

BETWEEN:

HIS MAJESTY THE KING, ON THE }
INFORMATION OF THE ATTORNEY-GEN- }
ERAL OF CANADA }

1937
June 28 & 29
1938
March 24.

AND

JOHNSON MATTHEY & COMPANY }
(CANADA) LIMITED }

DEFENDANT.

Revenue—Income War Tax Act, R.S.C., 1927, c. 97, s. 2 (b) and s. 9B, ss. 2 and ss. 4—Tax on dividend—Distribution of fully-paid shares—Transfer from earned surplus account to share capital account—Liability for tax.

The Income War Tax Act, R.S.C., 1927, c. 97, provides that:—

“2 (b) ‘Dividends’ shall include stock dividends.

9B. ss. 2. In addition to any other tax imposed by this Act an income tax of five per centum is hereby imposed on all persons who are non-residents of Canada in respect of

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(a) All dividends received from Canadian debtors irrespective of the currency in which the payment is made.

ss. 1. In the case of interest or dividends in respect of fully registered shares, bonds, debentures, mortgages or any other obligations, the taxes imposed by this section shall be collected by the debtor who shall withhold five per centum of the interest or dividend on the obligation and remit the same to the Receiver-General of Canada."

Defendant company was incorporated under the laws of the Dominion of Canada, with an authorized capital of \$250,000 divided into 25,000 shares of the par value of \$10 each. A by-law of the company, enacted on December 11, 1933, provided that: "For the amount of any dividend which the Directors may lawfully declare payable in money they may issue shares of this company as fully paid."

On December 11, 1935, the directors of the company declared a dividend "on the issued share capital of this Company in the form of an issue of whole shares of this Company's capital stock of such aggregate par value as shall be, as nearly as may be, equal in total amount to the surplus of this Company on 31st December, 1935, less the amount of a fair reserve for any taxes * * *"

The surplus was determined at \$49,571.51, and the company allotted and issued 4,957 shares of its capital stock to its shareholders of record at the close of business on December 31, 1935, pro rata according to their holdings of issued shares of the company as of that date, and these shares were paid up in full by the transfer from the "earned surplus" account of the company of the sum of \$49,570 to the credit of the share capital account. This surplus thus capitalized was available prior to its capitalization for the payment of cash dividends to the shareholders of defendant. The defendant did not collect or withhold or pay the tax in respect to 4,907 of these shares allotted and issued to a non-resident of Canada.

Held: That these transactions were in effect a declaration of a stock dividend within the Income War Tax Act and that defendant company was liable to pay tax on the value of the shares issued to non-residents of Canada.

INFORMATION exhibited by the Attorney-General of Canada to recover from the defendant a certain sum for tax upon a stock dividend paid by defendant to certain of its shareholders who were non-residents of Canada.

The action was tried before the Honourable Mr. Justice Maclean, President of the Court, at Ottawa.

J. O. Plaxton, K.C. for plaintiff.

B. B. Osler for defendant.

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

THE PRESIDENT, now (March 24, 1938) delivered the following judgment:

In this Information, the plaintiff seeks to recover from the defendant, under the provisions of s. 9B, ss. 2 of the

Income War Tax Act, a certain sum of money claimed to be due and payable, and being a tax upon a stock dividend paid by the defendant to certain of its shareholders who were non-residents of Canada. Sec. 9B, ss. 2 (a) of the Act is as follows:

In addition to any other tax imposed by this Act an income tax of five per centum is hereby imposed on all persons who are non-residents of Canada in respect of (a) All dividends received from Canadian debtors irrespective of the currency in which the payment is made * * *

Subsec. 4 of s. 9B provides that:

In the case of interest or dividends in respect of fully registered shares, bonds, debentures, mortgages or any other obligations, the taxes imposed by this section shall be collected by the debtor who shall withhold five per centum of the interest or dividend on the obligation and remit the same to the Receiver-General of Canada.

By s. 2 (b) of the Act "dividends" include "stock dividends."

The defendant is a company incorporated under the laws of the Dominion of Canada and having its head office in the City of Toronto, Ontario. Its authorized capital was \$250,000 divided into 25,000 shares of the par value of \$10 each. On December 31, 1935, the defendant company had outstanding and fully paid up 10,750 shares of its capital stock of which 10,650 shares were owned by non-residents of Canada. On December 11, 1933, a by-law, numbered 6, was enacted by the directors of the defendant company in the following terms: "For the amount of any dividend which the Directors may lawfully declare payable in money they may issue shares of this Company as fully paid." That by-law was subsequently sanctioned by the shareholders at a special general meeting called for that purpose. On December 11, 1935, the directors of the defendant company duly passed the following resolution:—

Resolved that whereas By-law No. 6 of this Company authorizes the directors to issue fully paid shares for the amount of any dividend they may lawfully declare payable in money, a dividend be and it is hereby declared on the issued share capital of this Company in the form of an issue of whole shares of this Company's capital stock of such aggregate par value as shall be, as nearly as may be, equal in total amount to the surplus of this Company on 31st December, 1935, less the amount of a fair reserve for any taxes, the amount of which may be based upon the operations of this Company up to 31st December, 1935, as the same may be determined by this Company's auditors, and that the same are hereby allotted and directed to be delivered on 2nd January, 1936, pro rata to the shareholders of this Company of record at the close of business on 31st December, 1935, or as they may respectively direct.

