LIFTING THE CORPORATE VEIL IN CANADA*

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> I don't believe that pudding ever was cooked. In fact I don't believe that pudding ever will be cooked! And yet it was a very clever pudding to invent.
>
> Lewis Carroll

The word "company" implies an association of a number of people for some common object or purpose. In usual parlance it is normally reserved for those who associate together for the purpose of carrying on a business for gain.[1] Colloquially the term is applied to both partnerships and incorporated companies, but the Canadian common lawyer, like his English counterpart, regards companies and company law as distinct from partnership.

The Italians formulated the theory of distinct corporate personality by recognizing the separate and independent existence of the corporation, and the concept is now well established in both civil and common law. But while the common law has tended to treat partnerships as a form of mutual agency, the civil law regards the commercial partnership as having a judicial personality apart from that of its members.[2]

Originally in England, incorporation was by charter from the Crown and was used chiefly for ecclesiastical and municipal bodies. By the sixteenth century, however, it was common for the Crown to charter "companies" of merchant adventurers for trading overseas. But incorporation was difficult to obtain as well as expensive. As commerce and trade expanded, unincorporated companies were organized on the joint stock principle. The bursting of the South Sea Bubble in 1720 made the Crown more chary

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[1] Gower, Principles of Modern Company Law (1954) p. 3.

[2] *Cité de Montréal* v. *Gagnon* (1904), 26 S.C. 178 (C.R.).

of granting charters but unincorporated companies developed apace. It was not, however, until 1834[3] that the Trading Companies Act made corporate advantages available without the requirement of special legislation in each case.

In Canada, neither the federal nor the provincial authority has exclusive control over companies. We, therefore, find company legislation on the federal statute books and on those of each of the ten provinces.

What then is this company or corporation over which the veil has been cast? It is a distinct legal personality created by the law. The basic concept in English law is that it owes its existence to the sovereign power of the state and that once created it acquires a distinct personality. As the Quebec Code states:[4]

> Every corporation legally constituted is an artificial or ideal person whose existence and succession are perpetual, or sometimes for a fixed period only, and which is capable of enjoying certain rights and liable to certain obligations.

This "creative" view was no doubt very useful in the days when the prerogatives of the Crown had political substance. But its validity is open to question. In the first place, when a group of people act together for a common purpose, they create a body or an organization which differs from the individuals who constitute it. We all recognize that a baseball team is different from the individuals who make it up. Each contributes part of himself to it, so the concept of the "team" encompasses part of the personality of each member but encompasses that of no member completely. The corporation is not "created" by the state any more than a baseball team is created by a league commissioner. The idea is fictional and arose from the political and economic necessities of the unincorporated bodies seeking legal recognition. Groups possessing the attributes of corporations existed before their "creation" by charter or statute. Corporations, instead of being creations of the law, actually compelled the law to recognize them. But the *persona* exists irrespective of legal sanction or recognition. All the law does is give to it a legal status dating the "creation" from the act of incorporation.

Where the corporation is controlled by a single individual the distinct social reality of the corporate personality may be nonexistent. The corporate entity instead tends to directly reflect the personality of the individual. In such cases the extent to which the two personalities are separated depends wholly upon a legal device.

[3] 4 and 5 Wm. 4, c. 94.

[4] Art. 352.

In either case this concept of the separate entity stems from the need for a means to control investment and to escape from the hazards and liability inherent in partnership and other non-corporate forms. The limited liability feature of the incorporated company defines the area of risk for the shareholder. A veil is drawn between the corporate person and the shareholder in an attempt to insulate the latter from responsibility. However, it sometimes becomes necessary to remove the veil and bare the relationship to the light of day. When this is done, the tendency is to subject the shareholder to some of the liabilities he sought to escape. In these instances, economic or other compelling circumstances cause the court to look at the realities behind the legal façade.

Speaking generally, Canadian courts like those of England, have been loath to lift the veil. They have, in most cases, been guided by the principal of the case of *Salomon* v. *Salomon & Co.*,[5] and, in particular, by certain statements in it. Salomon arranged the formation of a company with himself and his family as members. He then sold his business at a greatly inflated value for a small cash payment, a large block of shares and some debentures. Salomon had, for all practical purposes, complete personal control. The company soon ran into difficulties and went into liquidation. The assets were sufficient to pay the debentures but left nothing for the unsecured creditors. The matter was ultimately taken to the House of Lords where Salomon's claim to have the debentures paid was sustained. Lord Halsbury L.C. minced no words stating:[6]

> I am simply here dealing with the provisions of the statute, and it seems to me to be essential to the artificial creation that the law should recognize only that artificial existence—quite apart from the motives or conduct of individual incorporators. In saying this, I do not at all mean to suggest that if it could be established that this provision of the statute to which I am adverting had not been complied with, you could not go behind the certificate of incorporation to show that a fraud had been committed upon the officer entrusted with the duty of giving the certificate, and that by some proceeding, in the nature of scire facias you could not prove the fact that the company had no real legal existence. But short of such proof, 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.

[5] [1897] A.C. 22 (H.L.).

[6] *Ibid.*, at p. 30.

