1940
Oct. 30.
1941
April 15.

BETWEEN:

MURIEL S. RICHARDSON.....APPELLANT;

AND

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

Revenue—Income Tax—Income War Tax Act, R.S.C., 1927, c. 97, Secs. 2 (i), 21 & 35 (3)—Deductions—Principal and subsidiary personal corporations—Deduction of loss of subsidiary personal company not allowed to taxpayer who owns stock in principal personal company—Appeal dismissed.

Appellant owned 50 per cent of the issued capital stock of Interprovincial Trading Corporation Limited. That company owned all the stock, except qualifying shares, of North American Financial Corporation, Limited and Intercolonial Trading Corporation Limited. All these corporations are personal corporations within the meaning of s. 2, ss. (i) of the Income War Tax Act, R.S.C., 1927, c. 97, and have substantially the same powers.

Appellant in her income tax return for the year 1936 disclosed the sum of $37,997.69 as income from these three corporations, arrived at by adding to the net profit of the Interprovincial Company the net profit of the North American Company and deducting therefrom the net loss of the Intercolonial Company and dividing the result into two equal amounts.

The Commissioner of Income Tax refused to allow as a deduction the loss sustained by the Intercolonial Company and assessed the appellant for further taxable income in an amount equal to 50 per cent of that loss. This assessment was affirmed by the Minister of National Revenue from whose decision an appeal was taken to this Court.

Held: That appellant is properly assessed for income tax purposes and the appeal must be dismissed.

2. That under the Income War Tax Act all corporations are taxable as persons for the income tax upon their annual net profit or gain and personal corporations are not an exception to this rule, even though the tax be assessable against the shareholders upon the income of such corporations and not against the corporations themselves.

3. That Interprovincial Trading Company Limited never having elected to put itself within the terms of s. 35 (3) of the Act, and not having filed a consolidated return thereunder, the appellant cannot avail herself of the terms of s. 35 (3) of the Act; *quaere* whether the word "company" in s. 35 (3) of the Act includes, or was intended to include, a "personal corporation" as contemplated by s. 2 (i) and s. 21 of the Act.

APPEAL under the provisions of the Income War Tax Act from the decision of the Minister of National Revenue.

The appeal was heard before the Honourable Mr. Justice Maclean, President of the Court, at Toronto.

1941

MURIEL S. RICHARDSON v. MINISTER OF NATIONAL REVENUE.

C. F. H. Carson, K.C. and *G. E. Hill* for appellant.

F. P. Varcoe, K.C. and *J. R. Tolmie* for respondent.

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

THE PRESIDENT, now (April 15, 1941) delivered the following judgment:

This is an appeal from the decision of the Minister of National Revenue affirming an assessment for income tax levied upon the appellant for the year 1936 by the Commissioner of Income Tax.

The appellant, the widow of the late James A. Richardson who died in 1939, is the owner of 50 per cent of the issued capital stock of Interprovincial Trading Corporation, Limited (hereinafter called "Interprovincial"). Interprovincial owns wholly, except for qualifying shares, all the stock of two other corporations, namely, North American Financial Corporation, Limited (hereafter called "North American"), and Intercolonial Trading Corporation Limited (hereafter called "Intercolonial"). All these corporations are admittedly personal corporations within the meaning of s. 2, ss. (i) of the Income War Tax Act, and all were shown to have substantially the same corporate powers, namely, to buy, sell, deal in and hold stocks, bonds and other securities for money.

The appellant in making her income tax return for the year 1936 disclosed, *inter alia*, the sum of $37,997.69 as income from the three personal corporations just named. This amount was arrived at in the following manner:

Net profit of Interprovincial	$102,473 09
Net profit of North American	17,964 08
	$120,437 17
Net loss of Intercolonial	44,441 78
Net profit	75,995 39
50 per cent of Net profit	37,997 69

The Commissioner of Income Tax allowed the net profit of North American to be considered as a gain or profit of Interprovincial but refused to allow as a deduction the loss sustained by Intercolonial. He directed that 50 per cent of this loss, namely, the sum of $22,220.89, be added to the net taxable income of the appellant. The Minister of National Revenue affirmed this assessment and from that decision an appeal was taken to this Court.

