sold to C. Co. (and not the price received by C. Co., as claimed by the Crown) was the proper basis for the tax.

Held: C. Co. (but not P. Co.) was liable for the tax, based on the prices obtained by it, as being the real prices taxable under the true intent of the Act. The character and substance of the real transaction must, for taxation purposes, be ascertained and the tax levied on that basis. On the evidence it must be held that the goods in question were produced and sold to the public by a combination of the two incorporated departments of a foreign company doing business here in order to reach the Canadian consumer. While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, P. Co. being but a part of C. Co., acting merely as its agent and subject in all things to its proper direction and control.

Dixon v. *London Small Arms Co.*, 1 App. Cas. 632, at 647-648, 651, etc., and other cases, referred to.

Judgment of Maclean J., President of the Exchequer Court, [1932] Ex. C.R. 120 (holding P. Co. liable for the tax, to be based on the selling price of the goods calculated at the "fair market price," as and when sold), varied.

APPEALS and cross-appeal from the judgment of Maclean J., President of the Exchequer Court of Canada.(1)

The plaintiff claimed from the defendants a sum alleged to be due for sales tax, and for interest and penalties.

Maclean J. (1) found that the sale price on which the defendant, The Palmolive Manufacturing Co. (Ontario) Ltd., had paid sales tax was not the "sale price" on which it should have been paid, within the meaning of the *Special War Revenue Act,* and declared that the plaintiff was entitled to recover from that defendant the balance due, and that the sales tax be based upon the selling price of the goods calculated at the fair market

(1) [1932] Ex. C.R. 120.

price of same as and when sold, reserving the precise amount recoverable under the judgment and the question of interest and penalties. He dismissed the action as against the defendant, Colgate-Palmolive-Peet Co. Ltd.

The defendant, The Palmolive Manufacturing Co. (Ontario) Ltd., appealed to this Court. The plaintiff appealed and cross-appealed, claiming that the judgment below should be varied by declaring that the plaintiff was entitled to recover from the defendants sales tax calculated upon the price received by the defendant, Colgate-Palmolive-Peet Co. Ltd., and by giving judgment against the latter company as well as against the other defendant, and by directing payment by the defendants of interest and penalties.

The material facts of the case are sufficiently stated in the judgment of this Court now reported.

The appeal of the defendant, The Palmolive Manufacturing Co. (Ontario) Ltd., was allowed, and the action against it dismissed without costs throughout either to or against it. The appeal of the plaintiff against the defendant, Colgate-Palmolive-Peet Co. Ltd., was allowed and the case against that company remitted to the Exchequer Court with a direction to enter judgment for the amount of the sales tax, at the rates from time to time applicable, based on the prices obtained by that company (less the amounts already paid by the other defendant), with interest at the rate of 5% per annum up to 14th April, 1927, and thereafter at the rate of $\frac{2}{3}$ of 1% per month; with costs in this Court and in the Exchequer Court.

W. N. Tilley, K.C., and *G. M. Clark, K.C.*, for the companies.

H. H. Davis, K.C., and *D. Guthrie* for the Crown.

The judgment of the Court was delivered by

CANNON J.—These are an appeal and a cross-appeal from the judgment of the Exchequer Court of Canada of the 12th of May, 1932 (1), in an action brought by His Majesty the King on the information of the Attorney General of Canada against Colgate-Palmolive-Peet Company and The Palmolive Manufacturing Company (On-

(1) [1932] Ex. C.R. 120.

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tario) for the recovery of sales tax on goods sold between the 17th January, 1924, and the 13th April, 1927, together with interest and statutory penalties.

Prior to the 1st of January, 1924, the *Special War Revenue Act, 1915,* as amended, imposed, by sec. 19 BBB, an *excise* tax on sales and deliveries by manufacturers, or producers, and wholesalers, or jobbers. This section was replaced by 13-14 Geo. V, c. 70, s. 6 (1), as follows:

19 B.B.B. (1). In addition to any duty or tax that may be payable under this Part, or any other statute or law, there shall be imposed, levied and collected a *consumption or sales tax* of six per cent on the sale price of all goods produced or manufactured in Canada, including the amount of excise duties when the goods are sold in bond, which tax shall be *payable by the producer or manufacturer at the time of the sale thereof by him.*

This new levy came into force on the 1st of January, 1924, and imposed "a consumption or sales tax" on the sale price of all goods produced or manufactured in Canada, which tax was made payable "by the producer or manufacturer at the time of the sale thereof by him".

