1947

March 20
August 20

BETWEEN:

THE GREAT WESTERN GARMENT COMPANY LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Revenue—Income War Tax Act R.S.C. 1927, c. 97—Excess Profits Tax Act 1940, Statutes of Canada, 1940, c. 32—Wartime Salaries Order, P.C. 1549, February 27, 1942—"Free of income tax"—Bonus—Payment of income tax as part of salary—"Rate of salary established and payable" —Appeals allowed.

In June, 1941, appellant, by resolutions passed by its shareholders at a general meeting, fixed the salaries of certain of its officials at various amounts free of income tax. Respondent disallowed the amounts paid in 1943 and 1944 in excess of the salary and income tax for the base year commencing on November 7, 1940, and ending November 6, 1941, defined by the Wartime Salaries Order, Order in Council No. P.C. 1549, dated February 27, 1942, on the ground that the amounts disallowed were in excess of the amount permitted by s. 2 of the Wartime Salaries Order. The Company appealed. The Court found that the resolutions passed at the general meeting of the Company fixing the salaries were valid.

Held: That the payment of income tax by the appellant is not a bonus within s. 2 (*d*) of the Wartime Salaries Order.

2. That the "rate of salary established and payable" for each official by the resolutions passed by appellant was the number of dollars plus the tax payable by each official on those dollars and this was the standard or way of reckoning by which his salary was established each year.

3. That while the result of the resolutions passed by appellant was to increase materially the salaries paid the officials in 1943 and 1944 there was no increase in the "rates of salary" paid in 1943 and 1944 above the most recent rates established and payable to them prior to November 7, 1941, since the words "established and payable" in the Wartime Salaries Order refer to the "salary rate" and not to the amount of salary.

APPEALS under the provisions of the Income War Tax Act and Excess Profits Tax Act.

The appeals were heard together before the Honourable Mr. Justice O'Connor at Edmonton.

G. H. Steer, K.C. and *A. Smith* for appellant.

I. Friedman and *W. J. Hulbig* for respondent.

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

O'CONNOR J. now (August 20, 1947) delivered the following judgment:

These appeals are from assessments under the Income War Tax Act, R.S.C. 1927, chap. 97, and the Excess Profits Tax Act, 1940, Statutes of Canada, 1940, chap. 32, in respect of the taxation years 1943 and 1944.

The Minister acting under paragraph 7 of the Wartime Salaries Order, Order in Council P.C. 1549, dated the 27th day of February, 1942, as amended; under subsection (2) of Section 6 of the Income War Tax Act and under subsection (*b*) of Section 8 of the Excess Profits Tax Act, 1940, in computing the amount of the profits and gains to be assessed, for the taxation year 1943 disallowed as an expense of the appellant, a sum in the aggregate amount of $30,791.97, and for the taxation year 1943, a sum in the aggregate amount of $26,868.34, representing in each case a portion of the salaries paid by the appellant to certain salaried officials. The appellant served notices of appeal on the Minister, who affirmed the assessments and then, being disatisfied with the Minister's decision, brought its appeals from the assessments to this Court. The appeals were heard, together, in camera.

Resolutions were passed by the shareholders of the Company in June, 1941, fixing the salaries of these officials

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at various amounts free of income tax. The respondent disallowed the amount paid in 1943 and 1944 that was in excess of the salary and income tax for the base year defined by the order as the year commencing the 7th November, 1940, and ending the 6th day of November, 1941.

The respondent contends that the sums disallowed were in excess of the amount permitted by Section 2 of the said Wartime Salaries Order.

The respondent further contends that none of the proceedings at the meeting of shareholders conform to the constitution of the Company and the relevant Companies Act, and that the resolutions were not duly and validly passed.

Article 103 of the Articles of Association of the Company provides that directors may appoint one or more of their body to be managing director and Article 105 provides that his remuneration shall be fixed by the directors. Article 123(*d*) provides that the directors shall have the power to fix the salaries of the officers and servants of the Company.

"Special resolution" is defined by Section 2 of the Articles as a resolution passed by a majority of not less than three-fourths of the members of the Company * * * and confirmed at a subsequent meeting of the shareholders held not less than fourteen days and not more than one month from the date of the first meeting.

Section 92 of the Articles provides that no director shall, as a director, vote in respect of any contract or arrangement entered into by or on behalf of the Company in which he is in any way interested.

There were six directors on the board. Four of these were elected by the common shareholders and were all engaged in the active management of the Company. The remaining two were nominated by the First Preferred shareholders and elected by the common shareholders. The First Preferred shareholders had no right to vote in general meeting unless there had been a default in dividends continuing for three years. There had been no such default in dividends. These two directors were not engaged in the active management of the Company.

