1959

Sept. 9-10

Sept. 17

BETWEEN:

WOODWARD'S PENSION SOCIETY ...... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE .... RESPONDENT.

Revenue—Income tax—Income War Tax Act, R.S.C. 1927, c. 97, s. 5(1)(h)—Income Tax Act, R.S.C. 1952, c. 148, ss. 28(1), 62(1)(i)—Societies Act, R.S.B.C. 1948, c. 311—No claim for exemption unless requirements of exempting section complied with—Taxability of income not affected by purpose to which to be applied.

The appellant was incorporated in 1945 under the *Societies Act* of British Columbia. It was an affiliate of a group of Woodward companies that operated stores in various cities. It had been intended to set it up as a tax exempt society under section 5(1)(*h*) of the *Income War Tax Act* but the requirements for such a society could not be met. The appellant's object was to assist in providing funds for the payment of pensions to employees and ex-employees of the Woodward companies and it was required to pay its surplus funds from time to time to pension trustees for such employees and ex-employees. In order to be able to carry out its object it was to acquire shares in the Woodward companies and sell them. Immediately after its incorporation it took over the operation of a share sale scheme which had previously been carried on and continued it. Under this scheme it subscribed for large blocks of shares in the Woodward companies and sold them to employees of the companies. The shares were purchased at par with a small down payment and the balance payable in instalments with interest at the rate of 3 per cent per annum on the outstanding amounts. The appellant sold the shares to Woodward company employees at par with a small down payment and the balance payable in small weekly or monthly instalments with interest at the rate of 4 per cent per annum on the outstanding balance. It also took an option to repurchase the shares from the employee on his death or retirement. From time to time the appellant received dividends on shares it had on hand and it also realized capital gains due to Woodward company reorganizations.

By January 31, 1953, it had built up a surplus of $754,019.02 made up partly of capital gains and the balance of accumulated annual operating profits consisting of dividends and the interest differential between the 3 per cent interest that it had paid and the 4 per cent interest that it had received from its employee purchasers.

Up to October, 1951, the Woodward companies, under the direction of pension trustees, had paid pensions to employees and ex-employees under the pension schemes that had been set up, but the appellant then took over the provision of funds for the payment of the pensions by the pension trustees and relieved the companies from this operating expense. In the year ending January 31, 1953, the appellant paid the pension trustees a total of $42,273.23. The deduction of this amount was at first allowed but later disallowed, except for an amount, allowed under section 28(1) of the Act, equal to the amount of the dividends that the appellant had received. The Minister assessed the appellant only in respect of the net interest income received by it in the year, amounting to $31,503.28. The appellant appealed against this assessment.

It was contended for the appellant that it was organized and operated exclusively for a purpose except profit and, therefore, exempt from income tax under section 62(1)(*i*) of the *Income Tax Act* or that, since it was required to pay its surplus funds to the pension trustees, it did not own the income it had received and was exempt from income tax in respect of it.

Held: That section 62(1)(*i*) of the *Income Tax Act* is an exempting provision and subject to the rule of construction that a taxpayer cannot succeed in claiming an exemption from income tax unless his claim comes clearly within the provisions of an exempting section of the Act and that every constituent element necessary to the exemption is present in his case and that every condition required by the exempting section has been complied with. *Lumbers v. Minister of National Revenue* [1943] Ex. C.R. 202 at 211 applied.

2. That the appellant was not organized and operated exclusively for a purpose "except profit" and was not qualified for exemption under section 62(1)(*i*) of the Act.
3. That the purpose of the appellant's organization was to raise money by acquiring and selling Woodward company shares so that it could provide funds for the payment of pensions to Woodward company employees and ex-employees and that it was operated for a profit purpose.
4. That the interest income of the appellant was earned by it as the result of its own operation in dealing with its own property and was owned by it. *Minister of National Revenue v. St. Catharines Flying Training School Limited* [1955] S.C.R. 738 distinguished.
5. That it is a basic principle of income tax law that the taxability of income cannot be affected by the purpose to which it is to be applied after it has been earned. *Mersey Docks v. Lucas* (1882-3) 8 A.C. 891.
6. That the appellant cannot by its own pre-determination of the purpose to which its profit is to be applied make its profit non-taxable.
7. That the fact the appellant was required to pay its surplus funds to the pension trustees cannot nullify the fact that when it acquired its interest income it was its own or save it from liability for income tax in respect of it.
8. That the appeal be dismissed.

