

Docket: 2002-3402(IT)G

BETWEEN:

PIERRE GILBERT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal of **Adela Gilbert**
(2002-3401(IT)G) on July 7, 2005, at Montréal, Quebec

Before: The Honourable Justice Louise Lamarre Proulx

Appearances

Counsel for the Appellant: Paul Ryan
Agathe Cavanagh

Counsel for the Respondent: Nathalie Labbé

JUDGMENT

The appeal from the assessment made under section 160 of the *Income Tax Act*, the notice of which bears number 30123 and is dated June 6, 2002, is allowed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 17th day of October 2005.

"Louise Lamarre Proulx"

Lamarre Proulx J.

Translation certified true
on this 8th day of August 2006.
Monica F. Chamberlain, Reviser

Docket: 2002-3401(IT)G

BETWEEN:

ADELA GILBERT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on common evidence with the appeal of **Pierre Gilbert**
(2002-3402(IT)G) on July 7, 2005, at Montréal, Quebec

Before: The Honourable Justice Louise Lamarre Proulx

Appearances

Counsel for the Appellant: Paul Ryan
Agathe Cavanagh

Counsel for the Respondent: Nathalie Labbé

JUDGMENT

The appeal from the assessment made under section 160 of the *Income Tax Act*, the notice of which bears number 30124 and is dated June 6, 2002, is allowed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 17th day of October 2005.

"Louise Lamarre Proulx"

Lamarre Proulx J.

Translation certified true
on this 8th day of August 2006.
Monica F. Chamberlain, Reviser

Citation: 2005TCC672
Date: 20051017
Dockets: 2002-3402(IT)G
2002-3401(IT)G

BETWEEN:

PIERRE GILBERT,
ADELA GILBERT,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Lamarre Proulx J.

[1] These appeals were heard on common evidence. Both cases concern an assessment made under section 160 of the *Income Tax Act* (the "Act").

[2] The facts on which the Minister of National Revenue (the "Minister") relied in making his assessment, in the case of the Appellant Pierre Gilbert, are described in paragraph 13 of the Reply to the Notice of Appeal (the "Reply") as follows:

[TRANSLATION]

- (a) At all relevant times, the Appellant and Adela Gilbert were related by marriage.
- (b) At all relevant times, the Appellant and his spouse were the sole, equal shareholders of Sécovac Inc. (hereinafter the "Corporation").

- (c) The Appellant and his spouse belonged to a group that controlled the Corporation.
- (d) The Appellant was not dealing with the Corporation at arm's length.
- (e) The Appellant and his spouse are directors of the Corporation.
- (f) In his income tax return for the 1999 taxation year, the Appellant reported that he had received a salary of \$105,116.55. According to a T4 slip issued to the Appellant, that salary came from the Corporation.
- (g) He also reported a taxable dividend amount of \$43,750, on line 120 of that return. According to the T5 form appended to his income tax return, the Appellant received an actual dividend amount of \$35,000 from the Corporation.
- (h) According to the Corporation's financial statements to October 31, 1999, the Corporation paid a dividend of \$70,000 during that fiscal year. The Appellant and his spouse received a dividend of \$35,000 each.
- (i) In his income tax return for the 2000 taxation year, the Appellant reported a taxable dividend amount of \$25,000, on line 120 of that return. According to the T5 form appended to his income tax return, the Appellant received an actual dividend amount of \$20,000 from the Corporation.
- (j) According to the Corporation's financial statements to October 31, 2000, the Corporation paid a dividend of \$40,000 during that fiscal year. The Appellant and his spouse received a dividend of \$20,000 each.
- (k) At the time the Corporation paid a dividend to the Appellant, it had a tax debt to the Minister determined as follows:

<u>Taxation</u> <u>year</u>	<u>Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
1999	\$95,779.00		\$11,593.31	\$107,372.31
2000	\$26,238.00	\$343.36	\$2,384.37	\$28,965.73
Total				\$136,338.04

- (l) No consideration can be paid for receipt of a dividend.

[3] The facts concerning the Appellant Adela Gilbert are identical, except for the necessary changes.

[4] At the start of the hearing, subparagraphs 13(a), (b) and (e) to (k) of the Reply were admitted. During the hearing, subparagraphs 13(c) and (d) were also admitted.

[5] Two books of documents, one containing 11 tabs and the other eight, were filed by consent as Exhibits A-1 and A-3 for the Appellant Pierre Gilbert. Two similar books were filed for the Appellant Adela Gilbert as Exhibits A-2 and A-4.

