Montreal 1967 Feb. 14-15 — Ottawa April 7

BETWEEN:

THE MINISTER OF NATIONAL REVENUE .... APPELLANT;

AND

DIDACE DUFRESNE ....RESPONDENT.

Income tax—Benefit conferred—Income Tax Act, s. 137(2)—Stock rights —Increased equity of minority shareholders—Whether conferred by majority shareholder—Onus of proof—Rebutting assumptions on which assessment based—Gift tax.

D held 164 of the 180 issued $100 par value common shares of a company, his wife held one share, and each of his five children three shares, the seven shareholders being the company's directors. On December 31st 1960 the five children exercised a right conferred by directors' resolution of that day to purchase at par five new shares for each share held. On December 21st 1961 the five children exercised a right conferred by directors' resolution of that day to purchase at par three new shares for each share held. As a result of these purchases the book value of the children's shares increased in December 1960 by $76,515 and in December 1961 by $104,400. The Minister in reliance on s. 137(2) of the *Income Tax Act* assessed D for gift tax on the increases in book value of the children's shares borne by D's shareholding, *viz* $68,596.73 in 1960 and $76,930.91 in 1961.

Held, affirming the assessments, the requirements of s. 137(2) had been satisfied, *viz* (1) the increase in the children's proportionate share of the company's stock was the result of at least one transaction, *viz* the subscription contract; (2) although D was only one of seven directors the balance of probability was that he exercised a controlling influence and that if a benefit was conferred on his children it was he who conferred it; (3) the assumptions on which the assessments were based, *viz* that D conferred a benefit on his children in the amounts assessed had not been rebutted and therefore stood. *Johnston v. M.N.R.* [1948] S.C.R. 486 applied.

Held also, the gift tax assessments were not invalidated by s. 8(1)(iii) of the *Income Tax Act.*

APPEAL from Tax Appeal Board.

A. Garon and *P. H. Guilbault* for appellant.

H. P. Lemay, Q.C. and *J. M. Poulin* for respondent.

JACKETT P.:—This is an appeal by the Minister of National Revenue from a decision of the Tax Appeal Board dated October 22, 1965 allowing the appeals of the respondent Didace Dufresne from re-assessments made on May 31, 1963, whereby the respondent was assessed additional amounts for gift tax under Part IV of the *Income Tax Act,* R.S.C. 1952, chapter 148, as amended, for the taxation years 1960 and 1961.

By virtue of subsection (1) of section 111 of the *Income Tax Act,* a tax is payable upon the gifts made in a taxation year by an individual resident in Canada. (An extended meaning is given, for this purpose, to the word "gift" by subsection (2) of section 111, but it has not been suggested that that subsection has any application to the determination of the question raised by this appeal.) The tax on gifts imposed by section 111 is, by virtue of section 114, payable by the donor.

The question raised by the appeal relates to the acquisition, on two separate occasions, by each of the respondent's five children of shares in a company in which the respondent was the controlling shareholder in circumstances which resulted in the children having an interest in the capital stock of the company, relative to that of the respondent, that was greater than the interest that they had, relative to his, prior to such acquisition. The Minister does not contend that the respondent thereby made gifts to the children within the meaning of that word as defined in Part IV of the Act. What he does say is that the facts are such as to bring into play subsection (2) of section 137 of the *Income Tax Act,* which reads as follows:

(2) Where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatsoever is that a person confers a benefit on a taxpayer, that person shall be deemed to have made a payment to the taxpayer equal to the amount of the benefit conferred notwithstanding the form or legal effect of the transactions or that one or

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more other persons were also parties thereto; and, whether or not there was an intention to avoid or evade taxes under this Act, the payment shall, depending upon the circumstances, be

(a) included in computing the taxpayer's income for the purpose of Part I,

(b) deemed to be a payment to a non-resident person to which Part III applies, or

(c) deemed to be a disposition by way of gift to which Part IV applies.

To reach a conclusion as to the correctness of this contention, it is necessary to review the facts in some detail.

The company in question is a company incorporated under the laws of the Province of Quebec and is known as Dufresne et Frères Ltée. (It is hereinafter referred to as "the company".)

