Ottawa
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DONALD APPLICATORS LTD *et al*[1] APPELLANTS;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Income tax—Associated companies—Control—What constitutes—Voting rights to elect directors of subsidiaries not held by parent company—Power of parent to dominate shareholders' meetings—Whether de jure control—Income Tax Act, s. 39.

Each of the ten appellant companies was incorporated in Alberta by memorandum of association with an authorized capital of 200 class A shares having the exclusive right to elect directors and 19,800 class B shares having voting rights on all other matters. Under each company's memorandum of association the transfer of shares was prohibited without the directors' consent and annual net profits were required to be divided each year; each company's articles of association required the unanimous consent of shareholders to the issue of any shares. Only two class A shares of each company were issued, in each case to residents of the Bahamas (never the same two for more than one company), who elected themselves its directors; only 498 class B shares of each company were issued, in each case to SM Ltd, and the latter's controller was appointed manager of each company by its directors, who themselves performed only perfunctory duties. The purpose of these arrangements was to spread the profits of SM Ltd's business amongst several companies which would not be associated within the meaning of s. 39 of the *Income Tax Act*, and thus obtain the benefit of the lower rate of tax.

Held, SM Ltd had *de jure* control of the ten appellants which were therefore associated with one another within the meaning of s 39 of the *Income Tax Act*. A shareholder who, though lacking immediate voting power to elect directors, has sufficient voting power to pass any ordinary resolution at a meeting of shareholders and, as well, a special resolution to take away the powers of the directors and reserve decisions to his class of shareholders, dismiss directors from office, and ultimately even secure the right to elect directors, is a person of whom it cannot be said that he does not *in the long run* have the control of the company. Such a person has the kind of *de jure* control contemplated by s. 39: the *de facto* control which SM Ltd exercised through the appointment of its controller as manager of appellants was irrelevant

M N R. v. Dworkin Furs Ltd et al [1967] S.C.R. 223; *Vina-Rug (Canada) Ltd v M N.R.* [1968] S C R. 193; *Buckerfield's Ltd et al v. M N.R.* [1965] 1 Ex C R. 299; *M N.R. v. Aaron's Ladies Apparel Ltd* [1967] S C.R. 223, distinguished. *British American Tobacco v. I R.C* [1943] 1 All E R. 13, distinguished and applied.

[1] The other appellants are: Godfrey Building Products Limited; Whitemud Building Supplies Ltd; Graham Excavating & Equipment Ltd; Sawyer Building Supplies Ltd; McKinney Plumbing & Heating Ltd; Cyprus Building Products Ltd; Higgs Cement & Masonry Ltd; Boreas Building Supplies Ltd.

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INCOME TAX APPEAL.

H. Heward Stikeman, Q.C. and *Maurice A. Regnier* for appellants.

M. A. Mogan and *R. D. Janowsky* for respondent.

THURLOW J.:—The issue in each of these appeals, which are from re-assessments of income tax, in some cases for the years 1961 and 1962 and in others for the year 1962 alone, is whether in these years the ten appellant companies were "associated" with each other within the meaning of section 39 of the *Income Tax Act* and thus liable to tax at the higher rate prescribed by that section rather than at the lower rate which would otherwise be applicable. The basis relied on for treating the appellant companies as "associated" was that each of them was controlled at the relevant times by another corporation, viz. Saje Management Limited, later re-named MacLab Enterprises Limited, and was thus associated with that corporation, from which it followed from the statutory provisions that all eleven corporations were associated with each other.

All ten appellant companies were incorporated in 1961 under *The Companies Act*[2] of the Province of Alberta. While their objects, as expressed in their memoranda of association, differed somewhat from company to company all had objects concerned with some phase of the construction or construction supply business. In other relevant respects the memoranda and articles of association of the appellant companies can be treated as alike. Each had two classes of common shares, consisting of 200 Class A shares, each of the par value of $1.00, which carried the right to vote on any question and the exclusive right to vote on the election of directors, a right which could not be altered without the unanimous consent of the Class A shareholders, and 19,800 Class B no par value shares which carried the right to vote on all questions except the election of directors. In each case the memorandum of association further provided that no share or shares might be transferred without the consent of the directors and that the net yearly profits of the company should in each year be divided among the shareholders in dividends payable in cash. Each company adopted Table A of the First Schedule of *The*

[2] R S A, 1955, c. 53.

