

**Date: 20081126**

**Docket: A-235-08**

**Citation: 2008 FCA 370**

**CORAM: RICHARD C.J.  
EVANS J.A.  
SHARLOW J.A.**

**BETWEEN:**

**ALLAN FENWICK**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

Heard at Toronto, Ontario, on November 25, 2008.

Judgment delivered at Toronto, Ontario, on November 26, 2008.

**REASONS FOR JUDGMENT BY:**

**SHARLOW J.A.**

**CONCURRED IN BY:**

**RICHARD C.J.  
EVANS J.A.**

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**BETWEEN:**

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**REASONS FOR JUDGMENT**

**SHARLOW J.A.**

[1] Mr. Allan Fenwick is appealing the judgment of Justice Woods of the Tax Court of Canada dismissing his appeal of an income tax assessment (2008 TCC 243). The issue is whether Justice Woods erred in concluding that paragraph 8(1)(b) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5<sup>th</sup> Supp.) does not permit a deduction for legal expenses incurred by Mr. Fenwick to defend a

derivative action for alleged breaches of statutory and fiduciary obligations in which the central issue was the reasonableness of the remuneration that he caused to be paid to himself.

[2] Paragraph 8(1)(b) reads as follows:

8. (1) In computing a taxpayer's income for a taxation year from an office or employment, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto

[...]

*(b)* amounts paid by the taxpayer in the year as or on account of legal expenses incurred by the taxpayer to collect or establish a right to salary or wages owed to the taxpayer by the employer or former employer of the taxpayer.

8. (1) Sont déductibles dans le calcul du revenu d'un contribuable tiré, pour une année d'imposition, d'une charge ou d'un emploi ceux des éléments suivants qui se rapportent entièrement à cette source de revenus, ou la partie des éléments suivants qu'il est raisonnable de considérer comme s'y rapportant :

[...]

*b)* les sommes payées par le contribuable au cours de l'année au titre des frais judiciaires ou extrajudiciaires qu'il a engagés pour recouvrer le traitement ou salaire qui lui est dû par son employeur ou ancien employeur ou pour établir un droit à ceux-ci.

[3] The legal expenses in issue were incurred by Mr. Fenwick to defend an application by his sisters for leave to commence a derivative action against Mr. Fenwick on behalf 372116 Ontario Limited (also known as Hemispheres International Manufacturing Company, or "Hemispheres"). The remedies sought in the statement of claim included an award of damages. Leave was granted and the action was commenced. Ultimately, the action was settled.

[4] During the period relevant to the factual allegations in the statement of claim, Hemispheres was a corporation of which Mr. Fenwick was the sole director, president, secretary and chief executive officer, and thus its sole directing mind. He owned the only voting shares of Hemispheres, while his sisters owned non-voting shares. From 1982 to 1998, Mr. Fenwick received remuneration of approximately \$38 million from Hemispheres in the form of salary and wages.

[5] The statement of claim asserts a number of causes of action and forms of relief, but for the purposes of this appeal it is sufficient to refer only to the allegation that Mr. Fenwick, exercising the authority of his various positions with Hemispheres in breach of his statutory and fiduciary obligations, caused Hemispheres to pay him remuneration that was excessive. All of the claims turned in one way or another on that core allegation. The specific purpose of all or nearly all of the legal expenses in issue was to establish that the remuneration paid to Mr. Fenwick by Hemispheres was reasonable compensation for his services.

[6] It is argued for Mr. Fenwick that paragraph 8(1)(b) should be interpreted to apply to the legal expenses he incurred to establish that the amount of salary he received from Hemispheres was reasonable, because he had to prove that the remuneration he received was reasonable in order to prove that he was legally entitled to receive and retain it. As I understand this argument, it raises a question of the interpretation of paragraph 8(1)(b), which is a question of law, as well as a question of the characterization of the claims against Mr. Fenwick and of the application of paragraph 8(1)(b) to that characterization, which are questions of mixed fact and law. The decision of Justice Woods

must stand unless she misinterpreted paragraph 8(1)(b), or made a palpable and overriding error in characterizing the claims against Mr. Fenwick or in applying paragraph 8(1)(b) to the facts.

[7] Justice Woods rejected the broad interpretation of paragraph 8(1)(b) proposed on behalf of Mr. Fenwick. In my view she was correct to do so. Paragraph 8(1)(b) has a relatively narrow scope. It is intended to apply where an employee incurs legal expenses in attempting to collect unpaid salary or wages, or in attempting to resolve a dispute with an employer or former employer as to the amount of salary to which the employee is entitled (see *Loo v. Canada*, 2004 FCA 249). In the latter case, it is usually the employee alleging an underpayment.

