Victoria 1965
Apr. 12
Ottawa Aug. 4

BETWEEN:

PENDER ENTERPRISES LIMITED .....APPELLANT;

AND

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

Income tax—Capital cost allowances—Non-arm's length transaction—Control of company—Sale of asset—Adequacy of consideration—Lease acquired at no cost—Sale at economic value—Close family and business relationship of purchaser to vendor—Onus of disproving assessment—Whether casting vote at shareholders' meetings gives control—Income Tax Act, secs. 20(6)(g), 139(5)(a) and (b); 139(5a).

Bruce Sung acquired at no cost a restaurant business in Whitehorse in August 1953 under a verbal commitment from the company which owned it for a two-year lease of the building and an option to renew for two further years. In December 1953 he agreed to sell the business to appellant company for approximately $48,000, of which $32,000 was allocated by the parties to a lease of the building. In February 1954 Sung obtained a lease of the building for two years from 1 January 1954 at a rent of $100 per month, with an option to renew for two further years at a rent of $125 per month. On 1 March 1954 he assigned the lease to appellant company. The price of $32,000 for the assignment of the lease was based on the economic value of the business. Appellant company had two equal shareholders, both of them being long-standing valued employees of Bruce Sung in the operation of his many companies, and they continued as such after the purchase of the restaurant. One of the two was Bruce Sung's brother-in-law, who was president of appellant company, under whose articles of association he had a casting vote at shareholders' meetings. The other was Sung's cousin. In 1955 Sung acquired all the shares of the company which owned the building and notwithstanding the provisions of the lease the rent was increased to $400 a month in 1956, $466 a month in 1957, and $500 a month in 1958. Appellant company claimed capital cost allowances in respect of the lease of the building for the years 1955 to 1958 on the basis of a capital cost of $32,000. The claim was disallowed by the Minister, whose decision was upheld by the Tax Appeal Board [34 Tax A.B.C. 26]. The company appealed to the Exchequer Court of Canada.

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Held, appellant company was not entitled to any capital cost allowances in respect of the lease. The transaction between Sung and appellant company fell within the category of non-arm's length transactions by reason of the intimate business and family relationship of Sung with the two directors of appellant company; and the onus of disproving the assumption of the assessment that the transaction was not at arm's length (*Income Tax Act,* s. 139(5)(*b*)) had not been satisfied.

On the evidence the assignment of the lease was a disposition of depreciable property within the meaning of s. 20(6)(*g*) of the *Income Tax Act* and the consideration therefor was reasonable within the meaning of such enactment.

The fact that Sung's brother-in-law, holding 50 per cent of the issued shares of appellant company, had as president of the company a casting vote at shareholders' meetings under the company's articles of association did not give him control of the company within the meaning of s. 139(5a) of the *Income Tax Act* so as to make the transaction between Sung and the company a non-arm's length transaction. Control of a corporation requires at least a bare majority of shareholding.

[*Buckerfield's Ltd. v. M.N.R.* [1965] 1 Ex.C.R. 299 at p. 302; *Vancouver Towing Co. v. M.N.R.* [1946] Ex.C.R. 623 at p. 632, referred to.]

APPEAL from Tax Appeal Board dismissing appeal from income tax assessment.

Richard P. Anderson for appellant.

Kenneth E. Meredith and *T. E. Jackson* for respondent.

Noël J.:—This is an appeal from a decision of the Income Tax Appeal Board[1] dated October 30, 1963, dismissing the appellant's appeal from its income tax assessments whereby amounts of $6,400 for each of the years 1955, 1956 and 1957 and $6,933.37 for the year 1958, which had been deducted by the taxpayer as capital cost allowances in respect of the cost of a lease, were added to its income.

The appellant, sometime in the year 1954, purchased from one Bruce Sung a restaurant situated at Whitehorse, in the Yukon Territories, for $47,973.50 which in the bill of sale was broken down as follows:

Assignment of lease	$32,000.00
Goodwill	15,000.00
Stock	500.00
Equipment	473.50
	$47,973.50

[1] 34 Tax A.B.C. 26.