Companies Act as its articles of association with certain amendments among which was one providing that no share should be issued to any person without the unanimous consent of the existing shareholders of the company.

In each company during the relevant period two Class A shares had been issued and were held by two unrelated persons resident in Nassau in the Bahamas consisting of a solicitor and one of his partners or employees or of two of such persons other than the solicitor himself. In no case, however, did the same two persons hold the shares in more than one of the companies. In each case the Class A shareholders had elected themselves to be the directors of the company. In each case, as well, 498 Class B shares had been issued, at 10 cents per share, to Saje Management Limited. Each company thus had a nominal issued capital of $51.80. The directors of each appellant fixed the registered office of the company at 502 MacLeod Building, Edmonton, Alberta and appointed Mr. James G. Greenough, the controller of Saje Management Limited, as the company's manager. Mr. Greenough was not acquainted with the directors and received no instructions from them but in each case they ultimately approved charges in the company's accounts for management services supplied to the company by Saje Management Limited who paid Mr. Greenough's salary. In fact the only functions carried out by the directors as such were to sign financial statements and minutes of directors' and shareholders' meetings all of which were prepared from time to time in Edmonton and brought to Nassau by Mr. Sandy MacTaggart or his associate Mr. Jean de la Bruyere for the directors' signatures.

That these companies were incorporated and these arrangements were made for the purpose of securing that profits realized from the construction and construction supply activities carried out by Saje Management Limited, which carried on its business in Edmonton, Alberta, would be realized by several corporations who were not associated within the meaning of the Act and thus attract less tax was not merely not disputed but was frankly stated by the appellants' counsel in his opening and by Mr. MacTaggart, the principal witness called on behalf of the appellants who, with his associate, Mr. de la Bruyere, were the holders of all the shares of Saje Management Limited. However, no case was made out of any trust or other arrangement

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by which Saje Management Limited or its shareholders might be said to be in a position to exercise *de jure* control of the voting rights of the Class A shares of the appellant companies held by the Nassau solicitor or his several partners or employees and the evidence negatives the existence of any such arrangement. Nor was any attempt made to establish the case as one of dummy corporations whose fictitious legal personalities could be ignored. On the contrary the very foundation of the taxation appealed from is the assumption of the reality of these corporations and of their having made the profits in respect of which they have been assessed. The case therefore fails to be decided, despite the stark unreality of the situation, as disclosed by the evidence, on the basis that these appellants were corporations which in fact engaged in business and thereby realized the profits in question.

The question for determination, thus, as I see it, is simply whether Saje Management Limited by reason of its holding of 498 Class B shares, in each case, controlled the corporation. The appellants' position, as I have apprehended it, was basically that the Class A shareholders, by reason of their exclusive right to elect the directors, in each case controlled the corporation from which it followed that Saje Management Limited did not control it. I do not think, however, that it is necessary to reach a conclusion either on the broad question "who controlled the company" or on the narrower question whether the Class A shareholders controlled it since the answer would not necessarily be conclusive in either case. What the appellants require in order to succeed is, as I see it, in each case a determination that Saje Management Limited did not control the corporation.