[8] It is an open question whether paragraph 8(1)(b) also applies to legal expenses incurred by an individual who is being sued by an employer or former employer for reimbursement of an overpayment of salary or wages. For the purposes of this appeal, I will assume without deciding that paragraph 8(1)(b) could apply in those circumstances. However, Justice Woods held, and I agree, that paragraph 8(1)(b) is not intended to permit legal expenses to be deducted when they are incurred in litigation involving a claim for damages involving disputes other than those arising from the terms of employment, merely because the defendant's entitlement to particular remuneration is an element of the claim.

[9] Having in mind that interpretation of paragraph 8(1)(b), Justice Woods determined the essential nature of the claims asserted against Mr. Fenwick based on the statement of claim. It was argued for Mr. Fenwick that Justice Woods erred in failing to consider the evidence of the witnesses

for Mr. Fenwick who explained how and why legal expenses were incurred to establish that Mr. Fenwick's remuneration from Hemispheres was reasonable. There is no basis for concluding that Justice Woods disregarded that evidence, but I assume that she gave it little or no weight because she did not mention it in her reasons. In my view, she made no error in that regard. That evidence was not capable of casting light on the essential nature of the claims against Mr. Fenwick, which were necessarily derived from the statement of claim alone.

[10] Justice Woods construed the statement of claim as raising a dispute between Hemispheres and Mr. Fenwick in his capacity as the only corporate officer exercising control over the corporation's affairs. That understanding of the statement of claim compelled the conclusion that, even if the allegation of excessive remuneration was an element of the claim against Mr. Fenwick, and even if Mr. Fenwick was at risk of being ordered to pay damages quantified in part by reference to that remuneration, Mr. Fenwick *qua* employee was not at risk of being ordered to reimburse any of that remuneration to Hemispheres *qua* employer. On that basis, Justice Woods concluded that the legal expenses incurred by Mr. Fenwick in defending himself from the claims made against him were not deductible under paragraph 8(1)(b). In my view, it was reasonably open to Justice Woods to construe the claims against Mr. Fenwick as she did, and to conclude that paragraph 8(1)(b) did not apply.

[11] Counsel for Mr. Fenwick argued that the absence of any reference in Justice Woods' reasons to the allegations of unjust enrichment indicate a palpable and overriding factual error. I do not accept that argument. In my view, the allegations of unjust enrichment are not capable of

transforming what is fundamentally a corporate claim for damages into an employee/employer dispute about the amount of salary owed.

[12] Finally, it is argued for Mr. Fenwick that Justice Woods erred in basing her decision on grounds that were different from the basis of the Minister's assessment, and that were not pleaded or argued by the Minister, without giving Mr. Fenwick an opportunity to adduce evidence or advance argument at trial in respect of those grounds. This argument focuses in the statement of Justice Woods to the effect that the statement of claim did not put in issue Mr. Fenwick's right to retain the remuneration he received from Hemispheres "in his capacity as an employee".

[13] It is true that Justice Woods did not accept the interpretation of paragraph 8(1)(b) submitted by the Minister as the main legal basis of the Minister's assessment and argument in the appeal (i.e., that paragraph 8(1)(b) applies only where there is an allegation that salary or wages are owed but have not been paid). However, it does not follow that Justice Woods was obliged to adopt the incorrect interpretation proposed on behalf of Mr. Fenwick. Once she rejected both positions, she was required to adopt an interpretation of paragraph 8(1)(b) that was not proposed by either party. Having done that correctly, she then had to apply that interpretation of paragraph 8(1)(b) to the evidence presented. I see no merit in the argument that Mr. Fenwick was prejudiced by the inability of his counsel to ask a witness specifically whether the claim against Mr. Fenwick was in substance a claim against Mr. Fenwick in his capacity as employee for reimbursement of salary, when the interpretation of paragraph 8(1)(b) that he proposed raised that very notion.

[14] For these reasons, I would dismiss this appeal with costs.

“K. Sharlow”

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J.A.

“I agree  
J. Richard C.J.”

“I agree  
John M.Evans J.A.”



**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

**DOCKET:** A-235-08

**(APPEAL FROM THE JUDGMENT OF THE HONOURABLE JUSTICE J. WOODS  
DATED 25-APR-2008, IN THE TAX COURT OF CANADA NO. 2005-3862(IT)G.)**

**STYLE OF CAUSE:** *ALLAN FENWICK v.  
HER MAJESTY THE QUEEN*

**PLACE OF HEARING:** TORONTO, ONTARIO

**DATE OF HEARING:** November 25, 2008

**REASONS FOR JUDGMENT BY:** SHARLOW J.A.

**CONCURRED IN BY:** RICHARD C.J.  
EVANS J.A.

**DATED:** November 26, 2008

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