Federal Continued Corporations and the Deemed-Resident Provisions of Section 250(4) of the Income Tax Act

I. Introduction

The notion of residence is fundamental in determining the tax base under the federal *Income Tax Act*.[1] A determination of residence will affect the scope of income taxable,[2] the rate of tax levied,[3] the imposition of special taxes,[4] the obligation to withhold tax,[5] and the availability of tax exemptions and incentives.[6] The *Income Tax Act* does not provide a general definition of residence for corporate taxpayers, but does contain a deeming provision which imposes resident status: by virtue of section 250(4), a corporation is deemed to have been resident in Canada throughout a taxation year if, *inter alia*, the corporation was incorporated in Canada after April 26, 1965. Generally, a corporation which held non-resident status prior to April 27, 1965 and did not subsequently carry on business or situate its central management and control in Canada is not deemed to be a resident, subject to the powers of the Governor in Council to make regulations prescribing who is or has been at any time resident in Canada for the purpose of Part XIII of the *Income Tax Act*.[7]

The purpose of the present essay is to determine whether foreign corporations continued under the *Canada Business Corporations Act*[8] are deemed to be resident Canadian corporations under the *Income Tax Act*. The continuance of corporations under federal legislation is a recent phenomenon (the effective date of the new companies legislation being December 15, 1975); there are

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[1] S.C. 1970-71-72, c. 63 as am.
[2] *Ibid.*, s. 2.
[3] *Ibid.*, s. 190.
[4] *Ibid.*, s. 212.
[5] *Ibid.*, s. 215.
[6] *Ibid.*, s. 125.
[7] *Ibid.*, s. 214(13)(a). The foreign business corporation loses its preferential tax treatment after five years, commencing with the 1972 taxation year of the corporation: *Income Tax Application Rules, 1971*, S.C. 1970-71-72, c. 63, s. 60(2). See generally Poissant, *Taxation in Canada of Non-Residents* (1976), 4-5; Scace, *The Income Tax Law of Canada* 3d ed. (1976), 2-12; McDonald, *Cases and Materials on Income Tax* 2d ed. (1963), 31-41; LaBrie, *The Principles of Canadian Income Taxation* (1965), 18-19; Ward, Smith & Arnold, *Current Tax Planning* (1977), vol. III, § 192.11[b], 19-242—19-245; Cumyn, *A Non-Resident's Guide to Canadian Taxation* (1977), 14-17.
[8] S.C. 1974-75-76, c. 33.

as well similar provisions in the companies legislation of Ontario, Alberta and Manitoba.[9] Since continuance by a foreign company under federal legislation constitutes an "incorporation" under the *Canada Business Corporations Act*,[10] the question arises how the deemed-resident provisions of section 250(4) apply to the continued corporation.

Before embarking on the principal question, this study will deal with the most important preliminary issue: whether a federal company continued after December 15, 1975 is a *de facto* Canadian resident for tax purposes by virtue of the provisions of the *Canada Business Corporations Act.*

II. Statutory effects of continuance

A company incorporated in a foreign jurisdiction may, if authorized by the laws of the incorporating jurisdiction, apply to the Director[11] for a certificate of continuance.[12] The issuance of this certificate causes the company to become a corporation to which the *Canada Business Corporations Act* applies in the same way as if it had been incorporated under that Act.[13] The articles of continuance are deemed to be the articles of incorporation, and the certificate of

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[9] The mechanism of continuance has been enacted to attract foreign entrepreneurs into operating in Canada through a local corporate vehicle; the technique, to a lesser degree, was designed to facilitate interjurisdictional amalgamation, and thereby eliminate the cumbersome procedure of sale of assets and corporate dissolution in the foreign jurisdiction, or reincorporation and ultimate amalgamation in Canada. See generally Iacobucci, Pilkington & Prichard, *Canadian Business Corporations* (1977), 438-40, 444; Lavine, *The Business Corporations Act ... An Analysis* (1971), 299-300; Grant, *Continuance and Discontinuance under the Canada Business Corporations Act* [1975] Meredith Memorial Lectures 475; Dickerson, Howard & Getz, *Proposals for a New Business Corporations Law for Canada* (1971), vol. I, 121, § 365: "Similar provisions are commonplace in U.S. statutes but are generally characterized as inter-state mergers or consolidations. A similar regime could have been adopted here, but that would have entailed adoption of a whole body of complex rules governing interjurisdictional amalgamations ... If interjurisdictional amalgamation is desired, it can be effected in two steps: first, continuance under the laws of the desired jurisdiction; and second, an amalgamation [.]" See also American Bar Foundation, *Model Business Corporation Act Annotated* 2d ed. (1971), vol. 3, s. 77. For analogous provincial continuance legislation, see *inter alia The Companies Act*, R.S.A. 1970, c. 60, ss. 157-159; *The Business Corporations Act*, R.S.O. 1970, c. 53, ss. 198-200; *The Companies Act*, R.S.M. 1970, c. C160, ss. 129-131.