Since 1917, the Palmolive Company of Canada Ltd., whose name was later changed to Colgate-Palmolive-Peet Co. Ltd., one of the defendants (which will hereinafter be called the Dominion company), was engaged in the manufacturing and sale of soap and toilet preparations in Toronto. On the 17th January, 1924, the other defendant, the Palmolive Manufacturing Company (Ontario) Limited (which will hereinafter be called the Ontario company) was incorporated. The letters patent have not been produced; but from the evidence it appears that during the period from the 17th of January, 1924, until the 13th of April, 1927, this company was engaged, with the Dominion company, in the manufacturing and sale of toilet soap and toilet articles.

The only witness heard was Mr. Charles R. Vint, who has been, throughout that period, Vice-President and General Manager of both companies. Although the evidence would have been more satisfactory if the contracts between the two companies and with the parent American company had been produced, this gentleman seems to have given fairly and without reticence the relationship of the three companies and the mode in which the business was carried on. Avoiding the incidence of taxation is one of the reasons mentioned for the incorporation of the Ontario company,

and it is claimed that, by this incorporation in 1924 of a manufacturing company, the price arranged between this unit of the organization with the older company which continued to sell to the public, is the real price of the goods produced or manufactured by them and is, legally, the basis of the sales tax payable by this producer.

The Crown, by their cross-appeal, contended that the price received from the public by the Dominion company for their goods is the only and real price of sale which should be considered.

According to Mr. Vint, the following conditions obtained during the period under scrutiny:

1. All the capital stock of both the Dominion and the Ontario companies, except the few qualification shares, was owned and held by the parent company, the Palmolive Company of Delaware;

2. Each company had the same President;

3. Mr. Vint was Vice-President and General Manager of each company;

4. The Ontario company's activities were limited to manufacturing and, to a certain extent, shipping operations;

5. The salaries of the employees of both companies were fixed by the parent company;

6. The quantity of goods to be produced by the Ontario company was prescribed in advance by the selling company which controlled the formulae and prescriptions;

7. The raw materials (oils) were purchased as previously by or through the parent company;

8. The percentage over cost to be allowed to the Ontario company was fixed from time to time by the parent company on figures furnished by department heads;

9. The cost to the customers of the Dominion company was just the same (subject to trade fluctuations) as it was before what Mr. Vint calls the *departmentalization* of the original business;

10. Goods were shipped, from Toronto at least, by the manufacturing (Ontario) company direct to the customers on the instructions of the Dominion company and also, on the same instructions, to warehouses in

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Montreal and Winnipeg. These warehouses, although the evidence is not clear, seem to have remained the property of the Dominion company;

11. The two departments, during all this period, were carried on in the same premises as before, with the same machinery, and, more or less, the same workmen, the same superintendents and the same employees;

12. The Ontario company, according to Mr. Vint, had no right to sell Palmolive goods to outsiders. This is to be noted as the present case concerns only the sale of Palmolive goods. "The Dominion Company," says Mr. Vint, "are owners of the Palmolive Trade Marks; they could not allow their goods to be manufactured promiscuously, could they; they had to be manufactured under their proper arrangements in order to protect their trade marks, and they were interested primarily in goods *of their own manufacture,* but the Manufacturing Company sold goods on their own account that were not under trade marks";

13. The Dominion company gave permission to the Ontario company to make the goods according to the formulæ and prescriptions and to make the wrappers and everything necessary according to trade mark directions.

Under those circumstances, the Crown alleges as a fact that the defendant, the Ontario company, was the instrument or agent of the defendant, the Dominion company, and that the operations of the manufacturing company were the operations of the Dominion company; that the alleged sales made by the Ontario company to the Dominion company were fictitious and made with intent to avoid payment of the amount of sales tax properly payable and that the sales of the Dominion company to the trade were chargeable with sales tax.

In order to determine whether the Ontario company was an independent manufacturer or the agent and subordinate of the older company, I believe the case of *Dixon* v. *London Small Arms Company* (1) to be very much in point. The Lord Chancellor, Lord Cairns, Lord Hatherley, Lord Penzance, Lord O'Hagan and Lord Selborne all discuss under

(1) (1876) 1 App. Cas. 632.

what circumstances a manufacturer might be considered as a private contractor or as the agent of the person who wishes to produce a certain article.

Lord Hatherley, at pp. 647-648, says:

> Now I apprehend, my Lords, that when you speak of a home manufacture, and a manufacture through the medium of servants and agents of your own, you ordinarily mean, although in some cases some elements may be wanting, and in others, others—that there is a plant—that you have an establishment—that you either have in your own possession or have acquired by purchase the article upon which you are to operate in bringing your manufacture to perfection—and, having done all that, you proceed to manufacture as you think fit, at your own time and in your own manner, stopping the manufacture when you think fit so to do, and retaining the control over it in your own hands. I do not think that that would be interfered with because you might give out one or two portions of it to be manufactured by piece-work, if you think fit to do so. But how different is that from the contract which you enter into when you go out into the open market and purchase an article.

