

BETWEEN :

THE MINISTER OF NATIONAL }
 REVENUE } APPELLANT;

1959
 Nov. 23, 24
 25
 1962
 Nov. 15

AND

SAMUEL L. SHIELDSRESPONDENT.

Revenue—Income tax—Income Tax Act 1948, S. of C. 1948, c. 52, s. 15(1) —Income Tax Act, R.S.C. 1952, c. 148, s. 15(1)—Partnership Act, R.S.O. 1950, c. 270, s. 2—Partnerships Registration Act, R.S.O. 1950, c. 271—Excise Tax Act, R.S.C. 1952, c. 100—Validity of father and son partnership—Did partnership in fact exist in the conduct of the business—Appeal allowed.

Respondent is a builder who for many years built for sale houses on tracts of land subdivided by him. In 1950 he entered into a partnership agreement with his minor son, then at school, and for the next three fiscal periods of the business ending in 1951, 1952 and 1953 reported the profits as divisible half and half between himself and his son. The Income Tax Appeal Board allowed an appeal by respondent from his assessment for income tax and on appeal from that decision to this Court the Minister contends that the partnership agreement that was executed was not in fact recognized as governing the operations of the business but that it was conducted in fact as sole proprietorship. The issue before the Court is did a partnership in fact exist. The Court found that the partnership was "a mere simulate agreement and not a reality" and there never was in fact any intention on the part of the father to treat his son as a partner because: the father exercised complete dominion over all the partnership assets and used the assets to his own advantage treating them as his own property; the father registered a declaration under *The Partnerships Registration Act (Ontario)* stating that the partnership was in fact a sole proprietorship carried on by him; the father dealt with the banker of the partnership stating to the banker that the business was in fact a sole proprietorship; the son, at least in the initial period of the alleged partnership was in fact paid wages from which unemployment insurance was deducted; conflicting reports as to the ownership of the business for some of the years; the admission by both the respondent and the son that the largest single property of the business, then under construction, was an asset and undertaking of respondent alone and not subject to the partnership agreement.

Held: That the mere existence of a partnership agreement is not conclusive.

2. That the onus is on the taxpayer to demonstrate that the partnership agreement that was executed actually governed and controlled the operation of the business.
3. That the evidence showed beyond doubt that the partnership agreement was a mere simulate agreement and not a reality and that there never was any intention of the respondent to treat his son as a partner in fact.

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4. That while there was a partnership agreement it was never considered by the respondent as binding on him and did not in fact govern the actions of the parties to it in the conduct of the business.
5. That by virtue of s. 3 of the *Partnerships Registration Act* the respondent is estopped from denying a declaration made thereunder to the effect that he alone carried on the business.

APPEAL from a decision of the Income Tax Appeal Board.

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

W. Z. Estey and *F. J. Dubrule* for appellant.

H. H. Stikeman, Q.C. and *J. N. Turner* for respondent.

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

CAMERON J. now (November 15, 1962) delivered the following judgment:

This is an appeal from a decision of the Income Tax Appeal Board dated April 9, 1957¹ allowing the respondent's appeals from re-assessments made upon him for the taxation years 1951, 1952 and 1953, and dated September 1, 1955. The respondent is a builder residing in Toronto and during each of those years he received income from a number of sources, including income from Shields Construction Co. (which for the sake of brevity I shall at times hereinafter refer to as the "firm"). Attached to his income tax returns for those years (Exhibits I, J and K) are the annual financial reports of that firm stated therein to be a partnership in which he and his son Victor were equally entitled to the profits. Accordingly, in each of those years the respondent included in his personal returns only one-half of the profits of the firm as then computed by him.

In the re-assessments, the Minister made substantial upward adjustments to the net profits of Shields Construction Co. for each of these years as shown by Schedule I attached to the three re-assessments and no appeal has been taken in regard to these matters. In addition, the Minister, being of the opinion that the respondent was the sole proprietor of and therefore entitled to the whole of the profits of Shields Construction Co., assessed the whole of such profits

¹ 17 Tax A.B.C. 100.

as so revised, to him. The amounts involved are very substantial as shown by the following summary which relates only to the profits of Shields Construction Co.

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	1951	1952	1953	TOTAL
Net Profit Assessed	\$88,617.80	\$95,318.48	\$189,627.92	\$373,564.20
<i>Deduct:</i> Net Profit reported by Samuel L Shields	<u>25,675.77</u>	<u>21,334.51</u>	<u>32,973.38</u>	<u>79,983.66</u>
Additional Net Profit assessed against Samuel L. Shields ..	<u>\$62,942.03</u>	<u>\$73,983.97</u>	<u>\$156,654.54</u>	<u>\$293,580.54</u>

The appellant's appeals to the Tax Appeal Board were allowed, Mr. Fisher being of the opinion that Shields Construction Co. was a partnership in which the respondent and his son Victor were entitled to the profits in equal shares. From that decision the Minister now appeals to this Court. The onus, however, is on the respondent to establish that there is error in fact or in law in the re-assessments under appeal (*M. N. R. v. Simpson's Ltd.*¹).

Shields Construction Co. commenced business on April 1, 1950 and its fiscal period ended on March 31. Accordingly, under s. 15(1) of the 1948 *Income Tax Act* and the *Income Tax Act*, the profits therefrom to which the respondent was entitled formed part of his income for the taxation years 1951, 1952 and 1953.

The sole question before me is whether the whole of the profits of the firm for those years and as revised by the Minister in the re-assessments should be assessed to the respondent or only one-half thereof. That question is to be answered by a consideration of all the facts and a determination not only as to whether there was a partnership agreement between the respondent and his son, but also whether such an agreement governed and controlled the operation of the firm.