[10] S.C. 1974-75-76, c. 33, s. 181(4).

[11] Appointed under the *Canada Business Corporations Act*, s. 253.

[12] *Ibid.*, s. 181(2) and (3).

[13] *Ibid.*, s. 181(4).

continuance is deemed to be the certificate of incorporation of the continued corporation.[14] The property of the company and its liabilities and pending claims become that of the continued corporation.[15] Furthermore, continuance does not deprive a shareholder of any right which he claims, nor does it relieve him of any liability in respect of an issued share.[16]

A. *Resident Canadian directors*

Seeing that continuance forces the company to comply with the *Canada Business Corporations Act* in all respects,[17] the Canadian-resident-majority rule affecting the board of provisional and elected directors must be observed. The articles of continuance must contain a notice of directors, a majority of whom are required to be resident Canadians;[18] and no business can be transacted at meetings of directors unless a majority of the quorum are resident Canadians.[19]

The residency qualifications of the directors, however, are not absolute. Notwithstanding the Canadian-resident-majority rule, a holding company need not have more than one-third of its directorship resident in Canada so long as it earns less than five per cent of its gross revenues (including the revenues of its subsidiaries) in Canada.[20] A continued corporation is not required, for the purpose of transacting business, to secure a quorum of directors having a majority of Canadian residents, if a resident Canadian director unable to attend the meeting approves in writing or by telephone the business transacted, and if fifty per cent of the quorum otherwise consists of resident Canadian directors.[21] It should be noted at this stage that the term "resident Canadian" is defined on the basis of Canadian citizenship or landed immigrant status, together with "ordinarily resident" status, without reference to the *Income Tax Act* on the latter element.[22]

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[14] *Ibid.*

[15] *Ibid.*, s. 181(6).

[16] *Ibid.*, s. 181(7).

[17] Subject to special rules affecting continued corporations, *e.g.*, ss. 45(9), 181(8).

[18] *Ibid.*, ss. 182(2), 101(1), 100(3).

[19] *Ibid.*, s. 109(2) and (3).

[20] *Ibid.*, s. 100(4).

[21] *Ibid.*, s. 109(4). See also s. 110(2).

[22] *Ibid.*, s. 2(1). See s. 191(3) regarding deemed residence of a shareholder. The term "ordinarily resident" appears in s. 250(3) of the *Income Tax Act* and has been judicially considered in *Thomson* v. *M.N.R.* [1945] Ex. C.R. 17, 2 D.T.C. 684; *aff'd* [1946] S.C.R. 209, 2 D.T.C. 812.

B. *Canadian registered office and meetings*

A continued corporation must maintain at all times a registered office in the place within Canada specified in its articles of continuance[23] and keep at its office the corporate records and registers. While the use of a required registered office in Canada may have the possible effect of fixing the corporate residence, the *Canada Business Corporations Act* envisages and permits the use of extra-territorial offices for accounting and directors' records.[24] Notwithstanding the necessity of a Canadian registered office, the directors may, unless the articles or by-laws otherwise provide, meet to transact business at any place they deem fit, whether inside or outside Canada.[25] The same option is available to shareholders in respect of their meetings, provided all shareholders entitled to vote at that meeting so agree.[26]

C. *Central management and control*

Regardless of the rules respecting resident Canadian directors and Canadian registered offices, a continued corporation may practically and validly perform the bulk of its corporate operations extra-territorially — indeed, in the foreign jurisdiction where it was initially incorporated. While the *Canada Business Corporations Act* attempts to impart a Canadian identity to the corporate vehicle, it is fair to say that the legislation does not seek to attribute to the corporation a defined residence for the purpose of income taxation. While the statutory definition of residence has been discussed, the common law definition has still to be explored.

