

1955
*Jun. 17
*Oct. 4

THE MINISTER OF NATIONAL }
REVENUE } APPELLANT;

AND

ST. CATHARINES FLYING TRAIN- }
ING SCHOOL LIMITED } RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Revenue—Income and excess profits taxes—Company incorporated under Part I of the Companies Act, 1934, for purpose of training pilots under the British Commonwealth Air Training Plan—Whether income exempt—Income War Tax Act, R.S.C. 1927, c. 97, ss. 4(e) and 4(h).

The respondent was incorporated in 1940 as a private company under Part I of the *Companies Act*, S. of C. 1934, c. 33, for the purpose of giving flying training in conjunction with the British Commonwealth Air Training Plan. Its letters patent prohibited the declaration of dividends and the distribution of profits “during the hostilities or during the period that the company is required to carry on elementary training under the Training Plan”. The shareholders made a declaration of trust to the effect that they held their shares in trust for the benefit of the St. Catharines Flying Club, a company whose objects were the promotion of flying and aviation in general and the teaching and training of persons in flying and aerial navigation and whose letters patent provided that all profits and accretions should be used in promoting its objects.

The respondent entered into two contracts with the Crown in 1940 and in 1943. Both contracts provided the terms of payments to be made for the services to be rendered, and in the second it was provided further that any profit should be held in a reserve account until the termination of the contract to be then paid to a flying club approved by the Minister of National Defence, failing which it would revert to the Crown.

The respondent made a profit on both contracts and this was assessed for income and excess profits taxes. The assessment was affirmed by the Minister of National Revenue, but set aside by the Exchequer Court.

Held: The appeal should be allowed as to the profit made under the first contract and dismissed as to the second.

Under the second contract, there was no income liable to taxation since the terms of that contract amounted to a declaration that any surplus would be held subject to the direction of or in trust for the Crown.

Under the first contract, any profit realized under the powers granted to the company by its letters patent was income liable to taxation under the terms of the statute. The fact that the company was incorporated under Part I of the *Companies Act* and the reference to dividends in the letters patent indicated that profits were contemplated. These profits were the property of the company which could retain them

*PRESENT: Kerwin C.J. and Kellock, Estey, Locke and Cartwright JJ.

and distribute them after the termination of the hostilities or the period during which it was required to carry on under the Training Plan. The income under this contract was not exempt from taxation under s. 4(h) or 4(e) of the *Income War Tax Act*.

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APPEAL from the judgment of the Exchequer Court of Canada, Thorson P (1), allowing the taxpayer's appeal from the decision of the Minister of National Revenue.

J. Singer, Q.C. and *J. Boland* for the appellant.

H. H. Stikeman, Q.C., M. A. Seymour, Q.C. and *A. L. Bissonnette* for the respondent.

The judgment of the Court was delivered by:—

LOCKE J.:—The respondent was incorporated as a private company under the provisions of the Dominion Companies Act by letters patent issued on September 12, 1940, the capital stock consisting of five thousand shares without nominal or par value. The declared purposes and objects as stated in the letters patent were:—

To establish, maintain, conduct and operate a school or schools for instruction and training in flying to be operated for the purposes of and in conjunction with the British Commonwealth Air Training Plan.

A clause in the letters patent which has been regarded as affecting the liability of the respondent reads:—

And it is further ordained and declared that the company shall be prohibited from declaring dividends and shall also be further prohibited from distributing any profits during hostilities or during the period that the company is required to carry on elementary training under the British Commonwealth Air Training Plan.

The persons at whose instance this company was incorporated were Mr. M. A. Seymour, Q.C. and two other members of a company incorporated in 1928 under the provisions of the Companies Act of Ontario named St. Catharines Flying Club, the principal purposes and objects of which were the promotion of flying and aviation in general and the teaching and training of persons in flying and aerial navigation. The letters patent of this last named company contained a provision that the company should be carried on without the purpose of gain for its members and that any profits or other accretions should be used in promoting its objects.