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APPEAL against income tax assessment.

The appeal was heard before the President of the Court at Victoria.

P. N. Thorsteinsson for appellant.

F. J. Cross and *P. M. Troop* for respondent.

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

THE PRESIDENT now (September 17, 1959) delivered the following judgment:

This is an appeal against the appellant's income tax assessment for the taxation year ending January 31, 1953.

It is contended for the appellant that it is exempt from income tax for the said taxation year under section 62(1) of the *Income Tax Act*, R.S.C. 1952, Chapter 148, which reads as follows:

> 62. (1) No tax is payable under this Part upon the taxable income of a person for a period when that person was
>
> (*i*) a club, society or association organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof;

Counsel for the appellant submitted that it is entitled to the benefit of this section on the ground that for the period in question it was a society that was organized and operated exclusively for a purpose "except profit", within the meaning of the term "any other purpose except profit", and that no part of its income was payable to, or otherwise available for, the personal benefit of any proprietor, member or shareholder of it.

It is essential to a proper appreciation of the issue in the appeal, which is a narrow one, that the relevant facts be assessed correctly and this involves consideration of events prior to the organization of the appellant as well as those happening subsequently.

The appellant was incorporated on January 23, 1945, as a society under the *Societies Act* of British Columbia, now R. S. B. C. 1948, Chapter 311, with a declared object to which reference will be made later. In the taxation year in question it was one of a group of Woodward companies

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operating stores in various cities, namely, Woodward Stores Limited, operating the Vancouver store, and Woodward Stores (Edmonton) Limited, Woodward Stores (Port Alberni) Limited, Woodward Stores (Capilano) Limited, Woodward Stores (Victoria) Limited and Woodward Stores (Westminster) Limited, operating stores in the indicated places, and a holding company Woodward Stores (1947) Limited, which held the shares in the operating companies. The last named company is a public one with its shares listed on the Vancouver and Toronto Stock Exchanges.

To appreciate the appellant's place in this group of Woodward companies it is necessary to refer to the facts relating to two Woodward company activities, both of which were initiated prior to the incorporation of the appellant. One of these was the sale of Woodward company shares to Woodward company employees and the other the payment of pensions to Woodward company employees on their retirement from service.

I shall deal with the share sale activity first. This was initiated in 1931 by Charles Woodward, the founder and majority shareholder of the Woodward companies. He set aside two blocks of shares, of which he was himself the owner, totalling $148,000 in par value, for sale to Woodward company employees and the other for the Edmonton company employees. Mr. W. Swannell, the former secretary of the Woodward companies, stated that Charles Woodward had thus established trusts in respect of the blocks of shares thus set aside and described the transaction as the Charles Woodward Trust, but it appears from his evidence on cross-examination that all that Charles Woodward did in 1931 was to insert a sheet of paper in the share register bearing the words "Charles Woodward in Trust $148,000" or words to that effect. Mr. Swannell had never seen any trust agreement relating to the blocks of shares and there is no evidence of any declaration of trust having been made in respect of them. Nor could Mr. Swannell say whether the blocks of shares were identified. All that happened was a unilateral setting aside by Charles Woodward of $148,000 worth of shares. I am unable to see how his act could be regarded as the establishment of a trust or trusts.

Immediately after thus setting aside the blocks of shares Charles Woodward commenced selling shares to Woodward

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company employees. The shares were sold under a share purchase agreement at their par value of $5 per share. The agreement called for a small down payment and the balance in small weekly or monthly payments with interest on the outstanding balance at the rate of 4 per cent per annum. At the time of the agreement the employee gave Charles Woodward an option to repurchase the shares at their par value of $5 each on the retirement of the employee or his severance from employment. On the completion of the agreement by the employee the shares covered by it were transferred to him. In the meantime he had the benefit of whatever dividends were paid. Charles Woodward carried on this share sale scheme until his death in 1937. The control of the Woodward companies then passed to his sons, W. C. Woodward and P. A. Woodward, and W. C. Woodward carried on the scheme in the same way as his father had done for a short period up to June, 1938, when it was taken over by Woodward Holdings Limited, a holding company that was the predecessor of Woodward Stores (1947) Limited. This company carried on the scheme in the same way as Charles Woodward and W. C. Woodward had done until October 10, 1946, when the appellant took it over and enlarged it as will be seen later. The conduct of the scheme by Woodward Holdings Limited did not involve any element of trust.