At the end of the company's 1959 taxation year, being the end of the 1959 calendar year, the company had an issued share capital of $18,000 represented by 180 common shares of a par value of $100 each. As of the end of the same year, the company had undistributed income on hand, within the meaning of that expression as defined by section 82(1)(*a*) of the *Income Tax Act,* in an amount of $224,-322.57. (It should be noted that this amount does not necessarily bear any relation to the then current value of the assets of the company or to the then value of the company's issued capital stock.) The respondent owned most of the issued shares at that time.

On December 24, 1960, the respondent made a gift of two common shares in the company to each of four of his children and of one such share to his fifth child. On the same day, he made a gift of $750 to each of his five children. (In his gift tax return for the 1960 taxation year, the respondent reported such gifts and put a value on each of such shares as of December 24, 1960, of $1,421.47.)

On December 30, 1960, the authorized capital of the company was increased, by means of supplementary letters patent, from $20,000 to $300,000 divided as follows:

(a) 1,180 common shares of a par value of $100 each,

(b) 1,800 preferred shares, Class "A", with no voting rights of a par value of $100, and

(c) 2,000 preferred shares, Class "B", with a right to one vote for each share at shareholders' meetings at a par value of $1.

Immediately before a meeting of the Board of Directors of the company held on December 31, 1960, the issued common shares of the company were held as follows:

the respondent	164
his wife	1
his five children, 3 shares each	15
	180

These shares at that time had a book value of $1,421 each. The fifteen shares held by the children at that time had therefore a book value of $21,315, and those of the respondent had a book value of $243,044.

On December 31, 1960, at a meeting of the Board of Directors of the company at which the respondent, as president, presided, and which was attended by the respondent's wife and his five children, who were all shareholders and directors, a resolution was unanimously adopted conferring on each of the shareholders a right to subscribe to five new common shares of a par value of $100 per share for each share then held by him.

After that resolution was adopted, the meeting was adjourned for a few minutes to permit the shareholders to exercise the options that it conferred on them. Upon the meeting being resumed, the respondent reported that he and his wife were not exercising their options and were not subscribing to new shares, but that the five children were all exercising their options and each of them was subscribing for 15 common shares. The transactions were completed forthwith. Each of the children paid $1,500 to the company and 15 common shares were issued by the company to each of them.

After such shares were issued, the common shares in the company were held as follows:

the respondent	164
his wife	1
his five children—18 shares each	90
	255

The book value of the common shares of the company after the additional shares were so issued was $1,087 per share. At that time, therefore, the book value of the 90

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shares held by the children was $97,830, and the book value of the 164 shares held by the respondent had fallen to $178,268.

Immediately before December 21, 1961, the book value of the common shares in the company was $1,000 per share so that the 90 shares of the children then had a book value of $90,000 and the respondent's shares then had a book value of $164,000.

On December 21, 1961, a right to subscribe for three common shares at par for each share held was conferred on each shareholder in the company by a resolution along the lines of that which had been passed on December 31, 1960. Again, the children exercised the rights so conferred and the respondent and his wife did not; the result was that each child acquired an additional 54 common shares and paid $5,400 for them.

On that same day, the respondent subscribed for 2,000 Class B preferred shares and paid $2,000 for them; and they were issued to him.

The shareholding in the company after December 21, 1961 was as follows:

the respondent	164 common
	2,000 "B" preferred
his wife	1 common
his five children—	
72 shares each	360 common

The common shares then had a book value of $540 per share so that the children's shares had a book value of $199,400, and the book value of the respondent's common shares had fallen from $164,000 to $78,560.

The relevant part of section 137 of the *Income Tax Act* reads as follows:

(2) Where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatsoever is that a person confers a benefit on a taxpayer, that person shall be deemed to have made a payment to the taxpayer equal to the amount of the benefit conferred notwithstanding the form or legal effect of the transactions or that one or more other persons were also parties thereto; and, whether or not there was an intention to avoid or evade taxes under this Act, the payment shall, depending upon the circumstances be

(*a*) included in computing the taxpayer's income for the purpose of Part I,

(b) deemed to be a payment to a non-resident person to which Part III applies, or

(c) deemed to be a disposition by way of gift to which Part IV applies.