Of the five officials of the Company whose salaries were increased by the resolutions of June 2, 1941, four were directors of the Company elected by the common shareholders and in charge of the management of the Company.

Notice of the annual general meeting to be held on the 2nd June, 1941, was sent by the Secretary to all ordinary shareholders of the Company who were the only shareholders entitled to vote.

Under the Articles of the Company set out above, the directors had the power to fix the salaries in question. These four directors were apparently unwilling to have the directors do so and the Secretary of the Company was instructed to send out a second notice to the ordinary shareholders, advising them that at the annual meeting the resolutions making these salaries free of income tax would be submitted.

The Secretary sent out the notices stating that at the annual meeting * * * "the following special business will be submitted in the form of Special resolutions * * *", and then followed the resolutions in question.

A total of 437 ordinary shares had been issued of which these five officials held only 178 shares. At the annual meeting all the ordinary shareholders were either present in person or by proxy with the exception of one company holding eight shares and that company was represented by its Vice-President, although no formal proxy was filed on its behalf.

The following resolutions were then submitted to the meeting and carried unanimously:

> Mr. C. D. Jacox be and is hereby appointed Managing Director of the Company at the salary of ..... per year, as from January 1, 1941, free from income tax.
>
> The salaries of the following officials of the Company, viz, Mr. W. A. McAulay, Mr. F. D. Sutcliffe, Mr. W. B. Shaw and Mr. R. W. Roscoe, as at present in effect be free from income tax and subject to adjustment from time to time at the discretion of the Managing Director, effective as from January 1, 1941.

The resolutions were not confirmed at any subsequent meeting of the shareholders.

On the passing of the resolutions, Mr. C. D. Jacox assumed the duties of managing director and the other

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officials continued in their present positions and the Company paid these officials in accordance with the resolutions, making the necessary entries in books of the Company and filed income tax returns exhibiting such payments as expenses deducted from income.

A meeting of the directors was held on the 2nd of March, 1942, at which all the directors were present. The auditors' statement for the year ending December 3, 1941, was read to the meeting and, on motion of the two directors nominated by the First Preferred shareholders, was duly passed. There was included in the statement (Exhibit 9) the item showing the total payments for wages and salaries of $69,000 which included the income tax payments made pursuant to the resolution. Mr. Evans, one of the two directors, said that he and Dr. Allin (the other director) had previously been given full information and details as to what was being done in the way of salaries and were satisfied. That is borne out by the wording of the motion approving of the auditors' report which reads:

> After some discussion, on motion of Mr. Evans seconded by Dr. Allin, the auditors report and the statement of accounts were accepted, both Mr. Evans and Dr. Allin expressed their gratification with the excellent results secured during the year 1941.

No salary rates in respect to these officials other than or further to those fixed by these resolutions of June 2, 1941, were fixed or established by the appellant and these rates were therefore the most recent salary rates established for and payable to the officials prior to the 7th November, 1941.

The Court was informed by counsel that by an agreement between the parties these appeals were to be heard on the basis that payment of the salaries pursuant to the resolution had been made by the appellant to these officials during the period in question.

The increase of the rate at which the income tax was assessed in 1943 and 1944 had the effect of increasing the amount of the salaries paid in accordance with the resolution over the salaries paid in the base year.

The first question is: Were the resolutions passed at the general meeting of the Company valid? The argument against the validity of these resolutions is that the Articles

of Association of the Company gave the board of directors the power of appointing one or more of their body to be a managing director or managing directors of the Company, and to fix his or their remunerations and the power to fix the salaries or emoluments of the other officials and that the Company has accordingly surrendered these powers and that the directors alone can exercise them.

It is not necessary, however, in this case to determine whether it is competent for the Company to override the powers conferred by the Articles on the directors where the board is ready and willing and able to act because that is not the position.

These resolutions had the effect of increasing the salaries of four of the six directors of the Company.

Each of the four directors was prohibited from voting by Section 92 of the Articles in respect of any contract or arrangement entered into by or on behalf of the Company in which he shall be in any way interested.

The second resolution constituted a contract with three of the directors which was within the prohibition of Article 92.

If there had been no remuneration attached to the office of managing director, the appointment of Mr. Jacox would be merely a delegation of their powers by the directors to him and would not constitute a contract between him and the Company within Article 92. *Imperial Mercantile Credit Association* v. *Coleman* (1). But there was remuneration attached and, therefore, a contract between the Company and Mr. Jacox within Article 92. Peterson, J., in *Foster* v. *Foster* (2) said:

> In the *New British Iron Co., case* (1898) 1 ch. 324 the articles required the directors to possess a share qualification, and provided that the remuneration of the board should be an annual sum of 1,000£ to be paid out of the funds of the Company, and it was held that, although those provisions in the articles were only part of the contract between the shareholders *inter se,* the provisions were, on the directors being employed and accepting office of the footing of them, embodied in the contract between the Company and the directors * * *
> * * * In my judgment, if a resolution is passed at a directors' meeting that one of the directors be appointed a managing director at a remuneration and that director is present and accepts the appointment, there is a contract between the Company and the director, and the director is not under article 93 able to vote in support of such a contract.