1941

MURIEL S. RICHARDSON v. MINISTER OF NATIONAL REVENUE.

Maclean J.

The question for decision is whether a taxpayer who is a shareholder in a personal corporation may deduct from his or her income for tax purposes a loss sustained by another personal corporation, which is wholly owned by the personal corporation in which the taxpayer is a shareholder, or, in other words, can a holding personal corporation, for the purpose of computing its net income, consolidate its profit and loss with that of subsidiary personal corporations which it owns or controls. The income of a personal corporation, whether the same is actually distributed or not, is deemed to be distributed as a dividend to the shareholders, according to their several interests, and taxable each year.

Before proceeding further the provisions of the Income War Tax Act which enter into the issue here may be mentioned. Sec. 2 (i) of the Act defines a personal corporation as follows:—

> 2. (i) "personal corporation" means a corporation or joint stock company, irrespective of when or where created, whether in Canada or elsewhere, and irrespective of where it carries on its business or where its assets are situate, controlled, directly or indirectly, by one individual who resides in Canada, or by one such individual and his wife or any member of his family, or by any combination of them or by any other person or corporation or any combination of them on his or their behalf, and whether through holding a majority of the stock of such corporation or in any other manner whatsoever, the gross revenue of which is to the extent of one-quarter or more derived from one or more of the following sources, namely:—
>
> (i) From the ownership of or the trading or dealing in bonds, stocks, or shares, debentures, mortgages, hypothecs, bills, notes or other similar property.
>
> (ii) From the lending of money with or without security, or by way of rent, annuity, royalty, interest or dividend, or
>
> (iii) From or by virtue of any right, title or interest in or to any estate or trust.

Section 21 of the Act provides that "the income of a personal corporation, whether the same is actually distributed or not, shall be deemed to be distributed . . . . as a dividend to the shareholders, and the said shareholders shall be taxable each year as if the same had been distributed . . . ." Sec. 35 (3) of the Act relates to consolidated returns of the income of certain corporations, and it reads:

> 35. (3) A company which owns or controls all of the capital stock (less directors' qualifying shares) of subsidiary companies which carry on the same general class of business and have fiscal periods substantially

coincident with the owning or controlling company may, in respect of all such companies which carry on business in Canada, elect, before the commencement of the earliest fiscal period of any of the constituent companies in respect of which consolidation is desired and in such manner as may be prescribed by regulation hereunder, to file a return in which its profit or loss is consolidated with that of all of its subsidiary companies carrying on business in Canada, in which case the rate of tax provided by paragraph D of the First Schedule of this Act shall apply.

Interprovincial was incorporated under the Dominion Companies Act to buy and sell securities, and it held securities formerly belonging to Mr. and Mrs. Richardson. It held a large number of shares of the capital stock of James Richardson & Sons Ld., a grain company in which Mr. Richardson had his principal interest. Intercolonial was also incorporated under the Dominion Companies Act and to it were transferred 5,000 shares of James Richardson & Sons Ld., some of such shares being owned by Interprovincial and some by members of Mr. Richardson's family, his sisters and other relatives. In the taxation year 1936 Interprovincial owned all the shares of Intercolonial. Intercolonial issued 7 per cent debentures in the amount of $2,500,000 which were distributed to Mr. Richardson's relatives in exchange for their stock in James Richardson & Sons Ld.; Interprovincial received $1,000,000 in the par value of the stock of Intercolonial in payment of the shares of James Richardson & Sons, Ld., transferred by it to Intercolonial. By agreement Intercolonial was not to deal in other securities, and the debentures were apparently considered a form of security for the 5,000 shares of the stock of James Richardson & Sons, Ld. The officers and directors of Interprovincial and Intercolonial were the same persons. I should perhaps endeavour to explain more fully the facts relating to the transactions just mentioned. Mr. Richardson's principal business was the grain company of James Richardson & Sons Ld. He had transferred to Interprovincial the stock which he owned in James Richardson & Sons Ld. and he had suggested to his relatives that they also transfer to Interprovincial their holdings in James Richardson & Sons Ld. They apparently did not accept this suggestion because of the varied holdings of Interprovincial so Mr. Richardson organized a new company, Intercolonial. This company gave 1,000,000 shares of its capital stock to Interprovincial in exchange for that company's stock in James Richardson & Sons Ld. Aside from

1941

MURIEL S. RICHARDSON v. MINISTER OF NATIONAL REVENUE.

