BETWEEN:

DORIS TRUCKING COMPANY LIMITED ..... APPELLANT;

AND

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

Toronto 1968 Mar. 13-14 Ottawa May 15

Income tax—Direction by Minister that two companies be deemed associated—Whether their separate existence for business reasons only—Onus of proof—Income Tax Act, s. 138A(2)(a) and (b).

D, who with her husband was a principal shareholder in a building supply company, sold all of her shares in that company to her husband in 1958 upon the incorporation of appellant company of which she was sole shareholder. Appellant company took over the seven employees and three delivery trucks of the building supply company and thenceforth performed all deliveries for the building supply company. Pursuant to s. 138A(2)(*a*) of the *Income Tax Act* the Minister directed that the two companies should be assessed for 1964 as associated companies on the ground that their separate existence was not solely for the purpose of carrying out their business most effectively. Appellant appealed alleging that it was incorporated (1) to employ the building supply company's staff and thus to free it from the consequences of a strike, and (2) to take title to a parcel of land (bought in 1959) as a site for the two businesses and thus to safeguard the land from the creditors of the building supply company in the event of its insolvency.

Held, dismissing the appeal, on the evidence appellant had not dispelled a doubt, which s. 138A(3)(*b*)(i) required it to do, that none of the main reasons for the separate existence of the two companies was to reduce the amount of tax otherwise payable.

C.I.R. v. Brebner [1967] 1 All E R 779, distinguished.

INCOME TAX APPEAL.

Wolfe D. Goodman and *Arnold L. Cader* for appellant.

M. A. Mogan and *J. R. London* for respondent.

DUMOULIN J.:—This is an appeal from the Minister's decision, dated July 27, 1967, affirming his previous assessment in the sum of $5,876.80 added, for taxation year 1964, to the appellant's reported income. For reasons to follow the amount at issue herein, is $4,117.63.

In appellant's recital of the facts it is said that D. & M. Builders Supply Limited was incorporated under the laws of Ontario, in October 1955, "to carry on business of merchants and dealers in and manufacturers of lumber, wood

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and building products". As could be expected D. & M. Builders Supply Ltd. (hereinafter called "D. & M.") became unionized sometime in June 1958, the Construction Workers' Division of the United Mine Workers obtaining certification as bargaining agent of D. & M's employees, numbering no more than seven.

At this stage the problem looms up and is set forth in paragraphs 3, 4, 5, 6 and 7 of the Notice of Appeal, most of which I think useful to quote *verbatim*.

> 3 The principals of D. & M (no others than Morris Rosenberg and his wife, Doris) were concerned about the problem created by the certification of the union and discussed it with their solicitors and accountants.
>
> 4. On the advice of their solicitors and accountants, the Appellant (Doris Trucking Company, Limited) was incorporated on November 19, 1958. The Appellant then hired the truck drivers (3 in number), warehousemen (3 also), and all other staff (i.e. Mrs. Doris Rosenberg and four office workers) covered by the union's certification with D. & M.

Paragraph 5 notes that collective bargaining between the union aforesaid, as agent of the newly transferred working crew of appellant, and the latter, has gone on since 1959. The evidence at trial and exhibit 7 would, nevertheless, establish the "unionization" of the Doris Trucking personnel as occurring on August 8, 1963.

However that may be, appellant proceeds to explain in paragraphs 6 and 7, respectively, that:

> 6 The incorporation of the Appellant (Doris Trucking Ltd.) and the hiring by it of the employees referred to in paragraph 4 above, allowed D. & M. to be free from union involvement, with the intention that if a strike were called by the union, such a strike would affect only the operations of the Appellant, leaving D. & M. free to hire other truckers and to continue operations uninterrupted by a strike. D. & M., being non-unionized could also continue to deal with unionized customers during a strike against such customers by making deliveries through other truckers, notwithstanding any refusal on the part of the Appellant's employees to deliver merchandise to such customers

Such is the first reason suggested for launching a second and separate company; the other ground for doing so differs entirely; it is alleged that:

> 7. In or about 1959, the Appellant purchased a fourteen acre parcel of land in the township of Trafalgar, on which the Appellant intended to erect a building for both its own use and for lease to D. & M. By reason of the fluctuations in the building supply business, it

was felt necessary to have title to the said property in the Appellant's name to safeguard the said property from the hazards of the building supply business.

