BETWEEN:

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

1954
Feb. 3
June 17

AND

SHELDONS ENGINEERING LIMITED.. RESPONDENT.

Revenue—Income Tax—Deduction claimed for capital cost allowance—The Income Tax Act, 1948, c. 52, s. 20(2), s. 127(5)—Controlling interest—Corporations not dealing at arm's length—Corporations not controlled by same persons nor by each other.

Respondent was incorporated for the purpose of acquiring the assets and carrying on the business of the Sheldons company. An agreement was concluded making effective the transfer of the undertaking, property and assets of the Sheldons company to the respondent. In its income tax return for the taxation year 1951 respondent claimed a deduction in respect of capital cost allowance on the assets purchased by it from the Sheldons company and on certain additions made to its depreciable assets since it commenced business. This deduction was disallowed by the Minister of National Revenue and on appeal to the Income Tax Appeal Board his assessment was set aside. The Minister appealed to this Court.

No one person held a majority of the common shares of respondent company at the time the agreement with the Sheldons company was ratified and confirmed, and neither did respondent company hold any shares in the Sheldons company when its shareholders authorized the execution of the agreement, nor did the Sheldons company hold any shares in the respondent company at the time its shareholders ratified the agreement.

Held: That the Sheldons company and the respondent company were not controlled directly or indirectly by the same person at the times the agreement of sale and purchase was approved and its execution on their behalf authorized by their respective general meetings, or at the time the assets of the Sheldons company vested in the respondent company or at any other relevant time within s. 127(5) or s. 20(2) of the Income Tax Act.

2. That it is the total of the voting power or shares in the hands of those persons who own the shares that gives control of a company and it is the holding of the majority of these shares by which one

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

company controls another and because the company holding the majority of shares in another names proxies to vote them the company is not controlled by the proxy holders.

APPEAL from a decision of the Income Tax Appeal Board.

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

E. O. Hickey and *F. J. Dubrule* for appellant.

Donald Guthrie, Q.C. for respondent.

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

POTTER J. now (June 17, 1954) delivered the following judgment:

This is an appeal by the Minister of National Revenue, hereinafter called the appellant, from a decision of the Income Tax Appeal Board dated December 23, 1952, allowing an appeal from an assessment by the appellant dated January 18, 1951, whereby the appellant disallowed the sum of $6,672.14, being part of a deduction claimed in respect of capital cost allowance on assets purchased by Sheldons Engineering Limited, hereinafter called the respondent new company, shortly after its incorporation from another company known as Sheldons Limited, hereinafter called the old company, and on certain additions made to its depreciable assets since its commencement of business.

The old company was incorporated under the Ontario Companies Act and for many years had carried on a manufacturing business at Galt, Ontario. Its capital was divided into common shares, of which 4,009 shares had been issued.

As of June 1, 1949, three lots of over 1,000 shares each were held by the following:

S. E. Nicholson	1,024 shares
J. P. Stuart	1,153 shares
W. D. Sheldons, Sr.	1,168 shares

Any two of these shareholders, by combining the voting power of their shares, could control the old company, and the evidence was that J.P. Stuart and S. E. Nicholson, who together held 2,177 shares, for some time did control it and dictate its policies.

The old company had for many years made profits, but no dividends had been declared or paid.

Some time prior to June, 1949, it came to the knowledge of some of the employees of the old company that Mr. Stuart and Mr. Nicholson were endeavouring to dispose of their controlling interests, and four of them, viz. W. D. Sheldon, Jr., who at that time held two shares, George Murray Egoff, Harold William Mogg, and William Clark Caldwell, none of whom held shares in the old company, discussed the situation and, as a result of negotiations carried on by W. D. Sheldon, Jr. with Mr. Nicholson and Mr. Stuart and the Royal Bank of Canada, he arranged for a loan of $359,205.00 to enable him to purchase the 2,177 shares held by Mr. Nicholson and Mr. Stuart at $165.00 per share on the understanding that eighty per cent of the shares in the old company would be lodged with the Royal Bank of Canada as collateral to secure its loan to W. D. Sheldon, Jr.

It was further arranged that a new company would be formed for the purpose of acquiring the assets of the old company, which new company would issue and sell bonds in the amount of $300,000.00 to repay the bank loan, with the expectation that the minority shareholders of the old company would agree to take either preferred or common shares in the new company in exchange for their holdings in the old company.