The payment of pensions to Woodward company former employees started at a later date than that of the share sale scheme. The first payments were made in 1942. They were made by the operating companies themselves, the amounts paid were dealt with as operating expenses and their deduction from what would otherwise have been taxable income was allowed by the Department. The payments were made under the direction of a committee consisting of W. Mann, J. W. Butterfield and A. J. Rowse, all Woodward company executives and they continued to direct the payment of pensions until October, 1951, when the money required for their payment was provided by the appellant as will appear later.

I have already referred to the fact that the appellant was incorporated on January 23, 1945. The object for which it was incorporated was set out in a declaration, dated January 19, 1945, but this was enlarged, pursuant to the *Societies Act*, on September 15, 1947, and again on

February 2, 1949, and altered, pursuant to the *Societies Act,* on March 8, 1952. Since this enlarged and altered object was the appellant's object in the taxation year in question and since the purpose of its organization and operation in that year is in dispute it is desirable to set it out in full. It was as follows:

> The object of the society is to assist in providing funds for the payment of pensions to employees and ex-employees of Woodward Stores Limited in accordance with the pension plan of Woodward Stores Limited as such plan exists at the date hereof or as it may be hereafter constituted and to assist in providing funds for the payment of pensions to the employees and ex-employees of Woodward Stores (Edmonton) Limited, Woodward Stores (Port Alberni) Limited, Woodward Stores (Westminster) Limited, Woodward Stores (Capilano) Limited and Woodward Stores (Victoria) Limited and each of them and of the respective successors of said six companies and each of them in accordance with their respective pension plans as they now are or hereafter may be constituted from time to time and to pay over its surplus funds from time to time to the trustee or trustees for the time being of the trust established in respect of pensions by Woodward Stores Limited by Indenture dated the 19th day of January 1945 made between Woodward Stores Limited as the company and William Mann, John William Butterfield and Arthur John Rowse as trustees and also to pay over such portions of its surplus funds as the directors may from time to time decide to the trustee or trustees for the time being of all or any of the respective trusts as they now are or hereafter may be constituted from time to time in respect of pensions by all or any of such companies and all or any of their respective successors in the absolute discretion of said directors and for the purpose aforesaid to acquire by purchase, gift or otherwise shares in the share capital of Woodward Stores Limited, Woodward Stores (1947) Limited, Woodward Stores (Alberta) Limited, Woodward Stores (Port Alberni) Limited, Woodward Stores (Westminster) Limited, and Woodward Holdings Limited, or any of them, to sell all or any of the shares so acquired and to take options on the re-purchase thereof, and to do all such other things as may be necessary for or conducive to the attainment of the said object.

In the original object, as declared on January 19, 1945, the appellant was concerned only with the payment of pensions to employees and ex-employees of Woodward Stores Limited and paying over its surplus funds to the pension trustees mentioned in the trust deed of January 19, 1945, and it was confined in its dealings with Woodward company shares to the shares of Woodward Stores Limited. And there was no reference in the original object to any exercise of discretion by the directors of the appellant.

On the same date as that of the declaration of the appellant's original object, namely, on January 19, 1945, a trust deed was entered into between Woodward Stores Limited as the Company and William Mann, John William Butterfield and Arthur John Rowse as Trustees whereby

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they were constituted pension trustees for such employees and ex-employees of the Company as might be eligible to receive pensions. The said trustees, later referred to as the pension trustees, were the same persons as the members of the pension committee mentioned previously. They were also all members of the appellant, William Mann being its president and Arthur James Rowse its secretary.

Immediately after its incorporation the appellant took over the operation of the share sale scheme which Woodward Holdings Limited had taken over from W. C. Woodward.

But before I deal with this activity I should refer to another matter in order to clear it out of the way.