Maclean J.

qualifying shares Intercolonial issued no other shares and Interprovincial holds all the issued stock of Intercolonial. Intercolonial then created a debenture issue of $2,500,000 carrying interest at 7 per cent. These debentures were delivered to Mr. Richardson's relatives in exchange for their stock in James Richardson & Sons Ld. transferred by them to Intercolonial. In all, Intercolonial acquired 5,000 shares of the capital stock of James Richardson & Sons Ld., and this was and is the only asset of Intercolonial. And it was agreed between the members of the Richardson family that Intercolonial would carry on no other business, and would not deal in any other stock or securities, and would not dispose of the James Richardson & Sons Ld. stock held by it until the debentures had all been paid off. The debentures were made a charge on the assets of Intercolonial and were intended as a security for the shares of James Richardson & Sons Ld. These transactions suggest that Mr. Richardson was of the opinion that his relatives would be afforded greater safety of investment by having all the stock of James Richardson & Sons Ld. held by one concern. It was suggested that in the event of Intercolonial not earning enough to pay the debenture interest Interprovincial would come to the rescue and make up the deficiency, and we are told that this was actually done. However, it is to be noted that there was absolutely no legal obligation whatever on the part of either Interprovincial or Mr. Richardson, to guarantee or make good any default of Intercolonial in so far as the debenture interest was concerned.

Interprovincial had large holdings of United States securities amongst its assets. In order to simplify the assessment for the income tax in respect of such securities, by the taxing authorities of the United States and Canada, it was decided to incorporate a third company to which would be transferred all the United States securities held by Interprovincial. So these securities were segregated and put into North American, a company incorporated under the laws of Newfoundland. This company was granted exactly the same corporate powers as the other two companies and Interprovincial transferred to it all its holdings of United States securities, the consideration to Interprovincial being all the capital stock issued by North American. The officers and directors of North American

were the same as those of Interprovincial and Intercolonial. Interprovincial, thus owning all the issued stock of Intercolonial and North American, made or purported to make a return in which was shown its profit or loss for the period in question consolidated with that of the two subsidiary companies. Income tax returns were made by each of the three companies as well as by the appellant, but no consolidated return was filed in accordance with the terms of s. 35 (3) of the Act.

Intercolonial, in its tax return for 1936, showed the following result:

Interest paid to James Richardson & Sons Ld. ..... (This was borrowed money)	$ 38,407 78
Interest on Debentures	93,450 00
General and other expenses	84 00
Total expenses	131,941 78
Its income was	87,500 00
Net loss	$ 44,441 78

The Commissioner of Income Tax, in assessing the appellant for the tax, added one-half of the amount of this loss to her taxable income for the year 1936, that is, the appellant, who owned one-half of the issued shares of Interprovincial, had deducted that amount in her return showing the profit or loss of Interprovincial, and to that had added the net profit of North American. The taxing authorities refused this deduction, being $22,220.89, to be made from the income of the appellant as a shareholder in Interprovincial and it is this refusal that furnishes the subject-matter of this appeal.

The question, then, is: Can the taxpayer claim as a deduction for income tax purposes a loss sustained by a personal corporation which is wholly owned by another personal corporation in which the taxpayer has an interest, fifty per cent in this instance? Perhaps the question may be stated better in this way: Can Interprovincial file a return in which its profit and loss is consolidated with that of Intercolonial and North American, its subsidiaries, and can the appellant, who owns a share interest in Interprovincial, the holding company, in making her tax return, take advantage of the result arrived at by a consolidation of the profit and loss of Interprovincial with that of Intercolonial and

1941

MURIEL S. RICHARDSON v. MINISTER OF NATIONAL REVENUE.

Maclean J.

North American? All figures disclosed and appearing here are admitted to be correct, the *bona fides* of the appellant is not questioned, and the fact that all three companies are personal corporations under the Act is admitted.

