Holt Metal Sales of Manitoba Ltd et al (*Appellant*) *v.* **Minister of National Revenue** (*Respondent*)

Jackett P.—Winnipeg, March 10, 11, 1970.

Income Tax—Business divided among different companies—Direction of Minister that companies associated—Vacating direction—Reason for separate existence of companies in succeeding years—Income Tax Act, s. 138A(2), 3(b)(ii).

A company wholly-owned by *H* carried on a scrap metal business. In 1958 a new company, wholly-owned by *H*'s wife, was incorporated and thereafter acted as sales agent for the first company. In 1959 another company, wholly-owned by trustees in trust for *H*'s infant children, was incorporated and thereafter carried on a scrap metal business in ferrous metals previously carried on by the first company. All three companies were managed by *H* from the same premises with the same staff. In 1964 the Minister, applying s. 138A(2) of the *Income Tax Act*, directed that the three companies be deemed associated, thus limiting $35,000 of their combined income to the lower rate of tax.

Held on appeal, the Minister's direction should not be vacated under s. 138A(3)(*b*)(ii) on the ground that none of the main reasons for the separate existence of the two new companies in 1964 as distinct from the years in which they were incorporated was to reduce tax. Although the second new company was incorporated by trustees in 1959 for two main reasons, (1) as an investment for Holt's children, and (2) to reduce tax, but was continued by the trustees in 1964 for the first reason only, it could not be said that the fact that there would be a substantial tax saving was of no importance to the trustees.

INCOME tax appeal.

J. S. O'Sullivan for appellant.

D. G. H. Bowman for respondent.

JACKETT P.—These are appeals from a decision of the Tax Appeal Board dismissing appeals by the appellants from their assessments under Part I of the *Income Tax Act* for the 1964 taxation year. The sole question involved in each appeal is whether the appellant is entitled to a direction under section 138A(3)(*b*)(ii) of the Act vacating a direction under section 138A(2) that the two appellants and Holt Metals Limited be deemed to be associated for the purposes of section 39 of that Act for the 1964 taxation year.

In the Tax Appeal Board and in this court, the appeals were heard together and on the same evidence. The evidence in the court was substantially the same, in so far as the basic facts are concerned, as that given in the Tax Appeal Board. Counsel for the appellants relies in this court on certain additional evidence given by Mr. A. R. Micay, Q.C., and by Mr. Oscar

Antell, but, subject thereto, he found no fault with the detailed review of the facts in the Tax Appeal Board's reasons for judgment. I do not propose, therefore, to review the evidence but will content myself with stating very briefly the salient facts which, as I understand the appellants' case, give rise to the questions that have to be decided in this court.

Prior to 1958 Holt Metals Ltd, the shares of which belonged to William Holt,[1] was carrying on a scrap metals business consisting largely of the purchase and resale of non-ferrous metals but with some incidental purchase and resale of ferrous metals.

In 1959 a new company—one of the appellants, Industrial Metals Processing Limited (hereinafter referred to as "Industrial Metals")—was incorporated, and it acquired the premises and equipment necessary for a full-scale business of acquiring ferrous metals, processing them for resale and selling them. From that time on, Holt Metals confined its business to non-ferrous metals and Industrial Metals carried on the ferrous metals business on a completely different scale to the side line in ferrous metals theretofore carried on by Holt Metals Ltd. Both companies were managed by William Holt and each of them made use of premises and facilities vested in the appropriate company or used by it under appropriate inter-company arrangements, but so arranged that Mr. Holt and a single office staff could conveniently supervise and direct the two staffs of operating personnel engaged on the two different operations. This state of affairs continued throughout 1964, the year in question.

At its inception, all the shares in Industrial Metals were acquired by trustees for infant children of William Holt and such shares continued to be vested in such children at all relevant times.