(3) Where it is established that a sale, exchange or other transaction was entered into by persons dealing at arm's length, *bona fide* and not pursuant to, or as part of, any other transaction and not to effect payment, in whole or in part, of an existing or future obligation, no party thereto shall be regarded, for the purpose of this section, as having conferred a benefit on a party with whom he was so dealing.

The basis upon which the appellant supports the assessments in this Court is set out in the part of the Notice of Appeal that reads as follows:

3 L'appelant en établissant ses cotisations du 31 mai 1963 pour les années 1960 et 1961 s'est appuyé sur le fait que les opérations décrites dans le paragraphe 4 de cet Avis d'appel ont eu pour résultat que l'intimé a conféré au sens de l'article 137(2) de la *Loi de l'impôt sur le revenu* un avantage pour l'année 1960 de $68,596.73 et de $76,930.91 pour l'année 1961 à ses enfants, Yves Dufresne, Maurice Dufresne, Dame Louise D. René de Cotret, Dame Kate D. Chenevert de Dame Denise Leclerc.

4. En établissant ses cotisations du 31 mai 1963 pour les années 1960 et 1961 et en déterminant qu'un avantage a été conféré aux enfants susdits par l'intimé au sens de l'article 137(2) de la *Loi de l'impôt sur le revenu*, l'appelant s'est appuyé sur les faits et les opérations qui suivent:

(i) Pendant les années 1960 et 1961, l'intimé contrôlait effectivement Dufresne et Frères Limitée;

(ii) Les 31 décembre 1960 et 21 décembre 1961, la compagnie Dufresne Limitée conférait à tous les détenteurs d'actions ordinaires du capital de la corporation le droit d'y acheter des actions ordinaires additionnelles à leur valeur au pair de $100 chacune;

(iii) Les détenteurs d'actions ordinaires du capital de la corporation au moment où ce droit d'acheter des actions ordinaires additionnelles à leur valeur au pair de $100 chacune fut conféré, étaient l'intimé, Dame Didace Dufresne, épouse de l'intimé, et les enfants de l'intimé susdits.

(iv) L'intimé et son épouse ont pris la décision de ne pas se prévaloir du droit d'acquérir des actions ordinaires additionnelles à leur valeur au pair de $100 chacune.

(v) Les enfants susdits se sont seuls prévalus du droit d'acheter des actions ordinaires additionnelles à leur valeur au pair de $100 chacune, ont souscrit ces actions additionnelles et les ont payées.

B. DISPOSITIONS STATUTAIRES ET LES RAISONS QUE L'APPELANT A L'INTENTION D'INVOQUER À L'APPUI DE SON APPEL

5. L'appelant s'appuie entre autres sur l'article 137(2) de la *Loi de l'impôt sur le revenu*, S.R.C. 1952, Chapitre 148.

6. L'appelant soumet que la participation de l'intimé à la décision de la compagnie Dufresne et Frères Limitée d'accorder aux détenteurs d'actions ordinaires du capital de cette corporation le droit d'acheter des actions

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ordinaires additionnelles à leur valeur au pair de $100 chacune, la décision de l'intimé de ne pas se prévaloir lui-même de ce droit d'acquérir des actions ordinaires additionnelles et l'achat par les enfants susdits de l'intimé d'acquérir des actions ordinaires additionnelles à leur valeur au pair de $100 chacune constituent des opérations qui ont eu pour résultat que l'intimé a conféré un avantage à ses enfants susdits au sens de l'article 137(2) de la *Loi de l'impôt sur le revenu.*

The explanation of how the appellant computed the amount of the benefit (avantage) for each of the years in question (paragraph 3 of the Notice of Appeal) is to be found in the explanatory memorandum attached to the re-assessment appealed from, which reads in part:

M. Didace Dufresne

Calcul des bénéfices conférés à ses enfants lors de deux émissions d'actions de

«DUFRESNE ET FRÈRES LTÉE»

