1964
Jan. 16
Sept. 8

BETWEEN:

GORDON WILLIAM LADE ..... APPELLANT;

AND

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

Revenue—Income—Income tax—General rule of taxation—Employees profit-sharing plan—Meaning of "Employees profit-sharing plan"—Meaning of "computed by reference to profits"—Meaning of "profits from his business"—Income Tax Act, R S.C. 1952, c. 148, s. 79.

The appellant in 1959 was an employee of the Richfield Oil Corporation, an American corporation, and, as such, was a participant in the company's stock purchase plan under which both he and the company made contributions to a trustee who was required by the terms of the plan to purchase stock in the company on behalf of the appellant. In 1959 the appellant paid to the trustee of the plan the sum of $630 00 by way of payroll deduction and the company paid to the trustee the sum of $315 00 on behalf of the appellant and the sum of $3 24 as a dividend in respect of stock which had been allocated to the appellant's member account.

The question to be determined is whether or not the stock purchase plan is an employees profit-sharing plan as defined in s 79(1) of the *Income Tax Act*.

Held: That because s 79 of the *Income Tax Act* allows a deduction of the employee's contributions, exempts the income from the trust investments, creates a shift in the income tax burden and includes in the employee's income amounts allocated which amounts, however, he has not received and may never receive but on which he is called upon to pay taxes, which also is a departure from the general rule that taxation is based on "receivability", it must be strictly construed.

2 That the definition in s 79(1) of the *Income Tax Act* of an employees profit-sharing plan as "an arrangement under which payments computed by reference to profits . . . are made by an employer to a trustee" restricts the ordinary meaning of an employees profit-sharing plan, being one under which employees are given a share in the profits of their employer if and when such profits are realized, by limiting

[1] [1950] S C R. 168.

the plan to one only where the payments of the employer are computed by reference to profits and paid into trust.

3 That the exclusion by s. 79(1) of a plan based merely on the employees' contributions being made "out of profits" points out that something else than a mere contribution out of profits is required to qualify a plan under the section.

4. That the words in parenthesis in s. 79(1) "(whether or not payments are also made to the trustee by the officers or employees)" go beyond the ordinary concept of an employees' profit-sharing plan, extend the meaning of the heading of the section, as well as the definition contained in s 79(1) by allowing officers and employees to contribute, and have the effect of not only confirming that the ordinary meaning of a profit-sharing plan was contemplated by the legislators but also support the view that if these words had not been mentioned then a plan where the employees contributed would not have been considered as a profit-sharing plan under the *Income Tax Act*; and the definition of a profit-sharing plan under the Act is, therefore, except to the extent it is or may be affected by what has been pointed out, to be taken to mean what it says, which is that a set formula is worked out by reference to the employer's profits whereby a total amount of profits to be distributed to the employees or shared by the employer with them is determined and must be paid to a trustee when there is such a profit.

5 That what is required is a binding obligation by the employer to make payments in accordance with a formula which refers to profits and which must be paid in the event of profits. It is in this sense only that it can be "computed by reference to profits" and paid as required under this section.

6 That the words "computed by reference to profits" cannot mean that profits must be used only as a means of calculating the employer's contributions which is only a mathematical calculation, but they must also mean that the amount so calculated or computed must be paid under the plan when the profit is realized which is how the employer shares his profits with his employees.

7. That "payments computed by reference to profits . . . and make . . . to a trustee" cannot mean a plan such as here where the contributions of the employer are predicated upon payments being made by the employees as a prerequisite to the employer contributing a percentage of the contributions of the employees even if such percentage will increase with an increase of the ratio of profits to the capital invested.

8 That while employees' contributions are permitted under s. 79(1) there is nothing which permits them to be made a *"sine qua non"* of the contributions of the employer.

9. That although the contribution of the employer in this case is computed in one sense by reference to profits, there is no predetermined proportion necessarily shared with the employees and paid to them in the event of profits as it is dependent upon the employees' contributions and not upon profits, and the plan involved here cannot therefore be said to be an "employees profit-sharing plan" under the *Income Tax Act*.

10 That a plan would not fail to qualify under s. 79(1) merely because the employer made a contribution from funds other than profits or made a contribution in a year when there was no profit provided that under the plan the payments be computed by reference to profits and the proportions so calculated be paid into the trust in the event of profits.

