# The "One-Man Company": Some Principles of Taxation

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Although traditionally the corporation has been a favoured form of business organization because it offers such advantages as limited liability, it has become, with the introduction of the progressive income tax, an important vehicle for tax planning. The purpose of this discussion is to examined some of the principles of the law of taxation that come into play when the corporate entity is employed to achieve tax planning objectives. Particular emphasis is laid on those that are relevant to the closely held corporation, which in the jargon that has developed, is commonly referred to as the "one-man company".

## Canadian View of the Corporate Entity

Any discussion of the corporate entity must begin with the decision in *Salomon* v. *Salomon and Company, Limited*[1] where the House of Lords affirmed that incorporation was a privilege open to anyone who could meet the technical requirements of the relevant legislation, and that the corporation once formed must be recognized as separate and distinct from its corporators. Lord Halsbury L.C., summarized the views of their Lordships when he stated:

> ...it seems to me impossible to dispute that once the company is legally incorporated, it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.

One may reasonably question whether the principle enunciated in the *Salomon's* case, which dealt with a question of limited liability, should also be applied to recognize the shareholder and the corporation as distinct legal persons for taxation purposes. But the scheme of the Canadian Income Tax Act[2] is based on the premise that they are distinct, and that each is subject to tax separately.[3] Thus, in interpreting its provisions, it must be assumed that it was the intention

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* Of the Ontario Bar.

1 [1897] A.C. 22.

2 R.S.C. 1952, c. 148 as amended.

3 See, for example, ss. 139(1)(*ac*), 2, 6(1)(*a*)(*i*), 8, 17 and 81 of the Income Tax Act.

of Parliament, in the absence of special provisions in the Act,[4] to apply the general principles of corporate law in determining whether tax is to be imposed in any particular set of circumstances.

This was the approach adopted by the English Courts in interpreting the British tax legislation. For example, in *The Gramophone & Typewriter Limited* v. *Stanley*,[5] the English Court of Appeal held that the mere fact that an English company held all the shares of the German company did not subject the profits of the business of the German company to income tax in England as profits of the English company. Similarly, in *C.I.R.* v. *Sansom* [6] the Court of Appeal held that loans made to the sole shareholder of a corporation which in fact were never repaid could not in law constitute a distribution of the corporation's profits to the shareholder.[7]

The leading Canadian authority on this question is *Pioneer Laundry and Dry Cleaners, Limited* v. *M.N.R.*,[8] where the taxpayer appealed to the Judicial Committee of the Privy Council with respect to its liability for tax under the Canadian Income War Tax Act.[9] The appellant had sold its depreciable assets to an affiliated company at their appraised values and then sought to depreciate them at those values to arrive at taxable income. The Privy Council disagreed with the Minister and the Courts in Canada affirming that the depreciation base could be increased in this way. Lord Thankerton speaking for the Board said:[10]

> ... [The Minister] ... was not entitled, in the absence of fraud or improper conduct, to disregard the separate legal existence of the appellant company, and to inquire as to who its shareholders were and its relation to its predecessors. The taxpayer is the company and not its shareholders.

If any doubt remained as to the ambit of the right of a Canadian taxpayer to confound the tax collector by using the corporate entity, it must have been completely dispelled by the decision of the Supreme Court of Canada in *Army and Navy Department Store Limited* v. *M.N.R.*[11] The Supreme Court, by a majority judgment, in effect agreed with the taxpayer's contention that shares held by a group of individu-

[4] See, for example, ss. 8, 39, 67, 81, 138A(1) & (2), 139(5) and 105 of the Income Tax Act.

[5] [1908] 2 K.B. 89, 5 T.C. 358.

[6] [1921] 2 K.B. 492.

[7] The Privy Council confirmed that both the *Gramophone* and *Sansom* cases represented the law of Canada in *Export Brewing & Malting Co.* v. *Dominion Bank* [1937] 3 D.L.R. 513, a case which did not deal with the imposition of tax.

[8] [1940] A.C. 127.

[9] R.S.C. 1927 c. 97.

[10] [1940] A.C. 127, at p. 137.