To this prudent expectation, the unescapable conclusion must of needs be that expressed by Doris Trucking Co. in section 11, paragraph 1 of its Notice of Appeal:

> 1. The Appellant claims that the separate existence of the Appellant and D. & M. is solely for the purpose of carrying on the business of the two companies in the most effective manner and such separate existence is not to reduce the amount of taxes that would otherwise be payable by them.

At the hearing and in his very lucid written brief (an appreciation equally deserved by appellant's able counsel, for his accurate Summary of Argument), Mr. Mogan, for respondent, foregoing his party's initial direction of an association between D. & M. and Doris Trucking Co., contended that "the onus, by virtue of s.s. (3) of section 138A, is on the appellant to establish that none of the main reasons for the separate existence of the appellant and D. & M. Builders Supply Limited was to reduce the amount of tax otherwise payable under the *Income Tax Act,* R.S.C. 1952, c. 148".

The unsuitability of section 39(4) to the instant matter is accounted for at page 3 of respondent's Notes of Argument, hereunder reproduced:

> From 1958 (when Doris Trucking obtained corporate status) until 1964, if Mr. and Mrs. Rosenberg were to avoid having D. & M. Building Supplies Limited associated with Doris Trucking Company Limited, it was absolutely essential that Doris Rosenberg dispose of her shares in D. & M. This is in fact what she did. She sold all of her shares in D. & M. to her husband Morris Rosenberg, and her husband did not acquire any shares in the new company, Doris Trucking. It is clear that D. & M. and Doris Trucking have never been associated within the meaning of Section 39(4) of the *Income Tax Act*

The ensuing lines come close enough to the gist of the problem: the nature of the pertinent evidence, *pro* or *con,* to be adduced; I quote:

> Although we admit (writes respondent's counsel) that Section 39(4) is not applicable so as to make D. & M. and Doris Trucking associated, *the deliberate conduct of Mr. & Mrs. Rosenberg in arranging their share ownership in the two companies so as to keep them from being associated is relevant in determining the reasons for the separate existence of Doris Trucking in 1964.*

(Emphasis not in text.)

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For greater clarity, may I be permitted to repeat, in respondent's words, the basic elements of this appeal. (*cf.* Notes of Argument, at pages 4, 5 & 6): Mr. Mogan writes that:

> The Appellant has advanced two principal reasons for the separate existence of Doris Trucking in 1964, and those reasons are as follows:
>
> (1) The drivers and yardmen of D. & M. were forming a union and it was the desire of Mr. and Mrs. Rosenberg to keep D. & M. free from union involvement. Mrs. Rosenberg stated (in her evidence at the trial) that if a union was organized for another company (i.e. Doris Trucking Co.) 'working for us', and if the union went on strike, D. & M. could get other trucks, drivers and yardmen and could continue to operate;
>
> (2) It was decided to acquire a 14-acre parcel of land in Trafalgar Township in 1959, and it was considered desirable to have some person other than D. & M. hold the land Mrs. Rosenberg stated that there was a certain amount of risk in the business carried on by D. & M., and that she and her husband wanted to keep this land free from any potential action by creditors in the event that D. & M. came into financial difficulty.

An apprehension of this kind on the part of a small business set-up, transacting, nonetheless, a disproportionately large volume of affairs, surely does not seem exaggerated. Similar protective steps are resorted to so frequently, apart from any ethical considerations, that such "hedging" practices cannot escape judicial notice. This commercial foresight is plainly outlined at pages 5 and 6 of the appellant's Summary of Argument; quote:

> (a) D. & M. carried on a substantial volume of sales of plywood etc., over $1,000,000 a year, on a very small working capital. It sold to builders and others in the construction business and its accounts receivable were large and frequently overdue. Its risk of large credit losses was great and the failure of even one or two large customers could have resulted in disaster.
>
> (b) Accordingly, it made the best possible sense for the real estate which was bought in 1959 to be purchased in a corporation other than D. & M. Building Supplies, in order to protect it from any hazards of the D. and M. business and ensure that if the Rosenberg family lost their money in the D. & M. business they would still have this property.