(1) (1871) 6 Ch. 558 at 567. (2) (1916) 1 Ch. D. 532 at 547.

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In my opinion, making the salaries of these four free of income tax formed part of one transaction in which all four were equally interested and that all four would be prohibited from voting.

When two or more directors are interested, it will not avail to split up the resolution and for each director to abstain from voting on the part in which he is interested. *North Eastern Insurance Company* (1).

As stated by Lord Hatherley in *Imperial Mercantile Credit Association* v. *Coleman* (*supra*), these resolutions could not be split so that each could abstain from voting on the part in which he was interested because the Company is entitled to have the independent judgment of the whole board on every matter and an interested director cannot give an independent judgment.

While the directors had the power to increase their salaries, they were, in my opinion, by reason of Article 92, unable to exercise it.

But even if they were able to exercise this power, they were unwilling to do so and quite properly brought the matter before the shareholders.

While these directors were prohibited from voting as directors on such resolutions by Article 92, such a prohibition, however, would not prevent them from voting as shareholders at general meeting of the Company upon such resolutions. *North West Transportation Co.* v. *Beatty* (2), and *Burland* v. *Earle* (3).

In *Foster* v. *Foster* (*supra*) Peterson, J., at 551 said:

> From a business point of view it seems to me that there are only two persons who are possible managing directors, and the board had been reduced to the position that it is unable, owing to internal friction and faction, to appoint anybody as a managing director. In those circumstances I should apply the decision of Warrington, J., in *Barron* v. *Potter* (1914) 1 ch. 895, 903. The learned judge says: "If directors having certain powers are unable or unwilling to exercise them—are in fact a non-existent body for that purpose—there must be some power in the Company to do that itself that which under other circumstances would be otherwise done. The directors in the present case being unwilling"—in this case unable—"to appoint additional directors under the power conferred on them by the articles, in my opinion, the Company in general meeting has power to make the appointment."

(1) (1919) 1 Ch. 198.
(2) (1887) 12 A.C. 589.
(3) (1902) A C. 94.

Applying that principle to this case I hold that, while the directors had the power under the Articles of Association to fix their own salaries as officials, they were unable, for the reasons I have already given, or were unwilling, to exercise such power, the Company in general meeting had the power to do so.

In addition, the four directors must have discussed and agreed to making these salaries free of income tax. By placing the resolutions before the general meeting, the directors in effect, recommended that this be done. The ordinary shareholders approved the resolutions unanimously. The officials acted on the faith of the resolutions. So did the Company, as shown by the entries in the books of the Company, and in the income tax return filed.

In these circumstances a resolution of the directors fixing these salaries free of income tax will be assumed to have been duly passed. See *Wilson* v. *Woollatt* (1), in which Masten, J.A., at 627, reviews the authorities on this question.

The resolutions in question were not required by the Articles to be special resolutions so that it was not necessary to have them confirmed by a subsequent meeting of the shareholders.

For the reasons I have given, I hold that these resolutions passed at the general meeting were valid.

The respondent contends that the result of these resolutions was to materially increase these salaries during the years that followed, and that such increases were directly opposed to the spirit of the Wartime Salaries Order which was made to prevent inflation. The employees undoubtedly received a much higher income as the result, and there was, therefore, a corresponding increase in the cost to the employer.

The resolutions, however, were passed eight months before the Wartime Salaries Order was made and the practice of making salaries income tax free had been inaugurated by the appellant as early as 1920.

The Company was not, therefore, attempting to evade the provisions of the Order. It quite properly desired to carry out the obligation it had undertaken.

(1) (1928) 62 O.L.R., 620, C.A.

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The question is simply, can the resolutions be lawfully implemented within the provisions of the Salaries Order, the relevant parts of which are as follows:

2. Unless otherwise permitted by paragraphs 3 or 4 hereof, no employer shall, on or after November 7, 1941:

(*a*) increase the rate of salary paid to a salaried official above the most recent salary rate established and payable prior to November 7, 1941, or if no rate of salary for a particular salaried official were established and payable prior to November 7 because the said salaried official was not employed by the employer prior to the said date, increase the rate of salary above the rate of salary first payable to the said salaried official.

