

Docket: 2002-3297(IT)G

BETWEEN:

2159-2993 QUÉBEC INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal of
Daniel Lévesque (2002-3301(IT)G) on September 29, 2004,
at Québec, Quebec

Before: The Honourable Justice B. Paris

Appearances:

Counsel for the Appellant: Jacques Côté

Counsel for the Respondent: Martin Gentile

JUDGMENT

The appeal against the assessments made under the *Income Tax Act* for the 1995 and 1996 taxation years is allowed, with costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 25th day of November 2005.

"B. Paris"

Paris J.

Translation certified true
on this 13th day of March 2009.

Brian McCordick, Translator

Docket: 2002-3301(IT)G

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and

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Respondent.

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REASONS FOR JUDGMENT

Paris J.

[1] These two appeals, which were heard on common evidence, are from reassessments made by the Minister of National Revenue ("the Minister") in respect of Daniel Lévesque for the 1994, 1995 and 1996 taxation years, and in respect of 2159-2993 Québec Inc., his management company ("2159"),¹ for the 1995 and 1996 taxation years.

¹ The T2 income tax returns filed by 2159 for the 1994 and 1995 taxation years state that Mr. Lévesque held 100% of that company's shares.

[2] These appeals stem from the sale, in 1994, of two businesses that belonged to Mr. Levesque and his spouse Sylvie Morais: Garage Daniel Lévesque Inc. ("Garage") and Les Équipements Daniel Lévesque Inc. ("Les Équipements").² As part of this sale, the purchaser, Purdel, entered into a [TRANSLATION] "service contract" ("the Service Contract") with the Appellant 2159, under which 2159 was to provide consulting services in return for a total of \$120,000 in payments over the course of a period extending from 1994 to 1996. Effective June 1, 1995, at the request of 2159, Purdel made the payments under the Service Contract to Ms. Morais, who thereby received \$90,000 from Purdel.

[3] 2159 did not include this amount of \$90,000 in its 1995 and 1996 income tax returns because, in its opinion, the Service Contract was a simulation or sham and the amounts paid thereunder were actually in payment of a part of the selling price of the shares held by Ms. Morais in Les Équipements.

[4] The Minister took the position that the Service Contract was valid, and added \$15,000 to 2159's income for the 1995 taxation year and \$75,000 to its income for the 1996 taxation year as unreported business income.³

[5] In addition, under subsection 56(2) of the *Income Tax Act* ("the Act"), the Minister added \$52,500 to Mr. Lévesque's 1995 income and \$37,500 to his 1996 income on account of amounts that 2159 had asked Purdel to pay Ms. Morais.

[6] On July 28, 1994, and also in connection with the sale of the two businesses, Garage paid Mr. Lévesque a \$52,000 retiring allowance. Mr. Lévesque contributed this amount to an RRSP for his 1994 taxation year and deducted the same amount in computing his income.

[7] By the reassessments in issue, the Minister disallowed Mr. Lévesque's RRSP deduction claim for 1994 because he determined that Mr. Lévesque had not retired from Garage and that, under the Service Contract, he continued to perform substantially the same duties as before.

² Mr. Lévesque held all the shares of 2962-0192 Québec Inc. ("2962"), which, in turn, held all the shares of Garage Daniel Lévesque Inc. Ms. Morais held 99% of the shares of Les Équipements, and Mr. Lévesque held 1% thereof.

³ 2159's fiscal year ends on July 31. The company paid Ms. Morais \$15,000 in the course of its 1995 fiscal year, and \$75,000 in the course of its 1996 fiscal year.

[8] The Minister imposed the penalty prescribed by subsection 163(2) of the *Act* in respect of all amounts added to the income of Mr. Lévesque and 2159.

[9] The Appellants dispute all these changes to their income, and furthermore, Mr. Lévesque submits that the year 1994 was time-barred at the time of the reassessment.

