BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

MASSAWIPPI VALLEY RAILWAY COMPANY ..... RESPONDENT.

1959
Nov. 16, 17, 18
1961
Feb. 21

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 16 and 23—Assignment of right to receive income—Retroactive effect of fiscal legislation—Appeal dismissed.

Appellant corporation in 1871 leased all of its railway property for a term of 999 years, the lessee agreeing to make annual payments to both the bondholders and shareholders of appellant. Appellant was assessed for tax on the amounts paid to the bondholders and shareholders in 1951. An appeal to the Tax Appeal Board was allowed and from that decision the Minister of National Revenue appealed to the Exchequer Court.

Held: That the appeal must be dismissed.

2. That both parties having agreed that the transaction at issue should be envisaged in the light of the Quebec Civil Law, Art. 1029, C.C. regarding "stipulation for third person" should apply, according to which a valid stipulation in favour of a third person creates a contract between the third person and the person who has agreed to be bound by the contract; it establishes a *vinculum juris* between the latter and the third person.

3. That there was no transfer or assignment of any income within the meaning of ss. 16 and 23 of the *Income Tax Act* since the appellant never had the right to the income as the original lease provided that the consideration for it went directly to the bondholders and shareholders.

4. That the appellant could not be held liable for income tax because the contractual obligations under the leasing had been entered into prior to the effective date of the first income taxation statute in 1917.

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

Guy Favreau, Q.C. and *M. Paquin, Q.C.* for appellant.

John L. O'Brien, Q.C., F. S. Burbidge and *E. E. Saunders* for respondent.

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

DUMOULIN J. now (February 21, 1961) delivered the following judgment:

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This is an appeal from the decision of the Tax Appeal Board, given on November 5, 1958, allowing the appeal of the respondent from the assessment of tax for the year 1951 of Massawippi Valley Railway Company, of the City of Montreal, in the Province of Quebec.

Before attempting to review this appeal, it is appropriate to point out that two others were heard jointly with the instant one, the questions at stake in all three cases raising, practically, analogous problems of law. Consequently, the decision herein reached should also apply in the matters of: *Minister of National Revenue and Ontario and Quebec Railway Co.*, number 152826, and *Minister of National Revenue and Quebec Central Railway Co.*, number 152827, of the records of this Court.

The disputed amount is $22,388 (including penalty), exacted from respondent in a notice of re-assessment, dated February 25, 1954, whereby the company's income tax return, for 1951, declared at "Nil", was revised and set by appellant at $48,000.

No factual complexities whatever arise; the entire issue hinges upon the conflicting opinions entertained by litigants regarding the proper legal connotation of uncontested facts.

We must now retrace the path of time back to December 27, 1871, when a long since forgotten railroad, the Massawippi Valley Railway Company, then running from the Quebec Eastern Townships to points in the bordering State of Vermont, U.S.A., pursuant to statutory privileges conferred in 1862 by 25 Vict. c. 61 (s. 15, *inter alia*), leased the total operation and control of its line and properties, for a period of 999 years, to an American competitor, the Connecticut and Passumpsic Rivers Railroad Company (cf. ex. A-1).

Henceforward, to all intents material, Massawippi Valley Railway was to fade into the unsubstantiality of a mere corporative designation.

Some fifteen years after, on June 1, 1887, (cf. ex. A-2), the rights thus demised, in 1871, were passed on by the initial lessees to Boston and Lowell Railroad Corporation, which, in turn, assigned them to the Boston and Maine Railroad, on December 13, 1892. Next, fifty-nine years later, on November 7, 1946 (ex. A-3), the latter railroad entered

into a similar agreement with the Canadian Pacific Railway, rounded by an assignment on the part of Passumpsic and Connecticut Rivers Ry., to the C.P.R. (for short) of its interest in the unexpired residue of the lease or 824 years.

Reverting to the original indenture, ex. A-1, of December 27, 1871, I will reproduce hereunder the gist of its provisions affording relevancy in this litigation. The Massawippi Valley Railway, then:

. . . by these presents do demise and lease for the said period or term of nine hundred and ninety years . . .

The said road or Railway and Branch Line or Spur of the said Company of the first part [i.e. Massawippi Ry.] with all its franchise, rights & privileges secured by Law, and for that purpose do hereby transfer, convey and set over to the Company of the second part accepting as aforesaid all the real and personal Estate, Depots and Stations, houses and other Structures, its road bed and rights of way, gravel pits and every other right or thing pertaining to said Railway & Spur, and the operating and working of the same, and all privileges and franchises which the Company of the first part now have or may hereafter have under the Laws of Canada and of the Province of Quebec.

