DUPUIS FRERES LIMITED.....APPELLANT;

AND

THE MINISTER OF CUSTOMS AND EXCISE ..... } RESPONDENT.

1927

May 12.
May 31.

Revenue—Income Tax—Dividends—Preferred shares—"Borrowed capital" —Paramount right of Dominion Crown

The appellant was incorporated by letters patent under The Quebec Companies Act to take over a running concern and to pay for the same "en stock ou obligations . . . ou autrement." The capital stock was divided into 20,000 common shares and 20,000 fixed cumulative 8 per cent redeemable shares. The preferred shares carried certain priorities, etc., over common shareholders, *inter alia*, that of being paid out of the net profits of each year. Such shares, if not redeemed in the meantime, to be paid in 1936 at a fixed price and interest. A trustee was appointed to the sinking fund for the said preferred shares, which was protected as against the company and its creditors. Under

(1) (1888) 14 A.C. 46.

1927

DUPUIS FRÈRES LTD. v. THE MINISTER OF CUSTOMS AND EXCISE.

the provisions of the Companies Act no preference or priority is given to the holders of such stock over creditors of the company.

Held, that the stock in question herein was essentially part of the capital of the company, and was not "borrowed capital used in the business to earn the income" within the meaning of subsection H of section 3 of the Income War Tax Act, 1917, as amended by 13-14 Geo. V, ch. 52, sec. 2, and that the dividends declared in respect of such stock were not exempt from taxation under the said Act.

2. That no agreement, arrangement or contract between the company and its shareholders (allowed under the Provincial law) could operate in derogation of the right of the Dominion Crown to tax under the B.N.A. Act, which right is paramount.

APPEAL from the decision of the Commission of Taxation assessing the dividends of certain shares of the appellant.

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

Aimé Geoffrion K.C. for the appellant.

C. Fraser Elliott for the respondent.

The facts are stated in the reasons for judgment.

AUDETTE J., Now this 31st day of May, 1927, delivered judgment.

This is an appeal, under the provisions of sections 15 *et seq.* of The Income War Tax Act, 1917, and amendments thereto, from the assessment for the plaintiff company's fiscal year, ending 31st January, 1923.

The controversy may be succinctly stated as follows: The appellant contends that the "dividend on the preferred shares" as provided by the letters patent hereinafter referred to, is nothing but interest on "borrowed capital" which should receive the benefit of the exemptions and deductions mentioned in subsection (*h*) of section 3 of the taxing act. There is no question of amount involved in the controversy that is to be adjusted by the parties when the court has decided the question of law—the question of principle.

The appellant company was incorporated, by letters patent, on the 30th July, 1921, under the provisions of the Quebec Companies Act, 1920, for the purpose of purchasing and taking over, as a running concern, the company

known as "Dupuis Frères, Limitée, and Dupuis Frères Limited," and to pay the same "en stock ou obligations, ou les deux, de cette compagnie ou autrement." Therefore these shares used to pay for the purchase and which go to make the capital authorized by the company cannot be classed as "borrowed capital."

The company's capital is fixed, by the letters patent, at $4,000,000, divided into 20,000 common shares, and 20,000 fixed cumulative 8 per cent redeemable shares, all of the par value of $100 each.

These preferred shares are subject to a number of preferences, priorities, rights, privileges and restrictions mentioned in the said letters patent and among others: By par. (*a*) (P. 5) the shareholders of the preferred shares have a right, over the common shareholder, to be paid this 8 per cent dividend "à même les profits nets de chaque année."

A trustee (*b*) is appointed by the company who sees to the transfers of the preferred shares and who receives the monies forming the sinking fund for the said preferred shares, and this fund is protected by sec. (*n*) as against the company and its creditors.

The company has the right to redeem (*c*) in whole or in part these preferred shares by agreement with the shareholders, on the Exchange or otherwise, at the market price or at any other accepted price. It has also the right to force the sale of these shares and purchase them at $110 (*d*).

By sec. (*c*) the company has the right to redeem these preferred shares before the 15th August 1936, and such of the holders of these preferred shares who, at that date, have not had their shares redeemed, will have the right to claim, at that date, at $110 and interest.

Now these preferred shares form an essential part of the capital of the company,—both under The Quebec Companies Act, 1920, and the company's letters patent issued thereunder; and under subsection 6 of Article 5989 of the said Act

> no preference or priority given to the holder of preferred stock under this article shall in any way affect the rights of creditors of any company.

In other words does it not amount to a permissive internal arrangement or contract with the company which gives

1927

DUPUIS FRÈRES LTD. v. THE MINISTER OF CUSTOMS AND EXCISE.

Audette J.

prior rights to the preferred shares over the common shares? It is not necessary that equal rights and privileges should be attached to all shares.

