Company Law Problems Arising under Part IA of the Income Tax Act

STANLEY E. EDWARDS*
Toronto

A number of provisions of great significance to closely held corporations were added to the Income Tax Act in 1950. These provisions include Part IA (section 95A) and sections 73 and 73A. One of the principal results of their introduction into the Income Tax Act was to provide a method by which a company, particularly a closely held company, can solve the income tax problems resulting to its shareholders from the accumulation of profits in its hands. It is often desired to arrange the affairs of such a company in such a way that if a large distribution to the shareholders should be required at some time it may be made without subjecting the shareholders to income tax liability at the graduated personal rates.

Under the present income tax provisions this result can be accomplished by having a company make an election to pay the special 15% tax under section 95A and then carry out an appropriate corporate procedure. To be effective this procedure must result in a dividend being deemed to be received by the shareholders under section 73, and at the same time must result in redeemable securities of the company being placed in the hands of the shareholders. The most common procedure is for the directors to declare a stock dividend in redeemable preferred shares. Before this can be done it is frequently necessary to take steps to increase the company's authorized capital. In some circumstances the desired objective can be accomplished in other ways. For example, a reorganization of the company's capital stock may be carried out, which results in the capitalization of tax-paid undis-

* Stanley E. Edwards, B.A., LL.B. (Alberta), LL.M. (Harvard), of Fraser, Beatty, Tucker, McIntosh & Stewart, Toronto. Mr. Edwards' paper is a slightly modified version of an address he delivered to the Taxation Section of the Canadian Bar Association on September 11th, 1951, during the Association's Thirty-third Annual Meeting.

tributed income. Another method sometimes employed is for the assets of a company to be sold to a new company in return for redeemable securities of the new company and for the original company then to be wound up and the securities of the new company distributed to its shareholders. In any event, it is clear that in order to get any benefit from payment of the 15% tax on its undistributed income, a company must carry out some rather cumbersome corporate procedures. The introduction of these provisions in the Income Tax Act has, inevitably, raised numerous questions of company law, some of which are fairly simple but others more perplexing. In this paper I propose to outline a few of these company law problems and, so far as I am able, indicate the answers to them.

Power of Directors to Pay a Stock Dividend

The first problem relates to the power of the directors to pay a stock dividend. As I see it, there are two types of case in which the directors may have this power. The first is where they are given express authority to declare a stock dividend by the incorporating statute or by the company's charter. The second is where there is no such express authority but the shareholders unanimously agree to accept shares of the company in lieu of a cash dividend. The authorities are quite clear that unless one of these conditions is present a stock dividend may not be paid.[1]

The Dominion Companies Act provides that the directors of a company incorporated under it may declare a stock dividend only if they have been authorized to do so by a by-law which has been sanctioned by at least two-thirds of the votes cast at a meeting of shareholders. The Companies Acts of the provinces of Ontario, Quebec and New Brunswick expressly authorize the directors to pay a stock dividend. None of the other provincial Companies Acts, so far as I know, contain any provision relating to stock dividends. In the case of a company incorporated under any of these last mentioned statutes, the directors would not be authorized to declare a stock dividend unless express provision for it were contained in the letters patent or the articles of association. It may, of course, be possible for such a company to obtain supplementary letters patent or to amend the articles of association to provide that dividends may be paid in shares of the company.

Where the directors have no express authority to pay a stock

[1] *Hoole* v. *Great Western Ry. Co.* (1867), 3 Ch. App. 262.

dividend but the shareholders unanimously agree to accept shares of the company in lieu of a cash dividend, the legal position is not entirely clear. My view that a stock dividend may validly be declared in these circumstances is based on the decision of the Ontario Court of Appeal in *Re Dorenwends Limited*.[2] There is no need to go into all the facts of that case here. As I read the case, it establishes two principles. The first is that if the shareholders are in unanimous agreement they may deal with the surplus of a company as they see fit. The second is that where a company's surplus is dealt with in an unauthorized manner, but the same results could have been accomplished by following a different procedure, the transactions will not be set aside merely because the wrong procedure has been adopted. If the directors of a company have no express authority to issue a stock dividend, they can nevertheless accomplish the same result indirectly if they have the co-operation of all the shareholders. The directors may declare a dividend payable in cash. The shareholders may then subscribe the amount of the dividend for the purchase of capital stock of the company. Consequently, I submit that on the basis of the *Dorenwends* decision the directors, with the concurrence of all the shareholders, can accomplish the same result in a more direct manner by issuing a stock dividend in the first place.