1964

LADE
v.
MINISTER OF NATIONAL REVENUE

11 That the words in s 79(1) "profits from his business" should be given a wide interpretation and would go so far as to include therein, at least in the case of a corporation, the latter's net income after taxes.

12 That the appeal is allowed.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard by the Honourable Mr. Justice Noël at Ottawa.

P. N. Thorsteinsson for appellant.

G. W. Ainslie and *D. G. H. Bowman* for respondent.

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

NOËL J. now (September 8, 1964) delivered the following judgment:

This is an appeal from a decision of the Tax Appeal Board[1] confirming the addition by a reassessment of the Minister to the appellant's income for the 1959 taxation year of an amount of $315 paid by the appellant's employer, Richfield Oil Corporation, under what is termed a stock purchase plan for its employees and allocated to the appellant's TRUSTEED ACCOUNT as well as an additional sum of $3.24 dividends also allocated to the said account pursuant to the provisions of the said plan.

The question to be determined here is whether or not the above mentioned stock purchase plan is an employees profit-sharing plan as defined in s. 79(1) of the *Income Tax Act*, R.S.C. 1952, c. 148. If the said plan does not qualify under the above section, then the amounts cannot be added to the appellant's taxable income; on the other hand, if it does, as held by the Board, these amounts should be added to the appellant's income and are taxable.

The present appeal is a test case of special interest to a number of employees who, like the appellant, do not wish to be taxed on amounts allocated to them on a contingent basis under this plan, which amounts the employees would never see if they were to retire or leave the company within five years from the time they entered the plan.

At the beginning of the hearing of this appeal, counsel for the appellant filed an Agreed Statement of Facts as Ex. A, to which are attached, as Exs. 1 and 2 respectively, the stock purchase plan for employees, the appellant's tax

[1] 30 Tax A B C 397.

return for 1959 and the published annual report of the appellant's employer, Richfield Oil Corporation for the year 1958 as Ex. B. This Agreed Statement of Facts is reproduced hereunder:

AGREED STATEMENT OF FACTS

The parties hereto admit the several facts respectively specified, provided that these facts are admitted for the purposes of this cause only and the admission thereof is not to be used against either party on any other occasion or by anyone other than the parties hereto

1. The Appellant at all times material to this appeal was resident in Canada and was employed by Richfield Oil Corporation (hereinafter referred to as "the Company")

2 The Company is a body corporate, incorporated in the State of Delaware, one of the United States of America, registered to carry on business and carries on business in the Province of Alberta and elsewhere in Canada, and the substantial part of its business is carried on outside Canada

3 Attached hereto and marked as Exhibit 1, is a document entitled "Stock Purchase Plan for Employees—Richfield Oil Corporation", which document comprises two parts, viz: "PART I—THE PLAN", "PART II—DECLARATION OF TRUST".

4 Prior to the commencement of the 1959 calendar year the Appellant had complied with the eligibility requirements of sec 2, Part I of Exhibit 1, and at all times material to this appeal was a member of the Plan

5 During the 1959 calendar year, the Appellant authorized the Company to deduct and withhold from his salary the sum of $630 00, and to pay this sum to the trustee of the Plan as his contribution under sec 3 of Part I of Exhibit 1 The Company, during the 1959 calendar year, withheld the sum of $630 00 and paid the amount to the trustee pursuant to Article I of Part II of Exhibit 1, which amount was credited by the trustee to the Appellant's member account.

6 The Company since the inception of the Plan up to the end of 1959, has made the following contributions as company contributions pursuant to the provisions of Part I of Exhibit 1.

	Contribution in respect of Canadian members only		*Total contributions in respect of all members*	
	Section IV	*Section IV*	*Section IV*	*Section IV*
Year	Part A Monthly	Part B Annual	Part A Monthly	Part B Annual
1953 .	$ 120	None	$ 135,762	None
1954 .	388	None	289,828	None
1955 . ..	903	None	295,604	None
1956 . ..	1,738	84	315,885	30,515
1957 . .	3,146	None	350,358	None
1958 .	4,175	None	391,839	None
1959	8,592	None	431,033	None
	$ 19,062	$84	$ 2,210,309	$ 30,515

1964

LADE
v.
MINISTER OF NATIONAL REVENUE

Noël J.