[6] Pierre Gilbert testified. He is an engineering graduate from the École polytechnique de Montréal, as is the Appellant Adela Gilbert. He explained that Sécovac Inc. (the "Corporation") was incorporated in May 1996. It operated in the design and sale of lumber drying kilns for softwood or lumber. It also provided wood drying consulting services to Quebec sawmills. The Appellants were the Corporation's only two employees.

[7] At the start of 2000, the Americans levied a tax on softwood lumber exports. That had the effect of reducing investments by sawmills and was the start of the Corporation's financial difficulties.

[8] The Corporation gave its creditors a notice dated March 30, 2001 (tab 12 of Exhibit A-3) of its intent to file a proposal. The Corporation's creditors were tax creditors. The creditor meetings were held on May 17 and 31, 2001. The minutes appear at tab 16 of Exhibit A-3. The proposal was refused on May 31, 2001. The minutes state: [TRANSLATION] "*Under section 57, the debtor is deemed to have made an assignment this day and a meeting of the creditors of the bankrupt is deemed to have been called.*"

[9] In cross-examination, it was admitted that, in 1999, each of the Appellants had received from the Corporation a salary of \$105,116.55 and a taxable dividend of \$43,750 (tab 4 of Exhibits A-1 and A-2). The non-grossed-up amount of the dividend was \$35,000, according to the T5, Statement of Investment Income (tab 6 of Exhibits A-1 and A-2).

[10] For 2000, the Appellants each received a taxable dividend of \$25,000; the non-grossed-up amount was \$20,000, (tabs 5 and 7 of Exhibits A-1 and A-2).

[11] The Minister's officer who conducted the audit and attended the meeting concerning the proposal in bankruptcy was unavailable to testify for health reasons. Ginette Boucher, a collections officer with Revenue Canada, testified. She confirmed that the Corporation's only two creditors were the federal and provincial

governments. The tax liability of the Corporation is described in subparagraph 13(k) of the Reply, above.

[12] Ms. Boucher confirmed that, on March 30, 2001, the Corporation had given notice that it intended to file a proposal. On May 3, 2001, the proposal was filed. On May 16, 2001, Revenue Canada and Revenu Québec informed each other that the proposed amount was unacceptable. On May 17, the first meeting of the creditors was held. On May 25, 2005, the creditors received the financial statements for the period ending on October 31, 2000. Total "Shareholder Advances" now amounted to \$814,894. In 2000, the Corporation purportedly made a profit of \$140,482. The balance of the Shareholder Advance account increased from \$380,841 in 1998 to \$449,003 in 1999 and to \$814,894 in 2000. The shareholders had received a no-interest home loan.

[13] The proposal having been refused, there was an assignment of property or bankruptcy.

Arguments

[14] The principal argument of counsel for the Appellants was that a dividend payment does not result in a correlative enrichment of the transferee. It follows that a dividend is not a transfer of property contemplated in subparagraph 160(1)(e)(i) of the Act.

[15] According to counsel, when a corporation pays a dividend, the value of the corporation declines by a corresponding amount. The value of the shareholder's share in the corporation follows that decline. For example, if a corporation has retained earnings of \$90,000 immediately before a dividend is granted, each of the two shareholders has shares worth at least \$45,000. If a dividend in the total amount of \$70,000 is paid, the shares of each of the two shareholders are worth only \$10,000. The shareholder is thus not enriched. The value of his shares has been reduced by an amount corresponding to the amount of the dividend received.

[16] Counsel argues that the case law on section 160 of the Act always refers to the impoverishment of the transferor and the correlative enrichment of the transferee.

[17] As an example, he refers to paragraph 26 of the decision in *Hamel v. Canada (Minister of National Revenue - M.N.R.)*, [1995] T.C.J. No. 419 (QL):

... We have seen that the transfer does not have to be made directly to the transferee. There is a transfer if there is impoverishment of the transferor, whether the transfer is made directly or indirectly, and corresponding enrichment of the transferee. It is my view that this is what occurred in the instant case.

[18] However, according to counsel, where a dividend is received, there is no enrichment of the transferee. The corporation has been impoverished, but there has been no corresponding enrichment of the shareholder.

[19] In the alternative, counsel for the Appellants argues that, if there has been a transfer of property within the meaning of section 160 of the Act, the fair market value of the dividend is its amount less the tax payable. That is what a third party in a free market would agree to pay to acquire the dividend.