Power of Directors to Take Action without Approval of Shareholders

The next problem I would draw to your attention relates to the power of directors to make an election under section 95A without the approval of the shareholders, particularly if some of the shareholders object. As you know, the directors of a company have a fiduciary duty to the company. In the exercise of their powers they are bound to act in good faith for the benefit of the company.[3] It is difficult to see how a company can benefit from making an election under section 95A, although the election may certainly be advantageous to its shareholders. This is also true, however, in the case of the declaration of a dividend. It seems to me that if all the shareholders stand to gain equally from payment by a company of the 15% tax, there would not be much likelihood that a shareholder could successfully attack the making of the election. Nevertheless, it would appear to be the safest course,

[2] (1924), 55 O.L.R. 413.

[3] *The Sun Trust Company Limited* v. *Begin*, [1937] S.C.R. 305, at pp. 307-8; *Plain Ltd.* v. *Kenley and Royal Trust Co.*, [1931] 2 D.L.R. 801, at pp. 803-4; *In re International Equities Limited; ex parte Bulmer*, [1943] O.W.N. 514, at p. 517.

where feasible, for the directors to have all or substantially all the shareholders approve an election under section 95A.

There may be cases in which some of the shareholders do not stand to benefit from payment of the 15% tax. For example, some of them may be non-residents who would not receive any credit, under the tax laws of the countries where they are resident, for the 15% tax paid by the Canadian company. In these circumstances it would seem to me to be risky for the directors to make an election without the approval of all those shareholders.

The same type of problem may arise in a more acute form at the stage where the directors propose to capitalize tax-paid undistributed income. For example, the payment of a stock dividend may subject non-resident shareholders to heavy and in some cases confiscatory taxation under the tax laws of the countries where they are resident. Although I know of no closely parallel decided cases, it would appear that such action might be restrained or set aside on the general principle that the directors are not permitted to exercise a fraud on minority shareholders.[4] A court might well hold, in these circumstances, that it would be fraudulent for the majority shareholders to obtain a tax advantage for themselves at the expense of the minority.

Permitted Amount of Stock Dividend

Another problem which sometimes arises is the amount of the stock dividend a company may legally pay. This problem is most likely to arise where a company wishes to capitalize a capital surplus as well as its undistributed income on hand. Ordinarily, the amount of the stock dividend which may be issued is the amount of the dividend the directors may lawfully declare payable in money. Where the authorizing provision is in these terms the problem of the amount of the stock dividend which may be paid is the same as the problem of the amount of the cash dividend which may be declared.

Although the amount of a dividend or a stock dividend is seldom questioned by a shareholder, it may at some stage be challenged by a liquidator or by creditors. In addition, it is conceivable that in some circumstances the amount of a stock dividend may be questioned by the Income Tax Department. Suppose, for example, that redeemable preferred shares were paid to shareholders

[4] Cf. *Menier* v. *Hooper's Telegraph Works* (1874), 9 Ch. App. 350; *Punt* v. *Symons & Co., Limited*, [1903] 2 Ch. 506; *Ritchie* v. *Vermillion Mining Co.* (1902), 4 O.L.R. 588; *Elliott* v. *Orr Gold Mines Limited* (1920), 17 O.W.N. 447.

as a stock dividend, in an amount greater than the company might legally pay. The payment would be ultra vires and the issue of the shares would be null and void, at least to the extent that the stock dividend exceeded the amount legally permissible.[5] On redemption of the preferred shares, the Department might contend that the excess is taxable under section 8 of the Income Tax Act, on the ground that the company has appropriated funds to its shareholders otherwise than by payment of a stock dividend. It may therefore be important in some cases to determine the amount a company may legally distribute as a dividend.