The evidence of the respondent as to the formation and termination of the various partnerships and companies under which he and/or Victor carried on business as builders is as follows: The respondent, originally a printer, was associated with one Silver in the building and sale of houses for five or six years prior to 1950, first as a partnership under the name of Essex Housing Co. and thereafter until

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early 1950 as Essex Housing Ltd. The latter business was terminated early in 1950 and the assets divided equally between Silver and the respondent. The respondent then decided to continue in business as a builder and to take into partnership with him his son Victor, then less than seventeen years old, the partnership to be called Shields Construction Co. Victor at all relevant times resided in the family home and was a student at Forest Hills Collegiate Institute until May, 1952. A partnership agreement (Exhibit 1) was entered into in March, 1950 and continued for three years until terminated by mutual consent as of March 31, 1953. During those years four or five large parcels of land were purchased and subdivided, a large number of buildings constructed and many sold. The title to all the lands was taken in the name of the respondent alone. He executed all agreements, contracts, mortgages and deeds.

He states that as of April 1, 1953, he took over all the assets and assumed all the liabilities of the firm (including the amount due to Victor as then computed at \$58,044.74), carrying on business under the same name until March 31, 1954, when he incorporated Shields Construction Co. Ltd. (in which he owned all the shares), that company in turn taking over all the assets and assuming the liabilities of Shields Construction Co. (including the amount due to Victor revised upwards to \$103,345.80). He also says that at the dissolution of the partnership on March 31, 1953, Victor went into business on his own account as a builder under the name of Shields Housing Co., that he had no interest in that proprietorship although title to all the land was in his name; and that when Victor became of age about August, 1954, he (Victor) incorporated his business as Victor Shields Homes, Ltd., owning all the shares.

The evidence is that at all relevant times Messrs. Hattin, Moses & Co., Accountants, were the auditors of Shields Construction Co., and H. P. Botnick its solicitor.

The respondent produced Exhibit 1, a partnership agreement bearing date March 23, 1950, in which he and Victor are respectively the parties of the first and second part. The recital thereto reads:

WHEREAS the parties hereto are desirous of entering into the building business in partnership on the basis that the party of the first part shall purchase the land and finance the cost of construction, and the party of the second part shall give supervision and perform such other work

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of his intention to determine the partnership so far as he is concerned, and the partnership shall, at the expiration of three months after the giving or leaving of such notice, determine accordingly.

16. Upon the determination of the partnership, the assets of the partnership shall be realized and be applied, firstly, in payment of the debts of the firm; secondly in paying to each partner the amount of his capital in the business; and the surplus shall be divided equally between the partners or their respective representatives.

There is no clear evidence as to the precise date on which that agreement was prepared or signed. Undoubtedly it was prepared by Mr. Botnick, the firm's solicitor, on the instructions of the respondent and signed by the respondent and Victor, Mr. Botnick being the attesting witness. While no one could swear that it was executed on the date it bears, I am satisfied that it was executed on or shortly after its date, March 23, 1950. The respondent stated that he wanted Victor as a partner as the latter had shown an interest in the building business when the respondent was associated with Silver, and because such an interest would give Victor a chance and "a cause to be very interested". In doing so, he was following the precedent set by his father who had made him a partner in the printing business. Now I have no doubt that that agreement as between the parties thereto, if carried out, was sufficient to constitute a partnership within the meaning of that word as defined in the *Partnerships Act*, R.S.O. 1950, c. 270

2. Partnership is the relation which subsists between persons carrying on a business in common with a view to profit, but . . .

I think it is settled law, however, that for income tax purposes it is insufficient to establish a partnership in fact merely by the production of a partnership deed. It must also be shown that the parties thereto acted on it and that it governed their transactions in the business being carried on.

In *Simon's Income Tax*, 2nd Ed., Vol. I at p. 335, it is stated:

It is the actual carrying on of a trade under these conditions which constitutes a joint trading venture liable to be treated for tax purposes as a partnership or firm, not a mere agreement to carry it on. . . .

The production of a partnership deed or written agreement will not of itself establish a partnership if the agreement is not acted on. In *Dickenson v. Gross (Inspector of Taxes)* 1927, 11 T.C. 614, a deed was executed providing for the profits of certain farms to be divided between the owner and his three sons, the "partners" paying rent to the owner and

all having power to sign cheques. The farms were, however, carried on as they had been before the deed was entered into, the deed being ignored. Rowlatt, J. confirmed the General Commissioners' decision that no partnership existed for tax purposes, saying:—"Many people . . . think that by putting a bit of paper in a drawer they can make an Income Tax partnership, and they go on treating the undertaking as though it were still the sole uncontrolled property of the one person . . . instead of a partnership."

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It will be convenient to consider first the evidence relied on by counsel for the respondent as tending to prove that the partnership agreement governed the conduct of the partners. It may be noted here that the original books and records of Shields Construction Co. and Shields Housing Co., and Victor Shields Homes, Ltd., were not produced at the trial and most of the evidence led by the respondent on this point consists of the oral evidence of himself, of Victor and Mr. Moses, the auditor, and of annual financial reports prepared by Mr. Moses or his firm.

As to the agreement itself, there seems no doubt that Shields Construction Co. commenced business on April 1, 1950 (Clause 1) and that its banking business was carried on at the bank specified in Clause 3 in the manner stated in Clauses 4 and 5. All expenses incurred were paid or provided for out of the earnings of the firm (Clause 6), but there were no losses. There is evidence that the respondent was the office manager and that he had a superintendent—one Robitaille—who was in charge of many of the building operations. There is also evidence that Victor did devote considerable time to the business. Until he left school in May, 1952, he was engaged at times in the evenings, on weekends and on holidays, and occasionally perhaps during normal school hours, in co-ordinating the work at the various projects, arranging for the delivery of materials and the attendance of sub-contractors as needed; and in inspecting some of the work. When he left school, he was fully occupied in such work and actually in charge of two or three projects, probably under the guidance of the superintendent and of his father.