The statutory deeming of corporate residence in section 250(4) of the *Income Tax Act* does not by its wording purport to provide a definition of residence, nor is it intended to be all-encompassing if such a definition is provided elsewhere. It does not, for example, rule out the possibility of a multiplicity of residences for tax purposes,[27] nor does it deny the traditional common law criteria for residency developed in *De Beers Consolidated Mines, Ltd* v. *Howe*.[28] This judgment set forth the following principles:

(1) a company resides for the purposes of income tax where its

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[23] *Ibid.*, ss. 181(2), 6(1)(b), 19(1).
[24] *Ibid.*, s. 20(2), (3), (4), (5).
[25] *Ibid.*, s. 109(1).
[26] *Ibid.*, s. 126(2).
[27] See, *e.g.*, *Income Tax Act*, s. 214(13)(b).
[28] [1906] A.C. 455 (H.L.) *per* Lord Loreburn L.C.

real business is carried on, that is, where the central management and control actually abide;

(2) the test for corporate residency is a pure question of fact, to be determined, not according to corporate regulations or by-laws, but by a scrutiny of the course of business and trading;

(3) factors to be considered in determining residence include: the location of the principal business office, the location of the directors' meetings, the residence of a majority of the directors, the place of incorporation and registered office, and the location of the policy and decision-making process of the entire corporate activity.[29]

The residency of directors and the place of registered offices and meetings are therefore factors to be used in determining corporate residence. While it is admitted that these factors have played an often crucial role in judicial consideration of the problem,[30] there is little doubt that their presence is not conclusive. The courts are willing to disregard the formal or minimal statutory requirements of the company in favour of its "real business" location. In effect, formal characteristics of the company are often used as a mere accessory tool in determining the true tax residence of the corporate undertaking.[31] The following table provides an analysis of the factors, including statutory requirements, used in Canada in determining residence.

This review of the Canadian jurisprudence indicates that there is a correlation between a finding of Canadian residency and the fact that a majority, if not all, of the directors are resident Canadians. The correlation is not absolute, however, nor is it divorced from the overriding consideration that the resident directors are as well the *de facto* managers and controllers of the corporation. The location of incorporation and the existence of a registered office is given little consideration except as corroboration of the site of central management. Where formal meetings are held by nominal directors or shareholders, the location of such meetings is not

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[29] *Ibid.*, 458-59.

[30] See table, *infra*, p. 116.

[31] The Judicial Committee appears to emphasize the formal aspects of the corporate set-up in *British Columbia Elec. Ry* v. *The King* [1946] A.C. 527, 538 (P.C.). Unlike the requirements under the *Canada Business Corporations Act*, the company in that case was obliged by its articles of association to hold all general and directors' meetings in Canada, and all directors were required to be resident Canadians. On a similar fact pattern with the contrary emphasis, see *Egyptian Delta Land & Inv. Co.* v. *Todd* [1929] A.C. 1, 15 (H.L.).

	Canadian Central Management and Control or Dual Residence	Canadian Managing Personnel	All or Majority of Directors Resident	Canadian Registered and/or Administrative Office	Bank Account, Property, Contracts in Canada	Directors' and/or Shareholders' Meetings in Canada	Canadian Incorporation	Controlled by Canadian Resident Shareholder
Resident[A]	—	—	—	—	—	—	—	0
Resident[B]	—	—	—	—	—	0	0	0
Resident[C]	—	—	—	—	—	—	—	0
Resident[D]	—	—	—	—	—	—	0	0
Non-Resident[E]	0	0	0	—	0	—	—	X
Non-Resident[F]	0	0	—	—	—	X	—	0
Non-Resident[G]	0	0	0	X	0	0	0	—
Non-Resident[H32]	0	0	0	0	—	0	0	X

— applicable 0 not applicable X unknown from fact pattern

deemed significant. No judicial decision applies the strictly *de jure* approach in analyzing the question of central management and control. Accordingly, one may conclude that the residency requirements under the *Canada Business Corporations Act* do not conclusively determine the income tax residence of a continued corporation.

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[32] A) *Bedford Overseas Freighters Ltd* v. *M.N.R.* [1970] C.T.C. 69 (Ex.). See also *Unit Constr. Co.* v. *Bullock* [1960] A.C. 351 (H.L.).

B) *M.N.R.* v. *Crossley Carpets (Canada) Ltd* [1968] C.T.C. 570 (Ex.), *aff'g* 67 D.T.C. 522 (T.A.B.).

C) *Zehnder & Co.* v. *M.N.R.* [1970] C.T.C. 85 (Ex.). See also *Sifneos* v. *M.N.R.* [1968] Tax A.B.C. 652.

D) *B.C. Elec. Ry* v. *The King, supra,* note 31. See also *American Wheelabrator & Equip. Corp.* v. *M.N.R.* (1951) 4 Tax A.B.C. 356.