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The Dominion Companies Act 1934 contained in Part I the provisions under which commercial and other corporations organized for the purpose of carrying on business with a view to profit may be incorporated. Part II of this statute provided for the incorporation of companies without share capital for the purpose of carrying on, without pecuniary gain to its members, objects of a national, patriotic, religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character, or the like.

Whatever is to be said as to the admissibility of the evidence, it was shown at the trial that Mr. Seymour, who was the Vice-President of the St. Catharines Flying Club, and his associates, wished to incorporate the Dominion company under the provisions of Part II but, for reasons which are not explained and which cannot in any event affect the question to be determined, leave to do so was refused and, of necessity, the incorporation was carried out under the provisions of Part I.

On the same date as that of the grant of the letters patent, a contract was entered into by His Majesty, represented by the Minister of National Defence, and the respondent, for the establishment, equipment and carrying on of a flying school at St. Catharines, Ont. for the purpose of the instruction and training of members of the Royal Canadian Air Force. It is unnecessary to consider in any detail the terms of this arrangement other than to say that the services to be rendered by the respondent in the operation of the school were to be paid for on specified terms, and that the agreement was to continue until March 1, 1943 unless earlier terminated by the Crown, either by reason of the cessation of hostilities or for any other reason for which it should be considered that the school was unnecessary.

Following the incorporation of the respondent, common shares were issued to ten persons, in addition to the three applicants for incorporation. The Minister of National Defence, as a term of entering into the contract, had apparently stipulated that the company should have not less than \$35,000 in cash, and \$37,850 was donated by a number of corporations in St. Catharines and the vicinity. These monies were not paid as the purchase price of shares but were simply gifts for the purpose of assisting in the war effort.

Twelve of the thirteen shareholders became directors of the respondent, six of them being nominees of the St. Catharines Flying Club and the others representing the donor companies. It was the intention of the incorporators and their associates that any surplus that might result from the operations of the respondent company should enure to the benefit of the St. Catharines Flying Club and, in November of 1940, a declaration of trust was signed by the thirteen shareholders declaring that they held their shares in trust for that company and that, after completion of flying training under the contract with the Crown, or as might be required by the Crown, and upon the fulfilment of the objects for which the respondent was incorporated, they would vote to return the capital donated by the various companies without interest and would transfer the shares to the said *cestui qui trust*.

The declaration of trust contained, in addition, a recital that the life of the respondent company was by its letters patent "limited to duration of the war" but this was inaccurate: the letters patent contained no such limitation. It further declared that it was the intention of the Minister of National Defence for Air and the Minister of Transport that the St. Catharines Flying Club should benefit from any surplus earned by the respondent.

Mr. Seymour, who apparently had charge of the matter of incorporating the respondent and of negotiating the agreement with the Crown, said that, when permission to incorporate under Part II of the Companies Act was refused, he had asked that a complete prohibition of the declaration of dividends should be incorporated in the letters patent but this was refused, the prohibition being "restricted to the life of the contract".

The respondent operated the flying school under the terms of the agreement of September 12, 1940, as amended from time to time by agreement between the contracting parties, for the term agreed upon and the operations were continued thereafter under a new agreement dated March 23, 1943 between the respondent and His Majesty, represented by the Minister of National Defence for Air. The term of the new contract was until March 31, 1945 subject to earlier termination under its terms. The only term of the new arrangement which affects the matter to be

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decided was one which provided that the amount retained by the company "shall not be distributed and shall be held by the company in a reserve account until the termination of the contract and shall then be paid to a flying club approved by the Minister, failing which it shall revert to the Crown."

The result of the operations carried on by the respondent under the first agreement was that a substantial profit was realized. Whether the amounts received by the company surplus to the cost of operation under the second contract should be designated as income in view of the above quoted term of that contract, a sum of money remained in the respondent's hands at its conclusion which, it is claimed by the appellant, was liable to taxation under the *Income War Tax Act and the Excess Profits Tax Act 1940*.