Clause 8 was carried out and title to all land was taken in the name of the respondent (Clause 10). As to Clause 15, no written notice of dissolution was given by either party, but both stated that it was mutually agreed upon. As to Clause 16, it is said that after provision for payment of debts and the capital supplied by the respondent, the surplus, while not actually divided between the parties,

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was allocated to them in equal shares on the firm's books. I shall have occasion later to refer to that in more detail.

Mr. Moses produced a number of annual financial returns as supplied to the firm and its bankers, being respectively Exhibits 3, 4 and 5 for the years ending March 31 in 1951, 1952 and 1953, showing that the firm commenced business on April 1, 1950 and continued to March 31, 1953, and that the annual profits as then computed less drawings were allocated to the respondent and Victor equally. These reports form part of the respondent's tax returns for the years in question (Exhibits I, J and K). While Mr. Moses stated that his firm had access at all times to the firm's records and books, at times assisting in the keeping of the books of account and frequently discussing the accounts with the respondent and Victor, I am quite unable to determine how much of the information contained in these reports was actually taken from the original records or how much was communicated to them by the respondent or Victor. In any event, it is apparent that the auditors were not kept fully informed as to the date of commencement and termination of the alleged partnerships, as will later appear.

These annual reports indicate that for the firm's years ending March 31, the respondent made very substantial drawings of \$2,238.71, \$73,058.30 and \$40,809.50. For the same years they indicate that Victor for his own use drew \$562.40, \$2,050.00 and \$2,550.00. In addition, payments were made by the firm on account of Victor's income tax as follows: \$5,000.00, \$11,776.50 and \$11,723.94 in 1952, 1953 and 1954, but probably for the taxation years 1951, 1952 and 1953. They also show that at the end of the firm's fiscal year, Victor's capital account (representing accumulated profits less drawings as then computed) were respectively \$25,113.36, \$39,397.87 and \$58,044.74.

In support of the respondent's contention that the partnership with Victor was terminated on March 31, 1953, and that Victor then went into business on his own account as Shields Housing Co., the financial reports for each of the firms for the year commencing March 31, 1953, were produced. Attached to and forming part of the respondent's amended tax return for 1954, filed July 27, 1955, is the financial report of Shields Construction Co. in which the

whole of the net income of \$14,645.19 is allocated to the respondent. In the explanatory schedules thereto under the heading "Schedule of partners' capital accounts as of February 28, 1954," Victor's capital account totals \$103,345.80 after drawings of \$14,673.94 (paid on account of his income tax) and after increasing his capital account from \$58,044.74 as of March 31, 1953, by \$59,375.00, to a total of \$103,345.80. In the balance sheet that amount is shown as a loan payable to Victor. I may note here that the stated capital accounts of both the respondent and Victor were increased in that year by reason of the Department's having increased very substantially the value of the "work in progress" as of March 31, 1953, and by other upward adjustments.

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Exhibit O is Victor's 1954 tax return. Attached thereto is a financial report for Shields Housing Co. for the period April 1, 1953, to February 28, 1954, showing all the net income of \$46,238.02 allotted to Victor. It is significant that this report, while prepared by Hattin, Moses & Co., does not bear its name although a prior report for the same year (Exhibit W) has the name attached.

The balance sheet forming part of Exhibit G, the auditor's report for Shields Construction Co. Ltd. for the year ending February 28, 1956, shows "Loans payable—Victor Shields—\$102,658.51". Mr. Moses also stated that Victor was paid on account of his indebtedness about \$8,000.00 to \$9,000.00 in 1958 and \$82,000.00 to \$83,000.00 in 1959, all by cheque, leaving an unpaid balance of about \$12,000.00.

Counsel for the respondent submits that on this evidence it should be found that a partnership existed between the respondent and Victor, that it was carried out, and that while Victor's accumulated profits as of March 31, 1953, were not then paid to him, they were allocated to him and subsequently all but \$12,000.00 was paid five or six years later; and that, accordingly, the respondent should succeed.

These matters in my view are the only ones that tend to support the respondent's contention that the partnership agreement did govern the action of the parties thereto. In the absence of any other evidence, I think the respondent might have established his case.

There is, however, a great deal of evidence which points the other way. I am fully satisfied that the main purpose of the respondent in entering into the partnership with his

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minor son was to secure a benefit for himself by sharing the profits of the partnership with Victor and thereby reducing substantially his own taxable income. In certain circumstances that, of course, is permissible as pointed out in *Ayrshire Pullman Motor Services, et al. v. C. I. R.*¹ where at p. 763 the Lord President (Clyde) said:

No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow—and quite rightly—to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.

In *Dickenson v. Gross (Inspector of Taxes)*² Rowlatt J. stated it in this way at p. 620:

As I pointed out in the case Mr. Bremner cited to me—and as has been often pointed out before—people can arrange their affairs, if they do really arrange them, so as to produce a state of facts in which the taxation is different, and it is no answer—it is perfectly immaterial—to say that they have done it for that purpose.

But Rowlatt J. continued as follows:

But in this case the facts show that in very many ways the deed was simply set on one side and disregarded, and when you find the deed is disregarded, and also that it was entered into for the purpose of obtaining relief from taxation, one is apt, perhaps naturally and quite properly upon the question of fact, to pay a little more attention to those circumstances and those points in which it was disregarded.