Émission de 75 actions ordinaires le 31 décembre 1960:

Valeur des actions des enfants après l'émission: 90 actions à $1,087 00	$ 97,830 00
Valeur des actions des enfants avant l'émission: 15 actions à $1,421 00	21,315 00
Valeur transférée	76,515 00
Prix payé—75 actions à $100 00	7,500.00
Élément de don	$ 69,015 00
Bénéfice conféré par Didace Dufresne: $69,015 00 × 164/165	$ 68,596 73

Émission de 270 actions ordinaires le 21 décembre 1961:

Valeur des actions des enfants après l'émission: 360 actions à $540 00	$194,400 00
Valeur des actions des enfants avant l'émission: 90 actions à $1,000 00	90,000 00
Valeur transférée	104,400 00
Prix payé—270 actions à $100 00	27,000 00
Élément de don	$ 77,400.00
Bénéfice conféré par Didace Dufresne: $77,400.00 × 164/165	$ 76,930 91

By his Reply to the Notice of Appeal, the respondent put the above portions of the Notice of Appeal in issue and, in effect, pleaded that what had been done was that the company had conferred a benefit on its shareholders that was exempt from income tax by section 8(1)(*c*)(iii) of the *Income Tax Act*. The Reply expressly pleaded that the respondent did not confer any advantage on his co-shareholders (co-actionnaires).

At the hearing, the parties filed an "Admission de Faits", the effect of which I have already stated, to the extent that I regard it as relevant, in my recital of the facts. In addition, by agreement, the evidence given before the Tax Appeal Board was introduced as evidence in this Court and one of the sons of the respondent, who gave evidence before the Board, was produced by the respondent for cross-examination, and was cross-examined by counsel for the appellant.

I reject the submission by the respondent that section 8 of the *Income Tax Act* operates to invalidate the gift tax assessments that are under appeal. Section 8(1) reads as follows:

> 8. (1) Where, in a taxation year,
> (*a*) a payment has been made by a corporation to a shareholder otherwise than pursuant to a bona fide business transaction,
> (*b*) funds or property of a corporation have been appropriated in any manner whatsoever to, or for the benefit of, a shareholder, or
> (*c*) a benefit or advantage has been conferred on a shareholder by a corporation,
>
> otherwise than
> (i) on the reduction of capital, the redemption of shares or the winding-up, discontinuance or reorganization of its business,
> (ii) by payment of a stock dividend, or
> (iii) by conferring on all holders of common shares in the capital of the corporation a right to buy additional common shares therein,
>
> the amount or value thereof shall be included in computing the income of the shareholder for the year.

If it were not for the presence in this subsection of paragraph (iii) thereof, the subsection would have made all the shareholders of the company in this case liable to include in their incomes for 1960 and 1961, respectively, for income tax purposes, the amounts of the respective benefits, if any, conferred on them by the company in 1960 and 1961 by granting to them "rights" to acquire shares at par. Paragraph (iii) exempts them from the liability that would

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otherwise have been so imposed on them. It does not have any other effect and, in particular, it does not have effect to exempt the respondent from any liability that may be imposed on him, by Part IV of the *Income Tax Act* read with section 137, to pay gift tax, even though such liability arises from a series of transactions or other events of which the company's granting of "rights" to its shareholders is one.[1]

In my view, the appeal has to be decided by answering the question whether it has been established that the "result" of one or more "transactions" is that the respondent, in one or both of the years in question, conferred a "benefit" on each of his children within the meaning of those words in section 137(2). If he did, he is deemed to have made a payment to each of the children equal to the amount of the benefit, and that payment, in the circumstances of this case, is deemed to be a "disposition by way of gift to which Part IV applies".

If the "result" of the transaction or transactions was that the respondent so conferred a "benefit", it follows from the express words of section 137(2)

(a) that it does not matter what form the "transactions" took or what the legal effect of the transactions was, and

(b) that there does not have to have been an intention to avoid or evade taxes.