Mr. Swannell stated that W. C. Woodward had had the idea of setting up a tax exempt pensions society under section 5(1)(*h*) of the *Income War Tax Act,* R.S.C. 1927, Chapter 97, which read, in part, as follows:

> 5. (1)(*h*) In case of a trust established in connection with, or a corporation incorporated for the administration of an employees' superannuation or pension fund or plan, the income from the investment of the superannuation or pension funds shall be exempt if the trustee or corporation so elects.

and that before the appellant was incorporated discussions were held with the Department at Ottawa with a view to ascertaining the requirements of such a society. Mr. W. O. Skinner, the vice-president, comptroller and secretary of all Woodward companies, including the appellant, since June, 1959, and the Woodward companies' executive in charge of the appellant's affairs, stated that it had never obtained the Department's approval under the section referred to. There were two reasons that prevented it from becoming a tax exempt pension society under the section as W. C. Woodward had intended. The first was that it handled the share sale scheme and the second that it lacked the necessary funds to meet the past service liabilities to the employees that an actuarily sound pension fund should have. The matter has been discussed with the Department on a number of occasions but it is still in the air. Consequently, the appellant cannot be considered as having been organized as a tax exempt pension society. It has nothing to do with the administration of a superannuation or pension fund or plan or the administration of a pension scheme. It does not pay any pensions.

All that it does is to assist in providing funds for the payment of pensions and it obtains the desired funds by operating the share sale scheme. Mr. Skinner conceded that the appellant's operations consisted solely in dealing in Woodward company shares with Woodward company employees and nothing else and that it never engaged in any other operation. Consequently, it cannot be considered as a pension society in the ordinary sense of the term and, to that extent, its name is a misnomer.

Immediately after the appellant had purchased its first block of shares on January 26, 1945, it began to sell them to Woodward company employees under agreements similar in terms to those of the share purchase agreement already mentioned, namely, at their par value of $5 per share, with a small down payment and the balance in small weekly or monthly payments together with interest on the outstanding balance at the rate of 4 per cent per annum. At the same time the appellant took an option from the employee purchaser to repurchase the shares at the par value of $5 per share on the death or retirement of the employee. It is interesting to note that when the appellant purchased its first shares it had no money and had to rely on the sale of shares to employees to get the monies necessary to meet its payments as they became due.

I now come to the facts of the appellant's operation of the share sale scheme. On January 26, 1945, it entered into one agreement with Woodward Holdings Limited for the purchase of shares of Woodward Stores Limited having an aggregate par value of $710,050, at $5 per share, and agreed to pay this amount with a down payment of $1, a payment of $50,000 on April 15, 1945, and the balance at the rate of $50,000 on April 15, annually thereafter together with interest on the outstanding balance at the rate of 3 per cent per annum.

On October 10, 1946, the appellant entered into another agreement with Woodward Holdings Limited whereby it purchased shares of Woodward Stores Limited in the aggregate par value of $70,900, at $5 per share, for which it agreed to pay $73,026, the difference being due to an accrual of dividends, with a down payment of $1, a payment of $7,300 on April 15, 1947, and the balance at the rate of $7,300 on April 15, annually thereafter together

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with interest on the outstanding balance at the rate of 3 per cent per annum. This purchase took the residue of the shares which W. C. Woodward had turned over to Woodward Holdings Limited for sale by it.

On the same date, namely, October 10, 1946, the appellant entered into still another agreement with Woodward Holdings Limited whereby it took over its rights in agreements which it had made for the sale of shares to employees, the amount remaining unpaid on the said shares as at July 31, 1946, being $165,140.78, which amount the appellant agreed to pay at $17,700 on April 15, 1947, and the balance at the rate of $17,700 on April 15, annually thereafter together with interest on the outstanding balance at the rate of 3 per cent per annum.

Thus far the appellant dealt only in shares of Woodward Stores Limited but, subsequently, under the enlargements of its object on September 15, 1947, and February 21, 1949, it was enabled to deal in the shares of other Woodward companies, including Woodward Stores (Alberta) Limited, Woodward Stores (Port Alberni) Limited, Woodward Stores (Westminster) Limited, Woodward Holdings Limited and Woodward Stores (1947) Limited. Under its enlarged power it acquired large blocks of shares in various Woodward companies in addition to those already referred to. Thus in September, 1947, it acquired 180,058 shares of the aggregate par value of $900,290 of Woodward Stores (1947) Limited, which had been established on the reorganization of the Woodward companies in 1947 to hold all the shares in all the Woodward operating companies. It borrowed the amount necessary to pay for these shares from W. C. Woodward and P. A. Woodward on a demand note carrying interest at the rate of 3 per cent per annum but the interest was later waived and was never paid.