I turn now to a consideration of the evidence which tends to support the submission of counsel for the Minister that the partnership deed was in fact disregarded.

Under the *Partnership Registration Act of Ontario* R.S.O. 1950, c. 27, persons associated in partnership for trading, manufacturing or mining purposes are required to register a declaration in writing, signed by all the members of the partnership, and the declaration is required to name all the partners and specify the date of birth of any partner under twenty-one years of age. Exhibit A is a certified copy of a Declaration of Business made under that Act, dated and registered February 17, 1950, in which the respondent certified that he had carried on and intended to carry on

¹ 14 T.C. 754.

² (1927) 11 T.C. 614.

business as a builder under the name of Shields Construction Co. and "that the said business has subsisted since the first day of February, 1950 and that no other person is associated with me in the said business".

It is clear from the respondent's own evidence that this document was prepared *after* he had decided to enter into the partnership agreement with his son and after Mr. Botnick, the solicitor, had pointed out the difficulties that would result in the buying, mortgaging and selling of land if the partnership were registered as being composed of both the respondent and Victor, the latter then being a minor. The respondent first said that Mr. Botnick had then drawn up the declaration of partnership as registered, but later he stated that Exhibit A was in his own handwriting and that he prepared it himself. That registration was never changed at any time, no notice of dissolution was prepared or filed and there was no registration under the Act indicating that the partners in Shields Construction Co. were the respondent and Victor. The respondent explained the matter further:

I just registered because a company name had to be registered and since I could not register the partnership I had to register this to come under the—so I would not have any trouble in case someone wants to know if Shields Construction Co. was building houses and somebody would come along: "Who is Shields Construction Co.?" So I registered as being the sole owner and that is all.

The respondent added that he registered it so as to give notice to the world that he was the sole partner.

The firm had its banking account at a branch of the Royal Bank of Canada in Toronto. Mr. A. L. Leslie, its manager, was called as a witness for the respondent and in cross-examination produced certain documents from the bank's records filed with it by the respondent. Exhibit S contains *inter alia*:

(1) A certificate dated February 15, 1950, signed by the respondent that he was doing business as "Shields Construction Co." and was the sole owner of that business. That certificate was never revoked or cancelled.

(2) A certificate from the Registrar dated February 18, 1950 that the respondent had filed Exhibit A certifying that he was carrying on business as Shields Construction Co. and that no other person was associated with him in business.

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(3) A bank form signed by Shields Construction Co. per the respondent dated February 5, 1953, authorizing Victor Shields merely to receive from the bank a statement of the accounts of the firm with vouchers, etc., and to sign and deliver to the bank the bank's form of verification, settlement of balance and release.

The evidence of Mr. Leslie makes it clear that the bank at all relevant times relied on the respondent's representation that he was the sole proprietor of the business and solely responsible for all loans granted and that all the business was transacted with him. The bank had no official notice that Victor was at any time a partner although from the firm's auditors or from the respondent it received annual statements of its financial affairs, including for some years at least a statement that the profits were divided equally between the respondent and Victor. For example, in a "Statement of Affairs" prepared by the bank for reference to its head office for the year March 31, 1952 to March 31, 1953 (Exhibit U), the respondent is shown as the sole partner, but in the manager's remarks it states:

Although the auditors' report indicates it is operated as a partnership, this is for income tax purposes only, as it is actually a registered sole partnership. Mr. Victor Shields, the other partner shown, is our client's son who is a minor.

and much the same comment is made for the previous year. It is to be noted, however, that Mr. Leslie stated that neither the respondent, Victor, nor Mr. Moses had told him that the partnership was "for income tax purposes only".

Exhibit C is a statutory declaration taken by the respondent in connection with an application by Shields Construction Co. for a mortgage loan from the Prudential Insurance Co. of America. Therein the respondent declared himself as carrying on business as Shields Construction Co. and that the partnership was registered. The respondent admitted in evidence that that declaration was untrue.

It is in evidence that title to all lands acquired by Shields Construction Co. during these years was taken in the name of the respondent personally and no declaration of trust in favour of Victor's interest was prepared.

Exhibits D, F, and E are Returns of Remuneration Paid (T-4 Summary), signed and filed by the respondent with the Department of National Revenue and are respectively for the calendar years 1950, 1953 and 1954. The payor is stated to be "Shields Construction Co." In Exhibit D, dated February 7, 1951, for the calendar year 1950 and made ten months after the partnership with Victor was said to have begun, the name of the respondent only is shown after the words "Name and address of owner or partners", and in the certificate attached the respondent certified that the information given is true, correct and complete in every respect. In Exhibit F for the year 1953 and dated February 24, 1954, the respondent certified that the partners were Victor and himself although his own evidence is that the partnership was dissolved in March, 1953. In Exhibit E for 1954, he certified that he was the sole owner although Victor's name was originally included as a partner, but his name was later blocked out.

