Federal Court of Appeal | Cour d'appel fédérale

CANADA

Date: 20110613

Dockets: A-364-10
A-363-10

Citation: 2011 FCA 200

CORAM: **LÉTOURNEAU J.A.**
DAWSON J.A.
STRATAS J.A.

A-364-10

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

CARROLL A. SPENCE

Respondent

A-363-10

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

DAVID JOHN RATCLIFFE

Respondent

Heard at Toronto, Ontario, on June 8, 2011.

Judgment delivered at Ottawa, Ontario, on June 13, 2011.

REASONS FOR JUDGMENT BY:	LÉTOURNEAU J.A.
CONCURRED IN BY:	DAWSON J.A.
	STRATAS J.A.

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REASONS FOR JUDGMENT

LÉTOURNEAU J.A.

Issues on appeal

[1] These are appeals against a decision of Favreau J. of the Tax Court of Canada (judge) in which he allowed with costs the respondents' appeals against their reassessments under the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1, as amended (Act) for the 2003, 2004 and 2005 taxation years.

[2] I should say at the outset that the judge felt constrained to follow the decision of a colleague of his court in *Detchon v. R.*, [1996] 1 C.T.C. 2475 where the facts were similar to those of his case. It appears that his attention was not drawn to the decision of our Court in *Schroter v. R.*, 2010 FCA 98, [2010] 4 C.T.C. 143.

[3] I should also add for the sake of clarity that the judge rendered one set of reasons for the two appeals that were before him. Her Majesty the Queen appeals from the judge's finding in both files. Pursuant to an Order of Nadon J.A., both appeals were consolidated in our Court. In conformity with the Order of Nadon J.A., one set of reasons will be issued in the lead file (A-364-10) and a copy of said reasons will be filed in file A-363-10.

[4] The appellant submits that the only issue on appeal is the quantification of the respondents' employment benefits under paragraph 6(1)(*a*) of the Act. In this respect, the appellant contends that

the judge should have held that the value of the benefits was the fair market value of these benefits. Instead, the judge followed the *Detchon* decision where the value of the benefit was determined to be the actual costs of the good or service incurred by the employer.

[5] In their memorandum of fact and law, the respondents raise two additional issues:

a) whether the benefit was for them as employees or principally for the benefit of the employer; and

b) whether there was a material acquisition by the respondents which conferred an economic benefit on them.

[6] Counsel for the appellant objected to the issues raised by the respondents on the ground that they are contrary to, and in effect a withdrawal of, the judicial admissions of facts upon which the trial took place. After an exchange between counsel for the respondents and the members of the panel, it was understood that the sole issue before us was the valuation of the benefits received by the respondents.

[7] That being so, I am satisfied that there is no recanting of the admission that the respondents received a taxable benefit. Otherwise, there would be no point in discussing the value of the benefit received for taxation purposes if the benefit is not taxable.

The facts giving rise to the litigation

[8] The respondents are teachers at a Montessori School in London, Ontario. By virtue of their employment, they were able to send their children to that school for half the standard tuition fees. For the taxation years at issue, they declared as a benefit the difference between the actual overhead cost per student space available the school incurred in educating the children and the employee tuition rate they had paid. The Minister of National Revenue reassessed them on the basis that their benefit was the fair market value of the education, minus the tuition they had paid.

[9] The case proceeded in the Tax Court on the basis of the following agreed statement of facts reproduced at paragraph 2 of the judge's reasons for judgment:

> [2] These appeals were heard on common evidence. The parties to the appeals agreed to file in Court the following Agreed Statement of Facts:
>
> 1. during the years 2003, 2004 and 2005, the Appellants were employed as teachers for The Montessori House of Children located in London, Ontario ("the School");
> 2. the School serves approximately 400 children and their families annually, with the support of over 70 full and part time faculty and staff. The School's central location houses all program levels from Toddler to Junior High and two satellite locations, Westmount South and Whitehills North, have additional preschool programs.
> 3. during the years 2003, 2004 and 2005, the respective children of the Appellants were enrolled at the School;
> 4. the Appellants are unrelated to each other and each deals at arm's length with the School;
> 5. the Appellants are not shareholders of, and do not otherwise have an ownership interest in, the School;
> 6. the School granted a 50% discount on the tuition fees paid by all employees of the School, including the Appellants, for the enrollment of children of the employees, including the Appellants' children, at the School;