In 1958 the other appellant, Holt Metal Sales of Manitoba Ltd (hereinafter referred to as "Holt Metal Sales") was incorporated. All of the shares in this company were vested in William Holt's wife[2] throughout all relevant periods. This company was also managed by William Holt who used the same office staff for it as he used for Holt Metals and Industrial Metals. This company did not carry on any separate activity but was the beneficiary of an arrangement under which, technically, all sales made by Holt Metals were made through the agency of Holt Metal Sales on a commission basis.

At this point, it should be recalled that, by section 39 of the *Income Tax Act,* there was a corporation rate of 18 per cent on the first $25,000 of taxable income (which amount was increased to $35,000 in 1960-61) whereas the rate on the balance of a corporation's income was 47 per cent; but this lower rate of 18 per cent was only available for one amount of $25,000 (or $35,000) in the case of two or more corporations that were "associated with each other" within an arbitrary statutory definition of those words.

[1] In fact, until some time in 1959, half the shares belonged to Mr. Holt's brother, but this is an irrelevant complication which I omit for reason of simplicity.

[2] For a short time, half of these shares were vested in a sister-in-law of William Holt.

This explains the significance of section 138A(2), the provision under which the direction under attack in these appeals was made. That provision reads:

> 138A(2) Where, in the case of two or more corporations, the Minister is satisfied
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> (*a*) that the separate existence of those corporations in a taxation year is not solely for the purpose of carrying out the business of those corporations in the most effective manner, and
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> (*b*) that one of the main reasons for such separate existence in the year is to reduce the amount of taxes that would otherwise be payable under this Act
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> the two or more corporations shall, if the Minister so directs, be deemed to be associated with each other in the year.

The result is that, even though two or more corporations have been so set up that they do not fall within the statutory definition of "associated" companies and are, therefore, apart from any such direction, entitled to have the 18 per cent tax rate on $35,000 for each of them, once a direction is made under section 138A(2), they are only entitled to the 18 per cent rate on a single amount of $35,000 for all of them.

Section 138A was first enacted in 1963[8] and was not, therefore, in existence when the appellants were incorporated.

It should also be noted that, at the time they were incorporated, neither of the appellants became "associated" with each other or with Holt Metals. The result was that, to the extent that they had taxable income, each of them would, at that time, have been entitled each year to a tax rate of 18 per cent, instead of 47 per cent, on its first $25,000 of taxable income for the year. It is also to be noted that, in 1956, shortly before the incorporation of the appellants, Holt Metals had experienced a taxable income of $71,466.20.

What happened after the appellants came into existence, so far as the taxable income of the three companies is concerned, may be summarized as follows:

1958	Holt Metals	$ 28,369.30
	Holt Metal Sales	14,286.28
	TOTAL	$ 42,655.58
1959	Holt Metals	$ 22,913.59
	Holt Metal Sales	16,604.81
	TOTAL	$ 39,518.40
1960	Holt Metals	$ 962.19
	Holt Metal Sales	14,008.97
	Industrial Metals	1,057.01
	TOTAL	$ 16,028.17
1961	Holt Metals	$ 13,591.18
	Holt Metal Sales	9,111.23
	Industrial Metals	8,840.49
	TOTAL	$ 31,532.90

[8] 1963 (Can.), c. 21, s. 26(1).

1962	Holt Metals	$ 12,060.99
	Holt Metal Sales	10,406.67
	Industrial Metals	14,555.32
	TOTAL	$ 37,022.98
1963	Holt Metals	$ 24,257.27
	Holt Metal Sales	7,697.00
	Industrial Metals	17,056.07
	TOTAL	$ 49,010.34
1964	Holt Metals	$ 29,311.40
	Holt Metal Sales	10,480.77
	Industrial Metals	25,403.80
	TOTAL	$ 65,195.97

It is the direction in relation to this latter year that is being attacked under section 138A(3) of the *Income Tax Act* which reads, in part, as follows:

> 138A(3) On an appeal from an assessment made pursuant to a direction under this section, the Tax Appeal Board or the Exchequer Court may
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> (*a*) confirm the direction;
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> (*b*) vacate the direction if
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> (ii) in the case of a direction under subsection (2), it determines that none of the main reasons for the separate existence of the two or more corporations is to reduce the amount of tax that would otherwise be payable under this Act; or
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> (*c*) vary the direction and refer the matter back to the Minister for reassessment.