It is clear that a dividend may ordinarily be paid to the extent of a company's earned surplus. More difficult questions arise in connection with capital surplus. The authorities are quite clear that where capital assets have been sold at a profit the resulting capital surplus, being a realized surplus, is one from which dividends can ordinarily be paid.[6] Where, however, a capital surplus is unrealized, the legal position is less clear. An unrealized capital surplus ordinarily arises from writing up the value of assets on the company's books. The problem is complicated to some extent by differences in the provisions of various Canadian corporation statutes. Some of these statutes contain no provision limiting the amount of dividends which may legally be paid.[7] Most of the case law on the question is based on the English statute, which contains no such provision. Other corporation statutes expressly provide that a company may not pay a dividend which will impair or diminish its capital stock.[8]

There are practically no British or Canadian authorities which deal directly with the question whether a dividend may be paid from a surplus resulting from writing up the value of assets. There are a number of cases, however, which touch on this problem and a number of judicial dicta. In only one of these cases, so far as I am aware, was the court concerned with the interpretation of a corporation statute expressly limiting the amount of dividends

[5] Cf. *Lindsay* v. *Imperial Steel and Wire Co.* (1910), 21 O.L.R. 375; *Hood* v. *Caldwell* (1921), 50 O.L.R. 387, at p. 421.

[6] *Lubbock* v. *British Bank of South America*, [1892] 2 Ch. 198; *Cross* v. *Imperial Continental Gas Association*, [1923] 2 Ch. 553. However, in *Foster* v. *New Trinidad Lake Asphalt Company Limited*, [1901] 1 Ch. 208, it was held that a realized profit on an individual capital asset could not be distributed without taking into account the value of the other capital assets.

[7] The Companies Acts of Alberta, British Columbia and Nova Scotia are in this class.

[8] The Dominion Companies Act and the Companies Acts of Manitoba, New Brunswick, Ontario, Prince Edward Island, Quebec and Saskatchewan contain such provisions.

which may be paid. This was the case of *Executors of Massey Estate* v. *Minister of National Revenue*,[9] in which Chief Justice Duff was commenting on the provision of the Dominion Companies Act corresponding to the present subsection (1) of section 83. The section provided that "no dividend shall be declared which will impair the capital of the company". Chief Justice Duff made this statement:

> This section does not prevent the distribution of a capital profit provided the effect of doing so will not reduce the value of the assets below the sum total of the liabilities and the share capital. Broadly, it may be said that the company may distribute any of its assets among the shareholders so long as such is not the result of the distribution.

You will note that Chief Justice Duff appeared to regard the value of a Dominion company's assets as being the criterion of whether it can pay a dividend. From this it may be argued that if a writeup of the company's assets can be supported by a proper valuation, dividends may be paid from the capital surplus resulting from the writeup.

A decision of a New York court in the case of *Randall* v. *Bailey*[10] deals with the question of whether unrealized appreciation in the value of a company's assets may be taken into account in determining the amount of dividend which might be legally declared.

Since the judgments in this case went into the problem very fully, I will tell you something about the facts and the decision. The fixed assets of a terminal and warehousing company had increased greatly in value. They were revalued and written up on the company's books accordingly. A dividend was then paid out of the capital surplus resulting from the writeup. The court held that this dividend was properly paid and that the directors were not liable for having paid it. In delivering judgment, Mr. Justice Walter made this statement:

> It is to be emphasized at the outset that the question is not one of sound economics, or of what is sound business judgment or financial policy or of proper accounting practice, or even what the law ought to be. My views of the business acumen or financial sagacity of these directors, as well as my views as to what the legislature ought to permit or prohibit, are entirely immaterial. The question I have to decide is whether or not an existing statute has been violated. The problem is one of statutory construction.