[11] [1953] 2 S.C.R. 496, 53 D.T.C. 1185 (S.C.C.).

als through an intermediary holding company were not "owned by them directly or indirectly".[12]

### Instances of Non-recognition of the Corporate Entity

While it is fundamental to the corporate and tax law of Canada that a corporation is an entity distinct from its shareholders, the Courts have nevertheless held that in some instances, despite incorporation, the business or property in law remains that of the controlling shareholder. In doing so the Courts have frequently found that the corporation was merely an agent or sometimes a "sham, simulacrum, cloak, or *alter ego*" for the controlling shareholder.

The admonition that such a finding was possible in tax cases was clearly made by Lord Cozens-Hardy, M.R., in the *Gramophone* case.[13]

> I do not doubt that a person in that position [i.e. owning all the shares of the company] may cause such an arrangement to be entered into between himself and the company as will suffice to constitute the company his agent for the purpose of carrying on the business, and thereupon the business will become, for all taxing purposes, his business. Whether this consequence follows is in each case a matter of fact.

Lord Sterndale, M.R. in the *Sansom* case, *supra*, stated the principle in the following way:[14]

> There may... be a position such that although there is a legal entity within the principle of *Salomon* v. *Salomon & Co.*, that legal entity may be acting as the agent of an individual and may really be doing his business and not its own at all. Apart from the technical question of agency it is difficult to see how that could be, but it is conceivable. Therefore the mere fact that the case is one which falls within *Salomon* v. *Salomon & Co.* is not of itself conclusive. It goes some considerable way, but it is not conclusive.[15]

It is on this basis that the decision of the Supreme Court of Canada was adverse to the taxpayer in *Colgate-Palmolive-Peet Company, Limited* v. *The King*.[16] In that case, two companies, one Ontario and

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[12] The strict view of the corporate entity has operated to the disadvantage of the unwary taxpayer. For example, where a parent company has made good the losses of its subsidiary, the amounts paid could not be said to be exclusively laid out for the purpose of the shareholder's trade. *Odham's Press Ltd.* v. *Cook* [1940] 3 All E.R. 15, c.f., *Topper* v. *M.N.R.* 65 D.T.C. 5018.

[13] [1908] 2 K.B. 89, at p. 96.

[14] *Supra* at [1921] 2 K.B. 492.

[15] See also the brewery cases: *St. Louis Breweries, Ltd.* v. *Apthorpe* (1898) 4 T.C. 111; *United States Brewing Co., Ltd.* v. *Apthorpe* (1898) 4 T.C. 17; *Apthorpe* v. *Peter Schoenhofen Brewing Co., Ltd.* (1899) 4 T.C. 41 and more recently *Firestone Tyre and Rubber Co.* v. *Llewellin* [1957] 1 W.L.R. 464 (H.L.).

[16] [1933] S.C.R. 131; 1 D.T.C. 238.

the other Dominion, were incorporated by the same U.S. parent company. The Ontario company manufactured goods and sold them to the Dominion company which in turn sold them to the public. The Crown sought to impose a sales tax on the Dominion company's sale price on the basis that the Dominion company was the "producer or manufacturer at the time of the sale". Their Lordships were obviously impressed by the evidence that indicated that the Ontario company had to carry out the instructions of the Dominion company and that the Ontario and Dominion companies did not deal with each other as free agents. Cannon, J. speaking for the Court concluded:[17]

> ...we must, as matters of fact, identify the producer of the goods and determine the real price received by such producer when selling them to the public for consumption. In this case, it is abundantly clear that the Palmolive soap is produced and sold to the public by a combination of these two incorporated departments of a foreign company doing business here in order to reach the Canadian consumer. While the two companies are separate legal entities, yet in fact, and for all practical purposes, they are merged, the Ontario company being but a part of the Dominion company, acting merely as its agent and subject in all things to its proper direction and control.[18]

It is unfortunate that in many cases the Courts have chosen to describe the corporation in such terms as *"alter ego"*, "cloak", "simulacrum" or even "agent" to justify their conclusion that the separate existence of the corporation is to be ignored. If literally applied as a test to determine when the corporate entity is to be ignored, it is difficut to see how there could not be a finding in every case of the "one-man company" that the company is merely acting as agent for its shareholder. *Salomon's* case is, of course, direct authority that such a finding cannot be made in every case and therefore the question arises: when is a court entitled to find that the corporation is "agent" for the shareholder, or more properly, that the legal separation of shareholder and corporation has not been achieved ?[18]