All of the above contributions were delivered by the Company to the trustee pursuant to Article I of Part II of Exhibit 1, and were held by the trustee upon trusts set forth and declared in Part II of Exhibit 1. During the 1959 calendar year the Company did not make any annual contributions pursuant to para B, sec. IV, Part I of Exhibit 1, since during the year the percentage of its profits to invested capital was less than 11%.

7 Of the sum of $431,033 00, referred to in paragraph 6, the sum of $315 was allocated by the trustee during the 1959 calendar year to the Appellant's trusteed account.

8. During the 1959 calendar year a cash dividend of $1.62 was received by the trustee in respect of stock which had been allocated to the Appellant's member account and was credited to the Appellant's member account and a further cash dividend of $1.62 was received by the trustee in respect of stock which had been allocated to the Appellant's trusteed account and was credited to the Appellant's trusteed account.

9. Attached hereto and marked as Exhibit 2 is a true copy of the return of income filed by the Appellant with the Respondent for his 1959 taxation year The sum of $12,900.00 shown under "Salaries, Wages, Bonuses and Pensions", included the sum of $630 00 referred to in paragraph 5 hereof, but did not include the sum of $315 00 referred to in paragraph 7 hereof, nor the sums of $1 62 and $1 62 referred to in paragraph 8 hereof.

For a proper understanding of the issue involved here, the following excerpts from the plan, Ex. 1, should be set out. Paragraph A of section I spells out the purpose of the plan as follows:

> A. Purpose. Moved by a desire to foster a closer and continuing association with the business, your Company offers you voluntary participation in a Stock Purchase Plan. Under the PLAN contributions by you and the Company will be invested in Richfield common stock through a Trustee and accumulated in your accounts over the years of your employment

Section III of the plan deals with the contributions by members as follows:

> You will contribute monthly a sum determined by yourself, but not less than $5 nor more than 5% of your monthly salary, to be paid through authorized payroll deductions . . .

The contributions of the employer are dealt with by section IV of the plan under Part A and Part B thereof which read as follows:

> A. Monthly Contribution. The Company will make a monthly contribution of a sum equal to 50% of the member contributions made each month. These monthly contributions by the Company shall be reduced by amounts forfeited, if any, during the preceding month by members withdrawing from the PLAN.
>
> B. Annual Contribution. The Company will make an annual contribution of a sum based upon the ratio of its profits to invested capital which will adjust the total monthly contributions made by the Company to the following schedule:

Per cent of Profits to Invested Capital	Company Contribution as per cent of Member Contribution
Up to but less than 11%	50%
11% but less than 12%	55%
12% but less than 13%	60%
13% but less than 14%	65%
14% but less than 15%	70%
15% or over	75%

The plan further provides that "Invested Capital shall mean the total of all Capital Stock and Surplus (or equivalent) accounts and Long Term Debt of the Company as of the beginning of the preceding calender year, as reflected in its printed Annual Report to stockholders."

"Profits" for the purposes of the plan "shall mean the Company's Net Income after taxes for the preceding calendar year, as shown in its printed Annual Report to stockholders."

Section V A of the plan provides that "Member contributions will be paid to the Trustee by the Company within 20 days after the end of each month, for credit to each participant's MEMBER ACCOUNT as at the end of said month."

Under section V B "the Company's monthly contributions will be paid to the Trustee within 20 days after the end of each month, for allocation as of the end of said month to each member's TRUSTEED ACCOUNT".

Under section V C "the Company's annual contribution will be paid to the Trustee within 20 days after each March 31, for allocation as of said March 31 to each member's TRUSTEED ACCOUNT."

The rights under the said plan are set out in section VII as follows:

A. It is a fundamental rule that no cash or stock will be distributed to anyone while a member of the PLAN.

B. Upon termination of service the rules will be as follows:

1. At or after Age 55 if a Man or Age 50 if a Woman (regardless of years of membership in the PLAN):

   You will receive all cash and stock credited to your MEMBER ACCOUNT and TRUSTEED ACCOUNT as of your settlement date

2. Due to Death or Total and Permanent Disability or Mental Incompetency (at any age):

   You or your legal representative or your beneficiary will receive all cash and stock credited to your MEMBER

1964

LADE
v.
MINISTER OF
NATIONAL
REVENUE

Noël J

ACCOUNT and TRUSTEED ACCOUNT as of your settlement date

3 Before Age 55 if a Man or Age 50 if a Woman (except by reason of death or total and permanent disability or mental incompetency)

You will receive, as of your settlement date, all cash and stock credited to your MEMBER ACCOUNT and the percentage of cash and stock credited to your TRUSTEED ACCOUNT indicated below.