Facts

[10] Garage was a New Holland and Fiat dealer that sold and repaired agricultural machinery, sold parts, and provided after-sales service. Its establishment was in Pointe-au-Père, very close to Rimouski. The company began operations in or about 1984, employed roughly 15 employees and had \$5,000,000 to \$7,000,000 in sales.

[11] As for Les Équipements, its line of business was the same as Garage's. It had been a John Deere dealer since the early 1990s. It had seven to ten employees, and \$2,000,000 to \$3,000,000 in sales. The companies were located across the street from each other, and were roughly 200 feet apart.

[12] Purdel is a cooperative that supplies its 900 members with farming and petroleum products in addition to running a pig farm and operating renovation and gardening centres. Purdel carries on business between Saint-Simon and Sainte-Anne-des-Monts, as far inland as Sayabec, on the Matapédia River.

[13] Until 1993, Purdel was a Fiat farm machinery dealer in Mont-Joli, but, following Fiat's dealership restructuring, it lost its dealership. Consequently, Purdel became interested in Mr. Lévesque's businesses.

[14] Jean-Paul Thériault, Purdel's CEO since January 1993, was apparently the one who communicated with Mr. Lévesque to see if he was interested in operating Garage and Les Équipements in partnership with Purdel. Since Mr. Lévesque refused any partnership, negotiations followed with respect to the sale of the companies. The participants in these discussions included Valmond Santerre, a chartered accountant and planner with Investors Group, representing the sellers; and Claude Gauthier, a chartered accountant with Raymond Chabot Grant Thornton, representing the purchaser. Mr. Lévesque and Mr. Thériault were also present, but Ms. Morais attended only a few of the meetings.

[15] The sellers initially asked for \$2,200,000 for the two companies, but when they realized that the purchaser was willing to pay only \$1,600,000, they agreed to

lower the price to \$1,800,000. They said that they would not accept less than \$1,800,000 for the shares.

[16] On May 20, 1994, the parties met to continue the negotiations (in which Purdel was represented by Mr. Thériault and Mr. Gauthier and the sellers were represented by Mr. Lévesque and Mr. Santerre). According to Mr. Thériault and Mr. Gauthier, at that meeting Purdel proposed to pay \$1,600,000 for the shares of the two companies, plus a \$120,000 "salary" to 2159 for consulting services. It was also proposed that Mr. and Ms. Lévesque receive \$80,000 in the form of a retiring allowance payable by Garage immediately prior to the sale.⁴

[17] In the course of the negotiations, Mr. Gauthier prepared a calculation sheet setting out the amounts offered by Purdel. This worksheet sets out the components of Purdel's offer, and states, among other things, that the payment of \$30,000 of the "salary" portion would be spread over 26 weeks commencing August 1, 1994, and that \$90,000 would be paid over a 12-month period commencing June 1, 1995. An annotation next to the amount of \$90,000 states that it would not bear interest.

[18] Further to the oral agreement, three written contracts – a share purchase offer for each company and a Service Contract between Purdel and 2159 – were prepared by Purdel's counsel Claude-Henri Gendreau and were signed by the parties on May 26, 1994. The Service Contract stipulates:

[OFFICIAL ENGLISH TRANSLATION]

1. Purdel, Coopérative Agro-Alimentaire [agri-food cooperative], hires 2159-2993 Québec Inc. as a consultant for a determinate period commencing August 1, 1994, and ending May 31, 1996.
2. Under the direction of the Chief Executive Officer of Purdel, Coopérative Agro-Alimentaire, the representative of 2159-2993 Québec Inc. shall faithfully and fully carry out such duties as the Chief Executive Officer shall assign to him in his capacity as a consultant from time to time, and shall devote his attention and energy to the performance of those duties to the best of his abilities and knowledge.

⁴ Purdel would also pay the sellers' accounting fees, which totalled \$10,000.

3. 2159-2993 Québec Inc. and its representative shall act loyally and shall not use confidential information that it obtains [*sic*] in the performance of this Agreement or in relation hereto.

