BETWEEN:

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

1963
Mar. 18
May 6

AND

ROBERT VERNON TOMKINS .....RESPONDENT.

Revenue—Income tax—Income Tax Act, R S C. 1952, c. 148, ss. 3, 5(1)(a) and 85A (1)(2)(3)—Benefits to employees—Whether s. 85A applies to transfer of escrow shares to taxpayer—Shares of employing company acquired below value—Election to pay tax on special basis—Appeal allowed

Respondent was induced to enter the services of two companies by an offer of shares of stock therein which at the time were held in escrow as parts of blocks of shares issued to their President Respondent elected to be taxed under s 85A of the Act on benefits so received in 1955 and 1956. On the ground that the shares were not issued or sold to him by the companies but by the President in his personal capacity the election was refused An appeal to the Tax Appeal Board was allowed and the Minister appealed from that decision to this Court.

Held: That the escrow shares made available to the respondent were the personal property of the President of the companies and there was no agreement whereby the companies had agreed to sell or issue shares to respondent.

2 That the benefits deemed to have been received by an employee of a Corporation on benefits conferred on the employee by the Corporation and then the employing company did not agree to sell or issue any of its shares to respondent who did not acquire any shares under such agreement

3. That all the escrow shares were the property of the President and what respondent received was entirely the result of steps taken by the President and as the shares were provided by and at the expense of an individual the requirements of s 85A(1) had not been met and the respondent is not entitled to the benefits of the section.

4 That the appeal be allowed

APPEAL under the *Income Tax Act*.

The appeal was heard before the Honourable Mr. Justice Cameron at Regina.

E. C. Leslie, Q.C. for appellant.

P. H. Gordon, Q.C. for respondent.

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

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CAMERON J. now (May 6, 1963) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Tax Appeal Board dated January 26, 1962[1] which allowed the respondent's appeals from re-assessments dated July 25, 1958 and made upon him for the taxation years 1955 and 1956. In the re-assessments, the Minister added to the declared income of the respondent for 1955 the sum of $5,150, and for 1956 the sum of $10,828.12, stated in each case to be "Amount received from Allied Securities and Allied Securities Ltd."

By Notices of Objection dated August 22, 1958 the respondent, after setting out certain facts, alleged that he was entitled in respect of the amounts above mentioned to the benefits of s. 85A(1)(*a*) of the *Income Tax Act*; and alternatively, that these amounts were not taxable income but rather an appreciation of capital. By the Minister's notifications dated May 19, 1959, he confirmed the said assessments as having been properly made in accordance with the provisions of the Act, and added, "The provisions of s. 85A of the Act are not applicable". The decision of the Tax Appeal Board was that the provisions of s. 85A were applicable to the sums in question and accordingly the appeals of the respondent were allowed, the re-assessments set aside and the matter referred back to the Minister for re-assessments.

At the hearing of the present appeal it was agreed that the evidence given before the Tax Appeal Board, together with the exhibits there filed, should constitute the evidence on this appeal, supplemented only by a number of questions and answers taken from the Examination for Discovery of the respondent on February 28, 1963. It was also agreed that the sums so added by the re-assessments were not in the nature of accretions to capital, but were taxable income of the respondent. The only question remaining for consideration, therefore, is whether, as the respondent contends, he is entitled to the benefits of the provisions of s. 85A(1); or whether, as submitted by the Minister, that section has no application to the case.

[1] 28 Tax A.B.C. 276.

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While the Minister is the appellant, the onus is on the respondent to prove that the re-assessments are erroneous (*Minister of National Revenue v. Simpson's Ltd.*[1]).

There is little dispute as to the facts. In 1954 the respondent was employed by the Department of Mineral Resources of the Province of Saskatchewan as Director of the Industrial Minerals Research Branch. Mr. Ray Hauer was the president of Aggregates and Construction Products Ltd. (hereinafter to be called Aggregates), a company which he had promoted and caused to be incorporated on September 1, 1954, and in which he held the controlling interest. Mr. Hauer wished to secure the services of the respondent for that company and after some verbal discussions, the respondent wrote Hauer on November 13, 1954 (Exhibit A-1) outlining the general terms on which he would enter the services of Aggregates. One of the terms was "I will receive 10,000 shares of company stock".