Monetary stipulations, under the guise of rental, safeguarded the respective interests of the Massawippi Railway's bondholders and shareholders providing, furthermore, for the redemption of its maturing bonds; these clauses read thus:

SECONDLY: That the Company of the second part [i.e. in 1871, the Connecticut and Passumpsic Rivers Railroad Co.] shall and will and they do hereby stipulate, covenant and agree and bind and oblige themselves in consideration of the foregoing premises to pay to the Holders of the Bonds now issued by the Company of the first part, the sum of Twenty four thousand Dollars annually . . . by semi annual instalments . . .

THIRDLY: The Company of the second part shall and will and they do hereby further stipulate & agree and obligate themselves to set aside and pay to the holders of the capital Stock now issued by the said Company of the first part [Massawippi Ry. for short] amounting to the sum of four hundred thousand Dollars, equal dividends per Share as shall be paid to the Holders of the Preferred Stock of the Company of the second part [viz. Connecticut and Passumpsic Ry.].

AND FOURTHLY AND LASTLY: That the Company of the second part shall and will and they do hereby agree and bind and obligate themselves to provide for the redemption of the Bonds aforesaid at their maturity and shall have and receive as a compensation therefor the unissued balance of the capital Stock of the Company of the first part being a sum in stock equal at par value to the Bonds that shall be paid or redeemed and thereafter the said Company of the second part did and do hereby bind and oblige themselves to set aside and pay to the said Holders of the capital stock amounting to the sum of Four hundred thousand Dollars issued for the redemption of the said Bonds, the same rate of dividend as aforesaid.

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Had the Massawippi Railway resolved to sell its line and assets outright, these terms and conditions could quite fittingly have served that end.

In the cognate affairs of the *Minister of National Revenue v. Ontario and Quebec, and Quebec Central railways,* the basic indentures are, respectively, A-5 of January 1884, and A-9, dated October 2, 1912. The duration of the so-called "lease" in the Ontario-Quebec Ry. and C.P.R. deal is stated as "in perpetuity", and fixed at 999 years in the agreement with Quebec Central Ry. (A-9).

Other factors substantially compare with those previously cited, save that a sum of $121,000 is, by appellant's computation, alleged to be Ontario and Quebec Railway's income for taxation year 1951, and $161,900 that of the Quebec Central Ry. during the same period.

I seldom, if ever, recite copious passages of the pleadings, but presently I deem advisable to depart somewhat from such a practice, since the salient points in dispute, pro and con, are adequately set out in paragraphs 7 of the Notice of Appeal, 8 and 13 of the Reply. Section 7 submits that:

> 7. . . . the amount of $48,000.00 paid during the taxation year 1951 by the Canadian Pacific Railway Company to the holders of the common stock of the Respondent, being the rental payable by that company under the indenture of 1871, between Respondent and Connecticut and Passumpsic Rivers Railroad Company, whose rights were in due course assigned on November 7th, 1946, to Canadian Pacific Railway Company, which amount was so paid to the said holders of the common stock of the Respondent because of the direction contained in the said indenture, constitutes a payment or transfer of money made to the said stockholders pursuant to the direction of or with the concurrence of the Respondent for the benefit of the Respondent or as a benefit that the Respondent desired to have conferred on the said stockholders and to the full extent of the said amount of $48,000.00 would have been Respondent's income if the said payment or transfer had been made to it and, consequently, the said amount of $48,000.00 constitutes income of the Respondent for the said taxation year 1951 under the provisions of Subsection (1) of Section 16 of The 1948 Income Tax Act.

This attack upon the as yet unchallenged *status quo ante* of respondent or, more precisely, of its bondholders and shareholders, is squarely met, first in para. 8 of the Reply:

> 8. Pursuant to said agreement dated December 27th, 1871, and said assignment and the fulfillment of the conditions thereof, the assets and enterprise of Respondent became vested in Canadian Pacific Railway

Company for the duration of the said period of nine hundred and ninety-nine years, and the only rights which the holders from time to time of the capital stock of Respondent have during the said period of nine hundred and ninety-nine years are to receive payment of the said amounts from Canadian Pacific Railway Company and, if necessary, to enforce payment thereof by Canadian Pacific Railway Company;

Paragraph 13 mentions the legal tenets in whose light the transaction at bar should be envisaged.