At least part of the answer lies in the relationship that is established between the shareholder and the corporation. As a very minimum, the corporation must be vested with the assets with which its business is to be carried on.[19] Moreover, the affairs of the shareholder and those of the corporation cannot be so confused and intertwined that it is not clear to third persons whether it is the corporation or the shareholder that is carrying on the business — the principle being that if the shareholder disregards the corporate entity, he cannot expect outsiders, including the Tax Department, to be bound by the separation of shareholder and corporation.

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[17] *Ibid.*, at p. 140.

[18] See also: *Canada Rice Mills, Ltd.* v. *The King* [1939] 3 All E.R. 991.

[19] See, for example, *Apthorpe* v. *Peter Schoenhofen Brewing Co. Ltd.*, (1899), 4 T.C. 41.

This principle was stated by Rand, J., in *Toronto* v. *Aluminum Company of Canada Limited*[20] in the following way:

> The question, then, in each case, apart from formal agency which is not present here, is whether or not the parent company is in fact in such an intimate and immediate domination of the motions of the subordinate company that it can be said that the latter has, in the true sense of the expression, no independent functioning of its own.

Although the Courts have never said so specifically, it appears that they also look to the activity which is carried on by the shareholder to determine whether it is appropriate to separate the functions allocated to the corporation from the business of the shareholder.

For instance in *Kindree* v. *M.N.R.*[21] a medical doctor transferred his practice and clinic to a company with which he purported to make a contract of employment, under which he was to receive a fixed salary. The Exchequer Court refused to recognize that the medical practice could be carried on in the corporate form and, accordingly, held that the medical fees were received by the medical doctor in his personal capacity. Cattanach, J., in arriving at this conclusion, stated:

> In my opinion, the appellant is precluded in fact and in law and as a matter of public policy from practising the profession of medicine in any of its forms as agent of a body corporate and the document purporting to be a contract of employment between the appellant and the Company did not establish an employer-employee relationship. Similarly so, the documents purporting to be contracts of employment between the other doctors and the Company did not establish an employer-employee relationship as between them and the Company, but rather such relationship subsisted between them and the appellant.

It is well established, however, that the fact that a corporation's business is illegal does not prevent the profits from being considered its income and subject to tax.[22] Rather, it appears that the Court has made a judgment that in the circumstances the corporation was not the appropriate vehicle for carrying on a medical practice, and, therefore, no recognition could be made of its activities in determining the tax liability of the doctor who was its principal shareholder.[23]

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[20] [1944] S.C.R. 267 at p. 271; See also *Toronto* v. *Famous Players Canadian Corp.* [1935] 3 D.L.R. 327, af'd. [1936] S.C.R. 141, where dividends from operating subsidiairies were considered to be business income.

[21] 64 D.T.C. 5248 (Ex. Ct.).

[22] C.f. *Minister of Finanee* v. *Smith*, [1927] A.C. 193; *Mann* v. *Nash*, [1932] 1 K.B. 752.

[23] There are authorities which indicate that as a matter of law a corporation is incapable of carrying on a profession: *William Esplen, Son & Swainston, Ltd.* v. *C.I.R.*, [1919] 2 K.B. 731; *I.R.C.* v. *Peter McIntyre, Ltd.*, 12 T.C. 1006. At least there is a judicial bias against it. Compare *Shulman* v. *M.N.R.*, [1961] C.T.C. 385 and *Peate* v. *Commissioner of Taxation*, [1966] 2 All E.R. 766.

The recent decision of the Exchequer Court in *M.N.R.* v. *Consolidated Mogul Mines Limited*,[24] is another example where the ambit of the business attributed to the shareholder was not co-extensive with the "corporate borders". In that case the Exchequer Court held that the appellant's principal business was "mining or exploring for minerals" even though the actual exploration and mining activities were carried out by affiliated companies.[25]

### The Corporate Entity and Commercial Intention

Thus far our inquiry has been directed to the circumstances in which the Courts are entitled to find that business is carried on by the shareholder and not by the corporation. There are, however, instances where there is no doubt that the property is vested in the corporation, or that the proceeds resulting from sale of the property belong to the corporation. The only issue is whether a sale was made in the course of its business or whether it is properly characterized as a realization of capital investment.