There is some evidence, also, that for part of the time, at least, Victor was considered as an employee and so considered himself. Exhibit Y is a photostatic copy of an application for an insurance book from the Unemployment Insurance Commission dated April 14, 1950, signed by Victor, stating that he was a field supervisor *employed* by Shields Construction Co. As a partner in the firm, he would not have been entitled to so apply. The evidence of Mr. W. S. McInnis, formerly employed by the Income Tax Division, shows that while so employed he examined the books of the firm at its place of business. He found from the records that during the fiscal year ending March 31, 1951, Victor was paid *wages* of \$43.22 per week (after unemployment insurance was deducted) for one week in April, 1950 and for a number of weeks from June to August 31, 1950, totalling in all \$562.40. This information was secured from the firm's payroll records which were not available when later required by another tax official, or at the trial. In the auditor's statement for that year (Exhibit 3) that amount is shown as the only deduction from Victor's capital account. For the year ending March 31, 1952, Victor drew payments of \$50 per week from June 22, 1951 to March 31, 1952, a total of \$2,050.00. These payments were made regularly by cheque and did not appear in the payroll records. They were the only payments made to him in that

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year, but two payments of \$2,500.00 each were made on his behalf on account of income tax (presumably for 1951) and the total of \$7,050.00 was shown in the auditor's statement as drawings for the year. Similarly for the year ending March 31, 1953, Victor was paid \$50.00 per week (a total of \$2,550.00) and that amount, together with income tax payments made on his account amounting to \$11,776.50 (totalling in all \$14,326.50), were shown as drawings from capital account in the auditor's statements. For these three years, therefore, Victor personally received a total of \$5,162.40 and income taxes totalling \$28,500.44 were paid on his account.

As I have said, the respondent swore that he had no interest in Shields Housing Co. and that it was the sole property of Victor from its inception. The evidence establishes clearly that the respondent held himself out as its sole owner. Exhibit B is a declaration made by him under the *Partnerships Registration Act* dated and registered February 3, 1953, in which he certified "that I have carried on and intend to carry on trade and business as a builder under the name of Shields Housing Co. . . . that the said business has subsisted since the first day of February, 1953, and that no other person is associated with me in partnership in the said business." That was the only registration of Shields Housing Co.

A bank account for that firm was opened with the same branch of the Royal Bank. Mr. Leslie produced Exhibit T which contains a certificate dated December 15, 1952, and signed by the respondent that he was the sole owner; a certificate as to the registration of Exhibit B; and a general power of attorney signed by the respondent on behalf of the firm in favour of Victor. Mr. Leslie said that the bank had no knowledge that Victor was the owner of the firm and that he transacted all banking business with the respondent. It is admitted that the title to all lands of Shields Housing Co. was taken in the name of the respondent alone.

Earlier herein I referred to the auditors' financial report of Shields Construction Co. for the year ending February 28, 1954 (Exhibit L), indicating that the respondent in that year was the sole partner. In fact, that was the second report prepared by the same auditors for the same period. Copies of both were supplied to the bank and formed part

of Exhibit V. The first one shows the net income of \$33,382.09 divided equally between the respondent and Victor, as well as their capital accounts accumulated as of February 28, 1954; there is nothing in that balance sheet to indicate any "Loans payable to Victor".

Similarly, there were two reports prepared by the same auditors for the first fiscal year of Shields Housing Co. ending February 28, 1954. The second one, earlier mentioned, shows Victor as the sole partner and that the original investment of \$10,233.00 was his alone. The first report (Exhibit W) was given to the bank by the auditors and shows not only that the net income of \$46,238.02 was divided equally between the respondent and Victor, but that each had invested exactly one-half of \$10,233.00. A comparison of these two reports shows that they are identical in content except for the allocation in the second report of all the capital investment and all the profit to Victor.

Neither the respondent nor Victor attempted to explain these discrepancies in any way, although the practice of the auditor was to give all reports to each partner. Mr. Moses' explanation is not at all convincing. He referred to the first reports as "preliminary" reports, although there is nothing in them which suggests that they were not final and prepared according to the original entries in the firm's books. Mr. Moses made it perfectly clear that his firm had full access to the original records at all times, discussed them with the partners and took some part in the actual book-keeping. I cannot agree with his opinion that when a partnership or proprietorship is established the books do not show the partners or proprietor until the end of the first fiscal year when the auditors take over. I can reach only one conclusion, namely, that the first reports of each firm for that year were prepared from the original books and had the approval of the respondent and Victor. Mr. Moses made it clear that before reports were prepared it was his practice to have all statements to be contained therein verified by the owners.

I am confirmed in that view of the matter by the contents of Exhibit Z2, the auditors' working papers for Shields Housing Co. for the year ending February 28, 1954. On April 21, 1954, the auditors wrote a letter to "Shields Housing Co.—Attention S. L. and V. Shields", forwarding the first report. In a memo attached it is shown that the

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report was discussed with the principals "S. L. and V." on April 20, 1954, the reference clearly being to the respondent and Victor, and that the report was delivered to the firm on April 22, 1954. There is also a copy of another letter to "Shields Housing Co.—Attention Victor Shields"—dated April 13, 1955, enclosing the second report. The working papers attached clearly indicate that as originally prepared the profits were allocated to the respondent and Victor equally, but were later changed and allocated to Victor alone, presumably for the purpose of the second report. It is interesting to note that included in the working papers is the two page certificate of approval signed by Victor alone, indicating that he is the sole proprietor. Its date is given as April 20, 1954, but no witness confirmed that as the date of signature. Obviously, it was not in the hands of the auditors on that date which was the same as the date when the first report was discussed with both the respondent and Victor as principals, and two days before the first report was delivered. The clear inference, in the absence of any evidence to the contrary, is that the approval when signed by Victor was antedated so as to accord with the second report made in 1955.

Considerable doubt is thrown on the evidence of the respondent and Victor that their association terminated in March, 1953, by Exhibit H, a letter by Mr. Botnick, the solicitor, dated March 15, 1954, sent to the Director of Income Tax and written on the instructions of the respondent. It says in part:

I act for Samuel L. Shields and Victor Shields who are *carrying on* a building business in partnership under the name of Shields Construction Co. (The italics are mine.)