Years in PLAN	*Percentage*
Less than 5	None
5 or more	100%

It therefore appears from the above that if, for instance, the appellant were to retire or leave the company within five years from his entry into the plan, he would only get his own money back and not the amounts contributed by the company, on which amounts, however, he would have been taxed. This can also be expressed by saying, as already stated, that this allocation to the employee each year is made on a contingent basis.

Before examining the question as to whether the present plan falls under an "Employees profit-sharing plan" as defined by s. 79(1) of the Act, it may be useful to point out that as the employer of the present taxpayer is an American corporation, the plan, which is called a stock purchasing plan, was not prepared for the purpose of taking advantage of s. 79(1). I might also say that although in the United States of America there are special provisions in their tax legislation dealing with stock purchasing plans and profit-sharing plans, which are two different things, we have nothing dealing with stock purchasing plans as such but a stock purchasing plan may, if it fulfills the definition of s. 79(1) be considered as a "profit-sharing plan".

Section 79 of the Canadian Act which deals with an employee's profit-sharing plan provides that if the plan comes within the definition of the section, the following tax consequences will ensue. The employer may deduct the amounts paid by it into the plan provided they are paid during the taxation year or within 120 days after it. Otherwise, such amounts might be considered as a payment out of profits after they have been earned and not an incidence of earning the profits. The trust set up to receive the contributions of both the employer and the employees is exempt from tax on the income from the investments it

holds from time to time. All contributions and profits of the trust must be allocated by the trustee each year to individual officers or employees either absolutely or contingently and the officers or employees to which such allocations are credited must include the amounts allocated to them in calculating their incomes for tax purposes in the year in which they are so allocated but may deduct a dividend tax credit for the portion of these allocations representing dividends received by the trust from taxable corporations. When, however, the employees receive the amounts accumulated in the trust at some future date, they are then tax free to the extent that they (1) represent the employee's own contributions and have been previously included in calculating the income of an employee or officer, or (2) are out of "capital gains made by the trust".

As pointed out by Mr. Fordham, Q.C., in the Tax Appeal Board decision "Whatever may be the outcome of this appeal, there is no all-around avoidance of tax; there is simply a shift, as appellant's counsel aptly put it, in the incidence of the income tax burden. If the Plan comes within the ambit of s. 79(1), the trust is exempt, but the appellant must pay tax on the allocations to him. If, as the appellant submits, the Plan is not within the definition found in s. 79(1), the trust is taxable, but the employee then need not pay tax on the amount allocated because, in that case, the allocation is not regarded as made pursuant to s. 6(1)(*k*)."

The appellant, by counsel, has submitted a number of reasons why the present plan does not fall under s. 79(1) which can be summarized as follows: (1) the present plan is not an arrangement under which the employer's payments are computed by reference to profits at all, as for the year 1959, which is the sole period under review in the present appeal and during which the employer made no profit, the only matter considered was the employee's contributions and the employer's contribution was solely determined on the basis of 50 per cent thereof and had nothing to do with profit at all. The appellant's argument that the period under review should be so restricted is based on the fact that income tax is a phenomenon of annual incidence and not something that flows on indefinitely and that furthermore there is nothing in the said section which implies that if in one year the section covers a given plan that such