(*b*) * * *

(*c*) * * *

(*d*) pay as bonus (which, for the purpose of this sub-paragraph, shall include gratuities and shares of profits but shall not include cost of living bonus) a larger total amount to any one salaried official during any year following November 6, 1941, than the total amount paid to the said salaried official as bonus in the base year, provided that:

(i) where the salaried official has a contractual right evidenced in writing which existed at November 6, 1941, to receive such a bonus, defind as a fixed percentage of or in fixed ratio to his salary, the profits of the business, or the amount of sales output or turnover of the business, the employer may continue to pay the said bonus at the same fixed percentage or ratio as that contracted for previous to November 7, 1941.

The decision of the Minister shows that the respondent treated the amount paid for income tax as a bonus, and under section 2(*d*) disallowed the amount in excess of the salary and income tax for the base year defined by the Order, as the year commencing the 7th day of November, 1940, and ending the 6th day of November, 1941.

The statement of defence alleges that the amounts disallowed represent increases in the rates of salary paid to those officials in 1943 and 1944 respectively, above the most recent rates established and payable to them prior to the 7th November, 1941, as set forth in section 2(*a*) of the Order.

The next question is whether the payment of the income tax is a bonus within section 2(*d*) of the Order.

Bonus is not defined by the Order, but the meaning given by Webster's International Dictionary is, "Something given in addition to what is ordinarily received by, or strictly due to, the recipient". The Oxford Concise Dictionary defines bonus as, "Something to the good, into the

bargain (and as an example) * * * gratuity to workmen beyond their wages."

In *Shelford* v. *Mosey* (1), Lord Reading describes the "bonus" in that case to be "nothing else but a euphemism for 'addition to wages' ". That, in my view, is equally true of "bonus" in section 2(*d*).

A bonus may be a mere gift or gratuity as a gesture of goodwill, and not enforceable. Or it may be something which an employee is entitled to on the happening of a condition precedent and is enforceable when the condition is fulfilled.

But in both cases it is something in addition to or in excess of that which is ordinarily received.

Here, on the contrary, "free of income tax" is not something in addition to or in excess of that which is to be received, but is part and parcel of the salary.

In my opinion the payment of the income tax is not a bonus within section 2(*d*) of the Order.

While the result of the resolutions was to materially increase the salaries in 1943 and 1944, the question is whether the Company increased the rate of salary above the most recent salary rate established and payable prior to November 7, 1941, prohibited by section 2(*a*).

Section 2(*d*) prohibits the payment "as bonus" of a larger total amount "to a salaried official" than the "total amount" paid as bonus in the base year. Section 2(*a*) does not deal with "total amounts" at all. It prohibits an increase in the "rate of salary" paid to a salaried official above the most recent salary rate established and payable prior to November 7, 1941.

The words "established and payable" refer to the "salary rate" not to the amount of salary.

Under section 2(*a*) it is the employer who is prohibited from increasing the rate. In this case the employer has not increased the rate, the increase in the amount results from an increase in the income tax rate.

Rate is not defined by the Order and therefore must be given its natural and ordinary meaning. The meaning given by the Oxford Concise Dictionary is:

> Statement of numerical proportion prevailing or to prevail between two sets of things either or both of which may be unspecified, amount,

(1) (1917) 1 K.B. 154 C.A.

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etc., mentioned in one case for application to all similar ones, standard or way of reckoning, (measure of) value, tariff charge, cost, relative speed, (going at the r. of six miles an hour;) can have them at the r. of 1/- a thousand; the death r. was 19 per mille; the r. of interest, wages, etc, is to be regulated; the high rr. charged by the railways; * * *

The "rate of salary established and payable" for each official by these resolutions was the number of dollars plus the tax payable by each official on those dollars.

This was the "standard or way of reckoning" by which his salary could be ascertained each year.

In my view there was no increase in the "rates of salary" paid to those officials in 1943 and 1944 above the most recent rates established and payable to them prior to the 7th November, 1941.

Counsel for the respondent also relies on section 9 of the Order which reads:

> No agreement providing for an increase in the rate of salary above the rate payable at November 6, 1941, shall be enforceable in respect of such increase except and to the extent that such increase is within the amount that may be permitted by paragraphs 3 or 4 hereof, and no action shall lie against any person for breach of contract for complying with the provisions of this Order or for refusing to pay any salary in excess of the amount permitted by this Order.

The resolutions, however, do not provide for any subsequent increase in rate of salary. They established a rate of salary prior to the 6th November, 1941, which was applicable both prior to and subsequent to that date.

In my opinion the amounts in question should not have been disallowed under section 7 because they were not in violation of section 2 of the Order.

The appeal will be allowed and the assessments will be referred back to the Minister for an adjustment of the figures consequential on the allowance of the appeal.

The appellant is entitled to the costs of the appeal.

Judgment accordingly.