With equal emphasis, Lord Macnaghten stated:[7]

> I cannot understand how a body corporate thus made 'capable' by statute can lose its individuality by issuing the bulk of its capital to one person, whether he be a subscriber to the memorandum of association or not. The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them.

This decision established the legality of the one-man company and showed that incorporation was available for the purposes of the small private trader as well as for the large public company. The result is that the members of the public deal with a limited company to a great extent at their peril and for this the decision has been variously described as "shocking"[8] and "calamitous".[9] But, in any event, this case does mark the complete separation of the company and its members. The veil existed before the *Salomon* case, but it was now tightly drawn. Courts have pierced, lifted, and peeked through it on various occasions, but "in general it remains as opaque and impassable as the Iron Curtain".[10]

This formal view of the corporate form has been widely adopted but it has had to give way in some areas to economic and sociological demands. The retreat has been more marked on the Continent and in the United States than in England, but the tendency is universal.[11] In the United States, it has been a favourite topic of discussion.[12] In England it has also been the subject of review.[13]

In Canada the *Salomon* case has had a marked effect. Followed by the Privy Council[14] it has become an integral part of Canadian corporation law and has been applied by Canadian courts on many occasions.[15] But we are more concerned here with occasions

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[7] *Ibid.*, at p. 51.
[8] Gower, *op. cit.*, *ante*, footnote 1, p. 65.
[9] *Ibid.*, quoting O. Kahn—Freund in note 24.
[10] *Ibid.*, p. 66.
[11] See Friedmann, Legal Theory (1953) p. 406.
[12] E. G. Wormser, Disregard of the Corporate Fiction (1927).
[13] See Gower, *op. cit.*, *ante*, footnote 1, pp. 197-220.
[14] See for example *Export Brewing and Malting Co.* v. *Dominion Bank*, [1937] 3 D.L.R. 513, *per* Lord Russell of Killowen at p. 522.
[15] See for example *Hydro Electric Power Commission* v. *Townships of Thorold and Pelham* (1924), 55 O.L.R. 431 (C.A. Ont.), *per* Ferguson J.A. at p. 435; *Rural Municipality of Assiniboia* v. *Suburban Rapid Transit Co.*, [1931] 2 D.L.R. 862 (Man.); *Meadow Farm Ltd.* v. *Imperial Bank* (1922), 66 D.L.R. 743 (C.A. Alta.); *C.B.C.* v. *Cyr*, [1939] 4 D.L.R. 233 (C.A. Que.), *per* Galipeault J. at p. 237; *North & Wartime Housing Ltd.* v. *Madden*, [1944] K.B. 366 (C.A. Que.), *per* McDougall J. at p. 370; *Toronto* v. *Rogers Majestic Corp. Ltd.*, [1943] 1 D.L.R. 127 (C.A. Ont.), *per* McTague J. at

on which it was not followed, or with occasions on which the veil has been lifted. In Canada, as elsewhere, this has been effected both by statute and through the courts. We will consider these in turn.

II. *By Statute*

> Why, it's turning into a sort of a mist now, I declare! It'll be easy enough to get through.
>
> Lewis Carroll

Most Canadian corporations are formed under statutes rather than by direct legislative action. With eleven jurisdictions empowered to grant incorporation there is a considerable number of statutes in Canada and its provinces under which companies may be established and corporate personalities "created". In some instances, the veil is lifted by the terms of these.

The directors control and guide the operations of a company subject to the statute, company charter and by-laws. They act for the company in a great many ways. The acts of the directors are the acts of the company and it is, therefore, not surprising to find the veil lifted somewhat to help distinguish those situations in which the director acts for the company from those in which he will be looked upon as acting for himself. There are many provisions in company statutes which place personal responsibility on the director and deprive him of the protection of the corporate veil. For example, a director who authorizes payment of a dividend while the company is insolvent, incurs personal liability.[16] Similarly, he has a limited personal responsibility for the payment of wages.[17] Also he may be held liable if he arranges the sale of company shares at less than fair value[18] or sells them to someone who is insolvent.[19] Companies are usually required to keep their names prominently displayed and failure to so do, in some instances, renders the directors and officers personally liable.[20]

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p. 133; *Lippert* v. *Ford Hotel of Toronto Ltd.* (1930), 65 O.L.R. 340. *Rielle* v. *Reid* (1899), 26 O.A.R. 54 (C.A. Ont.); *Associated Growers of B.C. Ltd.* v. *Edmunds*, [1926] 1 D.L.R. 1093 (C.A.B.C.) where it was cited by both majority and dissenting justices. See Galliher J.A. at p. 1096, McPhillips J.A. at p. 1097, and Macdonald J.A. at p. 1099.

[16] Canada, Companies Act, R.S.C., 1952, c. 53, s. 83(5); Prince Edward Island, Companies Act, R.S.P.E.I., 1951, c. 26, s. 65; New Brunswick, Companies Act, R.S.N.B., 1952, c. 33, s. 97; Manitoba, Companies Act, R.S.M., 1954, c. 43, s. 85.

[17] Can. *ibid.*, s. 97; Man., *ibid.*, s. 87.

[18] Can. *ante*, footnote 16, s. 99.

[19] N.B., *ibid.*, s. 98.