13. By the said agreement dated December 27th, 1871, which agreement is goverened by the laws of the Province of Quebec, and in particular, by the provisions of the Civil Code of Lower Canada, and the said assignment to Canadian Pacific Railway Company, the acceptance of the obligation by Canadian Pacific Railway Company and by the stockholders of Respondent that Canadian Pacific Railway Company should pay the said amounts directly to the holders of the capital stock of Respondent rendered Canadian Pacific Railway Company directly liable to said capital stockholders and there was no obligation to make payments to Respondent, nor had Respondent any right to such payments. Respondent, in consequence, had no income for the year 1951, nor had Respondent the right to any income.

Though no doubt subsists as to the relevancy of the laws of Quebec in the matter, formal admissions to this effect, duly signed by both parties and in each appeal, are appended to the pleadings *ex majore cautela.*

It would therefore appear that the covenants of 1871 (A-1), 1884 (A-5) and 1912 (A-9) should be subjected to an initial test, that of the Civil Code, in order to establish their specific and technical entity, before being weighed in the balance of our fiscal statute.

On this score also the viewpoints of the contestants are at complete variance, the appellant holding that these agreements are nothing more than "simple indication of payment" in line with art. 1174 C.C., whilst respondent contends they constitute so many instances of "Stipulations for third parties" according to art. 1029.

A preliminary observation is that each of those three covenants falls in the class of "*sui generis*" contracts, known to the civil law doctrine and jurisprudence under the French appellation of "contrats innomés" innominate contracts.

Such undertakings, albeit nameless, possess a full measure of validity insofar as they do not contravene the laws of public order and good morals. They are construed conformably to their own terms and conditions.

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The spirit of the civil law regulating lease or hire of things, and quite likely the letter itself, seemingly require a specified duration (art. 1601), not exceeding ninety-nine (99) years (art. 568 concerning emphyteusis, a special class of lease). This element, if originally lacking, was excused in the instant cases by two Acts of Parliament, viz. (1862), 25 Vict. c. 61, s. 15; (1884), 47 Vict. c. 54, s. 2; and an Act of the Quebec Legislature (1912), 2 Geo. V, s. 1.

And now, resuming the main trend of argument, do these indentures give rise legally to the effects and consequences inherent to a "simple indication of payment" or, rather, to those of a "stipulation on behalf of third parties"? Article 1174, C.C., enacts that:

1174. The simple indication by the debtor of a person who is to pay in his place, or the simple indication by the creditor of a person who is to receive in his place, or the transfer of a debt with or without the acceptance of the debtor, does not effect novation.

If any common sense or strictly legal significance attaches, as it does, to the twice mentioned expression "simple indication", then, assuredly, the intricate, lengthy, documents evidencing the transactions, the Acts of Parliament and of a Provincial Legislature deemed necessary to their validity, and the far reaching extent of the deals, sweep away even the vaguest notion of simplicity. Nor is it "a transfer of a debt" for the decisive reason that as those instruments were executed no debt exisited between the railroad and their stockholders, and, at all events, we would be confronted here with much more than "the transfer of a debt". Therefore, this interpretation cannot be entertained.

On the other hand, art. 1029 provides as follows:

1029. A party in like manner may stipulate for the benefit of a third person, *when such is the condition of a contract which he makes for himself,* or of a gift which he makes to another; and he who makes the stipulation cannot revoke it, if the third person have signified has assent to it. [italics are mine]

This section, save for one word: "contrat" in the Quebec Civil Code text, "stipulation" in the Code of France, is, to all intents, a verbatim reproduction of art. 1121 of the French "Code Civil", which Quebec jurists still designate by its historical surname of "Code Napoléon" and it reads:

Art. 1121. On peut pareillement stipuler au profit d'un tiers, lorsque telle est la condition d'une stipulation que l'on fait pour soi-même ou d'une donation que l'on fait à un autre. Celui qui a fait cette stipulation ne peut la révoquer, si le tiers a déclaré vouloir en profiter.

Since complete identity exists between the progenitor text and its offspring, it will be useful to consult French jurisprudence and to notice it unquestionably holds that the "stipulant" (actually the respondent) is relieved of juridical responsibility so soon as the third party, "le tiers", has assented for his part.

Henceforth, in the eyes of the law "*in conspectu legis*" the two sole contracting parties remain the "promettant" (originally the Connecticut and Passumpsic Rivers Ry. Co.) and, as stated, the accepting "third party", bondholders and shareholders.

A most frequent instance of such transactions is to be found in the realm of insurance, especially life insurance, about which, so far back as 1888, the "Chambre civile de la Cour de Cassation D.P. 88, part 1, 77, 193, the French tribunal of last resort, wrote that:

> Le bénéficiaire acquiert contre l'assureur un droit propre et direct, qui ne fait à aucun moment partie du patrimoine du stipulant . . . Et qui n'est donc pas rapportable à sa succession. [The sentence just preceding is a commentary added by Mr. Crépon, a jurist of the last century].