I think there is a fundamental obstacle in the way of the appellant succeeding in her appeal. It is that the corporations here involved are separate taxable persons, and the profits of their respective businesses, if any, are separate taxable profits, and there is no provision in the Income War Tax Act applicable here which, in my opinion, in any way modifies that principle. Under the Act all corporations are taxable as persons for the income tax upon their annual net profit or gain, and if there be no such net profit or gain there can be no assessable tax; and personal corporations are not an exception to this rule, even though the tax be assessable against the shareholders upon the income of such corporations and not against the corporations themselves, and at a rate different from other corporations. The principle that corporations are, for the purposes of the income tax, separate taxable persons, and their profits separate taxable profits, I find well expressed in a passage of the judgment of Sir Wilfred Greene, M.R., in the case of *Odhams Press Ld.* v. *Cook* (1), and which, I think, is quite applicable here. He said:

> By way of preface, it is, I think, important to bear in mind in dealing with income tax cases what is, of course, elementary, but nevertheless sometimes seems to recede into the background, that limited companies who carry on businesses are separate taxable persons, and the profits of their respective businesses are separate taxable profits. Companies who, if I may use a convenient expression, choose to carry on their businesses with the assistance of subsidiaries not infrequently find that for taxation purposes certain inconveniences result, owing to the fact that their subsidiary is a taxable entity separate from themselves. For instance, if the holding company, the parent company, is carrying on a business, and makes a profit, and the subsidiary is carrying on a business which perhaps originally formed part of the parent company's business but which for convenience has been transferred to the subsidiary, and in that business the subsidiary makes a loss, obvious difficulties appear in the way of treating the loss made by the subsidiary as a trading loss of the parent company. One result of the present claim, if it were successful, would be to transfer into the accounts of the holding company a trading loss of the subsidiary. I am not suggesting for a moment that this particular method of accountancy has been adopted with income tax in view. Indeed, if it had been, there would have been nothing wrong about it. What has been done, as it appears, has been done for good commercial reasons. However, that

(1) (1938) 4 All. E.R. 545 at 551.

does not alter the fact that the result of the present claim, if it be correct, is to transfer for income tax purposes into the account of the holding company a loss suffered by the subsidiary company.

The same principle is laid down in many other authorities but it is unnecessary to mention them. There are no facts here, nor are there any provisions in the Income War Tax Act, which can, in my opinion, operate to modify that principle to the appellant's advantage.

In support of the appeal much reliance was placed upon s. 35 (3) of the Act which permits a company owning or controlling all the capital stock of subsidiary companies which carry on the same general class of business, to elect, within a prescribed time, to file a return in which its profit or loss is consolidated with that of all of its subsidiary companies, and in which case the Act prescribes that the rate of tax shall be that provided by paragraph D of the First Schedule of the Act. That section of the Act is perhaps wanting in clarity, but, as I suggested in *Wilson* v. *The Minister* (1), it is to be seriously doubted whether the word "company" in s. 35 (3) includes, or was ever intended to include, a "personal corporation" as contemplated by s. 2 (i) and s. 21, or whether Intercolonial is a subsidiary company carrying on the same general class of business as Interprovincial, the former being, in the period in question, only the holder of shares of James Richardson & Sons Ld. and which shares it was under agreement not to dispose of until the debentures earlier mentioned were retired; and further, Intercolonial was under agreement not to engage in any business within its corporate powers, other than the holding of such shares of James Richardson & Sons Ld. The provisions of the Act respecting personal corporations, s. 21, do not seem to contemplate the state of facts existing between a company and its subsidiary companies as provided for in s. 35 (3) of the Act. However, Interprovincial never elected to put itself within the terms of s. 35 (3), nor did it file a consolidated return thereunder, and the appellant cannot therefore now avail herself of the terms of that section of the Act. Reference was also made to the fact that certain provisions of the Companies Act provide that the income and expenditures of subsidiary companies may be included in the balance sheet and state-

(1) (1938) Ex. C.R. 246; (1939) 1 D.L.R. 678.

1941

MURIEL S. RICHARDSON v. MINISTER OF NATIONAL REVENUE.

Maclean J.

ment of profit and loss of a holding company. These provisions were designed for a purpose altogether different from that of the computation of taxable income under the provisions of the Income War Tax Act, and, in my opinion, would have no application here.

My conclusion therefore is that the appeal must be dismissed with costs.

Judgment accordingly.