The New York Corporation Statute provided that "no stock corporation shall declare or pay any dividend which shall impair its

[9] [1940] S.C.R. 191.
[10] 23 N.Y.S., 2d 173; affirmed 29 N.Y.S. 2d 512.

capital or capital stock, nor while its capital or capital stock is impaired", a provision very similar to the corresponding provisions in the Dominion Companies Act and several of the provincial Acts. In interpreting it, Mr. Justice Walter made these statements:

> I am of the opinion that the same reasons which show that unrealized appreciation must be considered are equally cogent in showing that unrealized depreciation likewise must be considered. In other words, the test being whether or not the value of the assets exceeds the debts and the liability to stockholders, all assets must be taken at their actual value.
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> I see no cause for alarm over the fact that this view requires directors to make a determination of the value of the assets at each dividend declaration. On the contrary, I think that is exactly what the law always has contemplated that directors should do. . . . What directors must do is to exercise an informed judgment of their own, and the amount of information which they should obtain, and the sources from which they should obtain it, will of course depend upon the circumstances of each particular case.

You will observe that this interpretation of the New York provision appears to coincide with Chief Justice Duff's view as to the meaning of the comparable provision of the Dominion Companies Act.

Section 83(1) of the Dominion Companies Act provides that no dividend shall be declared when the company is insolvent or which renders the company insolvent, or which will impair the capital of the company. It also stipulates that, for the purpose of determining a company's solvency, no account shall be taken of a writeup of its assets, unless the writeup took place at least five years before the date of the dividend in question. It may be argued by implication from this provision that, in some circumstances at least, such a writeup by a Dominion company may be taken into account for the purpose of determining whether the company's capital has been impaired.

Where the incorporating statute contains no provisions relating to the payment of dividends, the value of a company's assets in relation to capital stock is not the sole criterion whether a dividend may be paid. It has been held, for example, that if fixed assets have been lost, current profits may nevertheless be distributed by such a company.[11] But there is some authority to the effect that an upward revaluation of a company's assets may

[11] *Verner* v. *General and Commercial Investment Trust*, [1894] 2 Ch. 239; *Ammonia Soda Co.* v. *Chamberlain*, [1918] 1 Ch. 266. The former case was commented on in *Bond* v. *Barrow Haematite Steel Co.*, [1902] 1 Ch. 353, at p. 366, and in *Dovey* v. *Cory*, [1901] A.C. 477, at pp. 493-4.

be taken into account in determining the amount of dividend which its directors may declare.

In the case of *Rex* v. *Meilicke*,[12] Mr. Justice Martin of the Saskatchewan Court of Appeal made this statement: "it appears that accretions to capital not realized but immediately realizable and proved to exist must be taken into account in determining the amount of divisible profit". As authority for this opinion he referred to the decision in *Re Midland Land & Investment Corp. Ltd.*[13] In this case the directors had prepared a balance sheet based on an upward revaluation of the company's assets, which consisted of building lands, ground rents, contracts and options. Mr. Justice Chitty concluded that in a trading concern the directors are entitled to treat the surplus arising from a just and fair valuation as a profit, if they take all the precautions which ordinary prudent men of business engaged in a similar business would take. He was of the opinion that the directors would be justified in relying on the opinion of an experienced and skilled valuator in determining whether there was a profit from which a dividend could be paid. He indicated, however, that greater caution would have to be exercised in a business where the turnover is not rapid, where the nature of the business is eminently speculative or where the company cannot bring its commodity into the market rapidly. It is not clear whether Mr. Justice Chitty intended his reasoning to apply in cases where fixed assets are revalued, or only where circulating assets are written up on a company's books.

Where depreciation has been taken on a company's books but the fixed assets have not actually decreased in value by the amount of the depreciation, special considerations may apply. There are authorities which indicate that in such circumstances the directors may write the value of the assets up to their proper value, not exceeding cost, and pay dividends out of the resulting surplus.[14]

It is also established that where there is an increase in the value of fixed assets, which can be supported by an appraisal, the directors may wipe out a debit balance in the profit and loss account by resolution applying the capital surplus against it, and then pay dividends out of current earnings.[15]

Where it is desired that a company should capitalize a capital surplus by the payment of a stock dividend, consideration should

[12] [1938] 3 D.L.R. 33, at p. 45.