Planiol and Ripert, in their exhaustive treatise of "Droit Civil", (1930 ed. *Traité Pratique de Droit Civil Français,* tome VI, N° 362), under the caption of "Rapports juridiques nés de la stipulation pour autrui" and the sub-title of "Acquisition du bénéfice de la stipulation", profess that:

> 362. C'est le but et l'effet essentiels de la stipulation. Pour réaliser cette acquisition conformément à l'intention du stipulant qui normalement est d'en procurer au tiers le bénéfice à l'exclusion de tous autres, on a été amené à dire que le tiers a contre le promettant un *droit direct et personnel* [underlined in the text] remontant au jour du contrat.

The 1952 2nd edition of this authoritative work drops the above passage, simply to dilate more discursively on this topic and to a like effect.

Textual similitude and ensuing parity of motives prompted the Quebec Courts, as also the Supreme Court of Canada, to decide similarly. In 1908, the late Mr. Justice Cimon (*ad hoc*) speaking for the majority in re: *Baron v. Lemieux*[1] heard before the Court of King's Bench, quoting Defrénois, (1887 *Traité pratique du Contrat d'assurance sur la vie*), said:

> N° 318. Mais une fois que la stipulation a été acceptée par le bénéficiaire, elle devient irrévocable. L'assuré ne peut plus disposer du bénéfice, et le montant de l'assurance est définitivement acquis au bénéficiaire.

[1] (1908) 17 K.B. 177.

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Cette acceptation rétroagit au jour même du contrat, et par conséquent, le bénéfice est considéré comme n'ayant jamais fait partie du patrimoine de l'assuré.

I feel in duty bound to add that Defrénois, a Notary by profession, never achieved real eminence as a commentator; yet, in this instance, the Quebec Appeal Court was satisfied he felicitously expressed the purpose of the law.

Finally, the Supreme Court of Canada conferred its high approval on this interpretation in unambiguous words. Rinfret J., as he then was, giving judgment for the Court in *Hallé v. Canadian Indemnity Co.*[1], wrote:

> And in civil law a valid stipulation in favour of a third person creates a contract between the third person and the person who has agreed to be bound by the contract. It establishes a *vinculum juris* between the latter and the third person.
>
> Speaking particularly of the present case, the policy confers an independent right upon the third person who is insured under it.

Mr. Justice Rinfret then proceeds to cite from Planiol and Ripert the reference inserted some lines above.

It would be idle, I believe, to labour this point at greater length. The three contractual agreements of 1871, 1884 and 1912, admittedly subject-matter of Quebec's civil laws, are suitably analysed by attributing to each the genus of "innominate contract" and the species of a "stipulation for third parties", with necessarily, all correlative effects. I readily accede to respondent's submission, on page 9 of its "Notes and Authorities" that:

> The proper interpretation of the agreements under study pursuant to Article 1029 C.C. is, . . . sufficient in itself to defeat the claims of Appellant.

Unsuccessful in its counter submission that the transactions do not overstep the narrow bonds of "simple indications of payments" (C.C. art. 1174), the appellant next relied upon the applicability of ss. 16, s-s. (1-2), and 23, hereunder, of the 1948 *Income Tax Act*:

> 16. (1) A payment or transfer of money, rights or things made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person, shall be included in computing the taxpayer's income to the extent that it would be if the payment or transfer had been made to him.

[1] [1937] S.C.R. 368, 377.

I omit s-s. (2), marginally labelled "undistributed payments or profits" which, clearly enough, does not apply.

23. Where a taxpayer has, at any time before the end of a taxation year (whether before or after the commencement of this Act), transferred or assigned to a person with whom he was not dealing at arms' length the right to an amount that would, if the right thereto had not been so transferred or assigned, be included in computing his income for the taxation year because the amount would have been received or receivable by him in or in respect of the year, the amount shall be included in computing the taxpayer's income for the taxation year unless the income is from property and the taxpayer has also transferred or assigned the property.

I will, to begin with, comment briefly on the latter section. The learned counsel for appellant insisted on the bracketed passage "whether before or after the commencement of this Act", stretching its implication and fiscal reach back to 1871, 1884 and 1912, or from five (1912) to 46 (1871) years before income taxation was ever thought of (1917) in Canada, and 77 before the Statute of 1948. The basic principles of British and Canadian legislation regulating rigorously, even frowningly, retrospective enactments are so well known that one concise "reminder" may suffice. Lord Justice Lindley in *Lauri v. Renaud*[1] restated, as under, some well settled maxims:

. . . It is a fundamental rule of English law that no statute shall be construed so as to have a retrospective operation unless its language is such as plainly to require such a construction; and the same rule involves another and subordinate rule to the effect that a statute is not to be construed so as to have a greater retrospective operation than its language renders necessary.

