MANITOBA COURT OF APPEAL

Freedman C.J.M., Guy and Dickson JJ.A.

Coodin et ux. v. Binsky et al.

M. Greene, for appellants.

R. Penner, Q.C., for respondents.

12th December 1972. DICKSON J.A. (FREEDMAN C.J.M. concurring):—Max Coodin and his wife owned 50 per cent of the issued and outstanding shares of Winnipeg Cereal Milling Ltd. ("the Company"), the remaining 50 per cent being owned by the late Abram Binsky and his wife. Serious differences arose between Binsky and Coodin, as a result of which an agreement was entered into on 21st December 1967 giving Binsky the right to sell his shares to Coodin for $37,000 or purchase Coodin's shares for $50,000; the $37,000 or $50,000, as the case might be, being referred to as "the base price". In addition to the base price the purchaser, whether Binsky or Coodin, was required, by the terms of the agreement, to

pay to the other an amount equal to one-half the liquid assets of the Company, including cash, accounts receivable and grain inventory.

One clause of the agreement, cl. A(11), which led to the present litigation, reads:

"A (11) The vendor shall deliver to the purchaser, on or before the closing date, an indemnity in favour of the purchaser in respect to any contingent or other hidden liabilities of which the vendor, but not the purchaser, is aware, or of which the purchaser could not reasonably be expected to have had knowledge, at the date hereof *and also including an indemnity to the purchaser in respect of the vendor's portion of any unpaid tax liability with respect to the shares sold by the vendor and which liability is in existence at the date hereof.* The purchaser shall indemnify the vendor for any liability of the vendor under Section 138 (A) (1) and 81 (1) of the Income Tax Act of Canada." (The italics are mine.)

Pursuant to the agreement Binsky's shares in the Company were purchased by Coodin. Subsequently, relying on the quoted clause, Coodin demanded from Binsky payment of that portion of the income tax liability incurred by the Company during the fiscal year 1st July 1967 to 30th June 1968 which was alleged to have accrued due as at the date of sale, 21st December 1967. Binsky denied liability. Matas J., before whom the matter came on a motion for determination of the rights of the parties, allowed Coodin's claim, and the present appeal followed.

The first observation which might fairly be made is that on a literal interpretation the clause, or at least that part of the clause on which Mr. Coodin relies, is meaningless because: (i) the tax liability in respect of which the purchaser is to be indemnified must be, according to the agreement, "with respect to the shares sold", yet the scheme of the Income Tax Act, R.S.C. 1952, c. 148 [now R.S.C. 1970, c. I-5], is to tax persons, whether individual or corporate, and not property. No tax liability attaches to shares per se; (ii) the tax liability against which the indemnity is to afford protection is one "in existence at the date hereof", i.e., in existence on 21st December 1967, about midway through the fiscal year of the Company. Save in the event of a winding-up or reorganization of a business there is no tax liability part way through a fiscal year. A profit in the first part of a year may readily be dissipated through losses in the second part of the year. Section 2(1) of the Income Tax Act in force at the date of the agree-

ment provided that an income tax be paid upon the taxable income "for each taxation year" of every person resident in Canada at any time in the year. Section 4 made the point even clearer. It provided that income for a taxation year from a business or property was the profit therefrom "for the year".

Obviously the parties intended something by the wording adopted in the latter part of the quoted clause and if a literal interpretation leads to an absurdity, as it does, we must, I think, depart from the ordinary rule that words in a written contract are to be given their plain or literal meaning and seek a construction which will give the words a reasonable meaning within the context of the whole document.

Mr. Penner, counsel for Mr. Coodin, advanced this meaning. It seems clear, he submitted, that the agreement was drawn up so that insofar as ascertainable at the date of closing, each of the parties would know exactly what his *net* position was either as purchaser or vendor; and, with respect to liabilities which could not be ascertained at the date of closing, each party would be indemnified in whole or in part as the case might be; there was, as of the date of closing, an unpaid and, at that time, an unascertainable tax liability the amount of which would not be known until after the end of the fiscal year, when the corporation tax return was assessed and confirmed by the Department of National Revenue and the inventory valuation accepted by the Department; the clause was an indemnity for one-half of the Company's tax liability in respect of that portion of the fiscal year terminating with the date of closing of the transaction, i.e., one-half of the Company income earned to the date of closing.