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Deduction of the leasehold interest at $32,000 was refused by the Minister for the following reasons:

1. There was in fact no disposition of a lease made from Sung to Pender Enterprises Ltd.
2. In any event, the sum of $32,000 attributed as the value of the lease by the appellant could not be reasonably regarded as being consideration for the disposition of the lease or as the consideration for depreciable property of a prescribed class and consequently the appellant is deemed by virtue of paragraph (*g*) of s.-s. (6) of s. 20 of the *Income Tax Act* to have acquired the depreciable property comprised in the sale to it by Bruce Sung at a capital cost equal to the sum of $473.50 only, i.e., the cost of the restaurant equipment.
3. If there was in fact a disposition or a sale made of the lease by Sung to Pender Enterprises Ltd., which is a disposition of depreciable property, then such disposition was not at arm's length within s. 139(5)(*a*) or alternatively 139(5)(*b*) and by virtue of s-s. 4 of s. 20 of the Act the capital cost to the appellant of the said leasehold interest is deemed to be the capital cost thereof to the original owner Bruce Sung and the capital cost thereof to him was nil.

The relevant provisions of the *Income Tax Act* are the following:

20. . . .

(4) Where depreciable property did, at any time after the commencement of 1949, belong to a 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.

. . .

(6) . . .

(*g*) where an amount can reasonably be regarded as being in part the consideration for disposition of depreciable property of a taxpayer

of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property of that class irrespective of the form or legal effect of the contract or agreement; *and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount;*

(the emphasis is mine).

139. ...

(5) For the purposes of this Act,

(*a*) related persons shall be deemed not to deal with each other at arm's length; and

(*b*) it is a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length.

139(5a)—Relationship defined

(5a) For the purpose of subsection (5), (5c) and this subsection, "related persons", or persons related to each other, are

(*a*) individuals connected by blood relationship, marriage or adoption;

(*b*) a corporation and

(i) a person who controls the corporation, if it is controlled by one person,

(ii) a person who is a member of a related group that controls the corporation, or

(iii) any person related to a person described by subparagraph (i) or (ii);

In August 1953 one Bruce Sung acquired a restaurant business carried on at Whitehorse, Yukon Territories, known as the Tourists' Services Cafe, which was part of a complex consisting in a retail and wholesale food operation, a motel, a service station, a cocktail bar and a beer parlour. This business, according to counsel for the appellant, was acquired by Sung "for nothing, so to speak" and had been operated intermittently by previous operators to whom it had been leased and the owners, Tourists' Services Limited, had not, up until then, been satisfied with the manner in which it had been conducted. Sung states that his agreement with the owners at the time of his acquisition was that he would take over the lease of the restaurant premises for two years with a renewal option for another two years, but at this stage there was nothing in writing.

On November 16, 1953, Mr. Sung wrote a letter (Ex. A-3) to Tourists Services Limited, forwarding copies of an agreement for rental of the building in which he was operating this cafe and asking them to sign it. This agree-

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ment (Ex. A-2) is dated August 1953 and provides for a lease to commence on September 1, 1953, and to end on August 31, 1954, at a rental of $900, payable at the rate of $75 per month and contained a renewal clause which reads as follows:

> The lessor covenants with the lessee that if the lessee duly and regularly pays the said rent, and performs all and every the covenants, provisos and agreements herein, and on the part of the lessee to be paid and performed, the lessor will, at the expiration of the said term grant to the lessee a renewal lease of the said lands and premises for a further term of one, two or three years at the option of the lessee at the same rent and subject to the same covenants, provisos and agreement as are herein contained.

On November 21, 1953, Tourists Services Limited wrote to Mr. Sung (Ex. A-1) with regard to the above proposed agreement suggesting the following changes therein:

1. Page 2–Lessor has equipped the restaurant as fully as intended by them–Lessee to keep it so equipped or make additions thereto themselves, if desired.
2. Page 3–Rental rate and time element covering future rental agreements to be decided upon expiry of original agreement.
3. Also if the Cafe is not operated in a businesslike manner satisfactory to T S. Ltd. that the Lessor may have the privilege of terminating the agreement on 7 days notice.