Before this court may vacate the Minister's direction under this provision, as the appellants seek, it must conclude that "none of the main reasons for the separate existence of the . . . corporations is to reduce the amount of the tax that would otherwise be payable under this Act".

This question was dealt with by the reasons of the judgment of the Tax Appeal Board as follows:

> A most careful consideration of the extensive evidence given in the somewhat involved circumstances has led me to conclude that the activities of Holt Metals Limited in all its facets could very readily have been continued by that company and the activities in ferrous and non-ferrous metals could have been conveniently and successfully carried on by Holt Metals Limited and, if need be, by two divisions of that company in separate locations. A fair and reasonable appreciation of the evidence as I have understood it seemed to establish this beyond all doubt.
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> Nor is there any room for doubt that all the many income tax considerations were fully exposed and discussed by Mr. Holt with his expert advisers in such matters and that Mr. Holt was fully aware of the consequences of the course upon which he was embarking.
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> * * *

The question for determination herein is whether *none* of the *main* reasons for the separate existence of Holt Metal Sales of Manitoba Limited and Industrial Metals Processing Limited was to effect a reduction in the amount of tax to be paid. This question is one of fact to be decided upon the evidence adduced and the proper inferences to be drawn therefrom. The onus of establishing that the sole, main reason was that of business consideration falls upon the appellants. If I have correctly understood and evaluated the evidence, I am satisfied that the appellants have failed to discharge that onus.

The actual business operations were carried on in precisely the same manner after incorporation as before. The management agreements between the appellant companies and Holt Metals Limited left the effective control in the hands of Holt Metals Limited. It must be said that everyone concerned was aware of the incidence of income tax and the effect the incorporation of these two companies would have on the total amount of tax payable by the two divisions of the former business of Holt Metals Limited. The conclusion that professional advice from specialists in the income tax field was brought home to those involved is inescapable.

In this appeal as in the appeal of *Bay Cast Products Limited (supra)* I would adopt and paraphrase the reasoning of Cattanach, J., in *Alpine Furniture Co. Ltd, et al, v. MNR,* 68 DTC 5338; (1968) C.T.C. 532, at pp. 5345 and 543 respectively of the reports cited. It is inconceivable to me, in this day when the incidence of tax is always present, that a person with the business experience and undoubted business acumen of Mr. W. Holt would have been oblivious of the tax advantage that might result from the arrangement which he adopted and pursued.

I am satisfied from the evidence as a whole that the prospect of a reduction in the amount of income tax payable in the future was one of the main reasons for the adoption of this arrangement for the division of the business operations of Holt Metals Limited into two separate corporate entities, even though Mr. W. Holt was disposed to testify to the contrary.

There were many possible advantages to be gained from the incorporation of the one or other or both of the appellants, which, I am sure, were in the minds of those responsible for taking the decision to incorporate them. Some of the main ones are

(*a*) the incorporation of Industrial Metals provided an organizational means for dividing the ferrous metals operation from the non-ferrous metals operation, such operations being of a nature that required separate operating organizations, and it incidentally provided two different trade names under which to carry on the respective businesses;

(*b*) the appellant corporations provided a means for creating an estate, over the years, for William Holt's wife on the one hand, and for his children on the other hand; and

(*c*) the creation of Industrial Metals provided a means by which the risks of the one business would not imperil the assets of the other and, in particular, it shielded the assets to be built up for the children from the perils of the riskier non-ferrous metals business.