Two alternative proposals were to be made to minority shareholders, viz. to take 75 common shares in the new company for one common share in the old company, or five preferred shares in the new company for one common share in the old company.

In negotiating with a bond broker, he agreed to underwrite the bonds to be issued by the proposed new company, provided $50,000.00 in new capital was brought into the new company in cash.

Sheldons Engineering Limited, the respondent herein, which is referred to as the respondent new company, was incorporated by Letters Patent issued June 15, 1949, under

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

Potter J.

the Dominion Companies Act, with an authorized capital of $400,000.00, divided into 16,000 preferred shares of a par value of $25.00 each and 80,000 common shares without nominal or par value, the principal objects of the respondent new company being:—

To manufacture and install heating and ventilating machines and equipment, blowers and exhausters, mechanical draft fans, axial flow fans, steam engines and steam specialties, drying systems and equipment, conditioning and dust control systems and equipment and vacuum cleaners of all kinds and all the appurtenances to the foregoing.

The principal reason for the formation of the respondent new company was, of course, to acquire the assets and undertaking of, and to carry on the business carried on by, Sheldons Limited, the old company.

By an agreement dated July 4, 1949, and made between Sheldons Limited, the old company, called the vendor of the first part, and Sheldons Engineering Limited, the respondent new company, called the purchaser of the second part, the old company sold and the respondent new company purchased, free of all liens, charges, and encumbrances, the business, undertaking property and assets of the old company as a going concern, as of June 21, 1949, for the sum of $1,267,904.44, and paragraph 7 of the agreement was as follows:—

7. This Agreement is intended to operate as an actual transfer to the Purchaser of the business, undertaking, property and assets of the Vendor, but the Vendor shall forthwith on demand execute or cause to be executed or procure for the Purchaser, all necessary conveyances, transfers, assignments, agreements and consents that may be required or as counsel may advise to vest the said business, undertaking, property and assets in the Purchaser, free and clear of all liens, charges and encumbrances.

In its income tax return for the taxation year 1949, the respondent new company claimed capital cost allowance upon the cost of the assets acquired from the old company and upon the cost of additions to such assets, the total of such allowances claimed being $21,169.04.

The following tabulation illustrates the differences between the amounts claimed by the respondent new company as capital cost allowances and the amounts allowed, added or deducted by the appellant.

	Claimed	Allowed or Deducted
Class (3)— 5%	$ 2,603.11	$ 2,834.93
Class (8)—20%	17,435.09	9,681.44
Class (10)—30%	99.48	210.40
Class (11)—50%	1,031.36	1,770.13
	$21,169.04	$14,496.90
Net Disallowances		6,672.14
	$21,169.04	$21,169.04

By his Notice of Assessment dated January 18, 1951, the appellant assessed the taxable income of the respondent new company at $62,510.16, increasing to that amount its declared income of $47,585.31 as follows:—

Adjustments of Income Declared

Net Income Declared	$47,585.31
Capital Cost Disallowance *re* Section 20 (2)	6,672.14
Bond Interest Disallowance *re* Section 11 (1) (c) and Section 12 (1) (c)	6,678.10
Bank Interest Disallowance *re* Section 11 (1) (c)	1,574.61
	$62,510.16

The income tax levied was $19,412.19, to which was added interest amounting to $144.52, making the total amount payable $19,556.71, against which was credited the amount remitted by the respondent new company with its income tax return of $15,552.46, leaving a balance due of $4,004.25.

On March 12, 1951, the respondent new company gave Notice of Objection to the assessment and particularly to the disallowance of the capital cost allowance claimed, amounting to $6,672.14, the item and amount involved in this appeal.

On June 12, 1951, the Notification by the Minister was given, confirming the assessment on the ground that

> the capital cost allowance has been determined under the Income Tax Act and the income tax regulations based on capital cost in accordance with the provisions of subsection (2) of section 20 of the Act.

The respondent new company on July 9, 1951, gave Notice of Appeal to the Income Tax Appeal Board, and on December 23, 1952, judgment was delivered, allowing the appeal.

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

Potter J.

