
Ottawa 1965
Nov. 18, 19
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BETWEEN:

DWORKIN FURS (PEMBROKE) LIMITED ..... APPELLANT;

AND

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

Income tax—Associated companies—Control—What constitutes—Necessity of ownership of majority of votes—Income Tax Act, s. 39(4)(a).

The appellant, Dworkin Furs (Pembroke) Ltd, an Ontario company, had outstanding 100 shares, of which 50 were held by Sadie Harris, 48 by Dworkin Furs Ltd and the remaining two by Helen and Roy Saipe in trust for Dworkin Furs Ltd, a company controlled by Helen and Roy Saipe. The three named individuals were directors of appellant, and Roy Saipe was its president. The Minister, applying s. 39(4)(*a*) of the *Income Tax Act*, assessed appellant at the full rate of tax on its income for 1961, 1962 and 1963 on the ground that it was controlled by Dworkin Furs Ltd within the meaning of s. 39(4)(*a*).

Held, the assessment could not stand. The word "control" in s. 39 of the *Income Tax Act* contemplates the right of control that rests in ownership of such a number of shares as carries with it a right to sufficient votes to elect the board of directors.

The fact that Dworkin Furs Ltd could, by virtue of having control of one-half the votes in a general meeting of the appellant company, prevent the other shareholders from electing new directors, and could thereby cause the current directors to be continued in office indefinitely, did not give Dworkin Furs Ltd control of the appellant within the aforesaid meaning of the word "control".

[*Buckerfield's Ltd v. M.N.R.*, [1965] 1 Ex. C.R. 299 followed.]

APPEAL under the *Income Tax Act*.

C. S. Bergh for appellant.

G. W. Ainslie and *S. A. Hynes* for respondent.

JACKETT P.:—This has been a hearing of appeals by a company incorporated under the laws of Ontario from its assessments under the *Income Tax Act* for the 1961, 1962 and 1963 taxation years.

The sole question involved in each of the appeals is whether the appellant is "associated" with another company known as Dworkin Furs Limited (hereinafter referred to as "Dworkin") within the meaning of the word "associated" as used in section 39 of the *Income Tax Act* so as to authorize the Minister of National Revenue to take action that has effect to deprive the appellant of the lower income tax rate on its first $35,000 of income in each of the years in question.

It is common ground that the question whether the appellant was associated with Dworkin depends upon the application of paragraph (*a*) of subsection (4) of section 39 to the relevant facts. The relevant part of subsection (4) of section 39 reads as follows:

> (4) For the purpose of this section, one corporation is associated with another in a taxation year if, at any time in the year,
>
> (*a*) one of the corporations controlled the other,
>
> . . . .

If counsel for the respondent has not succeeded in showing that the facts fall within paragraph (*a*) of subsection (4) of section 39, he concedes that he cannot bring them within any of the other paragraphs of that subsection. If he has succeeded in bringing them within paragraph (*a*), it does not matter whether they also fall within some of the other paragraphs. The only question to be decided, therefore, is whether the facts fall within paragraph (*a*) of subsection (4) of section 39 of the *Income Tax Act*.

The only basis upon which counsel for the Minister has attempted to bring the case within paragraph (*a*) of subsection (4) of section 39 is that Dworkin "controlled" the appellant during the taxation years in question.

According to paragraph 3 of the Reply to the Notice of Appeal, the Minister says that in assessing the appellant for the years in question, he assumed "that Dworkin Furs

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Limited had vested in it the power of controlling by votes the decisions which would bind the Appellant in the shape of resolutions passed by the shareholders at its annual and general meetings, and therefore, controlled the appellant within the meaning of para. (*a*) of s.s. (1) [sic] of sec. 39 of the Income Tax Act". If this assumption were correct, I should have no doubt that the assessments appealed from were correct. It remains to examine the admitted facts for the purpose of ascertaining whether this assumption was correct.

As I understand the facts, all the shares in Dworkin belonged to Helen Saipe, who owned 1,500, her husband Roy Saipe, who owned one, and Roysay Investments. Roysay Investments was controlled by Roy Saipe and owned the remaining 999 shares in Dworkin.