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The amount of the surplus of the defendant company on December 31st, 1935, as determined by its auditors, after deducting the amount of a fair reserve for any taxes, was \$49,571.51. By virtue of the resolution just mentioned the defendant company duly allotted, as fully paid, 4,957 authorized and unissued shares of its capital stock of the par value of \$10 each to its shareholders of record at the close of business on December 31, 1935, pro rata according to their holdings of issued shares of the defendant company as of that date. Pursuant to the authority contained in By-law numbered 6, the said 4,957 shares were paid up in full by the transfer from the "earned surplus" account of the company of the sum of \$49,570 to the credit of the share capital account. The whole of the earned surplus so capitalized by the defendant company was available prior to its capitalization for the payment of cash dividends to the shareholders of the defendant company.

Johnson Matthey & Company Limited, an English company and a non-resident of Canada, was entered in the stock register of the defendant company as the owner of 4,907 of the said 4,957 shares, all of which have been credited as fully paid, and it has received share certificates representing them. The defendant company did not collect or withhold, or pay, the tax in respect of the said 4,907 shares of its capital stock allotted to Johnson Matthey & Company Limited.

The submission of Mr. Osler on behalf of the defendant was to the effect that what took place was simply a capitalization of surplus and a distribution of shares, and that there was no payment of a dividend because nothing was divided and nothing changed; that no "Canadian debtor," no "payment," and no "currency," was involved in the transactions that took place, and that s. 9B 2 (a) contemplates only the case where a dividend is being paid in Canadian funds and that therefore a stock dividend is not taxable under that section of the Act.

I have carefully considered the argument of Mr. Osler, but I do not think it can prevail. We are dealing with a particular statute which plainly declares that "dividends" include "stock dividends." The words "payment," "currency" are perhaps not apt words in the case of a "stock dividend," but I do not think they obscure what appears

to be the intention of the legislature. It being known that a stock dividend is taxable it is to be presumed that, before payment thereof, provision would be made for the payment of the tax either by the company or the taxpayer. A stock dividend, like any other dividend, is based upon an earned reserve or surplus, otherwise the dividend would not be declared. Here, it is agreed that the whole of the earned surplus so capitalized was available, prior to its capitalization, for the payment of cash dividends to the shareholders of the defendant company. There were many methods available to the defendant to ensure the collection of the tax. There was a definite statutory obligation on the part of the defendant to withhold the tax in question. At first, it might appear that the section of the Act in question is not practically operative in a case of this kind and was not therefore intended to apply, but as a stock dividend is a dividend and taxable, then the company paying it must make some provision for the collection of the tax. I assume that in all such cases if the liability to the tax is conceded there would be no difficulty in providing for its payment.

The case of *Swan Brewery Company Ltd. v. The King* (1) would seem applicable here. The Dividend Duties Act, 1902, of Western Australia, provided that when a company carrying on business in Western Australia and not elsewhere, declared a dividend, it became bound to pay a duty of 5 per cent on the amount or value of the dividend before distributing the same. The Act described the word "dividend" as including "every profit, advantage, or gain intended to be paid or credited to or distributed among the members of any company." The company had accumulated a reserve fund of more than £101,450. It passed the necessary resolutions to increase its capital by £101,450 divided into 81,160 new shares of £1 5s. each. These new shares were duly allotted to the then shareholders according to their holdings of old shares. No money passed, but £101,450 was transferred from the reserve fund to the credit of the share capital account, and thereafter represented the capital value of the new shares. It was held by the Judicial Committee that these transactions were in effect a declaration of a dividend amounting to £101,450,

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(1) (1914) A C. 231.

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within the Dividend Duties Act, and that the Swan Brewery Company was liable to pay duty upon that amount. In delivering the judgment of the Judicial Committee Lord Sumner said:

The argument is that there has been no dividend and no distribution, because nothing has been divided and nothing changed. Where formerly there was one share, enhanced in value by its right to participate in the reserve fund, if the company, being solvent, should be wound up voluntarily, now there are two, possessed of the same right of participation, but for that very reason worth no more and no less together than the one share was worth before. Formerly the company had a certain amount of capital; now it has the same without diminution or increase either temporary or permanent. The change is but one of name. Formerly its funds were so much share capital and so much reserve, all invested in the business; now they are so much more shares capital and so much less reserve, all invested in the business still and still unchanged in total amount. The duty claimed is not, it is said, a duty on or in proportion to any advantage either to the company or the shareholder measured by the increased stability of the company's own position or the increased facility to the shareholder in marketing his shares; it is measured by and is levied upon the whole nominal value of the new shares allotted, which is not the same thing as the value of the advantage distributed. Is this argument sound?

Their Lordships agree with the Supreme Court of Western Australia in thinking that it is not. There can be no doubt that the new shares were distributed and were not the same things as the old ones. They certainly were supposed to be advantages to the members of the company, none the less that the making of the issue was probably an advantage to the company also. In so flourishing a business doubtless they really were advantages. The new shares were credited as fully paid, and, what is more, they were fully paid, for after the allotment the company held £101,450 as capital produced by the issue of those shares and for that consideration, and no longer as an undivided part of its accumulated reserve fund. True, that in a sense it was all one transaction, but that is an ambiguous expression. In business, as in contemplation of law, there were two transactions, the creation and issue of new shares on the company's part, and on the allottees' part the satisfaction of the liability to pay for them by acquiescing in such a transfer from reserve to share capital as put an end to any participation in the sum of £101,450 in right of the old shares, and created instead a right of general participation in the company's profits and assets in right of the new shares, without any further liability to make a cash contribution in respect of them. In the words of Parker C.J., "Had the company distributed the £101,450 among the shareholders and had the shareholders repaid such sums to the company as the price of the 81,160 new shares, the duty on the £101,450 would clearly have been payable. Is not this virtually the effect of what was actually done? I think it is."

I am of the opinion that here the defendant is liable for the tax, and the claim of the plaintiff is accordingly allowed. and with costs.

Judgment accordingly.