Good and true, doubtless, if the one and only permissive condition stipulated by statute is not defeated by counter-evidence, in which case, two or more corporations, though not associated according to section 39(4)(*c*), "shall, if the Minister so directs, be deemed to be associated with each

other in the year" conformably to section 138A, s.s. (2) (*b*) and s.s. (3)(*b*)(ii). The distinctive legal or corporate identity of those two or more companies persists only if and when none of the main reasons for their separate existence "is to reduce the amount of tax that would otherwise be payable under this *Act*". A pure and simple question of facts, to be determined in the light of the evidence adduced. I agree with appellant's learned counsel, as stated on page 5 of his Summary of Argument, that "the proper test is...if one supposed that all corporations were subject to tax at a flat rate of 50%, as has been recommended by the Royal Commission on taxation, would it be expected that these particular operations would have been carried on by separate corporations".

Mrs. Doris Rosenberg, the only witness heard by the appellant, was examined and cross-examined at great length.

I now refer to my notes, on the topic of the organization and dealings of Doris Trucking Company, Limited, since the other salient parts of Mrs. Rosenberg's deposition are fairly reported in the excerpts cited from the memorandums of both parties.

"Until 1958, Mrs. Rosenberg owned shares in the joint concern, D. & M., which she sold to her husband at a stipulated price of $12,500, upon the incorporation of Doris Trucking Co. Ltd., November 19, 1958. Shortly afterwards, December 1st, 1958, the recently incorporated company took over the working crew, formerly in the employ of D. & M., and also its three delivery trucks that were paid for later by Doris Rosenberg. This state of affairs meant that D. & M. carried on its trade solely through the instrumentality of Doris Trucking Co., which, in turn, was unionized in August, 1963. Each company had its own bank account".

We now reach a more informative and significant phase of evidence. "Despite her ownership of Doris Trucking, of which she was President and sole shareholder, Mrs. Rosenberg continued working, five days a week, in the credit department of D. & M.; Doris Trucking Company is not listed in the Toronto telephone book; D. & M. Supplies being the registered party, at civic number 229 Wallace Avenue, a building owned by Mrs. Rosenberg who charges

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no rental whatsoever to D. & M. Nowhere does the name of Doris Trucking Co. appear at 229 Wallace Avenue, nor does it affix any commercial advertisement and has no business stationery. On the three trucks only, says the witness, a marking reads 'owned and operated by Doris Trucking Co. Ltd.'. From December 1st, 1958, repeats Mrs. Rosenberg, Doris Trucking has attended to all business requirements of D. & M. to which regular charges are made for trucking, deliveries and other services rendered by the appellant". She adds that corresponding payments were made by D. & M. to Doris Trucking. Mrs. Rosenberg Draws no pay from her own company but receives a considerable remuneration from D. & M. In 1964 the salary and bonus paid to her by D. & M. amounted to $16,330 (*cf* Ex. 1, Tab. 1, page 5). She agrees that the prospect of lesser income tax dues was casually referred to in the course of consultations with the companies' accountant.

Let us now inquire into the admissible plausibility of the known reasons invoked by appellant in vindication of its submission that "none of the main reasons for the separate existence of the two...companies is to reduce the amount of tax that would otherwise be payable under this *Act*".

And let us also keep in mind as a guide-line that the onus of proof resting upon the appellant, should any substantial doubt arise regarding the adequacy of such proof, its benefit must necessarily accrue to the taxing authority.

The respondent's reply to appellant's first allegation, in keeping with the proven facts, disposes of the rather shallow ground of eventual labour troubles. I now quote from pages 5 and 6 of Mr. Mogan's Notes of Argument:

> It was brought out in evidence that the premises at 229 Wallace Avenue had only three entrances which could be used by trucks and which might be sealed off by picketing in order to prevent strike-breaking drivers from using the vehicles owned by the employer (Doris Trucking) to make deliveries for D. & M.
>
> There was no other business premises used by Doris Trucking and we can only assume that the head office of Doris Trucking was integrated with the office of D. & M. at 229 Wallace Avenue. On the evidence we have no reason to believe and there is no assurance that D. & M. could go into the labour market and hire "strike-breaking" drivers and yardmen in the event of a strike against Doris Trucking, when it would be so obvious—particularly to the striking employees of Doris Trucking—that the two companies are closely related and do in fact work together.

> ...On the evidence, the most logical inference to draw is that a strike by the employees of Doris Trucking would in fact close down the business of D. & M....