And in November, 1947, the appellant acquired from Woodward Holdings Limited its rights in agreements which it had made for the sale of shares in C. Woodward Limited, the original Woodward company in Edmonton, the predecessor of Woodward Stores (Edmonton) Limited, to its Edmonton employees for $48,964.16, being the amount remaining unpaid on the said agreements. These shares were at the par value of $1 per share but were later exchanged for $5 par value shares of Woodward Stores (Alberta) Limited.

The appellant made two other substantial purchases of shares. In May, 1948, it purchased 80,000 shares of the aggregate par value of $400,000 of Woodward Stores (Alberta) Limited, which then held all the shares of Woodward Stores (Edmonton) Limited, and paid for them with money borrowed from Woodward Stores (Edmonton) Limited. No interest was ever paid on the amount thus borrowed.

And in December, 1948, the appellant purchased 20,000 shares of the aggregate par value of $100,000 from Woodward Stores (Port Alberni) Limited and paid for them with money borrowed from the Vancouver company, Woodward Stores Limited. This amount was covered by a demand note carrying interest at the rate of 3 per cent per annum but no interest was ever paid.

Prior to Woodward Stores (1947) Limited taking over all the shares of the Woodward operating companies the appellant sold shares of Woodward Stores Limited, Woodward Stores (Alberta) Limited and Woodward Stores (Port Alberni) Limited to the Vancouver, Edmonton and Port Alberni employees respectively but after the re-organization the only shares that were sold to employees regardless of where they were were those of Woodward Stores (1947) Limited. Previously the rates of dividend varied but after the 1947 re-organization they remained constant.

Whenever the appellant sold shares to a Woodward company employee it was always on terms similar to those already described and it always took from the employee purchaser an option to repurchase the shares on his death or retirement. The option was always taken up when the right to exercise it arose. The sale and the repurchase were always at the par value of $5 per share.

When the employee completed his agreement he received the share certificate for the shares purchased by him but until then the shares continued to be registered in the appellant's name. It did, however, turn the dividends on the shares over to the purchaser employee, subject to a provision in the share purchase agreement that dividends to be declared on the shares for the current year should be proportionately adjusted between the appellant and the employee as of the date of the agreement. There was a similar apportionment when shares were repurchased from employees.

The extent of the appellant's dealing in Woodward company shares is shown by the fact that in the eight years ending January 31, 1953, it had purchased from the various Woodward companies a total of 436,248 shares, in addition to 132,660 shares in respect of which it had taken over the equities of previous vendors, that it had sold 599,272 shares to employees and repurchased 263,593 shares from them, the first figure, no doubt, including shares which it had repurchased and then resold.

Moreover, it is beyond dispute that the appellant's operation of the share sale scheme was very profitable. During the eight year period since its incorporation ending January 31, 1953, it had incurred total obligations of $2,395,345.94 for the purchase of shares and equities in sale purchase agreement but by January 31, 1953, it had paid off all its obligations except $200,000 still owing to P. A. Woodward and had built up a surplus of $754,019.02 even after it had paid $13,089.30 to the pension trustees in October, 1951 and a further sum of $42,273.23 during the year ending January 31, 1953. And it is remarkable that it started with no assets at all.

It is true that this surplus included some capital gains. These came about as the result of Woodward company reorganizations. In August, 1947, Woodward Stores (1947) Limited exchanged all the appellant's shares of Woodward Stores Limited for shares of Woodward Stores (1947) Limited at the rate of 1½ for 1 with the result that it made a capital gain of $154,950 from this source. And in 1947 all the appellant's shares in C. Woodward Limited were exchanged for shares in Woodward Stores (Alberta) Limited, a subsidiary holding company of the shares of Woodward Stores (Edmonton) Limited, at the rate of 2 for 1 with the result that the appellant made a capital gain of $5,000 from this source. The total of the capital gains thus made in the year ending January 31, 1948, came to $160,050. And in the year ending January 31, 1953, all the appellant's shares of Woodward Stores (Alberta) Limited were exchanged for shares in Woodward Stores (1947) Limited at the rate of 3 for 2 with the result that in that year it made a capital gain of $25,975, from that source.