These obligations shall survive for a reasonable period following the termination of the Service Agreement and shall survive permanently where the information involves the reputation or privacy of others.

4. The services requested from 2159-2993 Québec Inc. shall be rendered during the regular working hours of Purdel, Coopérative Agro-Alimentaire.

5. For the services rendered, Purdel, Coopérative Agro-Alimentaire, shall pay 2159-2993 Québec Inc. the sum of \$30,000 to be invoiced in weekly instalments from August 1, 1994, to January 28, 1995, and the sum of \$90,000 to be invoiced in monthly instalments from June 1, 1995, to May 31, 1996. All invoices shall be issued at the end of the week or month in respect of which the services were rendered, and not in advance.

[19] In addition, section 9.1 of each share purchase offer stated that Mr. Lévesque would provide both companies with transition services without being compensated. In the purchase offer regarding Les Équipements, that section is worded as follows:

[TRANSLATION]

9.1 Transition. Daniel Lévesque further agrees to keep the Purchaser and its representatives advised of all his affairs and to personally introduce the Purchaser to his customers and suppliers.

In this regard, he shall remain available to the Purchaser for a period of six (6) months from the closing date, without compensation, at its place of business, to provide the Purchaser with any helpful information.

[20] During the summer of 1994, Daniel Lévesque and Jean-Paul Thériault contacted the representatives of the John Deere and Ford New Holland dealer licensors to get their consent to the sale of Garage's and Les Équipements' shares. In order to get John Deere's permission for the transfer of Garage's share capital, Purdel agreed, among other things, to Mr. Lévesque staying on [TRANSLATION] "as co-manager and co-owner of the John Deere Division of Équipements Daniel Lévesque Inc. for a minimum of five (5) years (health permitting)."

[21] Further to discussions with the licensors, the share sale contracts were signed on August 31, 1994.

[22] According to Mr. Thériault, after the sale closed on August 31, 1994, Mr. Lévesque continued to work every day at both businesses until he left for Florida on vacation in early November. Mr. Thériault provided few details about Mr. Lévesque's duties and responsibilities. He referred to at least one meeting with suppliers, and to Mr. Lévesque's assistance with the planning of machinery orders and sales.

[23] Mr. Thériault said that Mr. Lévesque could be reached by phone to discuss business while in Florida. He said that he spoke frequently with him during this period, and added that other employees of the businesses had contacted him in Florida as well.

[24] In March or April 1995, Garage and Les Équipements hired a manager, and Mr. Thériault said that he dealt mainly with that manager from that point onward. Mr. Thériault also said that Mr. Lévesque was much less available after late April 1995 because he had purchased the Hôtel Rimouski, but that he continued to phone Mr. Lévesque from time to time in connection with the businesses' operations.

[25] For his part, Mr. Lévesque denied that he continued to work for the two businesses or for Purdel after the sale. He said that, immediately after the sale, he went hunting, took a two-week vacation, and negotiated with a group of investors for the purchase of Hôtel Rimouski. Then he left for Florida in November.

[26] Mr. Lévesque admitted that he had frequent telephone conversations with Mr. Thériault or with people from Garage or Les Équipements during the fall and winter following the sale, but he described those services as transition services. He said that he answered questions about the business's sales, guarantees and customers, but he added that he did not recall whether he met with Mr. Thériault, and he categorically denied rendering management services in connection with the two businesses. He also admitted that he finalized sales of farm machinery that he had begun prior to August 31, 1994, and that he received commissions on those sales. Mr. Lévesque explained that, in accordance with a May 1994 agreement between himself and Mr. Thériault, once the share purchase offers were accepted, he no longer received a salary from either Garage or Les Équipements, but did earn commissions on his sales.

[27] The Appellants admit that Mr. Lévesque received \$17,076 in commissions from the two businesses in 1994 and \$35,490 in commissions from them in 1995, that he failed to include those amounts in his income tax returns for those years, and that he was found guilty of tax evasion in that regard.