It seems hard to disagree with this reasoning, especially so in connection with people, such as appellant's President, so acutely awake to the thoroughness of labour practices in the highly unionized region of Metropolitan Toronto. Yet, I will go so far as to concede that this dubious and surprisingly ingenuous scheme may have been one of the reasons "for the separate existence" of the companies, but not to the exclusion of others, as for instance, the second one (*supra*) advanced by Doris Trucking and commented upon at pages 7 and 8 of respondent's Notes of Argument in these lines:

> To summarize Mrs. Rosenberg says that the land (i.e. the $23,500 real estate purchase in Trafalgar Township) was put into Doris Trucking to keep it free from any potential action of the creditors of D. & M. And yet, at the commencement of 1964, the year under appeal, Doris Trucking had an unsecured loan receivable from D. & M in the amount of $30,000; and during 1964, Doris Trucking loaned to D. & M. an additional $2,000 so that at the end of 1964, Doris Trucking had a loan receivable from D. & M. in the amount of $32,000.

Respondent's counsel next infers that:

> When faced with these facts, I suggest that the alleged second reason for the existence of Doris Trucking in 1964, (that is to hold the land free and secure from D. & M.) is not a reason which this Court should accept because the same person, Doris Trucking, who is supposedly holding the land secure from the creditors of D. & M., has loaned to D. & M. throughout that year the amount of $30,000; a loan which is greater than the value of the land.

Another questionable factor raises doubt as to this assertion of appellant. The evidence reveals that Doris Trucking's entire business activities were concentrated upon D. & M., its only client, from which it consequently derived its one regular source of income, i.e. the wages paid to the drivers and yardmen it kept at D. & M.'s constant disposal, plus the cost of the three trucks engaged in the trade deliveries of this latter firm. Still, it is strange and unexplained, as revealed by Exhibit 1 (Tab. 1, page 6) and discussed at pages 9 and 10 of respondent's notes that:

> (4) The amounts paid by D. & M. to Doris Trucking exceeded the wages that were payable to the drivers and yardmen and the cost of operating the trucks. We know this to be true because the rental of

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trucks, drivers and yardmen to D. & M. was the only business carried on by Doris Trucking and Exhibit 2 demonstrates that throughout the period of 1959 to 1965, Doris Trucking earned the following profits:

YEAR	PROFIT
1959	$12,227 40
1960	10,033 30
1961	17,572 82
1962	12,658 16
1963	16,456 63
1964	14,198 72

> We can therefore see, continues Mr. Mogan, that D. & M. (by paying amounts to Doris Trucking which exceed the wages of drivers and yardmen, and the costs of operating the trucks) has had greater amounts to deduct in computing its income since 1958 with respect to its delivery service than it would have had if Doris Trucking had not been incorporated. These greater amounts paid by D. & M. to Doris Trucking, have the effect of reducing the (taxable) profit of D. & M. while at the same time accumulating a separate profit in Doris Trucking.

Since 1960, the rate of tax payable by a corporation is established thus by section 39(1) of the Act:

> 18% on the first $35,000 00 of revenue and 47% on all profits exceeding $35,000.00.

Therefore, the advantage of separate companies operated, either by the same family or by closely related interests, becomes readily perceivable. If not associated a group of companies can each pay income tax at the rate of 18% on the first profit amount of $35,000 respectively earned. Whereas, if associated, then, the rate of taxation at 18% applies only to the initial $35,000 of their joint income.

In the case at bar, the first eventuality just stated would mean for the appellant an income tax reduction of $4,117.63.

If Doris Trucking, *alias* Mrs. Rosenberg feared, as she told the Court, the several commercial risks incurred by her husband's company, to the point that she resolved to sever any responsibility with D. & M. Builders' Supplies, and seek legal refuge in her own separate firm, she managed, with remarkable celerity, to keep such anxiety under firm control, as shown by her acceptance of an enduring and unsecured loan to D. & M., the "danger spot", of $32,000 still outstanding in 1964.