Apart from these capital gains the rest of the appellants' surplus was an accumulation of annual operating profits.

These are set out in the appellant's annual financial statements, filed as Exhibits E1 to E8, which show how the surplus was built up year by year.

The items of revenue consist of interest and dividends received by the appellant and those of expenditure consist of interest paid by it on amounts owing by it or on deposits made by employees or in lieu of dividends and other items such as incorporation and legal expenses and small sundry expenses. The largest item of revenue, amounting to $559,843.18, as shown by Exhibit 6, consisted of dividends received by the appellant either in respect of the unsold shares held by it or as its share of the dividends on shares purchased by employees pursuant to the apportionment provision in the share purchase agreement. The total amount of interest received by the appellant from employees on their unpaid balances came to $254,280.91, as shown by the financial statements, which amount was reduced to a net $141,298.48, as shown by Exhibit 6, after the payment of interest by the appellant. There was thus a net interest profit of this amount gained during the eight periods from the employees to whom shares had been sold.

The appellant did not pay any moneys out of its surplus to the pension trustees until October, 1951. The reason for the delay, as given by Mr. Skinner, was that up to 1949 the appellant's cash position was low and it was not until 1951 that it was felt that it was in a position to supply the necessary funds. Up to that time the operating companies under the direction of the pension committee referred to paid the pensions themselves. The amounts so paid were charged as operating expenses and their deduction was allowed by the Department. But in October, 1951, the appellant took over the provision of funds for the payment of pensions by the pension trustees and thereafter the operating companies were relieved of this expense. Since then the operating companies have not paid any pensions. In October, 1951, the appellant paid the pension trustees the sum of $13,089.30, which was enough to meet the pension requirements for the balance of the year ending January 31, 1952. In the statement of revenue and expenditure for that year the amount thus paid is described as "pensions paid", but this is not correct. The appellant never paid any pensions. In the following year the appellant

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paid the pension trustees the sum of $42,273.23, which was all that was required for pension purposes in that year. The pension trustees advised the appellant each month of the amount required for the payment of pensions and the appellant paid them the necessary amounts. The sum of $42,273.23 was also erroneously described in the statement of revenue and expenditure as "pensions paid".

I should also refer to other facts on which counsel for the appellant relied as proof that it is not a commercial company in the ordinary sense. It has no paid officers or employees. It does not maintain an office. Its books are kept in the general office of the Woodward Vancouver store. It does not pay rent or bear any share of the overhead expense of the Vancouver store. All its work is carried on by the secretary and his staff which is the staff of the Vancouver store but it does not make any contribution to the expense of this staff.

There is also the fact that paragraph 4 of the appellant's by-laws requires it to carry out the objects set forth in the declaration filed with the Registrar of Companies on the incorporation of the society. This paragraph must, of course, be read subject to the enlargements and alteration of the appellant's object to which I have referred. And paragraph 54 of the by-laws provides that upon the dissolution of the society all its assets shall be conveyed, assigned, transferred and delivered to the pension trustees appointed on January 19, 1945, or their successors to be held by them or their successors upon the trusts declared in the indenture of that date.

The circumstances which led to the present appeal may be stated briefly. In its income tax return for the year ending January 31, 1952, the appellant claimed a deduction of the amount of $13,089.30 which it had paid to the pension trustees and this deduction was allowed by the Department. Similarly, its claim of a deduction of the amount of $42,273.23, which it made in its income tax return for the following year ending January 31, 1953, was also allowed. In the next year the amount paid by the appellant to the pension trustees exceeded its income for that year and it then filed an amended income tax return for the year ending January 31, 1953, and sought to carry back its 1954 loss as a deduction for that year. Subsequently, on July 25, 1957, the Minister re-assessed the

appellant for the taxation year ending January 31, 1953. On the reassessment the deduction of $42,273.23 claimed by it was disallowed, but it was allowed, under section 28(1) of the Act, to deduct an amount equal to that of the dividends which it had received from corporations and it was assessed only in respect of the net interest income received by it in the year, amounting to $31,525.58, less an expense item of $22.30, as shown on the appellant's statement of revenue and expenditure for the year, leaving a taxable income of $31,503.28. The appellant objected to the assessment mainly on the ground that it was exempt from tax under section 62(1)(i) of the Act. The Minister confirmed the assessment particularly on the ground that "the taxpayer does not qualify for exemption under subsection (1) of section 62 of the Act." Thereupon the appellant appealed to this Court.