The above agreement, however, was never signed and Mr. Sung continued operating the said restaurant on the basis of what he termed a verbal commitment that he had occupation of the restaurant premises for an initial period of two years with an option for him to renew for a further two or three years and he was then, prior to December 1953, paying the landlord a rental of $100 or $125 a month.

It is around December 16, 1953 that the appellant Pender Enterprises Ltd. entered the present picture if Ex. A-10 can be relied on. These are minutes of a meeting of directors of this company "held at the registered office of the Company, at 203-4 Holden Building, 16 East Hastings Street, in the City of Vancouver, in the Province of British Columbia, on Wednesday, the 16th. day of December, A.D. 1953" and contain a recital that Bruce Sung had offered to sell to the company and the latter had accepted to buy the restaurant business operated at Whitehorse, Y.T., for a price of $47,974.50 as well as the Keno Hill Steam Laundry, situated at Elsa, Y.T., for a price of $25,000.

Pender Enterprises Ltd. was incorporated on May 15, 1953, and the subscribers to the memorandum of association of the company were Mr. Richard Philip Anderson (one share) and Leslie Raymond Peterson (one share). Both of these gentlemen are the attorneys of the appellant as well as of Mr. Sung. On December 16, 1953, one share of the company was transferred to Sam Lee and one to James Wong and at the same date Sam Lee was appointed president and James Wong the secretary. Sam Lee is Bruce Sung's brother-in-law as the latter is married to the former's sister and James Wong is a cousin of Bruce Sung as the latter's mother and Wong's father are sister and brother.

On January 2, 1954, Mr. Sung wrote a letter (Ex. A-4) to Mr. J. Smith of Tourists Services Limited introducing his cousin, James Wong, an employee of one of his companies and one of his right-hand men, as follows:

> I have requested Mr. Wong to take up with your firm the matter of our lease on the restaurant which still remains to be completed. He has my full authority to negotiate the terms of the rental.

On February 4, 1954, James Wong, on the stationery of Columbia Caterers Ltd., one of Mr. Sung's companies, wrote to Tourists Services Limited forwarding three copies of the lease "for our tenancy in your cafe adjunct" and stating the following:

> Incorporated in the new agreement are the points which we discussed during the writer's recent trip to Whitehorse. We trust that you will find this satisfactory.
>
> You will note that the writer has affixed his signature for Mr. Bruce Sung. We would appreciate your letter accepting this signature, as per the instruction of Mr. Bruce Sung's letter of authorization to your Mr. Smith.
>
> Please return two copies of the lease to this office, properly affixed with your seal.

The lease, Ex. A-5, dated blank February 1954, was then entered and it provides for a rental of the restaurant premises in favour of Bruce Sung for a "term of 2 years commencing on January 1, 1954 and ending on the 31st day of December 1955" (sic) at a rental of $1,200 payable at the rate of $100 a month with a renewal lease for a further term of two years at the option of the lessee at a rental of $125 per month.

A conditional bill of sale dated February 1, 1954, (Ex. A-7), was produced which witnesses that Bruce Sung

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delivered to the appellant, Pender Enterprises Ltd., the following goods described as follows:

The business known as the Tourists' Services Cafe, situate at Whitehorse, Y.T., together with the said name and the good-will thereof and all the goods and chattels situate therein, including stock-in-trade, . . .

. . .

For the purpose of this agreement the business shall be valued as follows:

Assignment of lease—$32,000 00

Goodwill—$15,000.00

Stock—$500 00

Equipment—$474.50

On the same date, i.e., February 1, 1954, Pender Enterprises Ltd., by its president Sam Lee and its secretary, James Wong, signed a promisory note (Ex. A-8) in favour of Bruce Sung for the sum of $47,973.50 with interest thereon at the rate of 3%.