1964

LADE v. MINISTER OF NATIONAL REVENUE

Noel J

a situation will exist forever; (2) the section states that the employer's payments are made and not are to be made. This, counsel for the appellant says, is important because the only payments made in 1959 are under Part A of the plan which, as we have seen, are solely computed by reference to the amount contributed by the employees and are on a monthly basis. The contribution under Part B is not made until after March 31 of the following year, so that even if a Part B contribution had been made in the present case, the plan still would not qualify under s. 79 of the Act because this section requires that the payments be made in the taxation year under review and not in the following year, as required under the plan. (3) Even if we go beyond or outside of the year 1959 and look at the year 1956 for instance, when the employer made a profit and when a contribution under B of $84 was made by the employer, the plan would not qualify either as s. 79(1) requires computation by reference to the employer's profits and not by reference to profits and also to something else so that even if a Part B contribution was made we would still have the employer's contribution based on a compound formula. And finally, (4), s. 79(1) states that the said payments are to be computed by reference to the employer's profits from his business and not the employer's profits as set down in the plan which is not the same thing. Indeed, the plan says the B contribution is to be calculated upon the ratio of its profits to invested capital, and the profits are defined in the plan as being the company's net income after taxes for the preceding calendar year as shown in its annual report to shareholders which comprises profits on sales and interest income and loss on equipment which are items which normally would enter into the determining of the employer's profits but not into the employer's profits from his business, as set out in the statute.

Counsel for the respondent, on the other hand, argues that the definition of s. 79(1) is such that it includes plans which one might not normally describe as profit sharing plans or which would not come within the true meaning of the heading of s. 79 "Employees profit-sharing plan" and that the words "payments computed by reference to profits" have a very extensive meaning; that if profits are a factor or a variable in determining the scheme of the

payments, then it is a profit-sharing plan within the statute; that under the present plan there is merely more than one variable, the two primary requirements being both the amount of contributions made by the employees and the amount of profit earned by the employer, but that if the profits are a variable in determining the amount then it is correct to say that it is computed by reference to profits; that the payments of the employer here are computed by reference to profits because there is a direct relationship between the profits and the amount of the payments the company is required to make.

Those parts of s. 79, the reproduction of which will suffice for the proper determination of the present issue, are set down hereunder:

79 (1) In this Act, an "employees profit sharing plan" means an arrangement under which payments computed by reference to his profits from his business or by reference to his profits from his business and the profits, if any, from the business of a corporation with whom he does not deal at arm's length are made by an employer to a trustee in trust for the benefit of officers or employees of the employer or of a corporation with whom the employer does not deal at arm's length (whether or not payments are also made to the trustee by the officers or employees), and under which the trustee has, since the commencement of the plan or the end of 1949, whichever is the later, each year allocated either contingently or absolutely to individual officers or employees,

(a) all amounts received by him from the employer or from a corporation with whom the employer does not deal at arm's length, and

(b) all profits from the trust property (computed without regard to any capital gain made by the trust or capital loss sustained by it at any time since the end of 1955),

in such manner that the aggregate of all such amounts and such profits minus such portion thereof as has been paid to beneficiaries under the trust is allocated either contingently or absolutely to officers or employees who are beneficiaries thereunder.

* * *

(7) Where the terms of an arrangement under which an employer makes payments to a trustee specifically provide that the payments shall be made "out of profits", such arrangement shall, if the employer has so elected in prescribed manner, be deemed, for the purpose of subsection (1), to be an arrangement for payments "computed by reference to his profits from his business".

Before examining the above section, I might mention that because, as we have seen, it allows a deduction of the employer's contributions, exempts the income from the trust investments, creates a shift in the income tax burden and includes in the employee's income amounts allocated which amounts, however, he has not received and may

1964

LADE
v.
MINISTER OF NATIONAL REVENUE

Noel J

never receive but on which he is called upon to pay taxes, which also is a departure from the general rule that taxation is based on "receivability", it must be strictly construed. Indeed, if a plan does not meet with all the conditions set down in the section, it should not be considered as an "Employees profit-sharing plan" under the Act.

It is with this in mind that I now turn to s. 79 of the Act for the purpose of determining how far if at all the said section or its subsections have deviated from the ordinary meaning of an employees profit-sharing plan which, I believe, is one under which employees are given a share in the profits of their employer if and when such profits are realized.

Such indeed is the type of plan contemplated by the heading of s. 79 "Employees profit-sharing plan" unless, of course, the contents of the section or of its subsections extend or limit such a plan.