[28] The Appellants called three employees of the two businesses as witnesses: Jean-Marc Bouchard, a mechanic who worked for Les Équipements, Daniel Pigeon, a mechanic with Garage in 1994, and Solange Michaud, an office employee with Garage. The witnesses said that they saw Mr. Lévesque at work every day up to August 31, 1994, but that they did not see him again on the premises after that date.

[29] Upon returning from Florida in the spring of 1995, Mr. Lévesque met with Louis Martin, a tax specialist with Samson Bélair, to get his tax return and his wife's tax return prepared. While discussing the sale of the two businesses with Mr. Lévesque, Mr. Martin noticed what appeared to be a conflict between the payment of the retiring allowance to Mr. Lévesque and the requirements of the Service Contract between 2159 and Purdel. In response to Mr. Martin's questions, Mr. Lévesque allegedly told him that he did not render any services to Purdel, Garage or Les Équipements after the sale of the shares, and that he was receiving the balance of the share purchase price through the Service Contract.

[30] Mr. Martin testified that, on June 8, 1995, following his meetings with Mr. Lévesque, he sent a letter to Mr. Gauthier and to Mr. Gendreau, Purdel's lawyer, asking that the Service Contract be revised to reflect the fact that \$90,000 of the payments in question were part of the selling price of Ms. Morais' shares in Les Équipements.

[31] Apparently, neither Mr. Gauthier nor Mr. Gendreau received the letter, and they became aware of it only at the time of Mr. Lévesque's trial for tax evasion.

[32] Mr. Martin said that the letter was supposed to have been mailed by his office, but that he did not follow up because Mr. Lévesque changed accountants at that time.

[33] Mr. Thériault said that at the same time, that is to say in June 1995, Mr. Lévesque asked him to have the Service Contract revised so that the payment would no longer be made to 2159 but rather to Ms. Morais, which Mr. Gendreau refused to do because, in his view, the changes would result in an agreement fundamentally different from the one that the parties had entered into. However, given Mr. Thériault's insistence, Mr. Gendreau proposed that 2159 sign an assignment of payments to Ms. Morais in order to enable Purdel to make payments to her without changing the substance of the Service Contract. The parties agreed to proceed in this fashion and Ms. Morais received the \$90,000 from Purdel. Ms. Morais treated this amount as part of the proceeds of disposition of her shares in Les Équipements for her 1994 taxation year, and she was able to benefit from a capital gains deduction equal to the total proceeds of disposition of her shares.

[34] Mr. Thériault confirmed that all payments contemplated by the Service Contract were made, and that Purdel deducted the amount of these payments as current expenses for the relevant years.

[35] As for 2159, it included in its income, as business income for its 1995 fiscal year, \$30,000 of the payments received from Purdel between August 1, 1994, and January 31, 1995.

The parties' positions

[36] The Appellants submit that the Service Contract was merely a simulation to disguise the payment of the balance of the share purchase price. According to the Appellants, Purdel wanted to enter the \$120,000 expense as a current expense in its books and sought to conceal this part of the share price from its members. The Appellants say that Mr. Lévesque did not provide services to Purdel following the sale, with the exception of transition services, which were contemplated in section 9.1 of the share purchase offers. They say that Mr. Lévesque held no position at Garage or Les Équipements following the sale of the shares, and that there is no reason to deny him the deduction for the RRSP contribution that he made using the retiring allowance that he was paid.

[37] The Respondent submits that the evidence shows that the Service Contract reflects the parties' intent at the time that it was signed, and that the services that Mr. Lévesque rendered to Purdel following the sale of the businesses were substantial and accord more with the terms of the Service Contract than with his transition duties as stipulated in the share purchase offers. In the submission of counsel for the Respondent, all the documents tendered in evidence, notably the contracts between the parties, tend to show that the Service Contract was genuine, and the only testimony against this position was given by Mr. Lévesque and Mr. Santerre. Counsel for the Respondent says that the fact that 2159 reported the \$30,000 that it received from Purdel as business income constitutes an acknowledgment by the Appellants that the Service Contract was genuine.