As far as the appellant is concerned, the situation is that there were 100 shares, 50 of which belonged to Sadie Harris, who was unrelated to any of the other persons that I have mentioned. The other 50 belonged to Dworkin, 48 were held in Dworkin's name and the other two were held in trust for Dworkin by Helen Saipe and Roy Saipe, respectively.

The situation is therefore that Dworkin owned 50 per cent of the shares in the appellant company. It had therefore 50 per cent of the votes at shareholders' meetings but did not have a majority of such votes.

Counsel for the Minister could not therefore rest his case solely on Dworkin's shareholdings in the appellant. As I understand him, his position is that control is established, on the facts of this case, by the 50 per cent holding by Dworkin of the appellant's shares taken with the following circumstances:

FIRST, Roy Saipe, Helen Saipe and Sadie Harris were all the directors of the appellant company,

SECOND, as Roy Saipe and Helen Saipe held their qualifying shares as trustees for Dworkin, they were "nominees" of Dworkin and, in their capacity as directors of the appellant, were subject to the direction of Dworkin,

THIRD, Dworkin could keep Roy Saipe and Helen Saipe, as such nominees of Dworkin, in office as a majority of the appellant's directors indefinitely be-

cause, under the relevant corporation law and the appellant's constitution, the appellant's directors continue in office until new directors are elected and, with its 50 per cent of the appellant's shares, Dworkin could prevent new directors being elected. (Alternatively, counsel for the Minister says that such indefinite continuation of the Saipes as directors of the appellant could be achieved by Dworkin by a combination of ownership of 50 per cent of the shares and the fact that Roy Saipe had a casting vote at general meetings of the appellant company as President of the appellant company.)

I make no finding as to the correctness of the various propositions on which this contention is constructed. I doubt that a director or officer of a company can, as such, be regarded as an *alter ego,* nominee, or representative of some other person, merely because he holds the share that qualifies him for such office as a bare trustee for that other person.

Even assuming the correctness of all such propositions, I doubt that the holding of a veto over the replacement of a particular Board of Directors constitutes control in any of the possible senses in which that word may have been used. One corporation cannot, in my view, be said to be "controlled" by another in any possible sense of that word unless that other can, over the long run, determine the conduct of its affairs. The mere fact that one corporation can prevent a change in some or all of the directors of another is not a power of positive control. It is a mere veto over change in management.

After giving careful attention to the argument of counsel for the Minister, I have come to the conclusion that I adhere to a view that I expressed in *Buckerfield's Limited v. M.N.R.*[1] in the course of setting out the point that I had to decide in that case. I cannot do better than repeat that view here and adopt it for the decision of this case.

Many approaches might conceivably be adopted in applying the word "control" in a statute such as the *Income Tax Act* to a corporation. It might, for example, refer to control by "management", where management and the Board of Directors are separate, or it might refer to control by the Board of Directors. The kind of control exercised by management officials or the Board of Directors is, however, clearly not intended by section 39

[1] [1965] 1 Ex. C.R. 299.

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when it contemplates control of one corporation by another as well as control of a corporation by individuals (see subsection (6) of section 39). The word "control" might conceivably refer to *de facto* control by one or more shareholders whether or not they hold a majority of shares. I am of the view, however, that, in section 39 of the *Income Tax Act*, the word "controlled" contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the Board of Directors. See *British American Tobacco Co. v. I. R. C.*, [1943] 1 A.E.R. 13, where Viscount Simon L. C., at page 15, says:

> "The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes."

See also *Minister of National Revenue v. Wrights' Canadian Ropes Ltd.* [1947] A.C. 109, per Lord Greene M. R. at page 118, where it was held that the mere fact that one corporation had less than 50 per cent of the shares of another was "conclusive" that the one corporation was not "controlled" by the other within section 6 of the *Income War Tax Act*.

The appeals are allowed and the assessments are referred back to the Minister for re-assessment on the basis that the appellant was not, at any time in its 1961, 1962 and 1963 taxation years associated with any other corporation. The appellant is entitled to be paid by the respondent the costs of the appeals to be taxed.

Appeals allowed.