

1931
March 23.
April 4.

DAVID JUNE WATEROUS.....APPELLANT;

AND

THE MINISTER OF NATIONAL }
REVENUE } RESPONDENT.

Revenue—Income Tax—Dividends—Victory Bonds—Exemptions

W. Ltd., having accumulated profits, declared a dividend, and by consent of the shareholders, paid the same in Victory Bonds. W., a shareholder, in his income return for that year, claimed he should not pay income tax on this dividend because it was paid in Victory Bonds which were exempt from income tax.

Held that the payment of the distributed dividend in question in this case, in bonds, does not bring the transaction within the "obligation" of the bond in question which introduces the exemption in taxes.

That such payment is not the payment of the capital of the bond at maturity nor is it the payment of interest upon presentation and surrender of coupons which is what is exempt from taxation. That the amount so received as dividend represented by said bonds was liable to income tax as profits and gains.

APPEAL under the provisions of the Income War Tax Act from the decision of the Minister.

The appeal was heard before the Honourable Mr. Justice Audette, at Ottawa.

W. T. Henderson, K.C., for appellant.

C. Fraser Elliott, K.C., and *Stanley Fisher* for respondent.

The facts are stated in the Reasons for Judgment.

AUDETTE J., now (April 4, 1931), delivered the following judgment.

This is an appeal, under the provisions of The Income War Tax Act, 1917, (R.S.C., 1927, ch. 97) from the assessment of the appellant, for the year 1928, on that part of his income which he received from the Waterous Limited, a company incorporated under the Dominion Companies Act, in the nature of a dividend of \$30,500, the proceeds of gains and profits made by the company, distributed among its shareholders and paid to them otherwise than in specie—that is, with their consent and agreement—in Canada Victory Loan Bonds at par.

The appellant contends that as this dividend so distributed was paid in a War Loan Victory Bond, hereinafter recited, he is exempt from paying any income tax upon such dividend.

To facilitate a proper understanding of this question, it is thought advisable to recite the actual language of the Bond, which reads as follows:—

Series—T
No. H071813
CANADA'S VICTORY LOAN, 1918

\$

Dominion of Canada
War Loan.

15 years 5½ Gold Bond. Principal due 1st November, 1933.

The Dominion of Canada, for value received, will pay to the bearer or, if registered, to the registered holder hereof, the sum of

Dollars

on the first day of November, 1933, and will pay interest thereon at the rate of five and one-half per cent. per annum from the 1st day of November, 1918, semi-annually, on the first day of May and the first day

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of November, upon *presentation* and *surrender*, as they severally *mature*, of the coupons for such interest hereto annexed. Such principal sum is payable at the office of the Minister of Finance and Receiver-General at Ottawa, or at the office of the Assistant Receiver-General at Halifax, St. John, Charlottetown, Montreal, Toronto, Winnipeg, Regina, Calgary, Victoria. Coupons are payable free of exchange, at any branch in Canada of any chartered bank. Principal and interest are payable in gold coin that is legal tender in Canada. This bond is one of an issue of the Dominion of Canada, issued and to be issued of date 1st November, 1918, and payable 1st November, 1933. The obligation represented by this bond and the annexed interest coupons and all payments in discharge thereof are and shall be exempt from taxes—including any income tax—imposed in pursuance of any legislation enacted by the Parliament of Canada. This bond is issued under the authority of Statutes of Canada, "The War Appropriation Act, 1915," "The War Appropriation Act, 1916," "The War Appropriation Act, 1917," "The War Appropriation Act, 1918." This bond shall pass by delivery, unless it is registered in the owner's name in the books of the Department of Finance and such registration is noted hereon by or on behalf of the Deputy Minister of Finance, Registrar of the bond of this issue. Transfer of registered bonds and discharge from the registry may be made, subject to the conditions endorsed hereon. This bond shall not be valid or obligatory for any purpose until countersigned on behalf of the Department of Finance.

In Witness whereof

From the reading of this bond, it appears clearly that the *obligation* resulting therefrom is *first* the payment of the capital thereof on maturity in 1933 and *secondly* to pay interest, upon presentation and surrender of coupons for the same.

Now what is it in this bond which is exempt from income tax? The bond says: "The obligation represented by this bond and the annexed interest coupons and all payments in *discharge* thereof are and shall be exempt from taxes—including any income tax . . ."

The payment of the distributed dividend in question in this case in *bonds*, does not bring the transaction within the *obligation* of the bond above recited which introduces the exemption in taxes. It is not the payment of the bond at maturity, and it is not the payment of interest upon presentation and surrender of coupons. The bond passes by delivery, as appears by the recital in the bond itself.

Clearly the transactions in this case do not bring the bond to the stage when, in the discharge of its obligation, exemption can be claimed. The whole fallacy of the appellant's contention lies in the fact that while this bond is a bond free from taxation, he has not shown circumstances upon which this exemption would obtain in his behalf at the present time.