Counsel for the Minister on the other hand took two alternative positions. He submitted first that, notwithstanding the exclusive right of Class A shareholders to elect the directors, in the somewhat peculiar set up of the appellant companies, the *de jure* control of each of the companies rested in the ownership by Saje Management Limited of its 498 Class B shares. Alternatively, he submitted that even if there was an element of control vested in the Class A shareholders by reason of their exclusive right to elect directors there was also an element of control vested in the Class B shareholder since that shareholder had

overwhelming voting power on any other question that might come before a shareholders' meeting and since the directors of the appellant companies did not have all the powers commonly exercised by directors, in that they had no authority to accumulate profits or to issue the unissued shares. He went on to submit that in this situation the court should take into account the *de facto* control which, in respect of each of these appellants, was admittedly and undoubtedly exercised entirely by Saje Management Limited through its employee Mr. Greenough under the direction of its two shareholders, and should hold that Saje Management Limited controlled the appellant corporations.

I can deal with the alternative submission by saying that in my opinion *de facto* control is not to be taken into account, that *de jure* control is what is contemplated by the statute[3] and that in determining association for the purposes of the statute control itself and not some mere element or fragment of it is required to support a conclusion that corporations are in fact associated. This submission, in my opinion, accordingly fails.

The first submission, however, calls for closer examination. In the *Dworkin Fur*[4] and other cases and in the *Vina-Rug (Canada) Ltd. v. M.N.R.* case[5], as well as in the *Buckerfield's Ltd. et al v. M.N.R.* case[6] and the *British American Tobacco v. I.R.C.* case[7] therein referred to the problem presented and considered was essentially one of the quantity of voting power required to afford control of the particular corporation. As the votes in these cases were all exercisable in respect of any question that might arise no question of the quality or characteristics of voting power attaching to different classes of shares was involved. This

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[3] *Vide M.N.R. v. Dworkin Furs Ltd. et al* [1967] S C R. 223 per Hall J, at page 227:

> The word *controlled* as used in this subsection was held by Jackett P. to mean *de jure* control and not *de facto* control and with this I agree.

and at page 229:

> The arrangement or agreement between Wagenaar and Jagar, while it might be said to give Wagenaar *de facto* control, did *not* give him *de jure* control, which is the true test...

See also *Vina-Rug (Canada) Ltd. v. M.N.R.* [1968] S.C R 193 per Abbott J at page 196

[4] *ubi supra.*

[5] [1968] S C.R. 193.

[6] [1965] 1 Ex C R 299.

[7] [1943] 1 All E R. 13

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applied as well in the *Aaron's Ladies Apparel Ltd.*[8] case where unanimity rather than a majority vote was required. Nor was there involved in these cases any question as to the functions and authority of directors when elected, it having been, I think, assumed that the directors had the usual general authority to exercise the powers of the company. It therefore appears to me that while these cases afford principles by which one may be guided they offer no foregone conclusion for a case such as the present. Thus, while in an ordinary situation control may reside in the voting power to elect directors such power to choose directors in my opinion would not afford control of a company in which, by the memorandum and articles, the directors had been shorn of authority to make decisions binding upon the company and such decisions had been reserved for the shareholders in general meeting. If, therefore, in an ordinary situation control of a company rests in the voting power to elect directors but in the suggested situation does not rest in such voting power it seems to me that when the situation is not ordinary the question of *de jure* control of the company must be resolved as one of fact and degree depending on the voting situation in the particular company and the extent and effect of any restrictions imposed by the memorandum and articles on the decision making powers of the directors.

The statement of the President of this court in *Buckerfield's* case[9], when he said "I am of the view, however, that in section 39 of the *Income Tax Act,* the word 'controlled' contemplates the right that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors" should, I think, be read and understood as applying to a case where the directors when elected have the usual powers of directors to guide the destinies of the company.

In the present situation, as I see it, the authority of the directors of the appellant companies has been only slightly restricted or modified from that ordinarily applicable in companies which have adopted Table A of the First Schedule of the *Companies Act* as their articles and I should not have thought that such restrictions as have been imposed had any serious effect on the authority of the directors to

[8] [1967] S C.R. 223 at 231.

[9] *ubi supra* at p. 303.

govern the business of the company and generally to direct its affairs.[10] The directors of these companies, as I see it, had, for example, ample authority to commit them to contracts for the supply of materials or the construction of buildings anywhere in the world or to discharge Mr. Greenough and make other arrangements for the conduct of the companies' businesses whenever they might have seen fit to do so. I would not, therefore, on this account alone conclude either that control of these companies did not rest in the owners of the Class A shares or that control rested in the voting power of the Class B shareholders.