[20] Counsel also raised the possibility of a consideration given by the shareholder, relying on the comments of Archambault J. in *Gestion Yvan Drouin Inc. v. The Queen*, 2001 DTC 72, at paragraphs 42, 44, 45 and 46.

[21] Paragraph 42 reads as follows:

I mentioned earlier that the word "transfer" is broad enough to include a dividend paid to a shareholder. However, it is not as clear that a dividend constitutes property transferred for no consideration from the transferee. A corporation that wants to carry on a business needs capital to finance its operations and purchase the necessary fixed assets to run the business. One of its sources of funds is the capital stock provided by the shareholders; another is financing through loans. To interest a shareholder, the corporation offers a return in the form of dividends on the shares held by the shareholder. In the case of some preference shares, as here, the return may even have been fixed in advance.

[22] Counsel for the Respondent referred to the decision by Rip J. in *Algoa Trust v. Canada*, [1993] T.C.J. No. 15 (QL), at page 11:

... The payment of a dividend in money or other property is a transfer of property within the meaning of subsection 160(1) of the Act. The corporation is impoverished and its shareholders are enriched. I fail to see the reason why a dividend is not a transfer of property. ...

[23] The judge in that case clearly stated that, by paying a dividend, the corporation was impoverished and the shareholders enriched and that the payment of a dividend was a transfer. That decision was confirmed by the Federal Court of Appeal on February 4, 1998, without additional reasons being given.

[24] Again with regard to the argument of the impoverishment of the transferor and that of the assignee in the issuing of a dividend, counsel for the Respondent referred to a decision by Paris J. of this Court in *Therrien v. Canada*, [2005] T.C.J. No. 7 (QL). An argument similar to that of the Appellants was advanced in that case, as stated in subparagraph 46(e) of that decision:

- (e) the Appellant assumed a reduction of the value of his shares corresponding to the amount of the dividends paid out by the company;

[25] At paragraph 51 of that decision, the Court responded to that argument as follows:

51 Lastly, the Appellants' argument regarding the reduction in the value of their shares following the payment of the dividends is fundamentally flawed. Even if the value of the Appellants' shares diminished after the dividends were paid – and this was not proven here – this does not mean that the company received consideration for the payment of the dividends. It was not shown that the alleged reduction in the value of the Appellants' shares enriched the company by an equivalent amount.

[26] As to the possible consideration for a dividend, counsel referred to the decision by the Supreme Court of Canada in *Neuman v. M.N.R.*, [1998] 1 S.C.R. 770, at page 791, which clearly confirms that no consideration can be paid for receipt of a dividend (citing with approval the dissenting reasons of LaForest J. in *McClurg v. Canada*, [1990] 3 S.C.R. 1020): "... a dividend is received by virtue of ownership of the capital stock of a corporation. ... a dividend is a return on capital which attaches to a share, and is in no way dependent on the conduct of a particular shareholder."

[27] As to the fair market value of the dividend, counsel for the Respondent contends that the fair market value is that of the property in the hands of the transferor, not the transferee. On this point, she refers to the decision of the Federal Court of Appeal in *Hewett v. Canada*, [1997] F.C.J. No. 1541 (QL), and to the following passage:

2 We agree with the learned Tax Court judge that the purpose of section 160 of the *Income Tax Act* is to prevent a taxpayer from defeating the claim of the Minister to unpaid taxes by transferring his assets to a spouse, or certain other persons, for little or no consideration. In our view, this means that the "property" referred to in the section must be that property interest of the taxpayer that would have been available to the Minister for attachment had the transfer not taken place. ...

[28] Counsel submits that the purpose of section 160 is to allow the creditor, the Minister, to require payment of his claim against the property of the transferor, property that was transferred to a person not dealing at arm's length with the transferor where he was indebted to the Minister. There is no reason to consider the tax paid by the transferee.

Analysis and Conclusion

[29] Is a shareholder impoverished by the reduced value of the corporation of which he is a shareholder when a dividend is paid and received? Counsel for the Appellants cited no case law or doctrine on this statement.

[30] From my understanding of corporate law, it is when a corporation is wound up that the shareholders share the remaining property of the corporation. The issuing of a dividend is different in nature. I cannot accept the argument that receipt of a dividend causes the correlative impoverishment of the shareholder transferee. I do not believe that is the case in corporate law and it is decidedly not the case in tax law. In tax law, a person who receives a dividend must include it in computing his income because it is an increase in his income. For the corporation that issues it, it constitutes a reduction of its retained earnings and a reduction of its assets.