The dividend paid and distributed from the gains and profits of the company remains a gain and profit in the hands of the shareholder, whether that dividend is paid in kind, specie or in bond; because it is all through a dividend from, and of, profit and gain; it remains of such nature in the hands of both the company and the shareholder. What you cannot do directly, you cannot do indirectly.

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The case of exemption from taxation provided as resulting from the obligation of the bond does not in any manner or form arise under the present circumstances. The dividend, the proceeds of gain and profit, has been invested in bonds and whoever may be the owner thereof will benefit by the exemption from paying income tax upon the interest paid upon the surrender of the coupon or on the capital at maturity.

The bond in the hands of the shareholder does not come into his hands under any of the circumstances flowing from the obligation of the bond and therefore he cannot claim exemption.

The appellant stands in the same position as any other shareholder, in any company, receiving a dividend which constitutes part of his income, and which he may after receiving invest in such bonds. There is no reason to discriminate against the latter who buys bonds himself from the proceeds of the dividend and the one who gives his consent to accept in dividend a bond which this company bought with profit and gain coming to him. The payment of the dividend in bonds did not alter the nature of the dividend which always remains a distribution of profits and gains of the company among the shareholders who receive it as an income subject to taxation, as the obligation of the bond to exempt from taxation does not evidently apply to such circumstances. The appellant, however, having agreed to allow the company to pay the dividend in bonds—to invest for him such dividend—he will hereafter be exempt from taxation on what he will derive from the bond itself. The exemption mentioned in the bond only attaches upon the revenues derived therefrom and not upon gains and profits of monies used in purchasing the same.

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When the company declared the dividend in question on its shares, a debt immediately became payable to each shareholder in respect of his dividend for which he could sue at law; but that does not make the company a trustee or agent in respect of the shareholder's dividend and the fact of converting the dividend into bonds does not change the nature of the dividend. The bond was only a means of liquidating to shareholders the liability of the company to pay the declared dividend. In re *Severn and Wye and Severn Bridge Ry. Co.* (1).

When the bond comes in the hands of the shareholder it must be treated in the same manner as if it were coming into the hands of the company, which acquires it out of profits and gain upon which they had to pay taxes. It comes into the hands of the shareholder as gain and profit and forms part of his income without exemption of taxation as provided in the bond. It is not the money that purchases the bond that is exempt from taxation, but only what is derived from the bond.

The company at the time could not pay the dividend in bond except by the consent of shareholders (*Palmer, Company Law*, 13th Ed., 231); but see now the Act of 1930, 20-21 Geo. V, ch. 9, sec. 14.

A very apposite decision in the United States is to be found in the case of *Hitner v. Lederer* (2), where it was held that for income tax purposes, value of first Liberty Bonds, received in payment of salary, is to be considered, notwithstanding the Act of April 24, 1917, declaring them exempt, both as to principal and interest, from all taxes * * * ; salary in legal effect being paid in money.

There is also the opinion of the Attorney-General reported in *Alverson*, American Income Tax cases, 88, where it is said:

Corporate stockholders receiving dividends paid with non-taxable liberty bonds must include in the computation of net income subject to income tax the value of such bonds received as dividend payments, because the tax is not upon any part of the bond but upon it as a whole and cannot be evaded because the income or gain happens to be liquidated by the delivery of a certain number of . . . non-taxable securities.

Subsec. (j) of sec. 4 of the Income War Tax Act (R.S.C., 1927, ch. 97) provides, in dealing with exemptions and deductions, that "the income derived from any bonds or other

(1) (1896) 1 Ch. D. 559.

(2) (1926) 14 Fed. Rep. 2nd Ser 991.

securities of the Dominion of Canada issued exempt from any income tax imposed in pursuance of any legislation enacted by the Parliament of Canada" shall not be liable to income tax. But here again the provision is in confirmation of the obligation recited in the bond and that is that the exemption is upon the income derived from the bond and not upon the monies used in purchasing it.

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There were other questions raised at trial but in the view I have taken of the case it becomes unnecessary to pass upon the same.

Looking at all the circumstances of the case, it must be found that the real nature of the transaction in question was that the company intended to distribute and pay and did distribute and pay to the shareholders a dividend out of gain and profit realized in its business; but when it came to pay, it offered to the shareholders to liquidate such liability with war bonds instead of money or cheque and the shareholders accepted. The income tax sought is not upon any part of the bond, but it is upon the profits and gains of the company used in purchasing the bond which was handed over to the shareholder to liquidate its liability in respect of the dividend. The dividend was gain and profit in the hands of the company and in the hands of the shareholder and the question of exemption under the provisions of the bond and of the Act does not arise; because the payment in no manner can be said to be paid under such provisions.

There will be judgment dismissing the appeal with costs.

Judgment accordingly.