There is, however, another aspect of the situation in each of these companies which appears to me to require consideration and which was not involved in any of the cases cited. Here, in the case of each appellant company, Saje Management Limited as the holder of 498 Class B shares, had ample voting power, not merely to pass or to defeat any ordinary resolution (other than one electing directors), but to pass or defeat any special resolution or any extraordinary resolution that might be proposed. That shareholder thus had the voting power to change the articles of the company[11]. As I see it, it had the power to repeal Article 55 and any other article conferring upon the directors authority to bind the company, and thus to reduce the directors to the status of errand boys, while reserving all decision making power not specifically conferred on the directors by the statute or by the memorandum of associa-

[10] *Vide* Article 55 of Table A which reads:

55 The business of the Company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the Company, and may exercise all such powers of the Company as are not, by *The Companies Act,* or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the Company in general meeting, subject nevertheless to any regulation of these articles, to the provisions of the said Act, and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by ordinary resolution, whether previous notice thereof has been given or not; but no regulations made by ordinary resolution shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

[11] R S A 1955, c 53, s 52(1)

(1) Subject to the provisions of this Act and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles, and any alteration or addition so made is as valid as if it were originally contained in the articles, and is subject in like manner to alteration by special resolution.

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tion for the shareholders as a whole, or of Class B shares only, in general meeting. It had the voting power to remove the directors from office. It had as well the voting power to pass a special resolution to eliminate the need for unanimous consent of all shareholders to the issue of additional shares and to vest in the Class B shareholders authority to issue additional Class A shares in sufficient numbers to outvote the two shares held by the Nassau residents.

In these circumstances can it be said that Saje Management Limited did not have *de jure* control of the appellant companies? So far as I am aware there is no decided case in which such a situation has been considered but there is, I think, some guidance to be found for the decision in the *British American Tobacco* case where Lord Simon L.C. said:[12]

> I find it impossible to adopt the view that a person who, by having the requisite voting power in a company subject to his will and ordering, can make *the ultimate decision* as to where and how the business of the company shall be carried on, and who thus has, in fact, control of the company's affairs, is a person of whom it can be said that he has not in this connection got a controlling interest in the company
>
> 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,* when construing that phrase in the Finance Act, 1920, s. 53(2)(*c*). He said at p. 926 that the phrase had a well-known meaning and referred to the situation of a man
>
> .. *whose shareholding in the company is such that he is more powerful than all the other shareholders put together in general meeting.*
>
> The owners of the majority of the voting power in a company are the persons who are in effective control of its affairs and fortunes. It is true that for some purposes a 75 per cent majority vote may be required, as, for instance (under some company regulations) for the removal of directors who oppose the wishes of the majority; but the bare majority can always refuse to re-elect and so *in the long run* get rid of a recalcitrant board. Nor can the articles of association be altered in order to defeat the wishes of the majority, for a bare majority can always prevent the passing of the necessary resolution. (underlining added).

While the present is a converse case in that a particular shareholder has the voting power to pass a special resolution but no immediate right to elect directors, it seems to

[12] [1943] 1 All E R 13 at page 15

me that the same guiding principle can be applied. A shareholder who, though lacking immediate voting power to elect directors, has sufficient voting power to pass any ordinary resolution that may come before a meeting of shareholders and to pass as well a special resolution through which he can take away the powers of the directors and reserve decisions to his class of shareholders, dismiss directors from office and ultimately even secure the right to elect the directors is a person of whom I do not think it can correctly be said that he has not *in the long run* the control of the company. Such a person in my view has the kind of *de jure* control contemplated by section 39 of the Act. It follows that Saje Management Limited had control of all ten appellant companies at the material times and that they were all "associated" with one another within the meaning of section 39.

The appeals will be dismissed with costs.