By an indenture of the 1st day of March 1954 (Ex. A-9) and "in consideration of the sum of one dollar and other good and valuable consideration" paid by Pender Enterprises to Bruce Sung, the latter assigned to the appellant "that portion of the premises commonly known as 'Whitehorse Auto Camp' in Whitehorse, in the Territory of Yukon, now used as a restaurant, and formerly operated by Tourists' Services Ltd. together with the furniture, fixtures and equipment situate therein together with the residue unexpired of the said term and the said lease and all the benefit and advantage to be derived therefrom".

This assignment also contained the following:

IT IS expressly agreed between the parties hereto that the responsibility of the Lessee herein for the premises herein and payment of rents and observance of Lessee's covenants shall be effective February 1st. 1954.

From February 1, 1954, to the end of December 1954, the appellant in fact paid a rental of $200 instead of $100 as set down in the lease, Ex. A-5. In the summer of 1954, J. Wong negotiated with the landlord whereby a rental of $200 was agreed to upon the landlord more than doubling the seating capacity of the restaurant.

In 1955 Mr. B. H. Sung acquired all of the shares of Tourists' Services Ltd. so that at that stage Sung was in control of the landlord and the appellant was the tenant. In 1956 Tourists' Services Ltd. increased the rent of the premises to $400 a month which Sung explains by saying at that time

there were further additions made to the place at a cost of $5,000 and also because, as he admits at p. 42 of the transcript:

> A. . . . The business itself was doing very well, and I think that was the reason that Mr. Rathie [his financial adviser and accountant] and I at that time, you know, decided that possibly they could stand to pay a little more rent.

In 1957 the rent was again increased to $466 a month and in 1958 to $500 a month. All these increases were made on a verbal basis without any change being made to the written lease.

In 1958 a portion of the shares (40) of Tourists's Services Ltd., i.e., 20% of the outstanding capital, was acquired by the appellant at a price of $82,645.02. These 40 shares are now worth in the neighbourhood of $250,000.

The sequence of the above mentioned facts are, however, somewhat confused due to the assertion by J. Wong that although Bruce Sung stated, at p. 31 of the transcript, that about the middle of December 1953 a decision was reached as to the purchase of the restaurant business and the price at which Sung would sell it to the appellant was decided upon and this, of course, is supported by the minutes of December 16, 1953, of the appellant, Ex. A-10, this would not be so as, according to Wong, the price of the business was fixed only in March or April of 1954 and instructions to make up these minutes were given in March or April also and then backdated to December 16, 1953. The explanation given by J. Wong for such an unusual procedure was that they wanted to record the transfer of shares from the original incorporators, Mr. Anderson and Mr. Peterson to Wong and Lee prior to the end of the year, which, however, does not explain why the minutes with regard to the restaurant deal could not have reflected the true nature of this transaction as well as the true date (cf. p. 65 of transcript, Wong).

Wong also states that the conditional sales agreement, Ex. A-9, dated March 1, 1954, was also made at a later date, i.e., some time in March or April 1954.

He finally submitted that all these events took place at the same time when at p. 66 of the transcript he stated in answer to the following:

> Q. Do you suggest that all these events took place together then, firstly that the lease was signed, and secondly that the assignment was

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given; thirdly that the price between you and Mr. Sungh was agreed upon. All those events were more or less contemporaneous, were they?

A. They jelled about that time.

Wong and Lee, in addition to being related to Mr. Sung, had been employed by two of the latter's companies for a long time (Wong since 1942 and Lee since 1950) and were both admittedly his right hand men. Mr. Sung had operations in British Columbia as well as in the Yukon and they both were his senior employees. Mr. Sung explained their functions at p. 26 of the transcript as follows:

THE COURT:

Q. Tell me, Mr. Lee and Mr. Wong, what would be their functions and responsibilities in that organization?

A. Like we had the contracts with Keno Hill and Consolidated Mining & Smelting, and they would go out and inspect these jobs or, if required, stay to manage these jobs at different times, and we were acting as—one of our main functions was purchasing and procurement of food stuffs.