There were a substantial number of things which taken together indicate that the respondent never considered himself as bound by the terms of the partnership agreement; that he was prepared to carry it out only to the extent that it was necessary to show for income tax purposes that Victor was a partner and therefore entitled to one-half of the profits, and that otherwise he was prepared to disregard it and treat the firm, its assets and the profits as his own. Victor's personal drawings for the three years were small as compared with those of the respondent. In the first year he was paid wages only and in the second and third years at the rate of \$50.00 per week which would

seem to be little more than compensation for work done. The profits were not divided at the end of each year as provided by the agreement. In the first financial report for the year ending March 31, 1953, Victor's accumulated capital account was shown at \$58,044.74, whereas his true entitlement, had he been a partner, was shown to be \$165,180.47 (Exhibit Z1). Whatever his entitlement was as of that date, nothing further was paid to him on that account (except possibly an unexplained item of \$500.00) until 1958—a period of five years—by which time the Court below had given its decision and the Minister had appealed to this Court.

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It was suggested that the respondent was not in a position to settle accounts with Victor until 1958-59, that he owed the bank and other creditors large sums of money and that his assets were tied up in real estate holdings. But no one swore that he could not have paid Victor his share in March, 1953, or, at the earliest, in 1954, when Victor became of age and had commenced business on his own account, and, as a speculative builder would need large amounts of capital. As shown by his tax returns, the respondent was a man of wealth and I have no doubt that he could have settled with Victor had he desired to do so.

Three matters of particular importance must now be mentioned. In December, 1952, after Victor had told the respondent that he was about to enter business on his own account, Shields Construction Co. (per the respondent) issued a cheque to Victor for \$10,000.00. The respondent said that that cheque was charged to Victor's capital account and that in computing Victor's share as of March 31, 1953, it was taken into account. The evidence of Mr. Moses shows that neither of these statements was true according to the company books and that the cheque was charged to the respondent's own drawing account and never changed. The payment at that time and in that manner may perhaps suggest that it was a "terminal" payment and made out of what the respondent considered to be his own property.

Mr. Moses also stated that the books of Shields Construction Co. showed that after Victor went into business in April, 1953 as Shields Housing Co., and thereafter for many years, he, Victor, *purchased* lands from Shields Construction Co. and its successor; that for these purchases

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Victor owed Shields Construction Co. amounts as much as \$80,000.00 over the years and even as late as 1958 and 1959; and that this indebtedness was not shown as an offset against "Loans payable to Victor Shields", but was shown as a liability by Victor and carried as an open credit. This evidence, which was unchallenged, indicates clearly that the respondent had assets at all times with which he could have settled Victor's indebtedness had he wished to do so and that he considered that Victor owed him rather than that he owed Victor. It is also surprising that in 1959 the respondent should pay Victor about \$70,000.00 by cheque when, as stated by the auditor, there was a balance of more than that amount owed by Victor. It may well have been a further step by the respondent to endeavour to establish that there was an effective partnership between 1950 and 1953.

The third matter relates to a large apartment house called "Davick Court". It is fully established by the evidence of Mr. Moses that the records of Shields Construction Co. show that the land on which the apartment was built was purchased in 1952 as an asset of Shields Construction Co., that construction began in that year, that the cost of the land and the costs of construction up to March 31, 1953, were charged to the firm, and that while not fully completed as of that date, a number of tenants were in possession and rentals had been treated as income of the firm (Exhibit K). In the auditors' reports, the cost of construction to that date was shown at \$560,000.00 and the property was carried as inventory of the firm. In the re-assessments, the actual cost to March 31, 1953, was established at about \$680,000.00 (an amount not now disputed) and in order to enable the respondent to claim capital cost allowance, it was taken out of inventory and shown as a fixed asset. After March 31, 1953, the building was finally completed at a total cost of over \$900,000.00. Notwithstanding these facts, Victor stated at the trial that Davick Court was not part of the partnership enterprise and that it was built and owned by his father. It was shown, however, that Victor in evidence given to the Court below had stated bluntly that Davick Court was a partnership project.

The respondent, however, insisted at the trial that Davick Court was not and never had been part of the partnership business, that it was his own property and that in comput-

ing Victor's share in the partnership as of March 31, 1953, it was not taken into account in any way. He said that he commenced building it during the summer of 1953, but later said it might have been 1952. He stated:

At the time (of the purchase) there was no intention as to whether I should build it myself or for the company. I probably decided to build it for myself later on and we decided to dissolve partnership.

and,

It might have been purchased for the company and then I decided to build for myself.

and,

I do not believe the intention was to build under my own name until later on, to belong to me, I should say, until later on.

In thus claiming sole ownership to what was probably the largest single asset of Shields Construction Co. and after that firm had expended over \$680,000.00 on the construction of Davick Court, the respondent has made it abundantly clear that in his view the assets were his assets, to be disposed of or taken over by himself as he saw fit. His manifest intention was that Victor should not benefit from it in any way. Victor too, at the trial, seemed to agree that his father was entitled to do so notwithstanding the clear evidence of Mr. Moses to the contrary. Victor said that he trusted his father, that he never asked him for any part of his "share", would never have sued him for that share and that he never received any evidence of any indebtedness from his father. Even at the time the appeal was before the Tax Appeal Board in September, 1956, Victor had not the slightest idea as to how much was owing to him.