In making such a determination the Courts in many cases have looked to the intentions of the natural persons who are the corporation's shareholders.[26] For example, in *Regal Heights Limited* v. *M.N.R.*,[27] certain lands which had originally been purchased for the construction of a large shopping centre were transferred to a corporation which subsequently disposed of the land for a considerable profit. Judson, J. who delivered the reasons for the majority judgment of the Supreme Court of Canada, agreed with the Minister that the profit resulted from an adventure in the nature of trade, and held that it was not open to the appellant company to argue that its intentions were to be considered separate from those of its shareholders. He said:

> Throughout the existence of the appellant company, its interest and intentions were identical with those of the promoters of this scheme. One of the objects stated in a memorandum of association of the company was 'to construct and operate apartment houses, blocks, shopping centres and to otherwise

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[24] 66 D.T.C. 5008.

[25] For a discussion of the "Enterprise Entity" theory which has developed much further in the U.S.A., see Berle, "The Theory of Enterprise Entity", (1947) 47 Col. L.R. 343. It is interesting to speculate whether the "enterprise entity theory" is really only an aspect of the principle that the corporate entity will be ignored where the shareholder is in "intimate and immediate domination" of its affairs. If the business of the shareholder is not conveniently severable from that of the corporation is it not likely that just such a relationship will be established ?

[26] To determine uniquely human attributes from those of the shareholders who are natural persons is consistent with *Daimler Co.* v. *Continental Tyre & Rubber Co.*, [1916] 2 A.C. 307 (H.L.).

[27] [1960] S.C.R. 902.

carry on any business which may be conveniently carried on in the shopping centre'. Nothing turns upon such a statement in such document. The question to be determined is not what business or trade the company might have carried on but rather what business, if any, it did in fact engage in. (*Sutton Lumber and Trading Co. Ltd.* v. *M.N.R.* [1953] 2 S.C.R. 77). What the promoters and the company did and intended to do is clear to me on the evidence, as it was to the learned trial judge.

Even where a transaction would otherwise not be considered to have been made during the course of trade, if the corporate powers envisage such a transaction as part of its business, there is a tendency for the Courts to regard it to be within the stated intention for which the company was formed and therefore productive of taxable income.[28] The question that as yet has not been satisfactorily answered is whether an individual or corporation trading in assets capable of being held as an investment can segregate a portion of those assets for investment purposes by incorporation so that any gain realized upon their ultimate disposition will be considered to be received on account of capital rather than as income.[29]

**Transactions Between Shareholder and Corporation**

If in law the corporation and its shareholder are separate legal entities, it follows logically, and the Courts have so held, that the property of the corporation is not the property of the shareholder. This principle has been recognized by the Courts for tax purposes[30] although presumably it is open to a Court to find that in appropriate circumstances the corporation was merely an "agent" or *"alter ego"* of the shareholder.[31]

Therefore, if a shareholder is to be subject to income tax, it must be in respect of amounts received as income arising from the shares which he holds and not from the property of the corporation.[32] Accordingly if a corporation chooses to pay a stock dividend, although it may be in the form of a redeemable security coinciding in value

[28] See, for example, *Atlantic Sugar Refineries* v. *M.N.R.* [1949] C.T.C. 196; 49 D.T.C. 602 (S.C.C.); and *Balstone Farms Ltd.* v. *M.N.R.* 66 D.T.C. 5482.

[29] The recent decision in *Foreign Power Securities Limited* v. *M.N.R.*, 66 D.T.C. 5012, indicates that it is possible. At the time of writing, the decision is under appeal to the Supreme Court of Canada.

[30] See, for example, *Army and Navy Department Store Limited* v. *M.N.R.*, [1953] 2 S.C.R. 496.