E) *M.N.R.* v. *Tara Explor. & Dev. Co.* [1974] S.C.R. 1057, [1972] C.T.C. 328, 72 D.T.C. 6288.

F) *Yamaska S.S. Co.* v. *M.N.R.* (1961) 61 D.T.C. 716 (T.A.B.).

G) *Victoria Ins. Co.* v. *M.N.R.* [1977] C.T.C. 2443 (T.R.B.).

H) *The Hampstead Apts Ltd* v. *M.N.R.* [1971] Tax A.B.C. 1161.

III. Deemed residence

The principal question whether a foreign corporation continued after December 15, 1975 under the *Canada Business Corporations Act* may be deemed resident in Canada in accordance with section 250(4) of the *Income Tax Act* may now be considered.

Although continuance subjects a corporation to the *Canada Business Corporations Act* as if it had been incorporated under that Act, the fact of continuance does not affect pre-existing corporate rights and liabilities, including shareholders' rights. Continuance does not create a new corporate entity by way of reincorporation; it merely subjects imported corporations to new internal jurisdictional rules as of the date of continuance. The non-creative aspect of continuance may be more clearly seen in the treatment of federal companies incorporated under the *Canada Corporations Act*[33] which are required to continue under the new Act by December 15, 1980: the purpose of continuance in this regard is not to cause a reincorporation, but to subject all federal companies, without change in identity or existence, to the new legislation at an orderly pace.[34] The suggested consequence is that continued corporations do not fall under the deemed-resident provisions of section 250(4).

The residency issue has been indirectly treated by the Department of National Revenue in an advance ruling[35] respecting the tax implications of a continuance into Alberta of an Ontario corporation. The Department ruled that a company incorporated in Ontario prior to 1960 will not be considered to have been incorporated in Alberta after April 26, 1965 within the meaning of section 250(4) of the *Income Tax Act* where continuance occurs after that date. Although inter-provincial continuance is not within the scope of the present discussion, there is no substantive difference between federal and provincial statutory mechanics and effects of continuance.

It is further suggested that the words "incorporated in Canada" used in section 250(4) must refer to the creation of the corporate vehicle with its original powers, rights and liabilities. The word "incorporated" used in section 250(4)(a), for example, cannot be said to include "incorporated by continuance" because it is statutorily impossible to have federally continued corporations on April 27, 1965. Certainly Parliament is entitled to alter the meaning of

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[33] R.S.C. 1970, c. C-32.

[34] *Canada Business Corporations Act*, S.C. 1974-75-76, c. 33, s. 4.

[35] Ruling No. TR-1, June 24, 1974.

words used in prior legislation by subsequent statutory instrument; but there is little[36] to justify a radical expansion of the term "incorporated" as used in the tax legislation. One might be tempted to look by way of analogy to the mechanism of amalgamation and the recent decision of the Supreme Court of Canada in *Deltona Corp.* v. *M.N.R.*[37] In that case, two Canadian incorporated companies controlled by an American parent corporation were amalgamated in Canada. When the assets of the amalgamated company were subsequently liquidated by way of dividend distribution, the Minister imposed a fifteen per cent non-resident tax on the distribution, alleging that the amalgamated company was resident in Canada. The Court held that the amalgamated company was deemed to be resident in Canada by virtue of section 139(4a)(a)[38] [now 250(4)(a)] of the *Income Tax Act,* since the amalgamation itself constituted an "incorporation" within the meaning of that section.[39] It is to be noted that the applicable companies legislation at the time[40] referred, as it does now,[41] to the amalgamated companies being "continued" as one corporation as a juridical consequence of the fusion. Nevertheless, a clear distinction must be drawn between the mechanisms of amalgamation and continuance: the former results in a corporation that did not exist before,[42] the latter in the acquisition by a pre-existing corporation of Canadian corporate status. The distinguishing aspect of amalgamation is expressly confirmed in section 87(2) of the *Income Tax Act,* which indicates that the corporate entity formed as a result of the amalgamation shall be deemed to be a new corporation, the first taxation year of which shall be deemed to have commenced at the time of the amalgamation.

Notwithstanding the debate as to whether continuance implies reincorporation or jurisdictional modification of corporate existence, the peculiar wording of section 250(4) may arguably cover the

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[36] Aside from the ambiguous proposition in s. 181 of the *Canada Business Corporations Act.*

[37] (1973) 73 D.T.C. 5180, *aff'g* (1971) 71 D.T.C. 5186 (Ex.).