Q. Are they experts in purchasing?

A. Yes, Mr. Wong is still the purchasing agent for our group of companies.

Q. Would you consider them your right-hand men?

A. Very much so.

Q. Both of them?

A. Yes.

Mr. Sung in 1954 through 1957 had a company called Columbia Caterers which carried out the management of his companies. It provided the whole administrative and operating functions for all his companies such as auditing and payroll services, hiring and firing of personnel and purchasing as well as paying the bills. It also provided the same services for the appellant Pender Enterprises Ltd.

In 1957 or 1958 those functions were taken over by Sung Management Ltd. another of Mr. Sung's companies.

These management companies charged a fee for such services and as put by Mr. Sung at p. 26 of the transcript:

A. ...the fees charged were enough to cover our overhead, because we maintained a staff of our own then about fourteen people in Vancouver, here, and people like Mr. Lee and myself, and Mr. Wong and various other employees were paid their salaries out of this management fee we charged.

It may be interesting to note that both Wong and Lee entered the employ of Columbia Caterers Ltd. in 1952 or 1953 and have been with that company until 1957 or 1958,

when Sung Management Ltd. was formed and when they both became employed by the latter. Although the salary of both was paid by the above companies, Wong was called upon at times to render services to Mr. Sung, as the latter admitted he did when, for instance, he went up on behalf of Sung to supervise the operations of the cafe at Whitehorse in the initial stages.

The discussions between Lee, Wong and Sung with respect to the purchase by the appellant of the restaurant business started, according to Sung, two or three months after he had started operating the business and, as put by Sung at pp. 18 and 19 of the transcript:

> A. . . . as soon as I had some experience in the business and knew it was going to be a profitable business, then I had something to talk about.

Asked by the Court why he did not retain this business for himself, he answered at p. 19:

> A. I had other interests, my lord, and these kept me quite busy, and in business we have just got to zig and zag a little, I guess.

He later added that selling the business to Wong and Lee "is one way of getting them to remain with me" which, however, by making them independent would appear to me to be the best way to defeat his purpose.

He then stated that Wong and Lee were on a salary basis and not on a participation basis but later contradicted this assertion by saying that he was able to offer them a participation in his business. The evidence on this particular point, at p. 19 of the transcript, is rather interesting and worthy of reproduction:

THE COURT:

Q. Was that a problem, retaining your skilled men or good men?
A. It always had been and always will be.

Q. They were on a salary basis with you?
A. Yes, my lord.

Q. Not a participation basis on the profits or anything like that?
A. No. No, sir.

Q. How had you managed to retain them so long?
A. Well, now, I have been able to offer them participation by allowing them to buy stock in the companies that I do operate.

Sung stated that from the prices he charged, and the fact that Whitehorse was in an economic boom at the time

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because of the mining and construction activities in that area, he knew that he was able to make a very substantial profit, from the operation of this restaurant and, as expressed at p. 20 of the transcript:

> A. . . . I wanted to make sure that these two gentlemen were going to be there to help me run this thing; so I had felt this little deal on this restaurant was going to be a very good profitable deal; so I asked them if they wanted a chance to make some—something in this.

Wong and Lee discussed the price with Sung's auditor, accountant and adviser at the time, Mr. Andrew Rathie, of McDonald Currie, who helped them to arrive at the price of $47,973.50.

The price of $32,000 for the leasehold interest of the business was also established with the assistance of Mr. Rathie whom Sung admits advised him as well as Mr. Wong and Mr. Lee (cf. p. 43 of the transcript). Wong however states that he had estimated prior to the purchase of the business by the appellant that it could do a minimum of $10,000 of sales per month or $120,000 per year and, as he stated at p. 52 of the transcript "and using that as a basis we worked our figures back as to how much rent could be paid on that basis, and how much profit we should be able to earn."

According to Wong, the national norm of rental in relation to gross profit for a business of this sort would be 6½% and the rental here, therefore, should have been on a projected gross revenue of $120,000, $7,800 if Pender Enterprises Ltd. was paying the going rate. Sung, however, had a lease for a period of two years at $100 a month and a right to renew for a further two years at $125 a month. What was basically done, therefore, to arrive at the figure of $32,000 for the leasehold interest was to take the annual economic rent as calculated above, deduct therefrom the annual rent under the lease and multiply the difference by five to cover a five year period. Wong explained how the five year period was taken as a basis of calculation at p. 78 of the transcript as follows:

> A. Well, in our discussions with Andy Rathie he suggested five years, and I don't think we realized that it should have been four years, because actually that was the terms of the original lease, but

somehow we got talking about five years and that seemed to be the track we got on to.