Furthermore, it does not matter whether persons other than the respondent and his children were parties to the transactions. It is not surprising that Parliament inserted this latter clause because, in the nature of things, it is to be anticipated that, where a person makes arrangements to confer a benefit on another by a series of transactions, it will frequently be so arranged that the person granting the benefit will be a party to the first transaction and the person benefited will be a party to the last transaction, but

[1] In any event, it should be noted that the benefit in question here was not conferred on the children by the "conferring" on all the shareholders in the company of the "right" to acquire additional shares at par. It was the subsequent exercise of this "right" by the children together with the decision of the parents not to exercise the "right" which resulted in the benefit having been conferred.

third parties will be the other parties to those transactions and possibly to intervening transactions.

If subsection (2) of section 137 stood by itself, I should have been inclined to read into it an implied exception in favour of *bona fide* business transactions. As, however, subsection (3) of section 137, in effect, excepts from the operation of subsection (2) *bona fide* arm's length transactions subject to appropriate qualifications, I am of opinion that Parliament meant subsection (2) to be read without any implied exception.

In my view, therefore, the question in this case resolves itself into the following questions:

(a) Was a benefit conferred on each of the children in each of the two years?

(b) If so, was the benefit conferred by the respondent?

(c) If a benefit was so conferred, was the benefit the "result" of one or more "transactions"?

If the answer to all these questions is in the affirmative, it has not been suggested that there is any room for the application of subsection (3) of section 137 in this case.

I propose to consider the three questions in the reverse order from that in which I have set them out above.

It will be sufficient to consider the matter in relation to what happened in 1960. On the facts, as established, whatever result is reached for that year must be reached for 1961. It will also be more convenient to discuss the children as a group although, of course, each one engaged in the matter separately.

In 1960, the children acquired 75 shares in the company at a cost of $7,500 in circumstances such that, as a result of the acquisition, they became, after the acquisition, owners of 6/17 (90/255) of the stock in the company instead of the 1/12 (15/180) of the stock in the company that they held before such acquisition. Certainly, this "*result*" flowed from at least one transaction—that is the subscription contract—in the very special circumstances in which it was made possible for each child to enter into his or her subscription contract with the company. That being so, I do not have to decide whether the other acts that took place as a necessary part of the action required to create those

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special circumstances were "transactions" (English version) or "opérations" (French version) within the meaning of the statute. In my view they were, because, in my view, the word "transaction" or "opération" is used in the widest possible sense as meaning any act having operative effect in relation to a business or property.[1] However, I do not need to reach a concluded opinion on that question to conclude, as I do, that the "result" I have described was the result of a "transaction".

The second question is whether, if that result—acquisition at a cost of $7,500 of a holding of 6/17 of the stock of the company in place of the 1/12 previously held—was a "benefit" to the children, was that benefit conferred on them by the respondent?

That question cannot, in my view, be realistically answered by an analysis of each of the respective steps taken without taking account of the ordinary well known facts of life in the world of affairs. The resolution granting the "rights" was, it is true, passed by the Board of Directors; and the respondent was only one director and had in the proceedings of the Board only one vote. There is nothing, moreover, to show that the wife and children did not each act independently in deciding their respective courses of action in the whole series of events. Nevertheless, in the absence of any evidence by the respondent or on his behalf to show what in fact happened, I am of the view that the balance of probability is that he, as the owner of practically all the shares in the company and the head of the family, had the controlling influence in the determination of the course of events with which we are concerned. The sequence of events bears all the earmarks of a series of company transactions that had been arranged in advance by the major shareholder and father, after taking appropriate professional advice, with a view to achieving the result of increasing the children's proportions in the ownership of the stock of the company. That that is what in fact happened is corroborated by the evidence given before the Tax

[1] Compare *Minister of National Revenue v. Granite Bay Timber Company Limited,* [1958] Ex. C.R. 179, per Thurlow J. at pages 187 to 191, and the authorities reviewed by him.

Appeal Board. There was very little, if any, consultation in advance between the children and the respondent, who, in effect, presented them with what he had arranged for their benefit and assumed that they would accept it, which they did. Moreover, the benefit, if it was one, was an increase in the proportions of the children almost entirely at the expense of a decrease in the respondent's.