[20] Man. *ibid.*, s. 24; Ontario, Companies Act, R.S.O., 1950, c. 59, s. 38; Nova Scotia, Companies Act, R.S.N.S., 1954, c. 41, s. 67; Newfoundland, Companies Act, R.S.N., 1952, c. 168, s. 68.

Again when a prospectus is issued by the company, directors, proposed directors and promoters may be personally liable to subscribers for losses suffered,[21] and on liquidation if it appears that any promoter or director has been guilty of misfeasance or breach of trust, the court may compel repayment or compensation as it thinks just.[22]

While the director has the immediate control of the company, the ultimate control is in the shareholder. In his status as shareholder, he is, therefore, usually further removed from the activities of the corporate personality, and at the same time more secure behind the wall of the corporate entity. Yet the veil is pierced by statute both to subject him to liability and to add to his rights. For example, he may be called on personally to meet company debts incurred while the membership, with his knowledge, is below the minimum number required by statute.[23] On the other hand, he is given the right to personally oppose a change of the company's name effected by the registrar[24] and to plead by way of set-off against a creditor of the company, certain rights of set-off which he might raise against the company.[25]

The special position of the director and shareholder in relation to the corporate personality is seen in still other provisions. Directors and shareholders are sometimes restricted in their right to secure loans from the company[26] and directors are forbidden to act as company auditors.[27]

A very striking limitation on the recognition of the separate corporate personality is seen where one company owns shares in another. Companies can thus pyramid and one control be exercised over more than one corporation. The consequent centralization of directive power has advantages but is open to many abuses. The veil has here been lifted by statute in several ways, particularly in matters of taxation. But for the moment we are interested in the statutes under which incorporation is effected. A "subsidiary company" has been defined, for example, as one where over fifty percent of the voting shares carrying the right to elect a majority of the board of directors is held by the controlling or holding

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[21] Can. *ante*, footnote 16, s. 78; N.S. *ante*, footnote 20, s. 93; Nfld. *ibid.*, s. 23; British Columbia, Companies Act, R.S.B.C., 1948, c. 58, s. 134; Saskatchewan, Companies Act, R.S.S., 1953, c. 124, s. 118.

[22] Nfld., *ante*, footnote 20, s. 154.

[23] Ont., *ante*, footnote 20, s. 30. B.C., *ante*, footnote 21, s. 39.

[24] N.S., *ante*, footnote 20, s. 14(3).

[25] N.B., *ante*, footnote 16, s. 50.

[26] Sask., *ante*, footnote 21, s. 150.

[27] Sask., *ibid.*, s. 153.

company.[28] Circumstances can well be imagined in which the balance sheet and financial statement of the controlling company will not mean much to a potential shareholder or investor if its assets consist solely of shares of its subsidiaries. Accordingly, statutes provide for the inclusion of portions of the financial statements of subsidiaries in those of the holding company.[29] This represents a thorny problem but it is not our purpose here to discuss it. It has, however, made it necessary to look behind the fictitious personality of the corporate entity.

In taxation, the concept of the corporate personality has led to special problems. It is not surprising then, that in Canada, as elsewhere, it has been found necessary on many occasions to look behind the cloak. Income tax statutes offer many examples. In a provincial statute a "personal corporation" was defined as one controlled by one person or by such person and his wife or any member of his family.[30] "Family" was interpreted by the court as meaning those "who reside with him".[31] Under the federal statute a corporation and a person by whom it was directly or indirectly controlled, or more than one corporation controlled or indirectly controlled by the same person are deemed not to deal with each other "at arm's length".[32] Again, the same statute provides that one corporation is "related" to another if one of them owned directly or indirectly seventy percent or more of all the issued common shares of the other or if seventy percent or more of the issued common shares of each of them is owned directly or indirectly by one person or by two or more persons jointly or by persons not dealing with each other at "arms length", one of whom owned directly or indirectly, one or more shares of the capital stock of each of the corporations.[33] In construing this definitive section, a court held that legal ownership is not required but that beneficial or equitable ownership is sufficient and not restricted to the person who is registered as owner of the shares.[34] In still another place, the statute sets out that one corporation is "controlled" by another if more than fifty percent of its issued shares belong to the other corporation or to the other corporation and per-

[28] Can., *ante*, footnote 16, s. 119; N.S., *ante*, footnote 20, s. 111; B.C., *ante*, footnote 21, s. 158(5); Sask., *ibid.*, s. 163.
[29] Can., *ante*, footnote 16, s. 118; N.S., *ante*, footnote 20, s. 109; B.C., *ante*, footnote 21, s. 154(4); Sask., *ibid.*, s. 162.
[30] Income Tax Act, 1932, c. 5, s. 2 (Alta.).
[31] *Ramsay* v. *Provincial Treasurer of Alberta*, [1939] 2 D.L.R. 707 (C.A. Alta.).
[32] Income Tax Act, R.S.C., 1952, c. 148, s. 139(a).
[33] *Ibid.*, s. 39(4).
[34] *Banner Metal Products Ltd.* v. *M.N.R.* (1955), 13 Tax A.B.C. 356.

sons with whom it does not deal at arm's length.[35] In each of these terms "at arm's length", "personal", "related" and "controlled" corporations, the law, through statute, disregards the legal entity and looks to the realities behind it.