On November 19, 1954, Mr. Hauer as president of Aggregates wrote the respondent (Exhibit A-2), giving the general terms on which the respondent could enter the services of the company, the relevant portions thereof being as follows:

1. Your services will commence January 1, 1955.
2. You will receive a salary of $8,250 per year, payable at $687 50 per month.
3. You will receive 10,000 shares of Escrow stock in Aggregates & Construction Products Ltd. The first 2,000 shares to be released to you not later than January 31, 1955. Balance of 8,000 to be released as stock is sold, (or you will receive cash, less commission, to compensate for the stock).
7. We are also planning on forming a new company for the Saskatoon or Unity area as soon as the issue of stock is sold in this Company. We will then be able to give you a similar offer as you have with this Company. This would mean you would be holding two jobs, which would increase your income considerably.

By letter dated November 22, 1954 (Exhibit A-3) the respondent wrote to Mr. Hauer as president of Aggregates, accepting the offer of employment under the conditions detailed in Exhibit A-2.

Pursuant to the said agreement, the respondent entered the service of Aggregates on January 2, 1955 as chief engineer, remaining with the company until February, 1957;

[1] [1953] Ex. C.R. 93.

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throughout the whole of that period his agreed salary was paid by Aggregates.

It will be convenient to first consider the appeal for the year 1955 as the amounts in question for that year were the proceeds of sales of certain shares in Aggregates, while those in question for the year 1956 were the proceeds of sales in another company.

It will be recalled that by the terms of the accepted offer, the respondent was *to receive* 10,000 shares of *escrow stock* in Aggregates, or, alternatively, if such shares were sold, cash less commission, to compensate for the stock. Now the only escrow shares in Aggregates were those issued to Hauer personally as payment for his transfer to the company of rights which he had acquired from the Province of Saskatchewan to prospect and explore for clay in certain areas. Exhibit R-1 is a prospectus of Aggregates dated September 20, 1954, and the following extract from the Statutory Information is shown to be accurate.

> (11) The names and addresses of all vendors of property purchased or intended to be purchased by the company and the consideration paid therefor and the property acquired from each are as follows—
>
> Ray Hauer, 201 Connaught Blk, Saskatoon, Sask, 100,000 fully paid up shares for securing and transferring direct to the Company the property interests set forth in (1) hereof being the immediately preceding subparagraph hereto 90,000 of such shares are being held in escrow by the Toronto General Trusts Corporation under an escrow agreement and may only be released upon authority from the Registrar, Securities Act, Province of Saskatchewan

All the escrow shares in Aggregates were at all relevant times the personal property of Hauer. He was also the sole partner in a proprietorship called Allied Securities and the sole owner of all the shares in Allied Securities Ltd., a corporation which he later formed and which took over the business of Allied Securities. The date of the take-over is not stated and I shall refer to both organizations as Allied Securities. It was engaged in the sale of shares to the public.

On two occasions in 1955, the Saskatchewan Securities Commission released portions of Hauer's escrow shares for sale and presumably at his direction they were turned over by the Toronto General Trusts Corporation to Allied Securities and were sold by it to the public in that year. Allied Securities, no doubt by the direction and authority of Hauer, the owner of the shares, paid to the appellant a total of

$5,150 in 1955, representing the proceeds of the sale of 4,500 of the escrow shares. It was that amount that was added by the Minister to the respondent's declared income for 1955.

I find it unnecessary to review in detail all the evidence on this point. There is no evidence to indicate that Aggregates at any time took any steps to cause the respondent "to receive 10,000 shares of escrow stock" in that company or any part thereof, or the proceeds of the sale thereof. The evidence is conclusive that what the respondent did receive was entirely the result of steps taken by Hauer, namely, the sale by Allied Securities of his personally owned escrow shares in Aggregates and the allocation by Hauer personally to the respondent of the proceeds of the sale of 4,500 such shares. As I recall the evidence, the respondent has not as yet received any escrow shares or other shares in Aggregates, the unsold block of such shares still being held in escrow by the Toronto General Trusts Corporation.