Conformably to this last proposition is it "necessary" that the parenthetical clause ". . . or before the commencement of this Act" should refer not only to the Act immediately preceding, i.e. the *Income War Tax Act* (1927 R.S.C. c. 97 and amendments), but furthermore to an age and times when income taxation in this country remained an undreamt of burden? The affirmative would savour more of retrospective confiscation than retrospective taxation.

Other discrepancies preclude, in my opinion at least, the suitability of s. 23 to this set of facts, for instance:

a) A dealing at arms' length did occur, once and for all, between the respondent companies and their co-contractors: Connecticut and Passumpsic Rivers Railroad, and Canadian Pacific Railway.

[1] (1892) 3 Ch. R. 402.

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b) Merely for discussion's sake, assuming that s. 23 could obtain, then any amount the company had "transferred or assigned . . . shall be included in computing the taxpayer's income *for the taxation year* unless the income is from property and the taxpayer has also transferred or assigned the property". Now, "taxation year", in the language of s. 127(2)(*a*) "is a fiscal period", itself defined in 127(1)(*q*) as meaning ". . . the period for which the accounts of the business of the taxpayer have been ordinarily made up and *accepted, for purposes of assessment under this Act* . . ." (italics not in text). I am incapable of conjecturing a legal approach to the problem of accounts of business "made up and accepted for purposes of assessment under this Act" . . . of 1948, in the years 1871, 1884, 1912, save through the instrumentality of the corresponding covenants. Even so, any amount supposedly transferred or assigned would become assessable, according to the directions of sec. 23, for "taxation years" in periods when no taxation of the kind existed.

The notes devoted to art. 1029 C.C., from which section the transactions herein, performed and perfected prior to the supervening of income tax, derive their legal identity, inferentially prevent a recourse to ss. 16(1) and 23 of the Act. I am in sufficient accord with the résumé given by respondent on pp. 8 and 9 of its Memorandum:

(*a*) that the agreements are governed by Article 1029 C.C.;
(*b*) that the payments by C.P.R. or rights to payments never entered the patrimony of Respondents;
(*c*) that there was no payment or transfer of any money or right by Respondents to their shareholders;
(*d*) that Respondents conferred no benefit because the amounts paid or rights thereto were never part of their patrimony, and were never theirs to confer. [This conclusion, I repeat, technically results from a fiction of law, particularizing art. 1029];
(*e*) that consequently neither Section 16-1 nor Section 23 of the Income Tax Act [1948] applies in the circumstances.

Another appropriate outline of the circumstantial and legal factors surrounding this unusual suit appears in volume 21 of the Canada Tax Appeal Board Cases[1], penned by Mr. Fordham, Q.C., the learned member of the Tax Appeal Board who first heard the case; I quote:

. . . Taxing statutes are to be strictly construed and unless a taxpayer comes squarely within their four corners, he cannot properly be held

[1] (1958-59) 21 Tax A.B.C. 1, 10.

liable. Whatever the appellant did in respect of these requirements, first made statutory in 1948, must have occurred in or about December, 1871. Since then, the appellant has been powerless, as regards exercising any control in the matter, and unable to alter in any way what has long been *a fait accompli*. What occurred in 1871? It was remarked earlier herein, that there was a once-and-for-all agreement executed in that year whereunder the appellant ceased to be any more than an inactive corporate entity and the various stockholders became the payees as long as they continued to hold the appellant's stock. This arrangement may have been convenient for the appellant, but was of no *benefit* to it, or to the stockholders. There was then no income tax legislation in force and if the payments had been made to the appellant first, no tax would have been exigible and the stockholders would still have received as much money, in the form of dividends, as if the payments had gone to a trustee for them, direct. It could be said that, at some time after 1948, the arrangement became beneficial to the stockholders in that the payments continued to reach them without first being taxed in the appellant's hands. But this situation was not, and could not be, foreseen by the appellant in 1871. . .

I concur in this exposition of fact and law. Extraordinary legislation indeed, of the most encompassing pointedness could alone achieve the dubious feat of superimposing the fiscal clock of 1948 on the musty hour-glass of 1871.

For the reasons stated, the decision appealed from is affirmed and the instant appeal dismissed with taxable costs against the appellant.

Judgment accordingly.