Another federal taxation statute that illustrates the same legislative disregard of the corporate façade is that which taxes excess profits of corporations.[36] "Substantial interest" as used in that statute[37] has been before the courts for interpretation. It was held that forty-nine percent of the shares of a company came within the definition.[38] The court distinguished the term "substantial interest" from "controlling interest" and gave the corporation the benefit of an exemption because some shareholders had a "substantial interest" both in the present company and in its predecessor. Here we again see a lifting of the veil to relate the activities of the company to those of the shareholders.

Periods of national stress and emergency sometimes demand that the concept of the corporate entity be put aside. The corporate device can give anonymity to private transactions designed to further the economic designs of those hostile to the nation. During World War I the English Courts adopted the "control test" to determine the enemy character of a company.[39] It was not adopted by the United States courts until after World War II.[40] The Canadian law was brought into line in 1947 by a statute which provided that where it appeared to the Secretary of State that one third or more issued shares of a company was, at any time since the commencement of the war, held by enemies or enemy subjects, or that one third or more of the directorate consisted of enemies or enemy subjects, he was given power to take certain action.[41] Here we see the corporate veil being pulled aside to determine the character of the company from the character of those who owned and controlled it.

From these examples of veil lifting by statute we will now turn to the courts.

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[35] *Ante*, footnote 32, s. 28(3).

[36] Excess Profits Tax Act, 1940, c. 32 (Can.), as amended by 1940, c. 47, s. 1.

[37] *Ibid.*, s. 3.

[38] *Manning Timber Products Ltd.* v. *M.N.R.*, [1952] 3 D.L.R. 848 (S.C.C.).

[39] *Daimler Co. Ltd.* v. *Continental Tyre & Rubber (Great Britain) Ltd.*, [1916] 2 A.C. 307 (H.L.).

[40] *Clark* v. *Uebesee Finanz-Korporation* (1947), 332 U.S. 480.

[41] Trading with the Enemy (Transitional Powers) Act, 1947, c. 24, Schedule s. 8(1) (Can.).

III. *Judicial Interpretation*

> Our excellent preceptress always says, 'When in doubt, my dears, take an extreme case'. And I was in doubt.
> 'Does it always succeed?' her aunt inquired.
> Clara sighed. 'Not always', she reluctantly admitted.
>
> Lewis Carroll

The *Salomon* case has, in Canada, as in England,[42] greatly restricted the efforts of the courts to lift the veil. But as we will see, the courts, like the legislatures have, on occasion, found it necessary to take a look behind the scenes. The cases can be placed in two broad categories. In the first are those in which the court is concerned with intention. The second group consists of cases where the essential character of the corporate person must be ascertained. The line between the two is not always clear. Cases on taxation of corporations would fall into both categories but we will consider some of them separately in a third group.

The problem of finding corporate intent is obviously difficult. No general rule seems to work, perhaps for the good reason that no such intent in fact exists. But a corporation being a person in the eyes of the law, must, on occasion, explain its conduct or have someone else explain it. In line with the *Salomon* case our courts have held that companies are not capable of intent. A company can act and when it does you may deduce an intention from the act. But mental operations are not part of a company's activities. In *Toronto General Trusts Corporation* v. *Bartram*[43] we find English authority quoted as follows:

> In any case desires and intentions are things of which a company is incapable. These are mental operations of its shareholders and officers. The only intention which 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.

But notwithstanding such pronouncements, courts find themselves faced with facts which demand something different. For example, in *St. Catherine's Flying Training School Limited* v. *M.N.R.*[44] where a charter prohibited declaration of dividends or distribution of profits during the term of a contract with the federal government, the court took the view that:

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[42] See Gower, *ante*, footnote 1, p. 208.
[43] (1954), 11 W.W.R. (N.S.) 409 (Alta. S.C.) *per* Coady J. at p. 416, quoting Lord Sumner in *Inland Revenue Commissioners* v. *Fisher's Executors*, [1926] A.C. 395, at p. 411.
[44] [1953] Ex. C.R. 259.

> The fact that the Letters Patent and the contract with the Government assumed that the appellant would make profits and that it did so has little, if any, bearing on the question whether it was an association that was organized and operated for non-profitable purposes. . . .[45]

The court proceeded to consider the evidence of the president of the company as to why it was formed. Form was not treated as the substance.

Cases of fraud provide instances in which the court often feels obliged to go behind the curtain and see whose idea it really was. Sometimes the knowledge of the officer or director is simply held to be knowledge of the company. In *James Meyer Ltd.* v. *Northern Assurance Co.*[46] the secretary of the company took a statutory declaration as to loss upon which a claim for insurance money was to be made by the company. The court fixed the company with notice saying:[47]

> I find that many of the statements in the proof of loss as attested were wilfully false to the knowledge of the plaintiff.