And Lord Penzance says (p. 651):

> * * * and I conceive that the argument * * * that it was a contract of agency, rests upon the general proposition that in all cases where an individual, *bargaining,* contracts to sell a completed article, which is to be manufactured according to the special directions of the purchaser, he is, while in the course of manufacturing that completed article, the agent of the purchaser.

Another test proposed by the noble Lord Penzance is whether there is anything in the contract that would prevent the manufacturer from selling the same goods (in that case small arms) to a foreign government. If he could do so, he must be considered to have been an independent contractor and not an agent of the Crown.

Now, in our case, it clearly appears that the Ontario company were not at liberty to sell the Palmolive products to outsiders. They were not free agents, as far as the manufacture and sale of these articles were concerned.

Another test submitted by the House of Lords was: While the work was going on, could the dismissal of a workman be ordered or could any step which the officers of the Dominion company thought desirable in the organization of the Ontario company be ordered by the General Manager of the latter company, who was also the General Manager of the other company? Could the General Manager give any special direction for doing the work in a special way; or was that entirely in the power of the Ontario company? Could the Dominion company withdraw any

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orders they had given or order that the same should be done in a different way? Who could decide the rate at which the work should proceed?

Evidently the Ontario company had to carry out the instructions of the Dominion company. Was not this *home manufacture,* to use the expression of Lord Hatherley, acting under a master's control, dealing with a master's product and attending solely to a master's interest? The two companies were not even free agents in fixing the alleged price or remuneration, as this was determined by the parent company, as appears by the following:

Q. Then during that period, from January, 1924, to April, 1927, who fixed the cost, or the prices, rather, to be paid by the Dominion Company to the Ontario Company?—A. That was made by—in consultation with the Delaware Company, having regard for the interests of both companies.

Q. Consultation by whom with the Delaware Company?—A. Well, our Delaware office.

Q. By you?—A. Yes.

Q. You, as representing both the Dominion and the Ontario Companies?—A. Well yes, as Manager of both. I had facts, of course, on the operations of both companies.

Q. Well then, you, after consultation with the Delaware Company, decided what was a fair price to charge?—A. At the meeting in the Delaware office the facts were presented and it was the opinion of the meeting —prices were arrived at as of the opinion of the meeting, you see.

This is not an ordinary free sale in the open market, where a freely made tender by a person is freely accepted or rejected by another person. I entertain serious doubt, in the absence of a written contract between the two companies, whether this evidence is sufficient to show that the contract of sale really existed, as alleged by the defendant. In order to effect a sale, it is manifest from the general principles which govern all contracts that it requires two parties capable of giving, freely, a mutual assent.

According to *Collinson* v. *Lister* (1), a contract requires two parties and a man in one character can with difficulty contract with himself in another character. And in *Grey* v. *Ellison* (2): A company which carries on two kinds of business under two separate departments, is nevertheless one company, so that one department of it cannot enter into a contract with the other. At page 444, the Vice-Chancellor, in this case of *Grey* v. *Ellison,* says:

(1) (1855) 25 L.J. Ch. 38.

(2) (1856) 1 Giffard's Chancery Reports, 438.

If a man were so fanciful as to grant a lease to himself of his own house, with a covenant that he should quietly enjoy, and a covenant that he should pay to himself a rent for his own house, and chooses to conduct it in the way of having two departments, that is, that he will draw cheques upon himself upon his own account for rent, and pay them into another account of his own at his bankers—it would be a mere whimsical transaction; but it would be futile and an abuse of language to say that it came within the law of contract.

But, in the present case, the producer has incorporated the manufacturing department as a separate company. Is this sufficient to successfully avoid the payment of the sales tax on the real price paid by the public when purchasing the goods of this producer?

In *Cartwright* v. *City of Toronto* (1), which was also an assessment case, my brother Duff stated that taxing statutes "must be construed according to the usual rule, that is to say, with reasonable regard to the manifest object of them as disclosed by the enactment as a whole."

And under the *Interpretation Act,* R.S.C. 1927, c. 1, sec. 15,

> Every Act and every provision and enactment thereof, shall * * * receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act and of such provision or enactment, according to its true intent, meaning and spirit.

I believe that the character and substance of the real transaction must, for taxation purposes, be ascertained and the tax levied on that basis.