There can be no doubt in the present matter that the public spirited persons who were responsible for the incorporation of the respondent company were actuated by a desire to be of some service to the State by assisting in the war effort and that it was their intention that if any profits resulted from its activities they should be paid to the St. Catharines Flying Club, to assist in carrying on its work. The question, however, is not what the promoters of the company intended to do with these monies but whether profit realized in the operation of the respondent company under the powers granted to it by its letters patent was income liable to taxation under the terms of these statutes.

Different considerations apply, in my opinion, to the profits realized from the operations under the first contract and any surplus resulting from the operations under the second contract. As to the latter, it appears to me undoubted that there was no income liable to taxation since the surplus resulting was held by the respondent upon terms that, unless the Minister should consent to its being paid over to a flying club, it was to be paid to the Crown. The status of such monies does not, therefore, differ from that which would have existed had the contracts simply declared, without more, that the respondent would hold any surplus in trust for the Crown. The respondent is, in my opinion, entitled to succeed upon this aspect of the matter, not on the footing that the exempting provisions relied upon affect the matter but on the ground that there was no income.

The situation is, I think, different in regard to the income realized from the operations under the first contract. The carrying on of such work was one of the declared objects of the company. That it was contemplated that, as in the case of other companies incorporated under Part I of the Companies Act, profits would be realized is made clear by the reference to dividends.

It is said in the reasons for judgment delivered in the Exchequer Court (1), in support of the finding that the respondent was organized and operated solely for non-profitable purposes, within the meaning of that expression in s. 4(h) of the *Income War Tax Act*, that "the appellant could never keep any of its profits or distribute them to its stockholders or members" but, with respect, this appears to overlook the fact that the profits made were the property of the company and there was nothing in the letters patent which prohibited it from retaining them and the prohibition against declaring dividends or distributing profits was restricted to the period of the duration of hostilities or the period during which the company was required to carry on elementary training under the British Commonwealth Air Training Plan. There was nothing which prohibited the declaration of dividends or the distribution of profits after that time.

The question of the liability of the respondent to taxation depends, not upon the intention of the promoters or the shareholders as to the disposition to be made of the profits but rather upon consideration of the terms of the letters patent, the nature of the business authorized to be carried on and of the business which was carried on which resulted in the earning of the income. As I have pointed out, the fact that the company was incorporated under Part I and the reference to dividends in the letters patent both indicate that it was contemplated that profits would be made, and there was no restriction of the right of the company to retain such profits which would enure to the benefit of the shareholders by increasing the value of their shares or to pay dividends, except to the extent above indicated. If the company had succeeded in obtaining letters patent which prohibited the payment of dividends completely and, in

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addition, the retention of any earned income by the company, different considerations, which need not here be considered, would arise.

For these reasons, it is my opinion that the income resulting from the operations of this company under the first contract with the Crown is not exempt from taxation, either under the provisions of s. 4(h) or s. 4(e) of the *Income War Tax Act*. I think the liability to taxation of the income of this company resulting from those operations did not differ in any way from that of the income of any commercial company incorporated under Part I of the *Companies Act*.

Nothing said in the judgment of this Court in *Sutton Lumber Company v. The Minister of National Revenue* (1), or in the passage from the judgment of Sir Lyman Duff in *Anderson Logging Company v. The King* (2), there referred to, conflicts with the views above expressed.

I assume that all of the monies payable by the Crown under the first contract were received by the respondent before the end of its fiscal year in 1943 I would accordingly allow the appeal as to the assessments made for the years 1941, 1942 and 1943.

As success is divided, I think there should be no costs either of this appeal or of the proceedings in the Exchequer Court.

Appeal allowed for the years 1941, 1942 and 1943;

Appeal dismissed for the years 1943, 1944 and 1945.

Solicitor for the appellant: A. A. McGrory.

Solicitors for the respondent: *Stikeman & Elliott*.