[38] R.S.C. 1952, c. 148, as am. by S.C. 1960-61, c. 49, s. 38(6) and S.C. 1965, c. 18, s. 28(4).

[39] *Supra,* note 37, 5199-5200.

[40] *Canada Corporations Act,* s. 137(13)(a).

[41] *Canada Business Corporations Act,* s. 180(a).

[42] The conclusion is drawn by Cattanach J. in the case of *Deltona Corp.* v. *M.N.R., supra,* note 37, 5200 (Ex.). See also *Stanward Corp.* v. *Denison Mines Ltd* [1968] S.C.R. 441; and Income Tax Rulings TR-3, July 8, 1974; TR-37, August 9, 1976.

case of certain continued corporations. Let us deal with the case of a company incorporated in December 1965 in a foreign jurisdiction and continued in 1977 in Canada. Section 250(4)(a) deems resident a corporation "incorporated after April 26, 1965" (which is our case), *and* "incorporated in Canada" (which it may be, by way of continuance, in 1977). If we read the statutory phrasing as referring to a corporation which has a double birth date — that of its initial foreign incorporation and that of continuance — then continued corporations may be deemed resident. However, even upon a liberal reading of the statute, it is evident that continued corporations originally incorporated prior to April 27, 1965 which never subsequently carried on business nor situated central management and control in Canada would not be deemed to be resident. We are then faced with the unacceptable premise that the legislature seeks to discriminate among imported continued corporations according to the year of initial incorporation. Even if such discrimination were acceptable, due regard must be given to the grammar of the deemed-resident provisions of the provincial tax statutes, such as the Quebec *Taxation Act*,[43] which deems resident a corporation which "was incorporated in Canada after April 26, 1965" without making further reference to an arguable second birth date of the corporation. A clear incompatibility on the notion of residence between federal and provincial statutes could neither have been envisioned nor intentionally created.

In the event that continuance is ultimately determined by the courts to mean the extinction of the original corporation and reincorporation under section 250(4), the consequences appear varied. A corporation incorporated in Canada after April 26, 1965 and continued under a foreign jurisdiction in accordance with section 182 of the *Canada Business Corporations Act* may be taxed on a deemed disposition of its property under section 48(1) of the *Income Tax Act*, provided that it had always been a *de facto* non-resident. The original corporation, if extinguished by continuance in Canada, would likewise be taxed on the disposition of its taxable Canadian property which would theoretically accrue to the new continued corporate entity. Such a continued corporation would fall within the meaning of a "Canadian corporation" and a "taxable Canadian corporation"[44] and consequently would obtain some qualification for the small business deduction,[45] dividend tax

[43] S.Q. 1972, c. 23, s. 11(a).
[44] *Income Tax Act*, s. 89(1)(a) and (i).
[45] *Ibid.*, s. 125.

credit in the hands of shareholders,[46] status as an investment or mutual fund corporation,[47] eligibility under the amalgamation rules,[48] and avoidance of the additional branch tax under Part XIV.[49] These implications at first appear disconcerting when we consider that it is theoretically possible for the continued corporation to situate its central management and control in its original incorporating jurisdiction, and effectively function as if it were still the original foreign corporation subject to the relatively mild burden of electing Canadian resident directors and having a formal office in Canada. However, where the continued corporation (for reasons of business practice, shareholders' desire, or simple inertia) retains its central management and control in the initial incorporating jurisdiction, the practical effect of section 250(4) would be to create a dual residency, making the corporation subject in certain circumstances to double taxation on its income from all sources.[50]

IV. Summary

The view implicitly accepted by the Department of National Revenue, and thus far uncontradicted by any court decision, supports the theory that federal continued corporations under the *Canada Business Corporations Act* are not to be deemed resident under section 250(4) of the *Income Tax Act.* This view is largely based on the understanding that continuance does not effect an incorporation *ex nihilo,* but merely creates a jurisdictional variance in the operations of an existing foreign company.

Lazar Sarna*

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[46] *Ibid.,* ss. 82(1)(b) and 121.
[47] *Ibid.,* s. 131(8).
[48] *Ibid.,* s. 87.
[49] *Ibid.,* s. 219.
[50] Subject to possible relief by tax treaty arrangements between the relevant jurisdictions: see Pyrcz, *The Basis of Canadian Corporate Taxation: Residence* (1973) 21 Can. Tax J. 374, 388-390.