On April 30, 1953, the appellant appealed to this Court. By his Notice of Appeal to this Court the appellant, among other things, alleged that at the time the agreement of sale of the assets by the old company to the respondent new company was executed both corporations were controlled directly or indirectly by the same person, within the meaning of subsection (5) of section 127 of the Act.

And further that, even if subsection (5) of section 127 of the Act is not applicable, the transaction by which the respondent new company acquired the assets of the old company was one between persons not dealing at arm's length, to which the provisions of subsection (2) of section 20 of the Act are applicable.

Section 127 (5) of the Income Tax Act, 1948, (section 139 (5)) as it was re-enacted by Chapter 148 of the Revised Statutes of Canada, 1952, is as follows:—

(5) For the purposes of this Act,

(*a*) a corporation and a person or one of several persons by whom it is directly or indirectly controlled,

(*b*) corporations controlled directly or indirectly by the same person, or

(*c*) persons connected by blood relationship, marriage or adoption,

shall, without extending the meaning of the expression "to deal with each other at arm's length", be deemed not to deal with each other at arm's length.

Subsection (2) of section 20 of the Income Tax Act, 1948, as amended by section 7 (1) of Chapter 25 of the Statutes of 1949 (2nd Sess.), is as follows:—

(2) Where depreciable property did, at any time after the commencement of 1949, belong to one person (hereinafter referred to as the original owner) and has, by one or more transactions between persons not dealing at arm's length, become vested in a taxpayer, the following rules are, notwithstanding section 17, applicable for the purposes of this section and regulations made under paragraph (*a*) of subsection (1) of section 11:

(*a*) the capital cost of the property to the taxpayer shall be deemed to be the amount that was the capital cost of the property to the original owner;

(*b*) where the capital cost of the property to the original owner exceeds the actual capital cost of the property to the taxpayer, the excess shall be deemed to have been allowed to the taxpayer in respect of the property under regulations made under paragraph (*a*) of subsection (1) of section 11 in computing income for taxation years before the acquisition thereof by the taxpayer.

By section 32 of Chapter 29 of the Statutes of 1952 (assented to June 18, 1952), paragraph (*j*) of subsection 1 of section 31 of the Interpretation Act was made applicable

to the expression "one person", where it appears in that part of subsection 2 of section 20, preceding paragraph (*a*) thereof (as amended by section 7 of Chapter 25 of the Statutes of 1949), and that expression was deleted and the expression "a person" substituted therefor, but such amendment was not to apply to any matter in respect of which any appeal was pending before the Income Tax Appeal Board or a court when such amendment came into force.

The appeal in this matter to the Income Tax Appeal Board was commenced by Notice of Appeal to that Board dated July 9, 1951; judgment was not given therein until December 23, 1952, and the Notice of Appeal to this Court was filed May 1, 1953. For these and other reasons, hereinafter given, the definition of "person" contained in paragraph (*j*) of subsection 1 of section 31 of the Interpretation Act does not apply to this appeal.

Although the Notice of Appeal of the appellant pleads several sections of the Act, argument was in effect directed to the application of the provisions of subsection (5) of section 127 of the Income Tax Act, 1948, and the decision in this appeal depends upon the interpretation and application of that section.

Paragraph (*a*) of subsection (5) of section 127 refers to transactions between a corporation of the one part, and a person or one of several persons by whom it is directly or indirectly controlled of the other part, and as the transaction under consideration was between two corporations, viz. the respondent new company and the old company, paragraph (*a*) has no application.

Paragraph (*c*) of subsection (5) of section 127 refers to transactions between persons connected by blood relationship, marriage or adoption, and is not applicable.

The question for decision then is whether or not under paragraph (*b*) of subsection (5) of section 127 the two corporations, that is, the old company as vendor and the respondent new company as purchaser, were controlled directly or indirectly by the same person at the time the agreement of July 4, 1949, was approved and its execution authorized by the general meetings of the shareholders of the two companies.

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

Potter J.

The meaning of control of, or controlling interests in, corporations has been considered several times by the courts of England and recently by the Supreme Court of Canada in the following cases.

Noble (B. W.) Limited v. *Inland Revenue Commissioners* (1). Section 53 (2) (*c*) of the Finance Act, 1920 (10 & 11 Geo. V) applied to certain deductions from profits allowed in respect to the remuneration of any director, manager, or other person concerned in the management of a company who had a controlling interest in the company, and whether directly or indirectly and whether solely or jointly with any other persons, and the Crown alleged that Mr. B. W. Noble had a controlling interest in the appellant company.