The definition contained in s. 79(1) "an arrangement under which payments computed by reference to profits... are made by an employer to a trustee" restricts the above conception by limiting the plan to one only where the payments of the employer are computed by reference to profits and paid into the trust. This limitation is such that it apparently became necessary to insure by s. 79(7) that a plan, which merely says that the employer's contributions will be made "out of profits" be deemed an employees profit sharing plan if the employer so elects in accordance with the regulations, be brought back under the definition as, although such a plan would have qualified under the heading of the section, it would not without s. 79(7) have qualified under the definition. Indeed, had this not been done, such a plan would not have been considered an employees profit-sharing plan under the Act although it would have been one under the ordinary concept of an employees profit-sharing plan. This exclusion by the definition of s-s. (1) of s. 79 of a plan based merely on the employer's contributions being made "out of profits" points out that something else than a mere contribution out of profits is required to qualify a plan under the section.

On the other hand, the parenthesis in s. 79(1) "(whether or not payments are also made to the trustee by the officers or employees)" goes beyond the ordinary concept

of an employees profit-sharing plan, extends the meaning of the heading of the section as well as the definition contained in s. 79(1) by allowing officers and employees to contribute and has the effect of not only confirming that the ordinary meaning of a profit-sharing plan was contemplated by the legislator but also supports the view that if these words had not been mentioned, then a plan where employees contributed would not have been considered as a profit-sharing plan under the Act. It might of course be an investment plan or a stock purchasing plan or even a thrift plan but not a profit-sharing plan where the employer merely shares his profits with his employees.

The definition of a profit-sharing plan under the Act is therefore, except to the extent it is or may be affected by what I have just pointed out above, to be taken to mean what it says which is that a set formula is worked out by reference to the employer's profits whereby a total amount of profits to be distributed to his employees or shared by the employer with them is determined and must be paid to a trustee when there is such a profit.

It may be useful here to reproduce the definition of such a plan under s. 79(1):

> 79 (1) In this Act "an employees profit-sharing plan" means an arrangement under which *payments* computed by reference to his profits from his business . . . are *made* by an employer to a trustee in trust for the benefit of officers or employees . . . (the emphasis is mine).

What indeed appears to be required is a binding obligation by the employer to make payments in accordance with a formula which refers to profits and which must be paid in the event of profits. It is in this sense only, I believe, that it can be "computed by reference to profits" and *paid* as required under the section.

Bearing in mind that we are dealing with an "employees profit-sharing plan" these words cannot mean that profits must be used only as a means of calculating the employer's contributions which is only a mathematical calculation but they must also mean that the amount so calculated or computed must be paid under the plan when the profit is realized which is how the employer shares his profits with his employees.

It therefore follows that "payments computed by reference to profits . . . and made . . . to a trustee" cannot mean a plan such as here where the contributions of the employer

1964

LADE
v.
MINISTER OF
NATIONAL
REVENUE

Noel J.

are predicated upon payments being made by the employees as a prerequisite to the employer contributing a percentage of the contributions of the employees even if such percentage will increase with an increase of the ratio of profits to the capital invested. Employees' contributions, it is true, are permitted under the section but there is nothing which permits them to be made a *"sine qua non"* of the contributions of the employer.

The employer's contributions would be computed by reference to profits in the present plan, I believe, if they were computed by reference to a percentage of the employer's operating profit for instance instead of being a quantum of the employees' contributions and dependent thereon. Although the contribution of the employer, in the present instance, is computed in one sense by reference to profits, there is no predetermined proportion necessarily shared with the employees and paid to them in the event of profits as it is dependent upon the employees' contributions and not upon profits.

The plan involved herein cannot, therefore, in my opinion, be said to be an "employees profit-sharing plan" under the Act.

In view of the above it becomes unnecessary for me to deal with the other matters raised in this appeal except to say that I should not think a plan would fail to qualify under this section merely because the employer made a contribution from funds other than from profits or made a contribution in a year when there was no profit provided that, under the plan, the payments be computed by reference to profits and the proportions so calculated be paid into the trust in the event of profits. I might also add that I would be inclined to give the words in s. 79(1) "profits from his business" a wide interpretation and would go so far as to include therein, at least in the case of a corporation, the latter's net income after taxes.

It therefore follows that the appeal herein from the decision of the Tax Appeal Board and the income tax assessment for the year 1959 must be allowed and that the assessment appealed against be set aside. The appellant will be entitled to his costs to be taxed in the usual way.

Judgment accordingly.