7. the Appellants enjoyed the substantial benefits of reduced tuition fees by reason of their employment;
8. [t]he School enjoyed substantial benefits from having the Appellant's [*sic*] children attend the School, such attendance benefitting the School's recruitment of prospective students and retention of existing students;
9. the School calculated the amount of the benefits enjoyed by the Appellants as the difference between the discounted price charged by the School to the Appellants and the cost of providing education at the School as calculated by the School;
10. the amount of the benefits enjoyed by the Appellants as calculated by the School was included in the income of the Appellants on the T-4 information returns prepared by the School, and was reported by the Appellants in their incomes for the 2003, 2004 and 2005 taxation years;
11. the amount of the cost of providing education at the School as calculated by the School is the correct determination of that cost;
12. the Minister reassessed the Appellants to increase the amount of the taxable benefit to the full amount of the discount (50% of the tuition charged to non-employees)[;]
13. the amounts of the standard tuition, the discount granted, the benefit reported and the adjustment to taxable benefit as reassessed in respect of the Appellants are the following:

Carroll A. Spence	2003	2004	2005
Standard tuition	$9,400	$9,800	$5,250
Discount granted	$4,700	$4,900	$2,625
Employment Benefit reported	$2,772	$2,654	$1,023
Adjustment to taxable benefit	**$1,928**	**$2,246**	**$1,602**

David John Ratcliffe	2003	2004	2005
Standard tuition	$9,400	$9,800	$10,050
Discount granted	$4,700	$4,900	$5,025
Employment benefit reported	$2,772	$2,654	$2,271
Adjustment to taxable benefit	**$1,928**	**$2,246**	**$2,754**

> 14. the Fair Market Value of the discount, if determined by reference to the tuition which would be paid in respect of a child whose parent was not employed by the School is equal to the full amount of the discount.

Analysis of the judge's decision

[10] The fate of the present appeal, in my respectful view, is governed by the decision of our Court in *Schroter*, cited above. What is in issue here is not the cost for the employer of granting the benefit to the employees. It is the value of the benefit received by the employees, i.e. in the present instance, the amount of the tuition fees that the respondents would have had to pay to send their children at their employer's school if they had not been teachers at that school. This is the fair market value of the benefit they received, minus of course the amount that they paid for the tuition.

[11] I agree with Professor Kim Brooks that costs of the benefit to the employer is the wrong instrument to assess the value of the benefit. While in some cases (see for example *Stauffer v. R.*, [2002] 4 C.T.C. 2608, at paragraph 17) the cost may correspond to the fair market value, it is not necessarily the case.

[12] In her article entitled Delimiting the Concept of Income: The Taxation of In-Kind Benefits, (2004) 49 *McGill L.J.* 255, at pages 274 and 275, Professor Brooks writes:

> Employers can often provide some goods or services to employees at very little cost to themselves. It is sometimes argued as a result that because these benefits are provided at no substantial cost to employers, they should not be taxed in the hands of employees. However, the obvious reason for discarding this test is that it is the

> employee's income that is in issue. The employer's cost of providing these goods is irrelevant to this issue.
>
> …
>
> The "cost to the employer" method assumes that the value of the benefit to the employee will equal the cost of the benefit to the employer. Both of these empirical assumptions are wrong. Employees may receive a huge personal benefit from employer-provided goods and services even though they cannot sell the goods and services, and there is no reason for supposing that the value of a benefit to an employee should be in any way related to its cost to the employer.

[13] In *Schroter*, Dawson J.A. reviewed the principles and the jurisprudence applicable and applied to the existence and quantification of a taxable benefit under paragraph 6(1)(*a*) of the Act. She concluded as follows at paragraphs 47 and 48 of her reasons for judgment:

> [47] The equal treatment of taxpayers is facilitated by valuing their benefits at their fair market value. On an administrative basis, the Canada Revenue Agency recognizes this and instructs employers that where the fair market value of a parking pass cannot be determined, no benefit should be added to an employee's remuneration. Where the fair market value can be determined, employers are instructed that the value of the benefit is based on the fair market value of the parking pass, less any payment the employee makes to use the space. See: Canada Revenue Agency, *Employers' Guide – Taxable Benefits and Allowances 2009*, T4130(E) Rev. 09.
>
> [48] Given the inherent fairness of this method of valuation, and the absence of objective evidence demonstrating that a fair market value based valuation is somehow inappropriate on the facts of this case, the Tax Court judge did not err by valuing the parking pass in the amount of its fair market value.