Rowlatt, J., at page 926 said, speaking of the argument of counsel for the company:—

> It seems to me that "controlling interest" is a phrase that has a certain well known meaning; it means the man whose shareholding in the company is such that he is the shareholder who is more powerful than all the other shareholders put together in General Meeting. That is really what it comes to. Now, this gentleman has just half the number of shares, but those shares, in the circumstances of this case, are reinforced by the position that he occupies of Chairman, a position which he occupies not merely by the votes of the other shareholders or of his directors elected by the shareholders but by contract; and, so reinforced, inasmuch as he has a casting vote, he does control the General Meetings —there is no question about that—and inasmuch as he does possess at least half of the shares he can prevent any modifications taking place in the constitution of the Company which would undermine his position as Chairman.
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> Therefore, on the whole, giving what I think is the most obvious meaning to these words in the sub-section and having regard to the object of the section, I think the contention of the Crown is right, and that the one appeal must be allowed and the other dismissed with costs.

British American Tobacco Company, Limited v. *Inland Revenue Commissioners* (2). The appellant company itself controlled more than fifty per cent of the votes in four companies. In seven companies more than fifty per cent of the votes were controlled by the appellant company in conjunction with a company or companies in which the appellant company controlled more than fifty per cent of

(1) (1926) 12 T. C. 911. (2) [1943] 1 All E. R. 13.

the votes. The question was whether the appellant company had a controlling interest in all the companies within the meaning of the Finance Act, 1937, Schedule IV, paragraph 7 (*b*), and whether the dividends received by the appellant company from those companies should be included in its income and liable to National Defence contribution. Viscount Simon, L. C., at 14 and 15 said:—

> The case turns on the meaning of the words "controlling interest" in the context in which they are used. The word "interest", however, as pointed out by Lawrence, J., is a word of wide connotation, and I think the conception of "controlling interest" may well cover the relationship of one company towards another, the requisite majority of whose shares are, as regards their voting power, subject, whether directly or indirectly, to the will and ordering of the first-mentioned company. If, for example, the appellant company owns one-third of the shares in company X, and the remaining two-thirds are owned by company Y, the appellant company will nonetheless have a controlling interest in company X if it owns enough shares in company Y to control the latter.
>
> As to what may be the requisite proportion of voting power, I think a bare majority is sufficient. The appellant company has, in respect of each of the foreign companies referred to in the case, the control of the majority vote. I agree with the interpretation of "controlling interest" adopted by Rowlatt, J., in *Noble* v. *Commissioners of Inland Revenue* (*supra*) in construing that phrase in the Finance Act, 1920, s. 53 (2) (c).

In *Wrights' Canadian Ropes Limited* v. *Minister of National Revenue* (1), the question was whether or not the appellant company was directly or indirectly controlled by a company outside of Canada, within the meaning of section 6 (1) (i) of the Income War Tax Act.

Of the shares in the Canadian company 49·86 per cent were admitted to be held by a certain English company, and one question was whether or not the Canadian company was controlled by the English company.

Rinfret, C. J., said at 145:—

> There is . . . in the record a consent signed on behalf of both parties whereby they agreed that at all times pertinent to the issues in this appeal, Wrights' Ropes Limited held 49·86 per cent of the shares and not 50 per cent of the shares of the appellant.

And at page 147:—

> . . . the appellant has been proved and indeed admitted not to be controlled by the English company . . .

(1) [1946] S.C.R. 139.

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

Potter J.

On appeal to the Privy Council, *Minister of National Revenue* v. *Wrights' Canadian Ropes Limited* (1), Lord Greene, M. R., said at 726 and 727:—

> Two incidental questions were raised in connection with this argument. One was as to whether the required control of the respondents by Wrights existed in fact. As to this their Lordships are of opinion that the admission signed on behalf of both parties on June 1, 1945, and printed on page 57 of the Record to the effect that Wrights held only 49·86% of the shares of the respondents is conclusive that it did not.