[31] See, for example, *Leckie Estate* v. *M.N.R.*, 66 D.T.C. 5237, where the Exchequer Court found that the place of transfer of a corporation was where the principal shareholder was domiciled because the shareholder did not consider the corporation as distinct from himself.

[32] *I.R.C.* v. *Reid's Trustees*, [1949] 1 All E.R. 354.

with the accumulated trading profits of the corporation, the further shares do not constitute a realization of income but merely represent a rearrangement of the shareholder's investment in the corporation.[33]

Yet the law is also clear that when trading assets are disposed of for value, income is realized whether the consideration is in the form of money or money's worth, and shares of a corporation constitute money's worth.[34]

It becomes more difficult to determine when income is realized in circumstances where shares of a corporation are exchanged as part of the reorganization of an enterprise in which the shareholder is already participating. For instance, in *The Royal Insurance Company, Limited* v. *Stephen*,[35] the appellant company, a trader in shares, was required to accept new shares in an amalgamated company in exchange for the shares it held in the predecessor companies. The value of the new shares received was less than the original cost to the appellant of the shares surrendered, and the appellant claimed that the difference should be allowed as a deduction in computing its profits for tax purposes. Rowlatt, J., agreed with the appellant's claim, holding that the surrender of the old shares enabled the result of the company's holdings in those investments to be definitely ascertained, and therefore the loss had been realized. Rowlatt, J., expressed his reasons in his usual candid manner:[36]

> It is not a question of getting money as I have said. At the bottom of this principle of waiting for a realization, I think there is this idea: while an investment is going up or down, for Income Tax purposes the Company cannot take any notice of fluctuations, but it has to take notice of them when all that state of affairs comes to an end, when that investment is wound up I will say — "wound up" is an unfortunate expression perhaps and I will say when an investment ceases to figure in the Company's affairs, when it is known exactly what the holding of that investment has meant, plus or minus to the Company, and then the Company starts so far as that portion of its resources is concerned with a new investment.[37]

How then are these principles to be applied in the context of the "one man company" where the sole shareholder has transferred trading assets having a value in excess of his cost to a corporation, in con-

[33] *I.R.C.* v. *Blott*, [1921] 2 A.C. 171; 8 T.C. 101; *Re Waters*, [1956] S.C.R. 889; *Eisner* v. *Macomber* (1920) 252 U.S. 189, 4 Sup. Ct. 189.

[34] *California Copper Syndicate (Ltd. and Reduced)* v. *Harris* (1904) 5 T.C. 159; *Gold Coast Selection Trust* v. *Humphrey*, [1948] A.C. 459, [1948] 2 All E.R. 379, 30 T.C. 209.

[35] (1928) 14 T.C. 22.

[36] *Ibid.*, at p. 28.

[37] Contrast however, *British South Africa Company* v. *Varty*, (1965) 42 T.C. 406, where the House of Lords (Lord Guest dissenting) held that the exercise of the option by a trader in securities was not a realization of the asset.

sideration for the issuance of its shares? There is little doubt that the transaction between corporation and shareholder is properly characterized as a sale, and if strict recognition is to be given to the separate corporate entity, the consideration received arises out of a realization of these assets.[38] But such an analysis fails to recognize that a transfer to a wholly-owned corporation merely represents a change in the manner in which assets are controlled, and that those assets have not "ceased to figure in the taxpayer's affairs." It is arguable that there is no gain in any economic sense, since the shareholder's enrichment is still dependent on the assets transferred; and even on strict legal analysis, the owner of all the shares of a corporation has the right to liquidate the corporation and retrieve the assets.[39]

The Privy Council appears to have adopted the latter view of the transaction in *Doughty* v. *Commissioner of Taxes*,[40] where the Board held that the sale of trading assets of a partnership to a corporation was a mere bookkeeping entry and as such was not conclusive evidence of the existence of a profit. Lord Phillimore said:[41]

> The two partners made no money by the mere process of having their stock in trade valued at a high rate when they transferred to a company consisting of their two selves.
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> If they overestimated the value of the stock, the value of the several shares became less. The capital of the company would be to this extent watered. As already observed, they could not, by overestimating the value of the assets, make them more.