Where promoters or directors manipulate corporations to fraudulently serve their own ends, the courts often lift the veil to discover the real intention and to decide whose intention it is. The resolutions and instruments may evidence a substance that is regular on its face, but where fraud exists the courts go behind the forms. For example, where a promoter has made a contract with a corporation and has fully disclosed all the facts to the directors, it can be attacked if the directors are merely the tools of the promoter. The duty to disclose must inure to the benefit of future shareholders and formal compliance is therefore not sufficient.[48]

In other cases courts have found that where the company is manipulated so that it does not act on its own behalf, this may be shown to the court. The *Salomon* case says in effect that a company duly incorporated cannot be disregarded on the ground that it is a sham. But evidence may show that it does not act in its own behalf but rather on behalf of those who incorporated it.[49] In other words, if the company is simply a funnel or conduit to serve the ends of the promoter, the court will identify the company's acts with his.

Criminal law has posed some problems in relation to corpora-

[45] *Per* Thorson P. at p. 266.
[46] (1956), 20 W.W.R. (N.S.) 46.
[47] *Per* Cairns J. at p. 47.
[48] See *Proprietary Mines Limited* v. *McKay*, [1938] O.R. 508, *per* McTague J. at p. 514. Aff'd [1939] O.R. 461 (C.A.).
[49] See *Patton* v. *Yukon Consolidated Gold Corp. Ltd.*, [1934] 3 D.L.R. 400 (C.A. Ont.), at p. 403, citing Lord Buckmaster in *Rainham Chemical Works Ltd.* v. *Belvedere Fish Guano Co. Ltd.*, [1921] 2 A.C. 465, at p. 475.

tions and intent is one of the more significant. Today, there is no doubt that a corporation can be indicted for the criminal acts of its agents and that for this purpose there is no distinction between an "intention" or other function of the mind.[50]

Conspiracy is one of the crimes that a company can commit and the necessary *mens rea* may be found in an officer or agent authorized by the company to act for it.[51] If a company which has been party to a conspiracy or combine merges with another, the court will look to the acts of the natural persons who controlled both companies and from their similarity may determine that those persons did cause the present company to enter into the conspiracy.[52] The courts, in matters criminal, have been ready enough to lift the veil or walk around it. A company certainly can have *mens rea* but it obviously cannot exist apart from those in control. When there is but one person in control and management, the court readily attributes his *mens rea* to the company.[53] The principle of the *Salomon* case cannot be made use of to exempt a person, who, in effect, constitutes the company, from personal responsibility for what he causes to be done through the company.[54] The whole pattern of criminal law in Canada tends to cause a corporation and a natural person to stand on equal footing, and to prevent a corporation from escaping liability through the artificiality of its entity.[55]

We would expect a similar approach to cases quasi-criminal in nature. The courts here are quite prepared to seek out the ones really responsible for the acts of the company but at the same time to hold the company responsible for the acts of those natural persons who actually do the acts attributed to the corporation. In other words, the culpable intention or *mens rea*, and the illegal acts of the directors can be taken as the intention and acts of the company brushing aside the intellectual obstacles of the corporate veil concept.[56]

Turning now to our second group or classification in which the

[50] See *Mlle. Couture* v. *Commissionaires d'École pour la Municipalité Scolaire de Lauzon*, [1950] S.C. 201, *per* Pettigrew J. at p. 210, quoting Canadian Criminal Procedure (Popple).

[51] *Rex* v. *Ash Temple Co. Ltd.*, [1949] O.R. 315 (Ont. C.A.), *per* Robertson C.J.O. at p. 337.

[52] *Regina* v. *Howard Smith Paper Mills*, [1954] 4 D.L.R. 161 (Ont. H.C.), *per* Spence J. at p. 258.

[53] *Rex* v. *Martin*, [1932] 3 W.W.R. 1 (C.A. Man.).

[54] *Ibid.*, *per* Robson J.A. at p. 26.

[55] *Rex* v. *McGavin Bakeries*, [1950] 2 W.W.R. 735 (B.C.S.C.), *per* Boyd McBride J. at p. 749.

[56] *Rex* v. *Fane Robinson Ltd.*, [1941] 3 D.L.R. 409 (Alta. C.A.), *per* Ford J.A. at pp. 411-413.

essential character of the corporation presents the problem, we first meet the personal or privately controlled company. Some cases already referred to fall into this category so further references will be brief. Where, however, the evidence is clear that the company is dominated by one person the court may pay lip service to the *Salomon* case and yet in effect part the veil. This may happen where the bank account of the shareholder and that of the company are used for common purpose.[57] Again the veil may be pierced from the opposite side as it were. In *Kummen* v. *Alfonso & Wagner*[58] the sole owner of a corporation was injured in an automobile accident. As a result of his absence the company hired additional help. The owner claimed damages against the tort-feasor for this additional expense to the company. The trial judge distinguished this case from *Salomon* v. *Salomon & Co.* on the grounds that there the creditors sought to make the owner liable for the company's debt whereas in the case before it the sole owner was trying to recoup the company's losses. Finding was for the plaintiff. The appeal court reversed it on the facts but while so doing stated:[59]

> The amount of the loss, if any, of the plaintiff, due to the accident, in his business, carried on by him in corporate form — the company being wholly owned and operated by him — would, of course, be an item of damage. . . .