The learned Chambers Judge, Matas J., accepted the foregoing submission. He concluded that the reference "to the shares sold by the vendor" was a "shorthand means" of expressing an obligation on the part of the vendor to reimburse the purchaser for that part of the corporate tax attributable to the vendor's half ownership in the company, with the result that the vendor remained liable for a pro rata share of the corporate liability which could only be ascertained after the year was completed and tax assessment made.

With greatest respect, I do not agree. I cannot accept the basic point on which that conclusion rests, namely, that the corporate tax liability to 21st December 1967 could not be ascertained until after the fiscal year of the Company in June 1968. More particularly, I am of opinion that:

(1) If the experienced counsel who drafted the agreement had intended the vendor to pay one-half of the income tax liability of the Company accrued to 21st December 1967 it would have been only too easy to have said so.

(2) If such had been intended one would have expected to find in the agreement appropriate language to require preparation of a financial statement, including balance sheet and profit and loss account, as of the date of closing, such statement to be prepared at or immediately after the date of closing. The agreement does not contain any requirement for preparation of such a statement at any time, whether before or after the end of the fiscal year.

(3) No purpose would be served by waiting until the end of the fiscal year. The year-end values placed on inventory would bear no necessary relationship to mid-year values, either in terms of volume of grain or price per bushel. Also the determination of year-end values would rest with the purchaser. It is difficult to conceive that the vendor would agree to an indemnity, the extent of which would rest with the purchaser, with whom the vendor was at odds.

(4) Equally strange is the concept of pro-rating the tax, making the vendor responsible for that portion of the tax for the entire year which the time elapsed to date of closing bore to the whole year. The results for the latter half of the year depended entirely on what was done by the purchaser. If the Company prospered in the last half of the year the vendor, paying one-half of the tax for the year pro-rated to 21st December 1967, would be paying in respect of profits in which he would not share; on the other hand, if the Company faltered in the last half of the year the vendor would be relieved of making a payment under the indemnity which he should properly pay, if it was intended that the vendor bear one-half of the Company's income tax accrued to date of closing.

(5) Finally, if it had been intended that the sale price of the shares would be reduced by one-half of accrued tax liability of the Company to date of closing, one would expect, I should think, that something less than the full purchase price would be paid, in cash and promissory note, to the vendor at closing. One would expect provision for a hold-back of part of the purchase price until the amount of the reduction had been computed.

Being unable, for the reasons given, to accept the construction which commended itself to the learned Chambers Judge

there remains to give the language of the clause another construction which the words could reasonably bear. That is not an easy task.

The last sentence of the clause quoted earlier was handwritten. The Income Tax Act, s. 138A(1) [en. 1963, c. 21, s. 26] dealt with dividend stripping; s. 81(1) with the distribution or other appropriation of corporate funds or property to or for the benefit of one or more of its shareholders on the winding-up, discontinuance or reorganization of its business. The inclusion of the last sentence would appear to have been to assure Mr. Binsky that, in the unlikely event of the tax authorities regarding the transaction between him and Mr. Coodin as a dividend strip or distribution of undistributed income, thereby rendering the consideration taxable as dividend income, Mr. Binsky would be protected. It seems to have been the intent that Mr. Binsky would receive the price of the shares free of any tax arising by reason of s. 138A(1) or s. 81(1).

There are other sections of the Income Tax Act which can give rise to unpleasant consequences. Section 8(1) provides in part that where a payment has been made by a corporation to a shareholder otherwise than pursuant to a bona fide business transaction, or if corporate funds or property have been appropriated to a shareholder, or if a benefit or advantage has been conferred on a shareholder by a corporation, then in any of these events the amount or value of the payment or benefit is included in computing the income of the shareholder for the year. Other sections of the Act, such as those dealing with certain types of shareholder loans (s. 8(2)) and certain indirect payments (s. 16(1) [re-en. 1960-61, c. 49, s. 5]) have similar tax results.