If the evidence were such as to convince me that some or all of these and other reasons that have been advanced were sufficiently compelling in the minds of William Holt and his advisers to constrain them to select the crea-

tion of the appellants in preference to all other possible methods of achieving the same results, I should have thought that it might be open to me to conclude that the probable reduction in income taxes through having three companies instead of one to enjoy the 18 per cent tax rate was not one of the "main" reasons for deciding to have three companies instead of one. An example of a case where other considerations dictated the creation of several corporations and the income tax benefit arising therefrom was only an incidental benefit, is *Jordans Rugs Ltd et al v. M. of N.R.*[4] Here, however, no attempt was made to show that, in the minds of William Holt and his advisers, to achieve any one or more compelling objectives (such as conferring property benefits on members of the family) the only practicable method was the creation of multiple companies (and other methods of achieving such objectives certainly existed); one is left with the conclusion that the very substantial prospective annual reduction in income tax must have been, consciously or unconsciously, one of the main factors that operated on the thinking of William Holt and his advisers to bring them to elect for this particular method of reorganization and re-arrangement of William Holt's affairs in preference to all other alternatives.[5]

If the question were, therefore, whether one of the "main reasons" for the creation of the appellants was to reduce the amount of the tax, I should have to decide that question adversely to the appellants.

Counsel for the appellants in this court, however, put his case for Industrial Metals on a different ground. He says that the question to be determined under section 138A(3)(*b*)(ii) is not why the two or more corporations came into existence in 1958 and 1959, but is whether or not one of the main reasons "for the separate existence" in 1964 of the two or more corporations is to reduce the amount of the tax that would otherwise be payable. He says further that, in this court, it was established by the evidence of Mr. Micay and Mr. Antell, but particularly by the evidence of Mr. Micay, that the sole reason for the continued existence of Industrial Metals is that Industrial Metals was in an operation that was generating income for the benefit of the infant beneficiaries and the trustees would therefore have been delinquent in their duty as trustees if they had exercised their powers as shareholders to have that company wound up.

I am of the view that it confuses the issue to put undue emphasis on the fact that the shares in Industrial Metals were held by the trustees for the children. As I understand counsel for the appellants, he is saying that if we consider why the companies have continued to have a separate existence in 1964, we find that the reason is that the shares in Industrial Metals were such a good investment that the trustees would not have been justified in terminating that investment. But, as it seems to me, if such shares were such a good

[4] [1969] C.T.C. 445.

[5] I cannot accept the suggestion of one witness that the 18 per cent rate was of little or no significance because the companies involved could re-arrange salary rates to avoid the higher corporate rates. Even if such re-arrangement of salary rates by reason only of the incidence of income tax were otherwise permissible, it surely could not have been contemplated for Industrial Metals when it was planned that all the shares would be held in trust for infant children who, presumably, would not be in receipt of salaries.

investment that a trustee would have been bound to conserve them for the trust, then a reasonably prudent person who held them in his own right would have also decided to keep them alive rather than wind up the company. That does not, however, dispose of the point.

The real point that is being put to this court and that was not put to the Tax Appeal Board, as I understand it, is that, in applying section 138A(3)(*b*)(ii), you must forget about the reason for *the creation* of the separate existence of the two or more corporations and address your mind to the question as to why they have *continued* to exist separately during the year in respect of which the Minister has made his declaration.

This approach is not without some claim to validity. A thing may be brought into existence for one reason and be continued in existence after that reason has, for some other reason, ceased to operate. (A building may be constructed as a railway station and continue to exist after the railway is removed for some other purpose.) Even on that approach, however, the appellants cannot succeed. If we simplify the situation, for purposes of analysis, we find here that Industrial Metals came into existence as a corporation separate from Holt Metals for at least two main reasons—it supplied a means of building up an estate for the children and it provided a means "to reduce the amount of the tax that would otherwise be payable". Mr. Micay convinced me that the trustees continued to allow the two corporations to exist separately for the first of these two reasons but he did not convince me, and I do not think that he tried to convince me, that the fact that there would be a substantial tax saving was a reason that was of no importance to the trustees.[6]

The appeals will be dismissed with costs.

[6] As I see it, two things made the shares in Industrial Metals particularly advantageous for the children. One was the management supplied gratuitously by their father and the other was the 18 per cent tax rate on its first $35,000 of taxable income. Presumably the first might have been continued under a merger with Holt Metals. The second could only be retained by continuing the separate existence of the two companies.