Crown corporations offer another example. In *North & Wartime Housing Limited* v. *Madden*[60] suit was against a federal crown corporation, and the defence was raised that the cause should have been instituted by petition of right. The majority[61] applied *Salomon* v. *Salomon & Co.* and ruled that the defence would not hold but one judge in dissenting said:[62]

> J'ai rappelé aussi le principe qui ne prête à aucun doute que le souverain ne peut être fait partie à une instance que de son consentement.

He parted the veil, identified the Crown as the controlling force and reached a different result. Again in *Robillard* v. *Commission Hydro-électrique de Québec*,[63] a suit against a publicly-owned corporation created by provincial statute, the court followed the *Salomon* case[64] but the dissenting justices[65] took the view that the corporation was the Crown's agent administering assets which belonged to the Crown.

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[57] *The King* v. *Canada West Manufacturing Co.*, [1950] 2 D.L.R. 671 (Alta. S.C.). See Hugh J. McDonald J. at pp. 683-685.
[58] [1953] 1 D.L.R. 637.
[59] *Per* Coyne J.A. at p. 642.
[60] [1944] K.B. 366 (Que. C.A.).
[61] See McDougall J. at p. 370.
[62] *Per* Marchand J. at p. 377.
[63] [1954] S.C.R. 695.
[64] See Rinfret C.J. at p. 699.
[65] See Cartwright J. at p. 705 quoting Casey J.

In Canada the problem of disregarding the corporate form has not appeared to any great extent in insurance cases. In the United States it has been held that a shareholder has an insurable interest in a company.[66] In England the opposite view prevails.[67] In at least one instance, the English view has been followed in Canada but without reference to the English authority.[68] *Alliance Insurance Company* v. *Laurentian Colonies and Hotels Limited*[69] indicates that the records of the individual directors of an insured corporation can be material to a risk for which the company is insured. The court found that in the circumstances of that case they were not but the inference is that circumstances could exist in which they would be. The court's words were:[70]

> In the circumstances of this litigation the answer appears to be in the negative.

Turning now to taxation it might first be recalled that in this field the legislatures have frequently lifted the veil. When one considers the amount of litigation there has been in this field in recent years, the occasions on which the courts have seen fit to do likewise are far from extensive. In some instances the veil has been lifted but dropped again. For example, in *The King* v. *British Columbia Brick & Tile Co. Limited*[71] there was an action for recovery of provincial sales tax. The controlling interest in each of two companies was in a man and his wife. The one company made sales to the other and the latter resold the goods at a higher figure. It was contended that the tax which was levied against the first company should be based on the selling price of the second. The court decided otherwise on the basis that the shareholders were not precisely the same and the business operations were quite distinct.[72] The veil was not pierced but the court at least had peeked beneath it.

In the field of income tax the courts have had many opportunities to interpret statutes. For the most part the tendency has been to observe the sanctity of the separate personality of the corporation but there are instances where courts have done otherwise. In *M.N.R.* v. *Saskatchewan Co-operative Wheat Producers Limited*[73] the question arose in connection with a hold-back by a marketing co-operative of a portion of returns from the sale of pro-

[66] *Riggs* v. *Commercial Mutual Insurance Co.*, 125 N.Y. 7.
[67] *Macaura* v. *Northern Assurance Co.*, [1925] A.C. 619.
[68] *Bridgewater Hardware Ltd.* v. *Scottish Union & National Insurance Co.*, [1953] 2 D.L.R. 327 (N.S.S.C.).
[69] [1953] Q.B. 241 (Que. C.A.).
[70] *Per* McDougall J. at p. 264.
[71] [1936] 3 D.L.R. 23.
[72] See MacLean J. at p. 25.
[73] [1930] 3 D.L.R. 162.

duce. These sums were owned by the members and were repayable under a contract but were to stand in the name of the company and be paid out in the discretion of the directors. The question was as to whether or not these sums constituted income and the court held they did not. The court stated:[74]

> In revenue cases it is a well-established principle that regard must be had to the substance of the transactions relied on to bring the subject within the charge to a duty and that the form may be discarded.

and further on:[75]

> Stress was laid by counsel for the minister on the fact that there was no obligation upon the association to distribute the reserves among the growers either in cash or in specie. The answer to this contention seems to be that there is no necessity for any contractual or statutory obligation. As the growers who contribute the reserves have in their capacity as shareholders who elect the directors, the absolute control and management of the association, it must be amenable to their will without any express provision to that effect.

The court looked behind the scenes and recognized the will of the shareholders as the will of the company. The separate corporate personality is still there but it is openly recognized as the personality of a puppet. It is not the form of its transactions that is looked to but rather to the realities of the control of the company.

The conflict of view that is possible is well illustrated in another case, that of *Army & Navy Department Store Limited* v. *M.N.R.*[76] Here the shares in two companies were held by a family and the two companies each owned one half the shares in a third. The question was as to whether or not the three companies were "related" corporations. As set out above[77] a corporation is related to another if seventy percent or more of the shares are owned "directly or indirectly" by persons not dealing with each other at arms length. The court held that the two companies were related but that neither of them were related to the third. One justice quoted the *Salomon* case.[78] But one dissented,[79] holding that the first two companies were related to the third indirectly. He stated it thus:

> Parliament by the inclusion of the word 'indirectly' in this context, evidenced a clear intention that the share position of a corporation should be so far examined as to ascertain who in fact are the owners who effectually exercise the powers of ownership.