The evidence relating to Shields Housing Co. is particularly confusing and illustrates completely the conflict that exists between some items of the documentary evidence and between that and the oral evidence. Had the respondent seen fit to produce the original books and records, the actual facts might have been ascertained. The registered declaration filed by the respondent under the *Partnerships Registration Act* (Exhibit B) and the documents filed by him with the bank (Exhibit T) show the respondent as the sole proprietor, although his own oral evidence is that he had no interest in it at any time. The original capital investment of \$10,000.00 also came from his own account. Exhibit X, numbered C6542, is Mr. Leslie's report to head office for the period ending February 28, 1954, and dated May 4,

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1954. It must have been based on information supplied by the respondent or the auditors. It shows the respondent as sole owner and that the financial statement was audited by Hattin, Moses & Co. In the manager's remarks it is stated:

This firm was operated as a separate entity for the period under review from April 1st, 1953 to February 28th, 1954, *when the assets and liabilities were transferred to the newly incorporated account of Shields Construction Company Limited.* Operations were conducted by Mr. Shields' son, Victor and although the name is registered under the sole proprietorship of Mr. S. L. Shields, *the net income was allocated between the two parties.* It will continue to operate as a subsidiary of Shields Construction Company Limited until next August, when Mr. Shields' son, who is at present a minor, becomes 21 years of age. During the period under review, 35 houses were constructed and sold. A further three units were in process of construction at the date of the statement.

Exhibit W, the auditors' original report for the fiscal year, shows that the invested capital and the year's profits belonged equally to the respondent and Victor, whereas the second report for the same year (Exhibit O) shows Victor as having invested all the original capital and as entitled to the whole of the profits.

Further evidence as to what was later done regarding Shields Housing Co. is shown in the bank's report to head office numbered C7024, dated June 10, 1955 (part of Exhibit U) regarding Shields Construction Co. and revising the original balance sheet. In the manager's remarks therein it is stated:

Because of the difficulties Mr. Shields has experienced with the Income Tax Departments, his Auditors have found it necessary to set up the bookkeeping and balance sheets on a revised basis. Accordingly the closing statement for Shields Construction Company at February 28, 1954 is to be re-written. We have not yet been furnished with a revised statement but the Auditor has supplied us with a copy of trial balances, which is attached hereto. The principal changes will be found in respect to inventory, fixed assets, mortgages payable, depreciation reserve and personal loans.

The assets and liabilities of Shields Housing Company, which were to have been taken over by Shields Construction Co. Ltd., were instead transferred to Victor Shields Homes Ltd. As a result the pro-forma balance sheet showing combined assets of Shields Housing Co. and Shields Construction Company, submitted with our letter C 6542 has been cancelled. The revised figures at February 28, 1954 will apply instead.

While Shields Housing Company account was conducted with us under the registered sole proprietorship of Mr. S. L. Shields, it was up to 1953 operated for taxation purposes as a partnership of S. L. Shields and his son, Victor Shields, who until then was a minor. Subsequently Victor Shields took over the business but until the incorporation of Victor Shields Homes Limited, which took place when Victor Shields reached his

majority in August 1954, it continued with us under the sole ownership of his father. *Victor Shields was also shown as a partner of Shields Construction Co. until February 28, 1954, although Mr. S. L. Shields conducted the account with us as registered sole owner.* Henceforth Victor Shields Homes Limited, Shields Construction Co. Ltd., and Shields Investments Reg'd (S. L. Shields, proprietor) will be on a clearly defined basis.

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I must comment also on the unsatisfactory nature of the evidence of the respondent. I have already referred to a number of matters in which his evidence is shown to be completely untrue. His memory failed him completely on other matters in which one would have thought he would have been informed, more particularly so if he considered that Victor was in fact his partner for three years and entitled to a half interest in all the partnership assets. For example, he could not remember (a) what assets he received on the winding up of Essex Housing Ltd.; (b) when he had advised the auditors of the commencement and termination of the partnership with Victor; (c) what Victor's share in the profits amounted to at any time or why they were increased from \$58,000.00 to \$103,000.00 or more; (d) whether the \$10,000.00 paid to Victor in December, 1952 was in cash or in land or when it was made; (e) whether he had filed a sole partnership declaration with the bank for Shields Construction Co. and Shields Housing Co.; (f) whether the auditors' reports of Shields Housing Co. as filed with the bank showed that he or Victor or both were the owners, although undoubtedly he received and had knowledge of the reports and had probably approved them.

Finally, it is to be noted that the respondent insisted in the evidence that Victor at no time during the alleged partnership had any interest in the assets of the partnership and that all he was entitled to was a share of the profits; and that, although all the land was registered in his name, he did not hold any of it for the benefit of his son. It is also shown that when the respondent in 1953 took over Davick Court as his own, nothing was allowed to Victor for the difference between its cost and its then market value; and that after March 31, 1953, he used the assets of Shields Construction Co. in his own business and as if they were all his personal property.

In my opinion, these facts indicate beyond doubt that the alleged partnership agreement of the respondent and Victor was a mere simulate agreement and not a reality and

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that there never was any intention on the part of the respondent to treat his son as a partner in fact. I have reached this conclusion on the facts I have mentioned, but more particularly on the following matters:

- (a) The failure to produce the original books of account;
- (b) The complete dominion exercised by the respondent over all the assets of the partnership, both before and after March 31, 1953, and his use of all such assets for his own advantage after that date and his repeated statements that Victor had no interest whatever therein, except the profits;
- (c) His registered declaration and his certificate to the bank that he was the sole proprietor;
- (d) The unsatisfactory nature of the proof as to when the partnership commenced and terminated;
- (e) The payment of wages only to Victor for the first year and only small weekly amounts thereafter;
- (f) His failure to distribute the profits annually as provided by the agreement;
- (g) His attempt to withdraw for his own use the largest single asset of the partnership, Davick Court, from the partnership assets after more than \$600,000.00 had been expended thereon by the partnership;
- (h) That no interest was paid to Victor on the large balance said to have been owing to him;
- (i) The crediting of Victor's account with a fraction only of the amount he would have been entitled to as a partner;
- (j) His failure to pay over Victor's share until 1959 when this appeal was about to be heard;
- (k) The revised and conflicting auditors' reports, both of Shields Construction Co. and Shields Housing Co., which must have been made by his direction or at least with his approval, and which I have no doubt were made because of his difficulties with the Income Tax Department;
- (l) The failure of Victor to make any request to his father for payment on his alleged share of the profits even when he was in need of funds for his own business.