Q. There was really a mistake in a sense?

A. Yes.

In December of 1953 the directors of Pender resolved to buy this business for $47,973.50. In the following January 1954, Wong ostensibly, on behalf of Sung, went to Whitehorse to negotiate the lease. Sometime after February 1, 1954, a lease was signed and as late as March 1, 1954, that lease was purported to be assigned by Sung to Pender Enterprises Ltd.

On the basis of the above facts, the respondent urges that as the essential decision by Pender Enterprises Ltd. to purchase was made before any lease existed there, therefore, (*a*) could be no assignment of depreciable property with regard to this lease and (*b*) Sung could only have held this lease, negotiated after the decision to purchase the business, as trustee or nominee of Pender Enterprises Ltd.

Now although the manner in which the lease and rentals were negotiated and the documents were set up are somewhat confusing and may have some bearing on the overall picture of the transactions which took place here with regard to the question as to whether this was in fact an arm's length transaction or not, I do not consider that they establish that (*a*) the decision to purchase was made before any lease existed nor (*b*) that the lease after December 16, 1953, could only be held by Sung as trustee or nominee of Pender Enterprises Ltd.

In my view a correct appraisal of what took place here is that long before December 16, 1953, Sung had possession of the restaurant premises, was operating a business there since the preceding August or September and held a commitment from the landlord that he had a lease for four years. This appears from the evidence adduced herein and particularly in Sung's cross-examination at p. 31 of the transcript:

Q. Now, then, is it not true, Mr. Sungh, that at the date, that is the middle of December 1953, no lease existed between yourself and Tourist Services Ltd?

A. No written lease, but I had a verbal commitment from these people, if I didn't have I would not have gone into the business.

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And at p. 32:

THE COURT:

Q. Had they committed themselves to renting the premises to you for a certain period of time?

A. Yes, my lord, they did.

Q. How long?

A. I believe the initial period was to be two years with an option for me to renew for a further two or three years.

Q. Who told you this?

A. At the time I was dealing with Mr. Smith and Mr. Barker—Not Mr. Barker—Barker and Mr. Elliott, they were the owners of the company. Mr. Smith was their general manager.

I now come to the second submission made by the respondent herein that the sum of $32,000 attributed as the value of the lease by the appellant could not be reasonably regarded as being the consideration for the disposition of the lease under section 20, subsection (6) (*g*) of the Act.

This submission, as I understand it, is that if $100 a month rental (which was obtained when Sung took the restaurant business over) is the best that Tourists Services could get, then that is the test of the economic rent so that within the first few months after the take over the economic rent and the actual rent would be identical and based on the above rental figure for a period of four years would total at the most an amount of $4,800 instead of $32,000. It is urged for the respondent that this leasehold interest could not have achieved, within a matter of months, a value far in excess of what the landlord held it was worth and that by hindsight the reasonable economic rent might well be said not in any event to exceed $500 a month.

The question as to whether this amount of $32,000 can "reasonably be regarded as being the consideration for such disposition" can be determined by the evidence which, on this matter, in my view, indicates that the amount of $32,000 is in fact something less than the true value of this leasehold at the time the transaction took place if consideration is given to the fact that when one of Mr. Sung's companies took over another restaurant, the Whitehorse cafe in 1957, in the same locality, a rental of $1,000 was paid on an annual volume of business of about $175,000, when the annual volume of the restaurant taken over by

the appellant or its gross sales were for the same year $161,000 (cf. p. 55 of the transcript).