Here the statute removed the first veil. At least one member of the court went on through the second.

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[74] See Lamont J. at p. 168.
[75] *Ibid.*, at p. 173.
[76] [1953] 2 S.C.R. 496.
[77] See Income Tax Act, *ante*, footnote 32, s. 139(a).
[78] See Cartwright J. at p. 511.
[79] See Estey J. at p. 508.

This case is of special interest because it was decided after the right of appeal from Canadian judgments to the Privy Council was abolished.[80] On several occasions the Board had proved ready to dampen any enthusiasm displayed for veil piercing. For example in *Pioneer Laundry* v. *M.N.R.*[81] a tax official in deciding what was reasonable depreciation took into account the allowance made to an old company which had been the predecessor of the company being assessed. Notwithstanding that the official had a discretion under the statute, the Privy Council, reversing the Supreme Court of Canada, refused to allow him to disregard the separate existence of the company, or to inquire as to who the shareholders were or its relation to its predecessor. Again in *Export Brewing and Malting Co. Ltd.* v. *Dominion Bank*[82] the Board went out of its way to quote the *Salomon* case and, in reversing the judgment of the Ontario Court of Appeal, to suppress the heretical propensities of a member of that court who appeared ready to lift or circumvent the veil.[83]

It is of interest, therefore, to note if there has been any change in attitude by the Supreme Court in recent years. We have already discussed one case which indicates that the veil can still be tightly drawn.[84] But in the same year in the case of *Stanley Mutual Fire Insurance Company* v. *M.N.R.*[85] we find the court doing some effective veil piercing. Here a company was incorporated as a mutual under a provincial companies act,[86] to undertake contracts of fire insurance subject to the provisions of the Insurance Act of the province.[87] The company had no share capital, the policy holders being the members. Cash payments were made by the members and they were subject to further assessments to meet losses. Sums collected in excess of the current year's losses and expenses were placed in a reserve fund and the Insurance Act[88] provided that:

> The reserve fund shall be the property of the insurer as a whole and no member shall have a right to claim any share or interest therein in respect to any payment contributed by him towards it; nor shall such fund be applied or dealt with by the insurer or the board other than in paying its creditors, except on order of the Governor in Council.

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[80] An Act to amend the Supreme Court Act, 1949, c. 37, s. 3 (Can.).
[81] [1939] 4 D.L.R. 481 (P.C.). [82] [1937] 3 D.L.R. 513 (P.C.).
[83] See pp. 521-522 *per* Lord Russell of Killowen re Judgment of Riddell J.A.
[84] *Army & Navy Department Stores Ltd.* v. *M.N.R.*, *ante*, footnote 76.
[85] [1953] 1 S.C.R. 442.
[86] New Brunswick, Companies Act, R.S.N.B., 1927, c. 89 as amended by 1937, c. 19.
[87] Insurance Act, 1937, c. 44 (N.B.). [88] *Ibid.*, s. 249(3).

A sum transferred to reserve was assessed for federal income tax and the Supreme Court by unanimous decision found that it was not so assessable. The neat question was as to whether or not the fund belonged to the company or the members. The court, relying on earlier English cases,[89] found that the fact that the present membership was not constituted of exactly the same members as those who contributed to the fund did not prevent them as a class from claiming ownership. But the main problem was presented by the portion of the statute quoted above. It was urged on behalf of the Crown that the company having incurred the obligation of the members by issuing the policies, the fund must belong to the company because it was established for the express purpose of meeting the company's liabilities. But the court said:[90]

> The argument loses its force when it is realized that the fund is accumulated as directed by the statute, not in pursuance of a profit making enterprise but in furtherance of a mutual insurance plan carried on by the company in the interests of its members . . . .

The court made use of the statute to lift the veil and see whom the fund was actually intended to benefit.

But one swallow does not make a summer. Two cases with similar facts were recently considered. In *Re Waters*[91] an estate, and in *Re Hardy*[92] a trust, held shares in a company. In each case the company paid a special tax on undistributed income, thereby creating tax-paid undistributed income. In order to get the income to its shareholders, each company, acting within the limits of the governing statute, paid a stock dividend by issuing paid-up preferred redeemable shares. This effectuated a notional capitalization of income which when passed on to the shareholder was not taxable because of the special tax paid by the company in the first place. However, here the estate and the trustee were the shareholders. The beneficiaries under the terms of the respective trusts were entitled to income only. The question then in each case was as to whether the dividend was a distribution of capital or of income. The beneficiaries in each case submitted that the stock dividend was simply a device whereby undistributed income was made available to shareholders. But the Supreme Court held in

[89] *Particularly New York Life Insurance Co.* v. *Styles*, [1889] 14 A.C. 381, and *Jones* v. *South West Lancashire Coal Owner's Association*, [1927] A.C. 827.

[90] See p. 457.

[91] *Re Waters; Waters* v. *Toronto General Trusts Corpn.*, [1956] S.C.R. 889.