[13] Not reported but referred to at length in Palmer's Company Precedents (15th ed.) Part I, at pp. 824-6.

[14] *Bishop* v. *Smyrna Ry. Co.*, [1895] 2 Ch. 596; *Ammonia Soda Co.* v. *Chamberlain*, [1918] 1 Ch. 266; *Stapley* v. *Read Brothers, Limited*, [1924] 2 Ch. 1.

[15] *Ammonia Soda Co.* v. *Chamberlain*, *supra* footnote 14.

be given to the case law as well as the terms of the relevant corporation statute relating to the payment of dividends. Even when you reach a conclusion on the proper principle to be applied in a given case, there may still be difficult problems of valuation. The authorities indicate, however, that a court will not substitute its views on the value of property for those of the directors if the directors have informed themselves fully and have acted prudently.[16]

Where a company receives a stock dividend from a subsidiary, the question may arise whether the directors may write up the investment in the subsidiary on the company's books, and pay a stock dividend in respect of the surplus resulting from the write-up. The stock dividend may or may not represent an increase in the value of the subsidiary's assets over what it was at the time its shares were acquired by the parent company. If the stock dividend does represent such an increase in value, there would be a strong argument that the directors of the parent company might write up the value of the subsidiary on the parent company's books by the amount of the stock dividend and might then pay a stock dividend from the resulting surplus. The safer practice may be for the parent company not to pay a stock dividend in respect of the surplus until the shares it holds in the subsidiary company have been redeemed or reduced. At that time the surplus would become a realized capital surplus.

Whether a Stock Dividend is Capital or Income of a Trust

Another problem sometimes arises where a stock dividend is paid to a trustee and one beneficiary of the trust is entitled to the income and another to the capital. If the trust instrument is silent on the disposition of stock dividends received by the trustee, the question arises whether the stock dividend is income or capital of the trust. It would appear to me to be reasonable and equitable that a stock dividend should be treated as income of a trust, since it represents earnings of the company. The courts however have reached other conclusions.

There are a number of cases dealing with the question whether a stock dividend is income or capital in the hands of the recipient.

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[16] Cf. *In re City Equitable Fire Insurance Company, Limited,* [1925] Ch. 407. In that case Romer J. indicated (at pp. 471-4) that, before recommending a dividend, the directors should have a complete and detailed list of the company's assets and investments prepared for their use and should not be satisfied as to the value of the assets merely by the assurance of their chairman, however apparently distinguished and honourable, or with the expression of the belief of the auditors, however competent and trustworthy.

In some of these cases the question was whether the income beneficiary or the capital beneficiary of a trust was entitled to a stock dividend received by the trustee. In others the question was whether the stock dividend should be included in the income of the recipient for income tax purposes under the English Income Tax Act, which made no specific provision in that respect. In both types of case the courts have held that the decision depends upon whether the company intended to distribute the accumulated profits as a dividend or to convert them into capital.[17] The difficulty occurs in determining the company's intention and the decided cases are not particularly helpful. In the leading case of *Bouch* v. *Sproule,* Lord Herschell said that in order to determine the intention of the company for this purpose it is necessary to look at both the substance and the form of the transaction.[18] But then Lord Sumner made this statement in *C.I.R.* v. *Fisher's Executors:*

> Sometimes again it is the 'intention' of the company that is said to be dominant; sometimes it is what the company 'desired' to do. In any case desires and intentions are things of which a company is incapable. These are the mental operations of its shareholders and officers. The only intention, that the company has, is such as is expressed in or necessarily follows from its proceedings. It is hardly a paradox to say that the form of a company's resolutions and instruments is their substance.[19]

On the other hand, in the case of *C.I.R.* v. *Blott* Lord Sumner said this:

> I do not apprehend that a company can affect the taxing rights of the Crown against a shareholder by the particular name that it chooses to attach to its proceedings.[20]

And in *Bouch* v. *Sproule* Lord Watson made the following statement:

> Various resolutions were passed by the company at that and also at subsequent meetings; but I do not consider the terms of these resolutions as of material importance, because they merely provide the requisite machinery for enabling the directors to carry into effect the scheme suggested in their report. For the same reason, I do not think any importance can be attached to the form of the dividend warrant and allotment of new shares, which was subsequently issued to the shareholders by the officers of the company. None of these documents can, in my opinion, affect the substance of the scheme, which was recommended in the report of the directors and adopted by the company.

[17] See *Bouch* v. *Sproule* (1887), 12 App. Cas. 385, at pp. 398-9; *I.R.C.* v. *Blott,* [1921] 2 A.C. 171.
[18] *Bouch* v. *Sproule, supra* footnote 17, at p 398.
[19] [1926] A.C. 395, at p. 411.
[20] [1921] 2 A.C. 171, at pp. 210-11.

It is not very clear from the cases what the determining factors are in deciding whether a company's intention is to distribute its accumulated profits or to capitalize them. There are at least eight English cases in which it has been held that a stock dividend constitutes capital.[21] On the other hand, in *In re Malam*[22] it was held that a stock dividend constitutes income. There were two facts in this case which might distinguish it from other cases in which stock dividends were held to be capital. One was that the company allowed shareholders the option to take either cash or shares. In certain of the cases in which a stock dividend was held to be capital, such as *Bouch* v. *Sproule,* the shareholders were likewise given an option to take cash instead of shares, but in those cases the option was held to be of no importance since the shares were more valuable and it was obviously in the interests of all the shareholders to take them rather than the cash.[23] The other possible ground for distinguishing the *Malam* case from the other English cases is that in that case the company had assets not actually employed in the business, which were sufficient to pay the entire dividend in cash.

There are only three reported Canadian cases on this question of which I am aware. In all of them the courts were of the opinion that the stock dividend in question constituted income. One of these cases is *Quintal* v. *Bohemier,*[24] in which it was held that, under the Quebec civil law, stock dividends received by an estate were in law and in fact revenues as distinct from capital. In the case of *Re Lennox*[25] the Manitoba Court of Appeal held that a dividend paid partly in cash, partly in preferred stock and partly in debentures of the company should be regarded as income and not as capital in the hands of the shareholders. The third Canadian case is *Re Bicknell,*[26] in which Mr. Justice Middleton of the Ontario Court of Appeal held that stock issued in lieu of a dividend on preference shares constituted income in the hands of the recipient. In neither of the last two cases did the courts engage in any extensive reasoning, merely indicating that they regarded the question as one of fact, dependent upon the intention of the company.

[21] *In re Barton's Trusts* (1868), L.R. 5 Eq. 238; *Bouch* v. *Sproule* (1887), 12 App. Cas. 385; *I.R.C.* v. *Blott,* [1921], 2 A.C. 171; *In re Evans,* [1913] 1 Ch. 23; *In re Hatton,* [1917] 1 Ch. 357; *In re Ogilvie* (1919), 35 T.L.R. 218; *In re Taylor,* [1926] Ch. 923; *I.R.C* v. *Wright,* [1927] 1 K.B. 333.

[22] [1894] 3 Ch. 578.

[23] This distinction was also drawn in *C.I.R* v. *Coke,* [1926] 2 K.B. 246.

[24] (1941), 79 S.C. 198. Cf. *Bishop's College, Lennoxville* v. *Boulton,* [1924] 2 D.L.R. 715.

[25] [1948] 4 D.L.R. 753.

[26] (1919), 46 O.L.R. 416.