It does not indeed appear to me that the value to be attributed to a lease is necessarily the value to the landlord particularly when such as here, several attempts had been made to rent the premises out to a successful operator and where it seems that the main interest of the owner was to insure that the premises would be taken over by a good tenant who would supply a satisfactory restaurant service to the users of the commercial complex of which this restaurant was a part. Mr. Sung, upon taking over the operation of the restaurant with the knowledge and facilities he had, was able, during a short period of operation, it is true, to instil new life into this business and by establishing its potential, gave it an increased market value.

In view of the above, it therefore follows that the amount of $32,000 does not appear to me to be an unreasonable consideration for the disposition of the leasehold interest herein.

I will now deal with the Minister's assumption that if in fact a valid disposition or a sale was made of the lease by Sung to the appellant, then such disposition was not at arm's length within the meaning of section 139(5)(*a*) or, alternatively, section 139(5)(*b*) of the Act. If, indeed, this transaction was not at arm's length, then by virtue of subsection (4) of section 20 of the Act, the capital cost to the appellant is deemed to be the capital cost thereof to the original owner and as Sung paid nothing for this lease, the capital cost to the appellant would be nil.

The Minister's assumption under this heading is that the present transaction would be not at arm's length because it took place between a related person by marriage, i.e., Sung's brother-in-law, Lee who held 50% of the shares of the appellant company but who, being its president under clause 38 in Table A of the articles of association of the appellant "presides as chairman at every general meeting of the company and under article 43 in the case of an equality of votes whether on a show of hands or on a poll, is entitled to a second or casting vote."

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The submission here is that as there are only two shareholders in the appellant corporation, Wong (one vote) and Lee (one vote), Lee by this preponderant vote would thereby control the appellant corporation and being a brother-in-law of Sung, and therefore related by marriage, would be covered by section 139 (5a) (*b*) (iii) of the Act, which would make any transaction between Sung and a corporation controlled by his brother-in-law a non-arm's length one thereby rendering under section 20(4) of the Act the capital cost of the acquisition of the leasehold to the appellant nil as Sung, the original owner, paid nothing for it. However, this would be so only if Lee had control of the appellant corporation and I must now enquire as to whether, under the above circumstances, Lee had such control. This matter of control of a corporation was dealt with by Jackett P. in *Buckerfield's Ltd, et al* v. *M.N.R.*[1] where he stated that:

> Many approaches might conceivably be adopted in applying the word "control" in a statute such as the *Income Tax Act* to a corporation. It might, for example, refer to control by "management", where management and the Board of Directors are separate, or it might refer to control by the Board of Directors. The kind of control exercised by management officials or the Board of Directors is, however, clearly not intended by section 39 when it contemplates control of one corporation by another as well as control of a corporation by individuals (see subsection (6) of section 39). The word "control" might conceivably refer to *de facto* control by one or more shareholders whether or not they hold a majority of shares. I am of the view, however, that, in section 39 of the *Income Tax Act,* the word "controlled" contemplates the right of control 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. See *British American Tobacco Co.* v. *I.R.C.* ([1943] 1 A E.R. 13) where Viscount Simon L.C., at page 15, says:
>
> > "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."

Now although this interpretation was given in connection with section 39 of the *Income Tax Act,* I can see no reason why it should not apply as well to 139(5a) of the Act in which case Lee could not have control of the appellant corporation as he held only 50% of its shares and, therefore, could not be said to have a number of shares such that he carries with it the right to a majority of the

[1] [1965] 1 Ex. C R. 299 at 302.

votes in the election of the Board of Directors or that his shareholding in the company was such that "he was more powerful than all the other shareholders in the company put together in general meeting" as set down by Cameron J. in *Vancouver Towing Company Limited* v. *M.N.R.*[1] It indeed appears to be clearly settled that control of a corporation requires at least a bare majority in shareholding and as Lee here has not this majority, he cannot be considered as controlling the appellant and I say this notwithstanding the articles of association adopted by the appellant which gives its president a preponderant vote in the case of an equality of votes at every general meeting of the company. Indeed, such a power given to the president of the present corporation, in view of the particular circumstances of the instant case, could not, in my view, give Lee effective control over the appellant corporation which he would not otherwise have by virtue of his shareholdings because any control he would wish to exercise by virtue of his preponderant vote could not, in practice, be implemented. There being two shareholders only, Lee could not hold a general meeting of the appellant corporation without Wong's consent and as one director cannot constitute a meeting, he could not use his preponderant vote.