There is no doubt in my mind that, if the result of the transaction was a benefit to the children, it was conferred on them by the respondent.

This brings me to the question whether it has been established that the result of the transaction was, in fact, a benefit to the children.

In considering this question, it becomes important to examine the issues on which the parties went to trial as determined by the Notice of Appeal and the Reply thereto.

By paragraph 3 of the Notice of Appeal, the appellant said that he based the assessment for 1960 on the fact (le fait) that the transactions (les opérations) described in paragraph 4 of the Notice of Appeal, had as a result that the respondent conferred (in the sense of section 137(2)) a benefit for the year 1960 of $68,596.73 on the children. (As already noted, that "benefit" is calculated as though book values of the company's assets were actual values.) In paragraph 4 of the Notice of Appeal, there is outlined the facts and transactions (les faits et les opérations) already referred to, but there is no express allegation or indication that the appellant assumed, in making the assessment, that the shares had an actual value in excess of the $7,500 paid for them.

The position taken by the appellant by this pleading was nevertheless quite clearly to the effect that the appellant had based his assessment on the assumption ("L'appelant . . . s'est appuyé sur le fait") that arranging or permitting that the children acquire a larger proportion of the stock of the company by acquiring shares at par was, in itself, conferring a benefit on them, and that the amount of that benefit was $68,596.73.

By paragraph 2 of the Reply to the Notice of Appeal, the respondent denied, *inter alia*, paragraphs 3 and 4 of the

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Notice of Appeal. He did not otherwise plead with reference to the appellant's allegation that the appellant had based the assessment upon the facts and transactions outlined in those paragraphs or with reference to the facts and transactions there outlined.

In my view, the onus was on the respondent to plead and prove either

(a) that the assessment was not based on an assumption that the result of the transactions set out in paragraph 4 of the Notice of Appeal was that the respondent conferred a benefit of $66,596.73 on the children; or

(b) that it was not, in fact, a result of such transactions that the respondent conferred a benefit in that amount on the children.

In my view, this is the result of the state of the law concerning the onus on an appellant from an income tax assessment as established by *Johnston v. Minister of National Revenue*[1]. While that decision related to proceedings under the *Income War Tax Act,* I can see no relevant difference between the procedure provided by that Act and the procedure provided by the *Income Tax Act.*

These being the two ways in which the respondent could have met the appellant's position on this point, it remains to consider what he actually did.

With reference to the first alternative open to him, the respondent did, by his pleading, deny paragraph 3 of the Notice of Appeal, but he made no attempt at the hearing to show that the appellant did not base the assessments on the assumption in question. In fact, a review of the assessment and the subsequent proceedings (which may properly be looked at for this purpose as appears from the judgments in the *Johnston* case, *supra*) clearly establishes that this was indeed one of the assumptions upon which the assessment was based.

With reference to the second alternative that was open to him on this point, not only did the respondent not challenge the correctness of the assumption in question, but it seems clear that the preliminary proceedings and the appeal were conducted on the mutual assumption that a

[1] [1948] S.C.R. 486.

benefit had been conferred on the children by the transactions in question. The correctness of the assumption not having been challenged by the respondent, this point must be determined against the respondent.[1]

What I have said with reference to the 1960 assessment applies, as I have already indicated, to the 1961 assessment.

The appeal is allowed with costs and the assessments are restored.

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[1] In my view, the principle to be found in the following passage from the judgment of Rand J., delivering the judgment of the majority, in *Johnston v. Minister of National Revenue, supra,* at page 489, is applicable here:

> ...the proceeding is an appeal from the taxation; and since the taxation is on the basis of certain facts and certain provisions of law either those facts or the application of the law is challenged. Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant If the taxpayer here intended to contest the fact ... he should have raised that issue in his pleading, and the burden would have rested on him as on any appellant to show that the conclusion below was not warranted. For that purpose he might bring evidence before the Court notwithstanding that it had not been placed before the assessor or the Minister, but the onus was his to demolish the basic fact on which the taxation rested.

CORAM: Jackett P., Dumoulin and Noël JJ.