[38] Counsel for the Respondent submits that the evidence discloses that Mr. Lévesque carried out the same duties for both businesses after the sale as he had done prior to the sale, and that this shows that the Service Contract was not a simulation. He submits that the alleged retiring allowance received by Mr. Lévesque does not meet the conditions set out in subsection 248(1) of the *Act*, including the condition which states that the payment must have been made at the time that the taxpayer retired from his employment.

[39] The Appellants agreed that if the Court finds that the Service Contract was genuine, 2159 and Mr. Lévesque would have to include the amounts paid to Ms. Morais in their income, as the Minister did. However, the Appellants objected to the imposition of the penalties.

Analysis

[40] The first issue, whether the \$90,000 paid by Purdel to Ms. Morais is the disguised balance of the selling price or rather income attributed to 2159, is largely a question of fact, the answer to which depends on the parties' intentions at the time that the contract was formed. Article 1451 of the *Civil Code of Québec*,⁵ which is worded as follows, deals with simulated contracts:

Simulation exists where the parties agree to express their true intent, not in an apparent contract, but in a secret contract, also called a counter letter.

Between the parties, a counter letter prevails over an apparent contract.

⁵ S.Q. 1991, c. 64 (C.C.Q.)

[41] I had to consider the nature of simulated contracts in *Calce Holdings v. Canada*.⁶ At paragraph 39 of the decision, I stated:

The existence of a simulation therefore depends on a mutual intention of the parties that their rights and obligations be different from what is set out in their written agreement. In order to ascertain the true intention of the parties, regard must be had not only to the statements of the parties, but to their actions as well as all of the surrounding circumstances as objective manifestations of that intention.

[42] For the following reasons, I find that the contract of service was indeed a simulation, and was an attempt by Purdel to conceal the payment of a balance of the purchase price and convert the amount into a current expense deductible in computing its income.

[43] First of all, it is clear that when the parties met on May 20, 1994, they were trying to agree on a purchase price for the shares of the two businesses. The testimonies of Mr. Gauthier, Mr. Thériault, Mr. Lévesque and Mr. Santerre were in agreement on this point. What was negotiated that day was an allocation of that price. Referring to his calculation sheet dated May 20, 1994, Mr. Gauthier stated as follows:

[TRANSLATION]

Mr. Lévesque wanted a certain amount for all his shares. Due to a variety of considerations, the purchasers did not want to pay the amount that Mr. Lévesque was asking. Consequently, there were all sorts of discussions. One day, we finally agreed on \$1,810,000, which was allocated as stated in the document.⁷

[44] In addition, the evidence clearly shows that the sellers agreed to receive the price of their shares in this manner. Mr. Santerre, their tax advisor, noted that there were no tax consequences for Mr. Lévesque whether he received the \$120,000 as salary or as the balance of the selling price, and this explains why Mr. Lévesque was quick to agree to the terms proposed by Purdel. Nevertheless, I accept the point of view that the parties did not intend the contract to be performed, and the fact that Mr. Lévesque agreed to the sham cannot confer on the contract a legitimacy that it does not have under the law; the agreement does not reflect the legal reality.

⁶ [2005] T.C.J. No. 265 (QL).

⁷ The \$10,000 difference was the sellers' accounting fees, which Purdel agreed to pay.

[45] In *Farm Business Consultants Inc. v. Canada*,⁸ a case similar to the instant case, Judge Bowman (as he then was) said as follows at paragraph 14:

. . . The essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name. It is the true legal relationship, not its nomenclature, that governs. The idea of dressing up the payments for the customer list in the garb of consulting fees was the idea of Mr. Ibbotson, the president of the appellant, because he wanted to turn the payments for goodwill into currently deductible expenses. Evidently the Whalls were prepared to go along with this suggestion but their acquiescence, and the fact that they were prepared to include the payments in income, does not assist the appellant, nor indeed does the fact that the Minister did not question the Whalls' inclusion of the payments in income. After all, why would he?