In view of the existing state of the authorities it is very difficult to determine whether a stock dividend constitutes income or capital in the hands of a trustee shareholder. In spite of Lord Sumner's statement that the form of the transaction is conclusive as to its substance, it would appear that the courts will consider the surrounding circumstances. If, for example, a stock dividend in redeemable preferred shares is issued with the intention of redeeming it immediately, I should think the courts would likely hold it to be income. If a stock dividend were issued to the holders of preferred shares in satisfaction of arrears of dividends it is more likely that it would be considered to be income than if it had been issued to common shareholders. But no matter what the circumstances are, it may be difficult to forecast with any degree of certainty whether a stock dividend will constitute income or capital in the hands of a trustee shareholder.

Where shares of a closely held company are held by a trustee, it may be advisable for the directors, before declaring a stock dividend, to consider its ultimate disposition as between beneficiaries of the trust. One solution to the problem, in the case of a trust which has no infant beneficiaries, might be for the beneficiaries of the trust to agree as to the disposition of the stock dividend. Where a new trust is being established with separate capital and income beneficiaries and the property of the trust includes company shares, specific provision should be made in the trust instrument for the treatment of stock dividends received by the trustee. In drawing wills this question should also be considered and it may be advisable to review existing wills with the point in mind.

Payment of Dividends in Debentures

There are several cases which indicate that if a company issues debentures to its shareholders in lieu of a dividend, the debentures may constitute capital in the hands of the recipients.[27] A company will not ordinarily have power to declare a dividend payable in its own debentures unless there is express power to do so in the incorporating statute or the company's charter, or the shareholders unanimously agree to accept the debentures in lieu of cash. If the directors have power to issue debentures, it would appear that this method might be employed by a company to effectuate a tax free distribution of its tax-paid undistributed income. How-

[27] *C.I.R.* v. *Fisher's Executors*, [1926] A.C. 395; *Whitmore* v. *C.I.R.* (1925), 10 T.C. 645; *Commissioner of Income Tax, Bengal* v. *Mercantile Bank of India, Limited*, [1936] A.C. 478; *Commissioners of Inland Revenue* v. *Marbob, Limited*, [1939] 2 K.B. 872.

ever, the cases indicate that whether such debentures constitute income or capital in the hands of the shareholders will depend upon the intention of the company. As we have seen in the case of stock dividends, this is not usually easy to determine. The Income Tax Act does not specifically provide, as it does in the case of a stock dividend, that the issue of debentures as a dividend will constitute a capitalization of undistributed income. For this reason it may be risky to declare a dividend payable in debentures in case it should be held not to be a capitalization which will result in a deemed dividend under section 73(3), but rather an actual dividend constituting income in the hands of the shareholders.

Conclusion

I have dealt with some of the problems of company law which may be encountered when consideration is given to the methods by which a company may take advantage of Part IA of the Income Tax Act. There are, of course, many other problems which might arise, particularly if it is desired to carry out a procedure other than the payment of a stock dividend. For example, section 73(2) of the Income Tax Act provides that the shareholders are deemed to receive a dividend when a company converts common shares into obligations. It is very doubtful, in the case of companies incorporated under most corporation statutes, whether such a conversion can be accomplished. Other problems arise if capitalization of surplus is effected by way of compromise or arrangement.

The present legislation provides an excellent means by which closely held companies may solve or alleviate the tax problems resulting from the accumulation of income in their hands. But it raises numerous questions of company law, which must be given careful consideration before an election is made to pay the 15% tax.

Convention and Citation

There are peculiar conventions in pronouncing the names of cases. (1) A criminal case, such as *R.* v. *Sikes*, can be referred to informally as 'R. v. Sikes' (pronounced as written), or 'Rex' (or, 'Regina') 'v. Sikes' (again pronounced as written). In court, however, the proper method is to call it 'The King' (or, 'The Queen') 'against Sikes'. (2) In civil cases the 'v.' coupling the names of the parties is pronounced 'and', both in court and out of it. Thus *Smith* v. *Hughes* is always pronounced (but never written) 'Smith and Hughes', and similarly *British Coal Corporation* v. *The King* (which was a civil proceeding against the Crown) is pronounced with an 'and'. Lawyers thus write one thing and say another. (Glanville Williams: Learning the Law)