Counsel for the appellant does not now claim a deduction of the amount paid to the pension trustees and does not dispute the amount of the assessment if the appellant is found liable to tax.

Thus the narrow issue in the appeal is that the appellant contends that in the taxation year in question it was exempt from tax under section 62(1)(i) of the Act whereas it is contended for the Minister that it is subject to tax on the net interest income of $31,503.28 received by it during the year.

I am unable to accept the contention of counsel for the appellant that it was exempt from tax for the taxation year in question under section 62 (1)(i) of the Act. This is an exempting provision and, therefore, subject to the rule of construction laid down in *Lumbers v. Minister of National Revenue*,[1] which was stated as follows:

> a taxpayer cannot succeed in claiming an exemption from income tax unless his claim comes clearly within the provisions of some exempting section of the Income War Tax Act: he must show that every constituent element necessary to the exemption is present in his case and that every condition required by the exempting section has been complied with.

This rule has been applied in numerous cases.

In my opinion, the appellant does not meet the requirements of the section and the Minister was right in finding that it did not qualify for exemption under it.

[1] [1943] Ex. C.R. 202 at 211.

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The section presupposes that if a club, society or association is to be exempt from tax under it it should be organized and operated exclusively for a purpose "except profit", that is to say, for a purpose other than a profit one. That necessary condition does not exist in the present case.

While it may have been the purpose in W. C. Woodward's mind, when the organization of the appellant was being considered, to establish a tax exempt pension society that would enjoy the benefits of section 5(1)(*h*) of the *Income War Tax Act* that purpose was never accomplished. Mr. Skinner's evidence to that effect is conclusive. Consequently, any suggestion that the purpose of the organization of the appellant was to make it an element in the administration of a pension scheme for Woodward company employees and ex-employees is unfounded. The purpose of its actual organization was a much more limited one, namely, to assist in providing funds for the payment of pensions by the pension trustees or, in other words, to raise money. The raising of money was its basic purpose and for that purpose, namely, the raising of money, it was directed to deal in shares of the various Woodward companies by acquiring and selling them and it was intended that its dealings should result in the raising of money so that it could provide the necessary monetary assistance to the pension trustees. Thus the purpose of the appellant's actual organization was a profit one. It was certainly not organized for a purpose "except profit" within the meaning of the term "any other purpose except profit."

And I have no hesitation in finding that the appellant was operated for a profit purpose. Its only operations consisted in dealing in Woodward company shares. It made a profit from such dealing—indeed, a very substantial one—and it was intended that it should do so. In the taxation year in dispute it earned a net income interest of $31,503.28 from Woodward company employees to whom it had sold shares, which was almost enough to pay all the pensions for that year. In this connection I am unable to accept the submission of counsel for the appellant that its purpose in operating the share sale scheme was to provide shares to Woodward company employees at cost and that the making of a profit out of the operation was merely incidental. That submission runs counter to the

plain intendment of the appellant's object. It was to deal in the shares for the purpose of assisting in providing funds for the payment of pensions, which plainly meant that it was to make a profit out of such dealing so that it could assist in providing the desired funds. If it was intended that the operation should be solely for the purpose of getting shares into the hands of employees why did the appellant exact greater interest from the employees on their outstanding balances than it had to pay on its own outstanding balances and why did it keep for itself a portion of the current year's dividends on shares which employees had purchased? Moreover, even if the purpose of dealing in the shares was partly to put them into the hands of employees and partly to make a profit therefrom, the purpose of the operation was not exclusively for a purpose "except profit".

Since I have found that in the taxation year in question the appellant was organized and operated for a profit purpose it follows, of course, that it was not entitled to any exemption under section 62(1)(i) of the Act.