[Emphasis added.]

[46] Mr. Gauthier's testimony supports the Appellants' position that Mr. Lévesque had to provide services to Purdel during the transition period following the sale by monitoring the two businesses, and that these services were not to be rendered subsequent to that period. This description of Mr. Lévesque's obligations is more consistent with the meaning of section 9.1 of each share purchase offer than with the Service Contract, which spanned a period of almost two years.

[47] Among other things, it should be noted that, at the same time as Purdel was proposing the signing of the Service Contract with 2159, Mr. Thériault and Mr. Gauthier (Purdel's representative) were proposing that Mr. Lévesque and Ms. Morais retire from the two businesses. Neither Mr. Gauthier nor Mr. Thériault explained how they could justify the payment of the retiring allowance if Purdel nonetheless wanted Mr. Lévesque to continue working for the two businesses. It is clear that at least Mr. Gauthier was aware of the terms and conditions of the payment of the retiring allowance, namely that the payee was to stop working for the payor, and Mr. Thériault would undoubtedly have received advice from Mr. Gauthier about the possibility of paying the retiring allowance to Mr. and Ms. Lévesque.

⁸ [1994] T.C.J. No. 760 (QL).

[48] Another indicia of the nature of the payments to 2159 is the statement on the calculation sheet prepared by Mr. Gauthier during the meeting with Mr. Lévesque and Mr. Santerre on May 20, 1994, to the effect that the payment of "salary" to 2159 would not bear interest. This tends to show that the parties regarded the payment as a capital amount and as part of the selling price of the shares.

[49] With regard to Purdel's reasons for wanting a Service Contract, Mr. Thériault especially emphasized the demands by the John Deere and New Holland dealer licensors that Mr. Lévesque remain involved in the businesses. I do not find this explanation convincing. There is no evidence that Mr. Thériault or Purdel were aware of these requirements during the May 1994 negotiations. Actually, it appears that the company's first contact with John Deere to determine its position on the transfer was made by Mr. Lévesque in June 1994 and that it was only in July 1994 that John Deere let the parties know that its approval of the transfer of Les Équipements would be subject to the condition that Daniel Lévesque remain with Les Équipements as a co-manager for five years.

[50] Moreover, neither Mr. Thériault nor Mr. Gauthier explained why the Service Contract was proposed and then signed by Purdel and 2159 if Purdel wanted Mr. Lévesque to work at both businesses as a co-manager. Mr. Thériault said that this was done on the recommendation of Purdel's legal counsel, but, here again, the evidence shows that it was only once the parties had agreed on a price on May 20, 1994, that Purdel told its counsel about the plan to acquire the two businesses. Moreover, Mr. Gendreau, who had written the share purchase offers and the Service Contract, testified that it was at Purdel's request, likely through Mr. Thériault, that the Service Contract between Purdel and 2159 was entered into. I am satisfied that Mr. Gendreau was simply following his client's instructions when he drafted the contracts, and that the parties did not tell him about the simulation.

[51] I would note that the Service Contract contains no statement to the effect that Mr. Lévesque's work as a representative of 2159 was related to the operations of Les Équipements or Garage. In fact, the description of his duties is very broad. I refer to section 2 of the Service Contract:

[TRANSLATION]

2. Under the direction of the Chief Executive Officer of Purdel, Coopérative Agro-Alimentaire, the representative of 2159-2993 Québec Inc. shall faithfully and fully carry out such duties as the Chief Executive Officer shall assign to him in his capacity as a consultant from time to time, and shall devote his attention and energy to the performance of those duties to the best of his abilities and knowledge.