There are, however, three recent decisions, two of the Supreme Court of Canada and one of the Exchequer Court, which indicate that the law of Canada requires a strict adherence to the separation of the corporate entity and the shareholder in such circumstances.

The first is the decision of the Supreme Court of Canada in *Falconer* v. *M.N.R.*,[42] where certain persons, including the appellant, acquired an oil farm-out agreement as part of an adventure in the nature of trade. The agreement was transferred to a company formed by the syndicate in consideration for the issuance of no par value shares of the company to each of the members of the syndicate. The issue before the Court was whether the appellant

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[38] *John Foster & Sons, Limited* v. *C.I.R.*, [1894] 1 Q.B. 516, where for the purposes of the Stamp Act, which imposed a duty on every "conveyance or transfer on sale of any property", a transfer of assets to a limited liability company by a partnership was held taxable.

[39] Subject, of course, to the rights of creditors.

[40] [1927] A.C. 327.

[41] *Ibid.*, at p. 336.

[42] [1962] S.C.R. 644.

was to be taxed in respect of the value of the shares of the company at the time that the oil farm-out agreement was actually transferred to the company, or whether they were to be valued at the time the agreement to take shares of the company was entered into. The majority of the Supreme Court held that the crucial date for valuation purposes was the date that the agreement was entered into, and since the agreement with the company was entered into almost immediately after the acquisition of the oil farm-out agreement, the shares received could have a value no more or no less than the value of the asset which had been turned over to it. The case is significant in that it is implicit in the reasons for judgment of the Court that, had the oil farm-out agreement been transferred to the corporation at a time when its value had been in excess of the cost, the receipt of shares of the corporation would have constituted a realization of income for the purposes of the Income Tax Act. Although the *Doughty* case was cited, it was apparently not considered by their Lordships as authority for the proposition that no profit can be realized upon the transfer of assets to a corporation.[43]

In *R. K. Fraser (No. 1)* v. *M.N.R.*.,[44] the taxpayer, who admittedly was a trader in land, transferred an undeveloped piece of land to a corporation which was not controlled by him or his associates. The face value of the consideration, which took the form of fully-paid redeemable preferred shares and the assumption of a mortgage, was $205,000, whereas the fair market value of the land at the time of transfer was approximately $60,000. The Minister sought to tax the appellant on the basis that he had realized the amount of $205,000 on the transfer. The Exchequer Court allowed the taxpayer's appeal and held, relying on both the *Doughty* and the *Falconer* cases, that the value of the preferred share was no more and no less than the value of the land at the date of the transaction and that the value of the latter was the sole question to be decided.[45]

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[43] See also, *R.K. Fraser (No. 2)* v. *M.N.R.*, [1964] C.T.C. 372, 64 D.T.C. 5224 (S.C.C.), where dealers in land had transferred trading assets to a corporation immediately after acquisition. They were subsequently taxed upon a sale of the shares on the difference between the cost of the land and the amount ultimately realized upon the sale of the shares. Presumably, members of the syndicate in the *Falconer* case, *supra*, would be taxed in the same manner upon the ultimate disposition of their shares in the corporation if the sale were held to be part of the original adventure.

[44] [1964] C.T.C. 1, 64 D.T.C. 5003 (Ex. Ct.).

[45] It is probably only appropriate to value the assets transferred to determine the value of the amount realized on the transfer where those assets are the only ones held by the corporation. See, E. Saunders and P. Crawford, "Shares as Consideration", 1965 Canadian Tax Journal 38.

In *Belle-Isle* v. *M.N.R.*,[46] the taxpayer transferred a hotel property to a company formed by him as part of a transaction for the disposition of his hotel business. In consideration for the transfer, the taxpayer took back a mortgage and shares of the corporation to which a value was attributed that did not exceed the undepreciated capital cost of the depreciable assets. On the same day the appellant sold the shares to an individual for an amount which did exceed their undepreciated capital cost. The Supreme Court of Canada[47] held that the appellant was subject to recapture of capital cost allowance as determined by the Minister. Although it is not entirely clear from the reasons for judgment on what basis the taxpayer was subject to tax, Dumoulin, J., in the Exchequer Court, seemed to rest his decision upon the ground that the value of the shares received by the appellant was to be determined by their fair market value and not by an arbitrary valuation set up by the taxpayer. Their real value could, of course, be determined by reference to the agreement which was entered into in the same day between parties dealing at arm's length.[48]