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What is Interest? Tomell Investments Limited v. East Marstock Lands Limited

The division of legislative powers under sections 91 and 92 of the *British North America Act, 1867*[1] depends not only upon which particular federal and provincial laws are examined by the courts, but also upon the order in which those laws are examined. This is particularly true because the courts have always leaned in favour of the constitutionality of laws. Illustrative of this proposition are the decisions that have attempted to rationalize the potential overlap of the exclusive provincial jurisdiction over contracts[2] and Parliament's exclusive jurisdiction over interest.[3] As "interest" obviously is the narrower category of subject matter, the problem of overlap might have been easily solved by a constitutional challenge to the validity of the *Interest Act*.[4] However, it was not until the Supreme Court of Canada heard *Tomell Investments Ltd* v. *East Marstock Lands Ltd*[5] that such a challenge arose.

Of course, some sections of the *Interest Act*, such as sections 2 and 6, provided no problem.[6] Parliament has used only the word "interest" in those sections and, absent any definition of interest

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[1] 30-31 Vict., c. 3 (U.K.).

[2] Contracts fall within "Property and Civil Rights in the Province", *ibid.*, s. 92:13.

[3] *Ibid.*, s. 91:19.

[4] R.S.C. 1970, c. I-18. This statute was clearly enacted pursuant to s. 91:19, *ibid.*

[5] (1977) 77 D.L.R. (3d) 145, 16 N.R. 139 *per* Pigeon J. (Judson, Ritchie, Spence, Dickson and Beetz JJ. concurring; Laskin C.J.C. and Martland J. concurring in the result), *aff'g* the decision of the Ontario Court of Appeal (no recorded reasons), *aff'g* 8 O.R. (2d) 396, 58 D.L.R. (3d) 172 (H.C.). [References *infra* are cited to 77 D.L.R. (3d).]

[6] Ss. 2 and 6 read as follows:

2. Except as otherwise provided by this or by any other Act of the Parliament of Canada, any person may stipulate for, allow and exact, on any contract or agreement whatever, any rate of interest or discount that is agreed upon.

6. Whenever any principal money or interest secured by mortgage of real estate is, by the mortgage, made payable on the sinking fund plan, or on any plan under which the payments of principal money and interest are blended, or on any plan that involves an allowance of interest on stipulated repayments, no interest whatever shall be chargeable, payable or recoverable, on any part of the principal money advanced, unless the mortgage contains a statement showing the amount of such principal money and the rate of interest chargeable thereon, calculated yearly or half-yearly, not in advance.

in the Act, it has been safe to assume that those sections do not exceed Parliament's constitutional jurisdiction. It has been common ground in all the cases that the word "interest" must embrace, at a minimum, the day-to-day accrual of charges for money borrowed. Therefore, provincial legislation that sought simply to alter the rate of interest has been held to be *ultra vires*.[7] Yet the question has been whether the meaning of "interest" for constitutional purposes was wide enough to approximate the total cost for the use of the borrowed principal. A wider definition would embrace such phenoma as bonuses and penalties. Such items can be converted to a *per diem* accrual rate, but usually are collected collaterally to the contract specifying the interest rate (particularly in the case of mortgages), and often become payable only upon the happening of such contingencies as the debtor falling into arrears or the creditor being forced to take legal action.

In a series of decisions involving provincial legislation, culminating with the decision in *A.-G. Ontario* v. *Barfried Enterprises Ltd*,[8] the Supreme Court of Canada moved to restrict the meaning of "interest" to the narrowest of concepts, the *per diem* accrual.

In *Barfried, The Unconscionable Transactions Relief Act*[9] was alleged to be legislation in relation to interest. By section 2 of that Act, the Court was empowered to rewrite a contract of lending if it concluded that the cost of the loan was excessive and the transaction harsh and unconscionable. The "cost of the loan" was defined to mean (in part): "... the whole cost to the debtor of money lent and includes interest, discount, subscription, premium, dues, bonus, commission, brokerage fees and charges [.]"[10]

The majority held that the legislation was in relation to property and civil rights and only incidentally affected interest. To reach this conclusion, Mr Justice Judson felt compelled to restrict the meaning of "interest":

> The day-to-day accrual of interest seems to me to be an essential characteristic. All the other items mentioned in [the cost of the loan in]

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[7] *Reference Re Sask. Farm Sec. Act* [1947] S.C.R. 394, [1947] 3 D.L.R. 689, *aff'd* [1949] A.C. 110 (*sub nom. A.-G. Sask.* v. *A.-G. Can.*), [1949] 1 W.W.R. 742 (*sub nom. Ref. re The Farm Sec. Act, 1944 (Sask.)*) (P.C.); and *Board of Trustees of the Lethbridge N. Irrig. Dist.* v. *IOF* [1940] A.C. 513, [1940] 2 D.L.R. 273, [1940] 1 W.W.R. 502 (P.C.).