It would be doing violence to the language of the Company's Act, to the letters patent, and I might add, to the custom of trade and of experience to call these preferred shares "borrowed capital," because of some alleged analogy, if any, to a bond, in that at the maturity, in 1936, the shareholder, whose share has not been in the meantime redeemed, can claim, as against the company—but after the creditors—his share at $110 and interest. The mere existence of some feature which might in such respect make it resemble a bond or debenture is not sufficient to make this preferred share, which is an actual part of the authorized capital of the company, a bond or debenture or anything like it, and thereby transform it into "borrowed capital" for the purpose of assessment. Such dividends are paid only out of profits, a bond is quite different, it is primarily a liability. It is not the function of the court to pursue analogies which are insubstantial and incapable of defining rights and liabilities in law. The solution of the question must rest on fact rather than on the play of imagination.

The dividend paid upon these preferred shares is clearly and distinctly from the earned profits. The dividend in question was actually paid out of the profits and for all purposes remains a dividend. And notwithstanding any agreement, arrangement, or contract between the company and its shareholders—allowed under the law of the province,—it is obvious that a provincial law could not *ex proprio vigore* operate in derogation of the right of the Federal Crown to tax under the B.N.A. Act. The federal act gives the right to tax profits and that right is paramount. Sec. 3 of the taxing Act defines the taxable "income" as the net profit or gain . . . whether such gains are divided or distributed. The dividend in question has been divided or distributed, after the profits have been ascertained. And, as said in the case of *Commissioner of Taxes* v. *The Melbourne Trust Limited* (1), the profit was earned, for the purpose of the taxing Act, when distributed to the shareholders. *The King* v. *Anderson Logging Co. Ltd.* (2).

(1) (1914) A.C. 1001.

(2) (1926) 1 D.L.R. 785.

However a dividend declared out of profits must remain a dividend paid out of profits. There should not be any ambiguity. The taxes are deductions from undivided profits and should be so treated upon the financial record. Nicholson and Rohrback On Accounting. Profit is the remuneration of capital and you cannot redetermine it and call it borrowed capital. No dividend can impair the capital of the company. Art. 6010. According to the Oxford Dictionary, a dividend is the sum payable as the profits of a joint stock company and received as an undivided holder as his share.

Profits denote the remuneration which those receive who supply the capital. Fawcett—Manual of Political Economy 163.

In the result, if the company did out of its sinking fund, built out of profits, pay and redeem all these shares before 1936, it would thus have disposed of profits and avoided the payment of the taxes due upon such profits, without impairing the capital of the company, as was decided in *re Dicido Pier Company* (1).

Preference shareholders are members, not creditors of the company issuing the shares. Mitchell 436.

> The word "capital" (as used in the English Act says Hals. (at p. 84, vol. 1)) means share capital in contradiction to borrowed money. . . . The nominal capital does not at the outset, or necessarily at any time, represent money in the coffer of the company, or assets of any kind; but the amount limits the potentiability of the company to issue the shares into which that capital is divided.

The preferred shares form part of the authorized capital of the company as distinguished from borrowed capital. *The Attorney General* v. *The Milford Docks Company* (2); *W. M. G. Singer* v. *A. W. Williams* (3).

These preferred shares are entirely different from a bond. The dividend thereon is only payable out of profits and may be passed, while the bond has always its privilege. And as said in *Butler* v. *Fairhall* (4) accumulated undeclared and unpaid dividends on the preferred shares are not a liability of the company; it is only a matter of material importance as between the common and preferred shareholder. The capital is not a debt of the company.

(1) (1891) 2 Ch. D. 354, at pp. 355-357.
(2) (1893) 69 L.T.R. 453.
(3) (1919) 7 Tax Cases 419 at 426.
(4) (1927) 32 Ont. W.N. 191 at, p. 192.

1927

DUPUIS FRÈRES LTD. v. THE MINISTER OF CUSTOMS AND EXCISE.

Audette J.

Lee v. *Neuchatel Asphalte Co.* (1). In the case of the company making default in paying dividend, the preferred shareholders may take control in the management of the company, as provided by the letters patent; but they cannot wind up the company without the common shareholders joining in such resolution; while in the case of a bond, the bondholders have the power to take possession, run the company and wind it up and realize by privilege on the assets.

And as said by Orde J. in *Re Patricia Appliance Shops* (2) a claim capable of proof must be for a debt and not merely for a share in the ultimate distribution of the assets (*if any*) available for the shareholders.

It is admitted that the capital of these preferred shares was payable in four instalments. In the course of a winding up of the company, if any portion of this subscribed capital composed of these preferred shares remained unpaid, the shareholders would have to pay the balance to satisfy the debts of the company—far from having a right to claim as in the case of a bondholder.

Therefore, in view of the consideration to which I have just adverted I find that the preferred shares in question and the dividends paid thereunder are part of the subscribed capital and cannot in any manner or means be logically and legally considered as "borrowed capital." They are not what is contemplated by subsection (*h*) of sec. 3 of the taxing Act. These dividends paid out of profits are liable to taxation and the appeal is dismissed with costs.

Judgment accordingly.