[92] *Re Hardy; Official Guardian* v. *Toronto General Trusts Corpn.*, [1956] S.C.R. 906.

each instance that there had been capitalization of the income when the dividends were declared. In the *Waters* case, counsel argued that the company really intended to release earnings to shareholders. But a member of the court stated:[93]

> The company undoubtedly intends by its total act to pass money to the shareholder: but if what the company does converts the earnings into capital, the 'intention' of the company must take account of that fact: it 'intends' that fact; and to carry the intention to a conclusion it intends to distribute capital assets by means of an authorized reduction in capital stock. Here form is substance; and the moment form has changed the character of the earnings as assets, the intention follows that change.

This has a familiar ring and it was echoed in the *Hardy* case where we find direct reference to the English authority[94] quoted above[95] as follows:

> . . . Lord Sumner, referring to statements which appear in some of the reported cases that it is the intention of the company that is said to be dominant, said that desires and intentions are things of which a company is incapable, these being the mental operations of its shareholders and officers and that:—
>
> 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.

What apparently counts is what the company did formally and what it did was to replace profits or surplus by paid-up capital, and issue shares. This constituted capitalization of its profits and even though the real purpose may have been the release of earnings to the shareholders, form is the substance recognized even though the real substance lies behind the veil.[96]

The Supreme Court of Canada is still prepared to respect as well as lift the veil.

IV. *Conclusions*

> 'There's a fallacy somewhere' he murmured drowsily, as he stretched his long legs upon the sofa. 'I must think it over again'.
>
> Lewis Carroll

Our attention has been directed almost exclusively to illustrations as to how in one way or another the corporate veil has been lifted.

[93] *Ante*, footnote 91, *per* Rand J. at p. 905.

[94] *Commissioners of Inland Revenue* v. *Fisher's Executors*, *ante*, footnote 43.

[95] *Ante*, footnote 92, *per* Kerwin C.J. at p. 912.

[96] See the excellent discussion of the *Waters* and *Hardy* cases by Stuart D. Thom, Q.C., in (1957), 35 Can. Bar Rev. 326, from which the writer has drawn freely.

This, we have seen, has been done by statute and by the judicial process in a number of fields of law. But the *Salomon* case has had a very restricting influence. While the concept of the social reality of a corporate body where there are a number of shareholders does not apply where there is only one controlling shareholder, judges are often not aware of the distinction. The *Salomon* case has stood in the way of differentiation. Where there is marked fraud or criminal activity, the courts readily disregard the corporate form and in cases where it is clear that the company is simply an agent or tool of a shareholder they sometimes look behind the façade. But in fact the courts have just lifted the veil often enough to make the whole matter unpredictable. It is not, however, possible to form a rational pattern out of the courts' handling of the various situations.

The Supreme Court has not been Canada's final court of appeal for long enough to develop a trend, and none seems indicated to date. But the courts gave us the *Salomon* rule and ultimately the courts should make it fit the economic and sociological facts. Leadership, in this respect, in Canada, must come from the Supreme Court and it is now free to give it. Canadian courts, like those of England, are hard bound by *stare decisis*, and parliamentary supremacy. But in the final analysis, it is our courts that must make our laws work.

This is not to say that the *Salomon* case is without merit. Its rule is indeed very clear and understandable and if it fitted the facts it would be most convenient. The rule is easy to apply or rather, it is easy to see how to apply it. But it is after all only a legal device and as such it can only be put to best use when employed to bring law into line with practicality. The *Salomon* case did not do this, and as a result it has been in effect whittled away. But it still thrives with the blessing of both the House of Lords and the Privy Council.

Admittedly the concept of the corporation is not readily described and the idea of regarding it as an artificial creation completely separated from the motives of those who control it does serve to simplify it and make much of what it does explainable. Corporate bodies must, on the whole, be treated as separate from the individuals composing them because legal certainty and business necessity require it. But we must not lose sight of the fact that a corporation has a dual capacity. It arises from the unity of spirit or purpose of its incorporators and in one sense it symbolizes this unity. It is made to perform certain functions ordinarily per-

formed by natural persons, so some aspects of personality may be attributed to it. Actively it can only express itself through the instrumentality of actual people. Passively it can hold property in perpetual succession, a characteristic which distinguishes it from mortals. It does represent a separate capacity, a right to hold property and to dispose of it, a right to carry on most of the activities of the business world and to do so in a way that will segregate corporate business from private. The problem then is one of defining the area of this capacity and the results that flow from its separation from the private business of those who control it. Such definition and delineation will not be constant. The ramifications of human relations are multifarious and simply will not be confined to the narrow compass of a single rule, be it ever so readily understood. The courts have narrowed the defined limits of the corporation by endowing it with a personality separate and apart from those who comprise it. This cannot endure in an unaltered state and each time the veil is lifted is but further proof that it cannot. The legal problem was created through the judicial process. It can be corrected in the same way if our courts will but direct their efforts toward defining the limits of corporate function. While the concept of separate personality has a valid but limited purpose, in the final analysis the nature of the corporation is not so important as the uses which it can serve. The corporate concept is a legal device. Rules for its use must be developed and applied. But such rules must not become the masters. No such device should be allowed to defeat more important values in the law.