[8] [1963] S.C.R. 570, 42 D.L.R. (2d) 137 *per* Judson J. (Taschereau C.J., Cartwright, Fauteux and Hall JJ. concurring; Martland and Ritchie JJ. dissenting), *rev'g* [1962] O.R. 1103, 35 D.L.R. (2d) 449 (C.A.).

[9] Now R.S.O. 1970, c. 472.

[10] *Ibid.*, s. 1(a).

> *The Unconscionable Transactions Relief Act* except discount lack this characteristic. They are not interest. In most of these unconscionable schemes of lending the vice is in the bonus.[11]

The majority also saw no conflict with section 2 of the *Interest Act* which permits parties to stipulate whatever rate of interest they wish.[12] However, Martland and Ritchie JJ. in dissent, while refusing to pass upon the validity of the Act, did see a conflict with section 2:

> The power of the Court to act under this Act arises only if it has found that the cost of the loan is excessive. It is true that it must also find the transaction to be harsh and unconscionable, but it may happen, as it did in the present case, that the judge who hears the case decides that the transaction is harsh and unconscionable because of the excessive cost of the loan. The result is that the very Court to which a creditor must resort in order to enforce payment of the interest or discount which the *Interest Act* says he may exact is, by the Provincial legislation, empowered to decide whether that interest or discount is, in all the circumstances, excessive. Furthermore, if that Court decides that it is excessive and that the transaction is harsh and unconscionable, it may relieve the debtor of the obligation of paying that portion of his obligation which it considers to be excessive, and thus is in a position to relieve him from the payment of an obligation which the Parliament of Canada has stated the creditor is entitled to exact from him.[13]

In my view the meaning of "interest" subscribed to by the majority in *Barfried* is too restrictive, if not unrealistic, and, as has been indicated,[14] throws doubt upon the validity of federal legislation such as the *Small Loans Act*.[15]

In *Tomell*,[16] the Supreme Court had to rule upon the validity of section 8 of the *Interest Act*, which states:

> 8.(1) No fine or penalty or rate of interest shall be stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage of real estate, that has the effect of increasing the charge on

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[11] *Supra*, note 8, 575.

[12] See *supra*, note 6.

[13] *Supra*, note 8, 582-83.

[14] Rayner & McLaren (eds.), *Falconbridge On Mortgages* 4th ed. (1977), 679-80.

[15] R.S.C. 1970, c. S-11, of which s. 2 reads in part: "'cost' of a loan means the whole of the cost of the loan to the borrower whether the cost is called interest or is claimed as discount, deduction from an advance, commission, brokerage, chattel mortgage and recording fees, fines, penalties or charges for inquiries, defaults or renewals or otherwise, and whether paid to or charged by the lender or paid to or charged by any other person, and whether fixed and determined by the loan contract itself, or in whole or in part by any other collateral contract or document by which the charges, if any, imposed under the loan contract or the terms of the repayment of the loan are effectively varied [.]"

[16] *Supra*, note 5.

> any such arrears beyond the rate of interest payable on principal money not in arrears.
>
> (2) Nothing in this section has the effect of prohibiting a contract for the payment of interest on arrears of interest or principal at any rate not greater than the rate payable on principal money not in arrears.

Default had entitled the lender to a bonus equal to three months interest on the principal. The monthly interest on the principal was $6,000, at the specified rate of sixteen per cent. The arrears amounted to six months, or $36,000. The payment of the bonus would thus be $18,000, indicating a rate of fifty per cent on the arrears. This was clearly a breach of section 8(1).[17]

The Court had faced the interpretation, but not the constitutionality, of section 8 in *Immeubles Fournier Inc.* v. *Construction St-Hilaire.*[18] In that case, Mr Justice Pigeon held that the words "fine" and "penalty" must mean something more than "interest" and could not be equated thereto:

> In my view, we should not in any way here decide on the extent of the federal power regarding interest. Any adoption of a construction of s. 8 by reference to the extent of that power would, at least in the circumstances of this case, be tantamount to a decision on the extent of that power. Clearly this would be the very object of any argument on constitutionality if the issue of constitutionality were raised. In my opinion, s. 8 must consequently be construed irrespective of the argument that respondent seeks to make from the provisions of the constitution, and accordingly the constitutional question must be left completely open.
>
> As to the construction of the section by itself, I have already indicated why it does not appear to me that the words "penalty" and "fine" can be limited to what would be interest, that is to something accruing on a daily basis. This is not a case in which the maxim *noscitur a sociis* should be applied, as counsel for the respondent urged us to do, relying on certain sentences found in *Maxwell on the Interpretation of Statutes*, 10th ed., p. 332. One needs only read the cases cited by the author to see that his statement cannot apply in the present circumstances. The suggested construction would amount to no less than depriving the words "penalty" and "fine" of any meaning, since "rate of interest" obviously includes whatever may be described as interest.[19]

In *Tomell,* Mr Justice Pigeon reiterated both the *Barfried* and *St-Hilaire* decisions, holding that interest meant day-to-day accrual and that the words "fine" and "penalty" in section 8 must refer

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[17] It should be noted that if the arrears had amounted to $112,500, the bonus of $18,000 (three months interest) would not have offended s. 8(1), as it would then have represented a rate of 16% on the arrears.

[18] [1975] 2 S.C.R. 2, 52 D.L.R. (3d) 89, 10 N.R. 541 *per* Pigeon J. (Laskin C.J.C., Spence, Dickson and Beetz JJ. concurring; Martland, Judson, Ritchie and de Grandpré JJ. dissenting), *rev'g* [1972] C.A. 35 (Que. C.A.).

[19] *Ibid.,* 16.

to something other than interest.[20] He stressed that interest could not be equated to cost of loan.[21] However, he did find that Parliament had the right to specify the rate of interest on arrears and that, to make the legislation effective, it also had the right to deal with matters that were not interest, such as fines and penalties: not to permit Parliament to do so would rob it of effectiveness.[22] He thus found the legislation valid on the doctrine of ancillary powers:

> In my opinion, s. 8 of the *Interest Act* is valid federal legislation in respect of interest because, although it does not deal exclusively with interest in the strict sense of a charge accruing day by day, it is, insofar as it deals with other charges, a valid exercise of ancillary power designed to make effective the intention that the effective rate of interest over arrears of principal or interest should never be greater than the rate payable on principal money not in arrears.[23]

Chief Justice Laskin saw no need to rely upon the doctrine of ancillary powers and stated cryptically:

> Parliament is, in my view, entitled to require creditors to abstain from making or exacting a charge on arrears that goes beyond the rate of interest fixed for principal not in arrears and, in that respect, to prevent them from escaping the stricture through a designation of the charge as a fine or a penalty. This is an assertion of the interest power *simpliciter*, and, as in *Attorney-General of Canada* v. *Nykorak* (1962), 33 D.L.R. (2d) 373, [1962] S.C.R. 331, 37 W.W.R. 660, it is unnecessary to invoke any doctrine of ancillary power.[24]

Thus, the decision would seem to permit the enactment of federal legislation embracing matters that are not interest. If interest is not to be equated to the total cost of a loan, but Parliament may legislate with respect to charges that are not interest in order to enforce its stipulated rates, where is the line to be drawn?

The decision seems to be consistent with earlier jurisprudence in confirming that, for constitutional purposes, "interest" is confined to charges that accrue on a daily basis. Admittedly, the Laskin judgment is open to the interpretation that the meaning of "interest" is not so circumscribed.

Partly as a result of the order in which the issues have been adjudicated, the jurisdictional boundaries have been obscured and there exists at this point a measure of functional concurrency[25] in

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[20] *Supra*, note 5, 150-51.
[21] *Ibid.*, 153.
[22] *Ibid.*, 151.
[23] *Ibid.*, 154.
[24] *Ibid.*, 147.
[25] See Leigh, *The Criminal Law Power: A Move Towards Functional Concurrency?* (1967) 5 Alta L. Rev. 237.

the field of financing of borrowed money. The provinces may clearly legislate in relation to interest in some circumstances and Parliament may clearly legislate with respect to charges that are not interest in some circumstances. As a result, the meaning of "interest" has become less important than the possibility of conflict or repugnancy between federal and provincial legislation as analysed by Martland and Ritchie JJ. in *Barfried.*[26] A clearer interpretation of interest might be achieved in future by a reference or private pursuit of the constitutionality of the *Small Loans Act.*[27]

J. A. MacKenzie*

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[26] See *supra,* p. 123.

[27] R.S.C. 1970, c. S-11.

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