It would seem to me that the language used in the clause can be construed as intended to assure the purchaser, Mr. Coodin, that if there should arise any later reassessment of shareholders by reason of anything done prior to the date of closing, Mr. Binsky would continue liable for one-half of the assessment notwithstanding the sale of his shares to Mr. Coodin. That is a construction of which the words are susceptible taken within the context of the instrument as a whole. Whether or not it is the correct or only construction, it is, I think, a more reasonable construction than that advanced on behalf of Mr. Coodin. I find it impossible to construe the words of the clause as an undertaking on the part of Mr. Binsky to pay one-half of the corporate income tax accrued to closing date.

I would accordingly allow the appeal with costs.

GUY J.A. (dissenting):—This is an appeal from a judgment of Matas J. The learned trial Judge was required to determine whether or not the Binskys, as vendors of shares in a corporation, remained liable for "a pro rata share of the corporate liability" which could only be ascertained after the year was completed, and tax assessment made. His decision was that the vendors *did* remain liable for such pro rata share of the corporate liability.

As is often the case, the problem confronting the learned trial Judge can best be stated by repeating his opening remarks. Thus, despite the duplication, I repeat them below. They are as follows:

"This is an application under R. 537(1)(*b*) of the Queen's Bench Rules for determination of the rights of the parties under para. A(11) of an agreement dated 21st December 1967 ('the agreement').

"During the lifetime of the late Abram Binsky ('Binsky') and up until 21st December 1967, all of the issued shares of a Manitoba private corporation, Winnipeg Cereal Milling Ltd., ('the company' or 'Winnipeg Cereal') were owned as follows: as to 50 per cent by Binsky and Rita Binsky and as to 50 per cent by Max Coodin ('Coodin') and Lily Coodin.

"During the latter part of 1967 differences arose between Binsky and Coodin, who jointly managed the business of the company; as a result, the parties entered into an agreement dated 21st December 1967 which provided a basis for terminating the relationship between the parties. Under the terms of the agreement Binsky had the right to sell to Coodin his one-half of the outstanding shares of stock in the company or to require Coodin to sell his one-half of the shares in the company to Binsky. The agreement provided a formula for determining the price to be paid for the shares and by para. A(11) ('the paragraph') provided for indemnities in respect of unknown liabilities. The paragraph reads:

"'A. (11) The vendor shall deliver to the purchaser, on or before the closing date, an indemnity in favour of the purchaser in respect to any contingent or other hidden liabilities of which the vendor, but not the purchaser, is aware, or of which the purchaser could not reasonably be expected to have had knowledge, at the date hereof and also including an indemnity to the purchaser in respect of the vendor's portion of any unpaid tax liability with respect to the shares sold

by the vendor and which liability is in existence at the date hereof. The purchaser shall indemnify the vendor for any liability of the vendor under Section 138(A)(1) and 81(1) of The Income Tax Act of Canada.'

"The last sentence was written into the agreement and initialled by the parties.

"Binsky elected to sell and the Coodins became the owners of all of the shares in the company.

"Subsequently, the Coodins demanded from the Binskys payment of that portion of the income tax liability incurred by Winnipeg Cereal during the fiscal year 1st July 1967 - 30th June 1968 which was alleged to have accrued due as of 21st December 1967, the date of the sale by the Binskys of their share to the Coodins. The Binskys denied liability and, accordingly, refused to pay."

The lengthy agreement described by the learned trial Judge was followed by an indemnity agreement signed by Rita Binsky and Abram Binsky, dated 30th December 1967, under seal. The indemnity agreement itself reads as follows:

"KNOW ALL MEN BY THESE PRESENTS, that we, the undersigned, Abram Binsky, Manager, of the City of Winnipeg, in the Province of Manitoba, and Rita Binsky, wife of the said Abram Binsky, of the same place, for ourselves and our respective heirs, executors, successors and assigns, in consideration of the sum of One ($1.00) Dollar now paid to each of us by Max Coodin, of the City of Winnipeg, in the Province of Manitoba, Manager, and Lily Coodin, wife of the said Max Coodin, of the same place, and each of them, and for other good and valuable consideration (the receipt and sufficiency whereof is hereby acknowledged) do hereby jointly and severally indemnify and save harmless the said Max Coodin, and Lily Coodin, and each of them, from all claims, demands, costs, expenses, liability whatsoever, either at law or equity, attaching to our common or preferred shares of Winnipeg Cereal Milling Ltd. in respect of the period in which we owned same provided that the Indemnity given hereunder, is limited and restricted to contingent or other hidden liabilities attaching to the said shares of which liability we were aware of and which Max Coodin or Lily Coodin were not aware of or could not reasonably be expected to have had knowledge of, as at December 21st, 1967. Provided further that notwithstanding the above restriction this Indemnity shall extend to indemnify the said Max Coodin and Lily Coodin against any unpaid tax liability attaching to the

said shares and which liability was existing as at December 21st, 1967.

"IN WITNESS WHEREOF, the undersigned have hereunto executed this Indemnity this 30th day of December, A.D. 1967."

With respect, I am of the view that the learned trial Judge was correct in his assessment of the situation and in the conclusion he reached. We are fortified in this view by the fact that such evidence as we have before us clearly discloses that the Coodins (man and wife) and the Binskys (man and wife) went into the business of the milling of cereal as a Manitoba private corporation, Winnipeg Cereal Milling Ltd., on a straight 50-50 basis. Until 1967 this situation continued. When it was decided between the two sets of parties that they should come to a parting of the ways, this very lengthy written agreement was entered into; and a reading of the agreement as a whole indicates that each party was determined to ensure that the other party did not get one cent more than the exact 50 per cent to which that party would be entitled. To this end, they arranged for a base price; they agreed to two methods by which the matter could be settled. Either Coodin could purchase Binsky's share under method "A", or Binsky could purchase Coodin's share under method "B". It is astonishing to note the lengths to which the parties went to try to ensure that neither took advantage of the other. In any event, Binsky elected to sell pursuant to method "A", so that method "B" did not require any consideration, other than to emphasize that this was an "even-steven" concept from beginning to end.

One of the unknown factors at the time of the agreement (21st December 1967) was of course the matter of corporate income tax and the possibility of one or other of the parties being called upon to pay that tax if it were suddenly claimed by the Income Tax authority for earlier taxation years as well as for the entire company fiscal year (from 1st July 1967 to 30th June 1968).

In the light of the circumstances surrounding this entire transaction the only words in para. A(11) which really cause trouble are: "an indemnity in favour of the purchaser in respect to any contingent or other hidden liabilities of which the vendor, but not the purchaser, is aware, or of which the purchaser could not reasonably be expected to have had knowledge". This is an unhappily worded portion of the agreement, because the background of the partnership within the

corporation makes it quite apparent that no matter which party bought the shares, the value was to be determined after certain unknown liabilities were ascertained. This phrase should have been worded: "of which liability *neither* party could reasonably be expected to have had knowledge as at December 21, 1967". This is an alteration or modification of the actual language, but I am satisfied that such modification is justified. It adopts a broad liberal construction rather than a narrow, strict, book-keeping interpretation.

Once again, I rely on the dictum of Lord Wensleydale in *Grey v. Pearson* (1857), 6 H.L. Cas. 61, 10 E.R. 1216 (commonly referred to as Lord Wensleydale's Golden Rule). This reads in part [p. 1234]:

" . . . that in construing wills and indeed statutes, and all written instruments, the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified, so as to avoid the absurdity and inconsistency, but no farther".

Counsel for the respondents has cited Anson on Contracts, 22nd ed., pp. 138 et seq., 11 Hals. (3d) 430, and Black's Law Dictionary, 4th ed., p. 608.

In my opinion, these texts, with respect, simply enlarge upon the basic rule of Lord Wensleydale in *Grey v. Pearson*, supra. In the result, I would affirm the view of the learned trial Judge that it was the obvious intention of the parties that the Binskys as vendors of shares did remain liable for their pro rata or proportionate share of the corporate tax liability of Winnipeg Cereal Milling Ltd. to 21st December 1967. The reference to "shares sold" can only be interpreted as defining Coodin's or Binsky's shares — depending on the adoption of method "A" or method "B" in the agreement.

I would dismiss the appeal with costs.