That does not mean that I brush aside Mrs. Rosenberg's assertion, notwithstanding its limping logic. It stands to reason that in the event (quite an improbable one) of D. & M.'s insolvency, she should endeavour to save the most she could, but this natural impulse was coupled with risking a good deal of cash. But is it then improbable that the combined business acumen of Mrs. Rosenberg and her employer-husband might not have insinuated some gradual set-off, a yearly amortization of the unsecured loans from appellant to D. & M., by the tax reducing means of separate companies I suppose no blame attaches to even a perfervid zeal for thrift, and Doris Trucking took advantage at full stretch of this prevalent striving. On page 3 of J. F. Spencer's report, dated April 17, 1966 (Ex. 1, Tab. 1), filed with the consent of both parties, we read that:

> Doris (Trucking Company) charges D. & M. at the following rates:
>
> | | DRIVER (Including the truck) | YARDMEN |
> |---|---|---|
> | 1958 | $3.50 per hour | $1.75 per hour |
> | June 1960-July 1962 | 3.75 " " | 1.85 " " |
> | Aug. 1962 | 3.80 " " | 1 90 " " |
> | Sept. 1962-Dec. 1964 | 3.85 " " | 1 95 " " |
> | Jan. 1965 | 3.95 " " | 2 05 " " |

"These rates," states Mr. Spencer in his report, "are below a fair market value. This was verbally admitted by L. Kirshenbaum, auditor"; presumably the Rosenberg's auditor.

Assuredly, the Rosenberg couple kept a wary eye on every source or streamlet of gain, to such a degree that a saving of $4,117.63, in 1964, may not have escaped the statute's truly tentacular reach in being "one of the main reasons" for the separate existence of each company.

Appellant's counsel, Mr. Goodman, made reference to a recent decision of the House of Lords under the United Kingdom income tax law, *in re Commissioners of Inland Revenue v. Brebner*[1], the facts of which are summarized on pages 9 and 10 of his Summary of Argument from which I quote:

> ...The taxpayer (Brebner) engaged in a number of transactions with a company in which he was interested as a shareholder and a

[1] [1967] 1 All E R 779, at pages 781, 783, 784.

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director, and the purpose of the transactions was to defeat a take-over bid. One of the transactions was the capitalization of some of the reserves and the application of the resulting sum in paying up ordinary shares which were allotted to the shareholders among whom was the taxpayer.

The Inland Revenue served on the taxpayer a counteracting notice under Section 28 of the Finance Act 1960, contending that that particular transaction had as its main object or one of its main objects to enable the shareholders to obtain a tax advantage. It was contended for the taxpayer that the only purpose of the transaction was to defeat a take-over bid. The Special Commissioners decided in favour of the taxpayer and the House of Lords confirmed their finding.

There are, I believe, important dissimilarities with the circumstances leading up to the cited case and the instant one.

The corroboration sought by the appellant is, supposedly derived from the speeches of Lord Pearce and Lord Upjohn, the former writing at page 781 of the report that:

> The subsection (28) would be robbed of all practical meaning if one had to isolate one part of the carrying out of the arrangement, namely the actual resolutions which resulted in the tax advantage, and divorce it from the object of the whole arrangement. The method of carrying it out was intended as one part of a whole which was dominated by other considerations.

Then, by Lord Upjohn at page 784:

> I agree that the question whether one of the main objects is to obtain a tax advantage is subjective and, as Lord Greene, M.R., pointed out in Crown Bedding Co., Ltd. v. Inland Revenue Comrs. (1 All E.R. 452 at pp. 453, 454) is essentially a task for the Special Commissioners unless the relevant Act has made it objective (and that is not suggested here).

The eminent jurist concludes his pronouncement in the undergoing terms:

> My Lords, I would conclude my judgment by saying only that, where the question of carrying out a genuine commercial transaction, as this was, is considered, the fact that there are two ways of carrying it out—one by paying the maximum amount of tax—the other by paying no, or much less, tax—it would be quite wrong as a *necessary* consequence (emphasis in text) to draw the inference that in adopting the latter course one of the main objects is for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out commercial transactions except on the footing of paying the smallest amount of tax involved. The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide on a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.

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Of course I am in respectful agreement with all that precedes; namely that similar issues are a pure question of fact; that no one can be expected to commit fiscal "*hara-kiri*", and, lastly, the truism that the case must be dealt with in a subjective light. Yet, this subjective approach remains within the scope of judicial scrutiny.

Should the evidence fail to dispel the doubt, and so it does in my humble opinion, that "none of the main reasons for the separate existence of the two pertinent corporations is to reduce the amount of tax that would otherwise be payable under this Act", the appellant cannot succeed.

This appeal is therefore dismissed with all taxable costs recoverable by the respondent.