[14] Apart from the fact that I agree with this approach, no objective evidence was provided to us that demonstrates that resort to a fair market value based valuation is inappropriate in the present

instance. On the contrary, a value assessment based on the costs incurred by the employer as advocated by the respondents can work unfairness. I will offer two examples.

[15] Let us assume a non-teacher parent with an income of $50,000 who wishes to send his child to the Montessori school. He pays a tuition fee of $10,000. The school has an overhead cost of $7,000 for each student space available. Having disbursed $10,000, this parent would be left with an income of $40,000. However, his taxable income would be $50,000.

[16] Now let us take the situation of a teacher parent at the school who has an income of $45,000. He pays an employee-discounted tuition fee of $5,000. The school has an overhead cost of $7,000. The teacher would be left with an income of $40,000 after the disbursement of $5,000 for the tuition fee.

[17] If this teacher's taxable benefit were based on the overhead cost of the education for the school minus the tuition he paid ($7,000 - $5,000), he would be taxed on only $47,000, i.e. his salary plus the taxable benefit. He would be in the exact same position as the non-teacher parent in terms of the money he had left after paying tuition and in terms of the education his child received, yet he would be taxed on the basis of an income of $3,000 less. This seems unfair.

[18] If, however, the teacher parent were taxed on the tuition he had saved, he would be taxed on $50,000 total, i.e. his salary plus the benefit. Both parties would then be taxed on the same amount. They would thus be taxed equally for the equal benefits they have received from their respective

jobs. As Dawson J.A. said at paragraph 47 in *Schroter*, cited above, "the equal treatment of taxpayers is facilitated by valuing their benefits at their fair market value".

[19] The following graphics illustrate the two scenarios:

	Income	**Yearly tuition fee paid**	**Cost to the school**
Non-teacher parent	$50,000 - $10,000	$10,000	$7,000
Income left	$40,000		
Taxable income	$50,000		

	Income	**Employee tuition fee paid**	**Cost to the school**
Teacher parent	$45,000 - $5,000	$5,000	$7,000
Income left	$40,000		
Taxable income	$47,000	($45,000 +	($7,000 - $5,000)

[20] Counsel for the appellant argued that the costs to the school depend on many factors such as efficiency, overhead, suppliers, etc. which, I agree, "are irrelevant and have no impact on the value of the taxable benefit enjoyed by the respondents": appellant's memorandum of fact and law, at paragraph 26. He provides the following hypothetical example which, I think, also illustrates the unfairness of treatment if the cost method is used:

> The tuition in three schools if $10,000. Each offers the same benefit of a $5,000 discount to their employees. The cost per student for one school is $5,000, the other is $10,000 and the last one is $11,000. According to the cost approach taken by the trial judge, the value of the discount would be $0, $5,000 or $6,000, even though each recipient enjoyed the same benefit.

[21] The respondents argued at the hearing that the value of the taxable benefit to the employees should be determined by a balancing, I suppose in an offset fashion, of the benefit to the employer and the benefit to the employees.

[22] No authorities were cited for this proposal and I confess that I cannot find much legal and practical support for this test. As a general rule, an employer sees and seeks an advantage when he confers a benefit to an employee. With this proposed approach, instead of having to determine one value, i.e. the value of the benefit to the employee, the court would have to determine two values, i.e. that of the benefit to the employer as well.

Conclusion

[23] For these reasons, I would allow the appeals without costs as requested by the appellant, set aside the decision of the Tax Court of Canada and dismiss the respondents' appeals to the Tax Court of Canada without costs.

"Gilles Létourneau"

J.A.

"I agree
Eleanor R. Dawson J.A."

"I agree
David Stratas J.A."

FEDERAL COURT OF APPEAL

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