[52] Given the broad scope of this description, I would have expected the parties to have discussed the nature of Mr. Lévesque's duties and the time that he would need to devote to them. Although Mr. Thériault said that, by virtue of the Service Contract, Mr. Lévesque had to assume the role of manager at both businesses, he never said that he conveyed his expectations to Mr. Lévesque, and I would once again point out the testimony of Mr. Gauthier, who said that Purdel wanted Mr. Lévesque to provide transition services. In fact, the only available testimony concerning a discussion of the Service Contract and of Purdel's expectations is the testimony of Mr. Lévesque, who said that Mr. Thériault had told him that he would not be required to work for Purdel and that if he was ever asked what he was doing for Purdel, he was to say that he was selling feed.

[53] In my opinion, if Purdel, on May 20, 1994, had been expecting Mr. Lévesque to stay on as the manager of the businesses (for almost two years), it would have created a more precise and detailed contract concerning Mr. Lévesque's obligations and would have ensured that the two businesses themselves, and Mr. Lévesque, were the parties to the contract.

[54] Mr. Lévesque testified that there was no question of his continuing to work for the two businesses, and Mr. Santerre confirmed this intention.

[55] Another odd aspect of the Service Contract is the manner in which the payments were to be made to 2159. The contract stipulates that 2159 was being hired as a consultant for a fixed term commencing August 1, 1994, and ending May 31, 1996, but it says that the payments for the work were to be made as follows:

5. For the services rendered, Purdel, Coopérative Agro-Alimentaire, shall pay 2159-2993 Québec Inc. the sum of \$30,000 to be invoiced in weekly instalments from August 1, 1993, to January 28, 1995, and the sum of \$90,000 to be invoiced in monthly instalments from June 1, 1995, to May 31, 1996. All invoices shall be issued at the end of the week or month in respect of which the services were rendered, and not in advance.⁹

[56] Mr. Thériault said that the payment schedule was set up in this manner because Mr. Lévesque tended to go to Florida for the winter, and there were no payments for the periods in which he was less available. However, the evidence discloses that Mr. Lévesque left for the South before Christmas each year and that he returned around April. These dates do not coincide with the dates during which the payments were suspended under the Service Contract. Mr. Thériault was also unable to explain why the payments were not suspended during the second period as they were during the first if the contract truly took Mr. Lévesque's winter absences into account.

[57] The fact that Mr. Lévesque went to Florida for a few months at that time, and that he did not provide services to Purdel after late April 1995, also appears to suggest that Purdel's commitment to John Deere that Mr. Lévesque would be kept on as a co-manager for five years was not taken seriously.

[58] In my view, it is telling that Purdel continued to pay, at a rate of \$7,500 per month, the amounts contemplated by the Service Contract for the second period, that is from June 1, 1995, to May 31, 1996. Mr. Thériault admitted that Mr. Lévesque was much less available following his purchase of Hôtel Rimouski in late April 1995, but he said that Purdel never tried to terminate the Service Contract or to renegotiate the amounts set out therein or obtain more services from Mr. Lévesque. At the very most, Mr. Lévesque answered a few telephone calls from Mr. Thériault after late April 1995, supposedly in return for \$90,000.

⁹ Between the first and second period of the contract, the amount of the payments changed from \$5,000 per month to \$7,500 per month. No explanation of the 50% increase was given.

[59] Much time at the hearing was devoted to the question of whether or not Mr. Lévesque worked at Garage and Les Équipements after August 31, 1994, and, if he did, what the nature of his duties was. The two principal witnesses, Mr. Thériault and Mr. Lévesque, contradicted each other with respect to the extent of Mr. Lévesque's involvement in the activities of the two businesses following the sale to Purdel. Counsel for the Respondent submitted that I should favour Mr. Thériault's testimony over that of Mr. Lévesque because Mr. Thériault had no interest in the outcome of this litigation. I do not agree. Purdel, in calculating its income for the years in question, deducted as current expenses the payments made under the Service Contract. It was in Mr. Thériault's interest to defend this approach, for otherwise Purdel risked being reassessed for those years. In addition, Mr. Thériault's testimony about the work done by Mr. Lévesque was not corroborated by other witnesses or by contemporaneous documents.