The facts in regard to the 1956 taxation year are similar. In June, 1955, Hauer organized another company called "Winnipeg Light-Aggregate Limited" and about the end of that year a further company named "Western Clay Products Ltd." By arrangement with Hauer, the respondent became the chief engineer of both companies, continuing with the former until February, 1957 and with the latter until June, 1957. The terms of his employment were not in writing, but it is agreed that in respect of each of these companies, the arrangements were similar to those regarding Aggregates. I need say nothing further as to Western Clay Products Ltd. as the respondent in 1955 and 1956 neither received any escrow or other shares therein, nor the proceeds of sales thereof.

It was one of the terms regarding the Winnipeg Light-Aggregate Limited that the respondent would receive 15,000 escrow shares of that company, or the proceeds thereof if sold (less commission) to compensate for the stock. In this case, also, it is clear from the prospectus, Exhibit R-2, (and the evidence) that there had been issued to Hauer personally 120,000 shares as consideration for the purchase from him of the lands described of which "110,000 are held

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in escrow on the terms and conditions set out in para. 8 hereof", which reads:

> 8. A total of One Hundred and Ten Thousand (110,000) shares are held in escrow by The Toronto General Trusts Corporation, Saskatoon, Saskatchewan and will be released only upon the written consent of the Saskatchewan Securities Commission. The written consent of the Saskatchewan Securities Commission is also required for the transfer or other alienation of the shares within the escrow. The escrowed shares when released may be sold at the market price but the proceeds thereof will not accrue to the benefit of the treasury of the Company.

In January, 1956 the Saskatchewan Securities Commission released a part of the escrow shares which were then sold by Allied Securities to the public, and the respondent in that year received from Allied Securities $10,828.12, representing the amount received by Allied Securities (less its commission) from the sale of 8,250 shares in Winnipeg Light-Aggregate. It was that amount which was added by the Minister to the declared income of the respondent for 1956.

On the evidence and the admissions made, I have reached the same conclusion in regard to this matter as I did in regard to Aggregates, namely, that the escrow shares which were so sold by Allied Securities were the personal property of Hauer; that they were sold by his direction and that he allocated the proceeds to the respondent, Winnipeg Light-Aggregate Limited having nothing to do with the matter. Later, several portions of such escrow shares were released and Exhibit A-7 is a certificate for 6,750 shares of the company in the name of the respondent dated December 29, 1958. It is admitted that the shares represented by that certificate formed part of the 110,000 escrow shares issued to and owned by Hauer.

Exhibit A-8, a letter from Hauer personally to the respondent dated May 29, 1957, confirms the conclusion which I have reached in regard to all three companies. It reads:

> In reply to your letter of May 23rd, 1957, I wish to advise that all escrow stock is held by Toronto General Trusts Corporation in my name. This cannot be changed.

The amount of escrow stock which I have allocated to you and which is recorded in our records is as follows:

Aggregates & Construction Products Ltd.	10,000 shares		
Less: Shares sold & monies paid to you	4,500	Balance—	5,500 sh.
Winnipeg Light-Aggregate Ltd.	15,000 shares		
Less: Shares sold and monies paid to you	8,250	Balance—	6,750 sh.
Western Clay Products Ltd.			20,000 sh.

The transfer of these shares to you is dependent upon the manner in which they are released from escrow by the Saskatchewan Securities Commission.

The question for consideration is whether in these circumstances the respondent is entitled to the benefits of the provisions of s. 85A(1) of the *Income Tax Act*. It is unnecessary to consider the manner in which the tax is computed thereunder; it is sufficient to state that it confers a very substantial benefit on a taxpayer coming within its provisions and who elects to compute his tax thereunder. It is agreed that the respondent duly made his election and that in both years the tax, if so computed in reference to these gains, would be negligible.