[31] There is therefore impoverishment of the issuing corporation and enrichment of the transferee, as is the case in any transfer of property subject to section 160 of the Act.

[32] As to the possibility of consideration to be given for the issuing of a dividend, I believe that the Supreme Court of Canada clearly stated in *Neuman (supra)* there was no such possibility. The right to a dividend stems from ownership of the shares. The consideration given to acquire the shares must not be confused with the consideration for dividends. The consideration given to acquire shares is considered for the acquisition and disposition of shares. It is not a consideration given for a dividend.

[33] The fair market value of the dividend at the time of transfer remains to be determined for the purposes of subparagraph 160(1)(e)(i) of the Act. That subparagraph reads as follows:

160(1) **Tax liability re property transferred not at arm's length** -- Where a person has, on or after May 1, 1951, transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to

...

the following rules apply:

...

- (e) the transferee and transferor are jointly and severally liable to pay under this Act an amount equal to the lesser of
 - (i) the amount, if any, by which the fair market value of the property at the time it was transferred exceeds the fair market value at that time of the consideration given for the property,

[34] What of the fair market value of a dividend? Must it be reduced by the amount of tax payable by the dividend transferee, as counsel for the Appellants contends?

[35] Before starting the analysis of the fair market value of a dividend, I should note that it seems strange that a person should be assessed for the full amount of a dividend in respect of which that person has already paid tax to the tax creditor. In the United States, a person in such a situation is entitled to deduct a loss in the year in which that person remits a sum that he or she has already included in his income. See *Healy et al. v. Commissioner of Internal Revenue*, 345 U.S. 278; 53-1 U.S. Tax Cas. (CCH P292); *Samuel Stein Estate*, 37 T.C. 945, and the comments under section 1341 of the *Internal Revenue Code*, volume 12 of the United States Tax Reporter.

[36] Counsel for the Appellants notes that, by the application of fair market value, one could avoid a result that does not appear entirely consistent with the logic of the law. According to counsel, the fair market value is the likeliest price that a person could obtain in a free competitive market and, in such a market, the fair market value of a dividend would be the amount of the dividend less the tax payable.

[37] I find the definition of fair market value proposed by counsel correct, if I refer to the definition of that expression in the *Dictionnaire de droit québécois et canadien*, Hubert Reid, 2nd ed., Wilson & Lafleur, which reads as follows:

[TRANSLATION]

Highest price that can be obtained in a free market, where the parties to a transaction are well informed, prudent and independent of one another and none is compelled to conclude the transaction.

[38] I was unable to find any decision or doctrine on the fair market value of a dividend. I assume the question does not arise or does not have to be asked. A dividend is of a certain amount and one does not usually need to ask questions about its fair market value.

[39] Can the notion of fair market value be applied to a dividend? In a transfer case subject to section 160 of the Act, I must expressly consider that section 160 of the Act refers to the fair market value of the transferred property. In that perspective, relying on the notion of market value, what would be the highest price that a dividend issuer could obtain from a third party buyer. It seems to me that the answer can only be the amount of the dividend less the tax payable on that dividend.

[40] On another point, the impoverishment of the tax debtor and the enrichment of the transferee to the detriment of the tax creditor, I find that that creditor is impoverished and enriched by the amount of the dividend less the tax paid to that creditor in respect of the dividend.

[41] Accordingly, the appeals are allowed, with costs, on the basis that, for the purposes of section 160 of the Act, the fair market value of a dividend is that amount less the tax payable by the transferee in respect of the dividend.

Signed at Ottawa, Canada, this 17th day of October 2005.

"Louise Lamarre Proulx"

Lamarre Proulx J.

Translation certified true
on this 8th day of August 2006.
Monica F. Chamberlain, Reviser

CITATION: 2005TCC672

COURT FILE NOS.: 2002-3401(IT)G
2002-3402(IT)G

STYLE OF CAUSES: Adela Gilbert and The Queen
Pierre Gilbert and The Queen

PLACE OF HEARING: Montréal, Quebec

DATE OF HEARING: July 7, 2005

REASONS FOR JUDGMENT BY: The Honourable Justice Louise Lamarre
Proulx

DATE OF JUDGMENT: October 17, 2004

APPEARANCES:

For the Appellants: Paul Ryan
Agathe Cavanagh

For the Respondent: Nathalie Labbé

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