[60] On the other hand, Mr. Lévesque's account of the events was supported by the testimony of the two mechanics, Mr. Pigeon and Mr. Bouchard (independent witnesses) who did not see Mr. Lévesque at work any time after September 1, 1994.¹⁰

[61] Counsel for the Respondent claimed that Mr. Lévesque could have worked without being seen by the mechanics, but this seems unlikely to me since they saw him every day prior to the sale to Purdel, since the businesses were relatively small and close to each other, and since each mechanic worked for one of the businesses. Counsel for the Respondent did not offer any other reason to reject the testimony of Mr. Pigeon and Mr. Bouchard.

[62] It would have been relatively easy to prove that Mr. Lévesque continued to work as a manager at Garage and Les Équipements; this could have been done either through witnesses or through internal documents of the businesses. However, as counsel for the Appellant noted, no evidence of this nature was adduced.

¹⁰ Ms. Michaud, the other witness, testified on the subject, but she contradicted herself a few times, and I therefore do not consider her testimony credible.

[63] Counsel for the Respondent claimed that Mr. Lévesque continued to sell machinery for Garage and Les Entreprises in the fall of 1994. He referred to the commissions that Mr. Lévesque admitted receiving in 1994 and 1995. However, Mr. Lévesque said that the commissions that he received in 1995 were on sales that he had started prior to September 1, 1994, but which closed later, when the goods were delivered. This was not contradicted. No contract, pay slip or internal document from Garage or Les Entreprises was adduced in order to show that Mr. Lévesque made machinery sales after August 31, 1994.

[64] Even if Mr. Lévesque had worked for the two businesses as a salesperson for some time after August 31, 1994, this would not support the Respondent's position in the instant dispute. Mr. Lévesque received remuneration for the sales in excess of the payments received under the Service Contract, even though that contract, assuming it was genuine, had already fixed his remuneration for working at Garage and Les Équipements.

[65] Lastly, counsel for the Respondent claims that the fact that 2159 reported the \$30,000 that it received from Purdel as business income shows that the Appellants themselves considered the Service Contract genuine.

[66] Mr. Martin did not remember why, in his June 1995 letter to Purdel's counsel, he did not ask that the Service Contract be revised in relation to the \$30,000 already paid to 2159, and Mr. Lévesque said that the inclusion of the \$30,000 in 2159's income was a mistake that he did not notice because he was very busy, having just recently purchased Hôtel Rimouski.

[67] In any event, I am satisfied by the remainder of the evidence that, at the time that the parties signed the Service Contract, the terms of that contract did not reflect the legal reality, and that it was not the parties' intention, at that time, that Mr. Lévesque stay on as a consultant to, or manager of, the two businesses following the sale.

[68] Given my finding that the Service Contract was a simulation, the Appellants have succeeded in demolishing the Minister's assumption that the \$90,000 paid to Ms. Morais constituted business income in the hands of 2159, and consequently there is no amount to include in Mr. Lévesque's income under subsection 56(2) of the *Act*.

[69] Mr. Lévesque is also entitled to the deduction that he claimed for the contribution to his RRSP in 1994 because he did in fact retire from Garage and did not continue to perform the same duties as before.

[70] Lastly, there is no need to address the issue of penalties or of the limitation period for the year 1994.

[71] For these reasons, the appeals are allowed, with costs.

Signed at Ottawa, Canada, this 25th day of November 2005.

"B. Paris"

Paris J.

Translation certified true
on this 13th day of March 2009.

Brian McCordick, Translator

CITATION: 2005TCC639

COURT FILE NOS.: 2002-3297(IT)G and 2002-3301(IT)G

STYLES OF CAUSE: 2159-2993 QUÉBEC INC. v. HER
MAJESTY THE QUEEN AND
DANIEL LÉVESQUE v. HER MAJESTY
THE QUEEN

PLACE OF HEARING: Québec, Quebec

DATE OF HEARING: September 29, 2004

REASONS FOR JUDGMENT BY: The Honourable Justice B. Paris

DATE OF JUDGMENT: November 25, 2005

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