It therefore follows that Lee not having the effective control required, the transaction between Pender Enterprises and Sung cannot, under section 139(5)(*a*) and 139(5a)(iii) be deemed to be not at arm's length.

The only matter which now remains to be considered is whether the persons involved here were in fact dealing at arm's length under section 139(5)(*b*) of the Act.

The expression "to deal with each other at arm's length" is not defined in the Act. However in *M.N.R.* v. *Sheldon's Engineering Limited*[2] Locke J. clarified the term somewhat by stating at p. 643 thereof:

> The expression is one which is usually employed in cases in which transactions between trustees and *cestuis que trust* guardians and wards, principals and agents or solicitors and clients are called into question.

The intimate business and family relationships of both Lee and Wong with Sung and the various corporations

[1] [1946] Ex. C.R. 623 at 632. [2] [1955] S.C.R. 637 at 643.

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involved, as disclosed by the evidence, was of a nature such that the transaction involved would, in my view, have to be included in the above described categories.

Furthermore, the onus clearly lies on the appellant to show error on the part of the Minister in his assessment in holding that the transaction herein was not at arm's length and this onus, in my view, has not been satisfied by the appellant here. This, indeed, appears from the various relationships of the individuals and companies involved herein which I have already described and particularly from the following: Lee and Wong, the shareholders of the appellant, were in the employ of Sung and had been employed by him for a long time prior to the transaction involved herein and they still are; Wong negotiated the lease herein for Sung. In the first years of operation and afterwards, Pender Enterprises Ltd. paid substantial sums to Sung's companies, Columbia Caterers Ltd. and Sung Management Ltd.; the deal was set up and the price of sale as well as the leasehold was determined by Sung's accountant and financial adviser, Mr. Rathie. Sung, through his management companies, received statements from Pender Enterprises Ltd. every year, which enabled him to keep a tab on the appellant and raise the rent when desirable. The above alone might have been sufficient to establish that the deal was not of an independent nature and, therefore, not at arm's length. There is, however, more and this, in my view, confirms the non-arm's length nature of this transaction, in that in the course of the operation of the restaurant business, whatever lease Pender Enterprises Ltd. had, was never respected and although in 1954 the increase of the rent might have been justified by the increase of the size of the premises, there is no such reason for the subsequent increases in rent which took place particularly in 1957 and 1958, at a time of course when Sung was the owner of the landlord, Tourists' Services Ltd. The evidence of Wong at pp. 58 and 59 of the transcript is illuminating in this respect:

MR. ANDERSON:

Q. Mr. Wong, you will recall Mr. Meredith asking Mr. Sungh why the rental was increased to $400 a month and $500 a month. Can you tell the court why that was?

A. Well, those years we were doing a very substantial volume of business, and it was just agreed that it would be only fair for us to pay a higher rental.

THE COURT:

Q. Did you decide that on your own, together with Mr. Lee or did Mr. Sungh ask you to increase the rent? How was it arranged? How did you come to pay more rent than what you were paying before? When was this done?

A. Well, it was just like—it is very informal as is with all our meetings. We sit down and it is just a casual talk, and—I am going by memory now—but he probably says, "You fellows are doing pretty good, how about a little more rent?" So we probably bandied it back and forth and finally it was agreed, "All right, it is fair that we should pay a little more rent."

It is, in my view, a fair inference from the foregoing that in the dealings between Sung and Pender Enterprises Ltd., the parties were not acting independently but as highly interdependent parties and Sung, at the time of the transaction and throughout the period under review, was in a constant position of advantage or interest with regard to the appellant corporation to a point where in fact the parties involved here cannot be considered as dealing at arm's length.

The appeal, therefore, in respect of the assessments to income tax for the years 1955, 1956, 1957 and 1958 is dismissed with costs.

Appeal dismissed.