In *Army and Navy Department Store Limited* v. *Minister of National Revenue* and *Army and Navy Department Store (Western) Limited* v. *Minister of National Revenue* (2), the question was whether certain companies were taxable as related corporations under section 36 of the Income Tax Act, 1948, as amended, subsection (4) of the section being as follows:—

> 36. (4) For the purpose of this section, one corporation is related to another in a taxation year if, at any time in the year,
>
> (*a*) one of them owned directly or indirectly 70% or more of all the issued common shares of the capital stock of the other, or
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> (*b*) 70% or more of all the issued common shares of the capital stock of each of them is owned directly or indirectly by
>
> (i) one person,
>
> (ii) two or more persons jointly, or
>
> (iii) persons not dealing with each other at arms length, one of whom owned directly or indirectly one or more shares of the capital stock of each of the corporations.

Section 127 (5), as applicable, was in the same words as section 127 (5) already quoted.

Cartwright, J., at page 190, speaking of an argument to the effect that, as two of the companies concerned were both controlled by the same two individuals, they were controlled directly or indirectly by the same person, said:—

> If the statute were silent as to the circumstances in which corporations shall be deemed not to deal with each other at arm's length this submission would have great force, but when s. 127 by ss. (5) (b) provides that corporations controlled directly or indirectly by the same person shall be deemed not to deal with each other at arm's length it appears to me to negative the view that corporations are to be deemed not to deal with each other at arm's length when controlled not by the same person but by the same group of persons. *Expressio unius est exclusio alterius.* When the wording of cl. (b) of s. 127 (5) is contrasted with that of cl. (a) it seems to me impossible to read the word "person" in cl. (b) as including the plural. While the Alberta company and the

(1) [1947] 1 D.L.R. 721; [1947] C.T.C. 1.

(2) [1954] 1 D.L.R. 177.

Saskatchewan company may well be said to be controlled by the same persons they are not controlled by the same person and in my opinion they cannot on this ground be deemed for the purposes of the Act not to deal with each other at arm's length.

When the learned judge spoke of contrasting the wording of clause (*b*) with that of clause (*a*) of subsection (5) of section 127, he was evidently referring to the fact that clause (*a*) is as follows:—

(*a*) a corporation and a person or *one of several persons* by whom it is directly or indirectly controlled,

whereas clause (*b*) is:—

(*b*) corporations controlled directly or indirectly by the *same person*,

If Parliament had intended to mean that a corporation controlled by a group of persons was to be included within clause (*b*), it could have added to it the necessary words so that it would read as follows:—

(*b*) corporations controlled directly or indirectly by the same person solely or jointly with other persons,

The appellant's Notice of Appeal refers to paragraph (*k*) of subsection 1 of section 31 of the Interpretation Act, but it must have been intended to refer to paragraph (*j*) of subsection 1 of section 31 of Chapter 1, R.S.C., 1927, which is as follows:—

31. (1) In every Act, unless the contrary intention appears,

(*j*) words in the singular include the plural, and words in the plural include the singular;

It is clear that in section 127 (5) (*b*) the contrary intention does appear when, as Mr. Justice Cartwright said, it is contrasted with the wording of clause (*a*) of the said subsection (5).

Were the respondent new company and the old company controlled directly or indirectly by the same person at the time of the transaction between them, when the property of the old company became vested in the respondent new company?

The agreement of July 4, 1949, provided by paragraph 1 that:—

The Vendor sells and the Purchaser purchases, free of all liens, charges and encumbrances, all the business, undertaking and assets of the Vendor as a going concern

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

Potter J.

and paragraph 7 provided:—

> This agreement is intended to operate as an actual transfer to the Purchaser of the business, undertaking, property and assets of the Vendor, but the Vendor shall forthwith on demand execute or cause to be executed, etc., all necessary conveyances, transfers, assignments, etc.

By paragraph 4 it was provided:—

> The sale and purchase shall take effect as from the 21st of June, 1949, from which date the Vendor shall be deemed to have carried on its undertaking and business for and on behalf of the Purchaser . . .

If the agreement amounted to a transfer of the depreciable assets, as of its execution by the respondent new company, and under the circumstances I am of opinion that it did, it is only necessary to examine the registers of shareholders of the respondent new company and the old company at that time.

As of June 21, 1949, the following was the distribution of shares in the old company and, according to the evidence, no further transfers of shares took place until after the general meeting at which the execution of the agreement was authorized by the shareholders of the old company.