In *The Gramophone and Typewriter Limited* v. *Stanley* (2), Cozens-Hardy, M.R., said:

> I do not doubt that a person in that position may cause such an arrangement to be entered into between himself and the company as will suffice to constitute the company his agent for the purpose of carrying on the business, and thereupon the business will become, for all taxing purposes, his business. Whether this consequence follows is in each case a matter of fact.

In *The King* v. *Bloomsbury Income Tax Commissioners* (3), Lord Reading, C.J., deals with two companies in the light of the law as laid down in the *Salomon* case (4), and says that if the companies were in fact acting as agents for and carrying on the business of a partnership the applicant would be liable to income tax in respect of the profits and gains made by the firm.

(1) (1914) 50 Can. S.C.R. 215, at 219.
(2) [1908] 2 K.B. 89, at 96.
(3) [1915] 3 K.B. 768, at 785.
(4) [1897] A.C. 22.

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In *Daimler Company Limited* v. *Continental Tyre & Rubber Company* (1), Lord Halsbury, at page 316, went behind the legal entity and held that the English company controlled by German directors and shareholders was in substance a hostile partnership and was therefore incapable of suing. To use his words, it became material "to consider what is this thing which is described as a 'corporation'."

In *Rainham Chemical Works Limited* v. *Belvedere Fish Guano Company Limited* (2), Lord Buckmaster says:

> A company, therefore, which is duly incorporated, cannot be disregarded on the ground that it is a sham, *although it may be established by evidence that in its operations it does not act on its own behalf as an independent trading unit, but simply for and on behalf of the people by whom it has been called into existence.*

A reference may also be made to the Supreme Court of the United States' decisions treating two distinct corporate entities as parts of the same enterprise and the apparent transactions between them as really nothing more than book-keeping entries. *Southern Pacific Company* v. *Lowe* (3); *Gulf Oil Corporation* v. *Lewellyn* (4).

The above authorities satisfy me that we must, as matters of fact, identify the producer of the goods and determine the real price received by such producer when selling them to the public for consumption. In this case, it is abundantly clear that the Palmolive soap is produced and sold to the public by a combination of these two incorporated departments of a foreign company doing business here in order to reach the Canadian consumer. While the two companies are separate legal entities, yet in fact, and for all practical purposes, they are merged, the Ontario company being but a part of the Dominion company, acting merely as its agent and subject in all things to its proper direction and control. In order to reach completely the producer, both companies had to be brought before the court; and I believe that the Crown's cross-appeal against the Dominion company should be allowed. That company should be condemned to pay the tax at the rates from time to time applicable based on the prices obtained by the Colgate-Palmolive-Peet Company, Limited, during the

(1) [1916] 2 A.C. 307.
(2) [1921] 2 A.C. 465, at 475.
(3) (1918) 247 U.S. 330.
(4) (1918) 248 U.S. 71.

period under scrutiny, less the amounts already paid, with interest at the rate of 5% per annum to the 14th of April, 1927, and thereafter at the rate of $\frac{2}{3}$ of 1% per month. We are bound on this issue by *The King* v. *Carling Export Brewing & Malting Co. Ltd.* (1), confirmed on this point by the Privy Council (2).

The condemnation against the Palmolive Manufacturing Company (Ontario) cannot stand, as they were, under the evidence, only agents of the producers, who also looked after the sales of the Palmolive products, and its appeal should therefore be allowed and the claim against it dismissed—but, in view of the circumstances, there should be no costs throughout either to or against that company.

The cross-appeal should be allowed and there should be judgment against the Dominion company for the amount of sales taxes at the rates from time to time applicable and based upon the price received by the Colgate-Palmolive-Peet Company Ltd. for the goods mentioned in paragraph seven of the information herein, less the amounts paid by the Palmolive Manufacturing Company (Ontario) Limited, with interest at 5% from the date on which such sales taxes became due until the 14th of April, 1927; and thereafter a penalty of $\frac{2}{3}$ of 1% per month. Each party will pay their own costs on the appeal of the Ontario company against The King; costs will be against the respondent in the cross-appeal of His Majesty versus The Colgate-Palmolive-Peet Company Limited both here and before the Exchequer Court; and the case will be remitted to the latter court with a direction to enter judgment accordingly.

Appeal of The Palmolive Mfg. Co. (Ont.) Ltd. allowed without costs.

Appeal of His Majesty the King against Colgate-Palmolive-Peet Co. Ltd., allowed with costs.

Solicitors for the companies: *Parker, Clark & Hart.*

Solicitors for the Attorney General of Canada: *Cassels, Brock & Kelley.*

(1) [1930] Can. S.C.R. 361 at 374. (2) [1931] A.C. 435, at 445.