While, in effect, this finding disposes of the appellant's contention I should deal with two specific submissions made by counsel for the appellant in support of his contention that it was exempt from tax under section 62(1)(i). One was that the profit purpose envisaged by the section was a purpose of earning a commercial profit and that this element was missing in the appellant's case. I do not agree. It seems manifest to me that there was what might well be considered a commercial purpose behind the appellant's organization, namely, that it should so operate the share sale scheme as to raise money by it and pay it over to the pension trustees and thereby relieve the operating company from a considerable operating expense. This was certainly a commercial purpose and it was accomplished in such a substantial manner that most of the money required to pay pensions in the taxation year in question came from interest income received from employees who had purchased shares and still owed balances of purchase price.

The other specific submission was that the appellant was entitled to exemption under the section by reason of the fact that it was impossible for it to keep or distribute its profit but must pay it to the pension trustees and that, consequently, the appellant did not own it. In support of this

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contention counsel relied strongly on the decision of the Supreme Court of Canada in *Minister of National Revenue v. St. Catharines Flying Training School Limited.*[1] There it was held by Locke J., who delivered the judgment of the Court, that the respondent in that case had no income liable to taxation since the surplus held by it was, in effect, held in trust for the Crown. In my opinion, that finding has no application to the facts in the present case and is certainly not an authority for the submission that the appellant was exempt from tax under section 62(1)(i). It would be unrealistic and fanciful to hold that the appellant had no income in the year ending January 31, 1953. Its own statement of revenue and expenditure for the year, Exhibit E8, shows its income. The fact that it was required to pay over its surplus funds to the pension trustees cannot possibly nullify the fact that the appellant had an income. The income was earned by it as the result of its own operation in dealing with its own property. How can it then be said that it did not own its income? The fact that a person must devote his property to a particular purpose cannot alter the fact that when he acquired the property it was his.

Now that it has been determined that the appellant has not qualified for exemption under section 62(1)(i) of the Act the only remaining question is whether it was subject to tax in respect of its income for the taxation year in dispute and we are here concerned only with the interest portion of it.

There can, I think, be no doubt about it. The interest was earned, as already stated, by the appellant on the result of its own operation of its own property so that it does not matter whether the profit gained by it was a profit from a business or a profit from property. And it is a basic principle of income tax law that the taxability of income cannot be affected by the purpose to which it is applied after it has been earned. This was established beyond dispute by the House of Lords in *Mersey Docks v. Lucas*[2]. There, a corporation was constituted for the management of the Mersey Dock Estate by an Act which provided that the moneys to be received by them from their dock dues and other sources of revenue should be applied in payment of expenses, interest upon debts, construction of works and

[1] [1955] S.C.R. 738.

[2] (1882-3) 8 A.C. 891.

management of the estate; and that the surplus should be applied to a sinking fund for the extinguishment of the principal of the debts; and that after such extinguishment the rates should be reduced; and that except as aforesaid the moneys should not be applied for any other purpose whatsoever; and that nothing should affect their liability to parochial or local rates. It was held unanimously by the House of Lords that under the Income Tax Acts the corporation was liable to income tax in respect of the surplus although applicable to the said purposes only. The decision in *Mersey Docks v. Lucas* (*supra*) was later regarded as binding authority and applied by the House of Lords in *Forth Conservancy Board v. Inland Revenue Commissioners*[1].

In my opinion, the principle thus established is as applicable in Canada as in the United Kingdom.

If a statutory requirement that an item of profit must be applied to a particular purpose cannot affect its taxability it follows as a matter of course that the appellant cannot by its own pre-determination of the purpose to which its profit is to be applied make its profit non-taxable. A taxpayer cannot make his profit non-taxable by determining in advance of his making it what is to be done with it. The purpose to which he applies his profit cannot affect his liability to tax in respect of it.

Consequently, the fact that the appellant was required to pay its surplus to the pension trustees does not save it from liability for income tax on the amount in question. The Minister was, therefore, right in assessing the appellant as he did—and its appeal must be dismissed with costs.

Judgment accordingly.

N.B. The judgment herein was affirmed by the Supreme Court of Canada [1962] S.C.R. 224.

[1] [1931] A.C. 540.