Section 85A(1) reads as follows:

85A. (1) Where a corporation has agreed to sell or issue shares of the corporation or of a corporation with which it does not deal at arm's length to an employee of the corporation or of a corporation with which it does not deal at arm's length,

(*a*) if the employee has acquired shares under the agreement, a benefit equal to the amount by which the value of the shares at the time he acquired them exceeds the amount paid or to be paid to the corporation therefor by him shall be deemed to have been received by the employee by virtue of his employment in the taxation year in which he acquired the shares;

(*b*) if the employee has transferred or otherwise disposed of rights under the agreement in respect of some or all of the shares to a person with whom he was dealing at arm's length, a benefit equal to the value of the consideration for the disposition shall be deemed to have been received by the employee by virtue of his employment in the taxation year in which he made the disposition;

(*c*) if rights of the employee under the agreement have, by one or more transactions between persons not dealing at arm's length, become vested in a person who has acquired shares under the agreement, a benefit equal to the amount by which the value of the shares at the time that person acquired them exceeds the amount paid or to be paid to the corporation therefor by that person shall be deemed to have been received by the employee by virtue of his employment in the taxation year in which that person acquired the shares; and

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(*d*) if rights of the employe under the agreement have, by one or more transactions between persons not dealing at arm's length, become vested in a person who has transferred or otherwise disposed of rights under the agreement to a person with whom he was dealing at arm's length, a benefit equal to the value of the consideration for the disposition shall be deemed to have been received by the employee by virtue of his employment in the taxation year in which that person made the disposition.

It will be convenient to consider the provisions of the section in regard to Aggregates only, since it is agreed that the legal position is the same in respect to each company.

To come within the provisions of the opening paragraph of the section, the respondent in this case must establish that Aggregates, had agreed to sell or issue shares of that company to him, an employee thereof. For the purposes of this case, I shall assume (without deciding) that the respondent was an employee of Aggregates, although it is clear that at the time he entered into the agreement he had not then entered its service but agreed to do so later, and in fact did so.

Inasmuch as the respondent did not transfer or otherwise dispose of his rights under the alleged agreement with Aggregates, he does not fall within the provisions of clauses (*b*), (*c*) or (*d*), and, in order to succeed, must come within the provisions of clause (*a*) and establish that he *acquired* the shares under the agreement, i.e., an agreement to sell or issue shares of Aggregates to him.

Now I am unable to find anything in the offer of employment dated November 19, 1954 (Exhibit A-2) which would indicate that Aggregates agreed to sell or issue to the respondent any shares in that corporation. The relevant clause reads:

> 3. You will receive 10,000 shares of Escrow stock in Aggregates & Construction Products Ltd The first 2,000 shares to be released to you not later than January 31, 1955 Balance of 8,000 to be released as stock is sold, (or you will receive cash, less commission, to compensate for the stock)

When that letter was written and signed by Hauer, he knew that all the escrow shares were his personal property and were registered in his name, and that Aggregates had no interest in such shares. He knew, also, that he alone could carry out that part of the agreement by allotting the agreed number of such shares to the respondent or by pay-

ing him the proceeds thereof when sold. As I have found, that is precisely what was done.

I think, also, that the respondent was well aware that Hauer would be the one to implement that part of the agreement, and that it was from Hauer personally that he would receive the escrow shares or the proceeds thereof. Aggregates had no escrow shares of its own and there is no evidence which suggests that the respondent ever looked to that company to fulfill that part of the agreement; he knew also that all the escrow shares were the personal property of Hauer.

In or about 1957, when he felt that he should have some evidence as to his interests in the shares or proceeds thereof which he had not received, he secured from Allied Securities three receipts, all signed by Hauer as agent for Allied Securities, being Exhibits A-4, A-5 and A-6, indicating that he had paid Allied Securities two cents per share for all the shares in the three companies. These receipts are dated January 2, 1955, July 15, 1955 and January 2, 1956, all relating to escrow stock in Aggregates, Winnipeg Light-Aggregate Limited, and Western Clay Products Ltd., and are for $200, $300 and $400 respectively. It is now admitted that no money changed hands. It is shown, however, that the respondent in his Notice of Objection stated in his alternative submission that "These transactions have to be treated as a capital gain whereby I purchased the shares from Mr. Hauer at two cents per share".

From Exhibit A-8 it will also be seen that he accepted Hauer's statement that all the escrow shares were in Hauer's name and that in the case of all three companies, it was Hauer who had allocated the shares or the proceeds to him.

On these findings I think it is clear that all parties understood clearly that such escrow shares or the proceeds thereof, which the respondent was to receive, would be allocated to him by Hauer as was actually done. The agreement was that the respondent would *receive* them or the proceeds thereof, and not that Aggregates would sell or issue its shares to him.