A. S. MacKay and S. M. Baird		
transferred from S. E. Nicholson	1,024	
transferred from J. P. Stuart	1,153	
transferred from W. D. Sheldon, Sr.	1,167	
transferred from B. B. Sheldon	77	
transferred from W. D. Sheldon, Jr.	15	3,436
Mrs. N. Sneyd		30
Mrs. M. O. Sheldon		130
Miss M. Taylor		161
E. J. Coate Estate		37
Mrs. Jennie H. McGill		77
Mrs. Lottie B. Baker		77
Mrs. Elsie Isabelle Shields		49
W. D. Sheldon, Jr.		2
G. M. Egoff		1
W. D. Sheldon, Sr.		1
J. S. Roberts		1
A. K. Spotton		1
Theodore F. McHenry		2
Miss Rebecca Hilda Gregory		2
Miss Jean L. Richmond		2
		4,009

It was established by the evidence that A. S. MacKay and S. M. Baird were employees of the Royal Bank of Canada to which the shares in question had been hypothecated as collateral security for the loan of $359,205.00, and while it is true that at the general meeting of the shareholders of the old company of July 4, 1949, when the execution of the agreement was authorized, W. D. Sheldon, Jr. and G. M. Egoff appeared as proxies for A. S. MacKay and S. M. Baird, as well as proxies for some other shareholders, they were there as the nominees of A. S. MacKay and S. M. Baird, who were holding the shares in question on behalf of their employer, the Royal Bank of Canada.

No authorities were cited by either side relative to the legal effect of control of a meeting of a company by proxies, and the weight of authority is that it is the total of the voting power or shares in the hands of those persons who own the shares that gives control.

A company which holds shares in another company must vote at meetings of such other company by the use of proxies. Nevertheless, on the authorities, particularly the statement of the law by Viscount Simon, L. C., in *British American Tobacco Company* v. *Inland Revenue Commissioners* (*supra*) it is the holding of the majority of the shares by which one company controls another, and it was not suggested that, because the company holding the majority of shares in another named proxies to vote them, the company was controlled by the proxy holders.

I therefore hold that neither W. D. Sheldon, Jr., George Murray Egoff, Harold William Mogg, nor William Clark Caldwell was a person who controlled directly or indirectly the old company at the time approval was given to the agreement of July 4, 1949, and its execution authorized on behalf of the old company.

At a meeting of the directors of the respondent new company held on July 4, 1949, applications for 24,001 common shares were read and a by-law passed allotting the same to the applicants, remittances totalling $48,000.00 at the price of $2.00 per share having been received.

1954

MINISTER OF NATIONAL REVENUE v. SHELDONS ENGINEERING LIMITED

Potter J.

Of these 24,001 shares, W. D. Sheldon, Jr. was allotted 9,000; G. M. Egoff, 2,500; W. C. Caldwell, 1,500; and H. W. Mogg, 5,000.

In addition thereto, 100 preferred shares of a par value of $25.00 each were applied for and allotted.

By by-law number 5 the purchase by the respondent new company of the business and undertaking of the old company as a going concern was approved, and the president and secretary of the company were authorized, upon the confirmation of the by-law by the shareholders of the company, to execute the agreement.

At a general meeting of the shareholders held subsequently the same day, by-law number 5 of the directors was unanimously ratified, approved and confirmed by the shareholders.

No one person held more than 9,000 of the 24,001 common shares of the respondent new company at the time the agreement of July 4, with the old company was ratified and confirmed, and neither did the respondent new company hold any shares in the old company when its shareholders authorized the execution of the agreement, nor did the old company hold any shares in the respondent new company at the time its shareholders ratified the agreement.

It follows that the old company, Sheldons Limited, and the respondent new company, Sheldons Engineering Limited, were not controlled directly or indirectly by the same person at the times the agreement of sale and purchase was approved and its execution on their behalf authorized by their respective general meetings, or at the time the assets of the old company vested in the respondent new company or at any other relevant time, within subsection (5) of section 127 or subsection (2) of section 20 of the Income Tax Act, 1948, as amended.

The appeal must, therefore, be dismissed and the assessment varied by adding to the capital cost allowance to the respondent new company the sum of $6,672.14, disallowed by the said assessment, and by reducing the respondent new company's taxable income and the tax thereon accordingly, and the respondent new company will have its costs.

Judgment accordingly.