These facts lead me to the conclusion that while there was a partnership agreement, it was never considered by the respondent as binding on him. It was put aside and

did not in fact govern the actions of the parties thereto, except to the extent that it was helpful in carrying out his scheme to reduce his own taxable income, namely, by making payments of income tax on account of Victor's alleged profits.

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Counsel for the respondent cited *Ayrshire Pullman Motor Services and D. M. Ritchie v. C. I. R.*¹, a case decided by the Court of Session, Scotland, in 1929, and referred to earlier herein on another point. That case, in my opinion, is clearly distinguishable on its facts. There, in 1927, a father entered into a written contract of co-partnership between himself and his five children relating to the operation of a motor-bus service; four of the children were daughters and two of them were minors. The contract provided, *inter alia*, as follows:

The partnership to be held to have commenced in January, 1926. Capital to be a loan already contributed by the father and such further sums as he might contribute. The children to be interested in the profits equally, the father's interest being the sum advanced and interest thereon only. The children to draw wages but no share of profits until the father's advances were repaid. The father to have the sole general management and to operate alone on the firm's bank account.

Assessment to income tax was made on the footing that the father was the sole owner of the business and the General Commissioners dismissed appeals against these assessments. On appeal by the firm and the father it was held that the father could not be held to be for income tax purposes the sole owner of the business and the whole profits thereof.

As I read the judgment of the majority in that case, the main contention on behalf of the Crown was that the agreement had not been fully acted upon, since the accumulated profits were not divided at the end of the fiscal years, but were allowed to accumulate to the credit of the five children, and the father's indebtedness was not paid off although it could have been paid. But the partnership agreement provided that except for wages, the children should withdraw no profits from the business until the cash loan or loans made by the father should be repaid in full with interest—the father not being entitled to any profits as such. Having found that the agreement was neither a fraud nor a simulate agreement, the Court held

¹ 14 T. C. 754.

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that the mere failure to pay off the father's loan could not be regarded as a failure to carry out the agreement since, in view of the expansion of the business, it was desirable to let his capital remain in the business. The Court pointed out that the profits here had been regularly credited to the children and that after payment of the father's loan, such profits belonged to them and to no one else.

The facts in the instant case are substantially different. In the *Ayrshire* case (as shown at p. 757 of the Report), two registrations of the firm were made after the date of the partnership agreement (under the *Registration of Business Names Act*) and in both the five children were shown as partners, although in the second the father was also shown as a partner. I need not repeat the evidence as to the declarations and certificates of the respondent herein that he was the sole owner of Shields Construction Co. throughout. The facts which I have set out earlier in detail and which have led me to the conclusion that the alleged partnership agreement between the respondent and Victor are not a reality, but a mere simulate agreement, are sufficient to distinguish the present appeal from that in the *Ayrshire* case.

Dealing with the merits of the case, I have come to the conclusion that the respondent has failed to satisfy the Court that there is error in fact or in law in the re-assessment under appeal.

The conclusions which I have just stated are based on the evidence as to what actually took place in regard to the alleged partnership of the respondent and his son in the business of Shields Construction Co. But there is another ground on which I think the Minister is entitled to rely.

Section 5 of the *Partnerships Registration Act* R.S.O. 1950, c. 271, reads:

5. The statements made in any declaration shall not be controvertible by any person who has signed the same nor as against any person not being a member of the partnership by any person who has signed the same, or who was really a member of the partnership therein mentioned at the time the declaration was made.

As I have set out earlier, the respondent prepared, signed and registered a declaration under that Act (Exhibit A) certifying that he was carrying on business under the name

of Shields Construction Co. and that no other person was associated with him in partnership in the said business. That statement, therefore, may not be controverted by the respondent as against any person not being a member of the partnership. Since these proceedings relate merely to the validity of the re-assessments made on the respondent, I do not think that s. 14 of the same Act, which provides, "Nothing in this Act shall affect the rights of partners with regard to each other", has any bearing on the matter.

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Section 5 was considered by the Court of Appeal of Ontario in *Regina v. Tennen*¹. In that case the accused was registered under the *Partnerships Registration Act* as the owner of a business named Majestic Lamp Company. Two separate charges were laid against her for breaches of the *Excise Tax Act* R.S.C. 1952, c. 100. She pleaded guilty before the magistrate, but on appeal to the County Court she asked to be allowed to change her plea to "not guilty" on the ground, *inter alia*, that it was proposed to call evidence to show that she was only the nominal owner of the business. Shea, C.C.J. refused to allow the pleas to be withdrawn and dismissed the appeal. The accused then appealed to the Court of Appeal. After disposing of other matters raised in the appeal, Roach, J.A., in giving judgment for the Court, said at p. 85:

In my opinion having filed the declaration under the Partnerships Registration Act declaring that she alone was carrying on the business, for the purposes of the Excise Tax Act she is estopped from denying it.

The principle so laid down is in my view of equal application to the *Income Tax Act* and to the present appeal.

Accordingly, and for the reasons which I have given, the appeal will be allowed, the decision of the Income Tax Appeal Board set aside, and the re-assessments made upon the respondent affirmed.

The appellant is entitled to costs after taxation.

Judgment accordingly.

¹ [1959] O. R. 77.