It is apparent from these cases that even though shares of a corporation are received as a result of what may fairly be described as a non-commercial disposition of trading assets, the courts can be expected to adopt a strict view of the separate existence of the corporate entity and deem that the shareholder has received money's worth for the assets.[49] To criticize such an approach may overemphasize the fictitious nature of the corporate entity and ignore the fact that in a very real sense, from the point of view of both the market place and the law, the rights arising out of the ownership of shares of a corporation are very different from those arising from direct ownership of the underlying assets. As Learned Hand, J., said in a leading U.S. tax decision:[50]

> Though courts at times ignore the corporate guise, and look to the control reserved through share ownership, neither the law nor commercial custom

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[46] 66 D.T.C. 5100 (S.C.C.).

[47] Affirming the decisions of the Tax Appeal Board, 63 D.T.C. 347, and the Exchequer Court, 64 D.T.C. 5041.

[48] It is perhaps significant that under the provisions of section 17(7) and section 20(4) of the Canadian Income Tax Act transfers at less than fair market value are envisaged between persons who do not deal at arm's length. Quaere: whether in the light of this case any transfer for common shares in the capital of a corporation can be made for less than the fair market value of the assets.

[49] Leaving aside any consideration of the specific provisions of the taxing statutes, e.g. section 17 of the Income Tax Act.

[50] *Insurance & Title Guarantee Company* v. *Commissioner*, (1929) 36 F. (2d) 842 (Cir. C.A.), at page 843.

assimilates absolute title with share holding for purposes of sale and so of profit. Shares are separate salable units, not even aliquot interests in the company's property, for their owner has no more than a right against the company, at least before insolvency. Collectively they may allow the holder still to deal with the assets as he will, but he adopts the corporate form just for a new convenience in subdividing and disposing of his rights, and because law and commerce impute substance to the change in form. This divisible command of money so realized does not exist until he does so; he must sell the goods en bloc or piecemeal, practically a very different thing If chattels received in exchange would create a profit, shares will do as well...

Once having conceded that the ownership of shares is neither practically nor legally the equivalent of ownership of the corporate assets, the fact that the acquisition of the shares arises out of dealings which are, in substance, with oneself does not offend any fundamental principle of the law of taxation. The House of Lords in *Sharkey* v. *Wernher* [51] affirmed that a non-commercial disposition of trading assets could be productive of taxable income even where in essence a trader was trading with himself. Lord Radcliffe stated the principle in the following way:[52]

...it seems to me better economics to credit the trading owner with the current realisable value of any stock which he has chosen to dispose of without commercial disposal than to credit him with an amount equivalent to the accumulated expenses in respect of that stock. In that sense, the trader's choice is itself the receipt, in that he appropriates value to himself or his donee direct instead of adopting the alternative method of a commercial sale and subsequent appropriation of the proceeds.

## Conclusion

In summary, the principle in *Salomon's* case recognizing the strict separation between the shareholder and the corporation appears to remain unimpaired and applicable in determining liability for tax under Canadian taxing legislation. It is therefore with some justification that the authors of a recent book have opined that, in the tax planning context, the corporation has replaced the dog as man's best friend.[53] But the law has recognized that there are significant limitations on the use of the corporation, especially where functions allocated to the corporation cannot be separated conveniently from the activities of the shareholder or where he fails to separate them. Even where the separation is achieved, in the light of the present state of the authorities, transferring assets to a corporation may have the unanticipated effect of accelerating the incidence of tax rather than minimizing or deferring it.

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[51] [1955] 3 All E.R. 493. The doctrine of deemed realization as set out in *Sharkey* v. *Wernher* was held applicable to transfers of property between related companies in *Petrotim Securities* v. *Ayres* [1964] 1 All E.R. 269.

[52] [1955] 3 All E.R. 493, at p. 506.

[53] Spindler and Timbrell, *Canadian Estate Planning*, Don Mills (1966).