On these facts I have come to the conclusion that the respondent is not entitled to the benefits of s. 85A(1) and that the appeal must be allowed.

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I find as a fact and for the reasons stated earlier, that there was no agreement between the respondent and Aggregates by which Aggregates agreed to sell or issue its shares to the respondent. In my opinion, the agreement referred to in the section, insofar as it is here applicable, must be one in which that corporation agreed either (a) to *sell* its shares to the employee and "sell", I think, means to sell at a fixed or ascertainable price; or (*b*) to *issue* its shares and "issue", I think, means in the context to issue its own treasury shares, possibly without monetary consideration. Then para. (*a*) is applicable only if the employee has *acquired* shares under the agreement. The facts in the instant case indicate clearly that Aggregates did not agree *to sell* any of its shares or to *issue* any of its treasury shares to the respondent, and also that the respondent in each of the taxation years in question acquired no shares under any such agreement. What he did receive was the proceeds of the sale of escrow shares in Aggregates owned by Hauer (and as allotted by Hauer to him) as provided for in the agreement of employment.

After a careful consideration of the whole of s. 85A, I have also come to the conclusion that the benefits deemed to have been received by the employee as therein mentioned are benefits conferred on the employee *by the corporation.* It is submitted by counsel for the respondent that the agreement of employment was with Aggregates, and that it makes no difference if (as I have found to be the case) the shares—or rather the proceeds of the sale thereof—which came into the respondent's hands were the personal property of Hauer and were allotted to him by the respondent. I cannot agree with this submission.

It seems clear to me that the section relates to an agreement in which by the sale or issue of the shares, not only may a benefit be acquired by the employee, but some detriment, loss or cost may be sustained by the corporation through having sold or issued its shares. Subsection (5)(*b*) provides that the corporation in computing its taxable income may not deduct any of the cost of conferring the benefits referred to in the section. As amended by s. 25 of c. 54, Statutes of Canada 1955, and made applicable to the 1955 and subsequent taxation years, it reads:

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(5) Where a corporation has agreed to sell or issue shares of the corporation or of a corporation with which it does not deal at arm's length to an employee of the corporation or of a corporation with which it does not deal at arm's length,

* * *

(*b*) the income for a taxation year of the corporation or of a corporation with which it does not deal at arm's length shall be deemed to be not less than its income for the year would have been if a benefit had not been conferred on the employee by the sale or issue of the shares to him or to a person in whom his rights under the agreement have become vested.

Section 85A was first enacted by s. 73(1) of c. 40, Statutes of 1952-53 and made applicable to the 1953 and subsequent taxation years in cases where the agreements were made after March 23, 1953. Paragraph (*b*) of s-s. (5) as so enacted read as follows:

(5) Where a corporation has agreed to sell or issue shares of the corporation or of a corporation with which it does not deal at arm's length to an employee of the corporation or of a corporation with which it does not deal at arm's length,

* * *

(*b*) the income of the corporation for a taxation year shall be deemed to be not less than its income for the year would have been *if it had not conferred a benefit on the employee* by the sale or issue of the shares to the employee.

That paragraph which applied to the agreements referred to in s. 85A(1) and to the section as a whole, in clear terms refers to benefits conferred *by the corporation*. While the paragraph as amended in 1955 is couched in somewhat different language, I think that in disallowing the deduction by the corporation of any amounts relative to the benefits conferred on the employee, there is a clear inference that Parliament was speaking of benefits conferred by the corporation.

That view of the matter is supported, I think, by the provisions of s-s. (1)(*a*) (*supra*). It provides a formula for the ascertainment of the amount of the benefit deemed to have been received by the employee under the agreement, namely, by deducting from the value of the shares at the time of acquisition the amount "paid or to be paid to the corporation therefor by him". The second item in that computation relates only to the terms of the agreement with the corporation and to the amount which by the agreement has been or is to be paid to it. It can have no application

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to a case in which the shares are provided by and at the expense of an individual such as I have found to be here the case.

For these reasons, the appeal will be allowed with costs, the decision of the Tax Appeal Board set aside, and the re-assessments made upon the respondent affirmed for each year.

Judgment accordingly.