Docket: 2000-587(IT)G

BETWEEN:

LOUIS MASSICOTTE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals from ***Les Consultants Pub Création Inc.*** **(2000-590(IT)G)** on October 20 and 21, 2005, in Québec, and on December 7, 2005, in Montréal, Quebec.

Before: The Honourable Judge Pierre Archambault

Appearances:

Counsel for the Appellant:	Richard Généreux
Counsel for the Respondent:	Nathalie Labbé

JUDGMENT

The appeals from the assessments under the *Income Tax Act* for the 1993 and 1995 taxation years are allowed, and the assessments are referred back to the Minister of National Revenue for review and reassessment on the grounds that the $44,650 benefit conferred on the Appellant is to be excluded from his income for 1993, that for 1995 the employment benefit is to be reduced to $239,000, and that the sum of $750 is to be included as a taxable capital gain in that year, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 14th day of November 2006.

"Pierre Archambault"

Archambault J.

Translation certified true
on this 20th day of December 2006.
Monica F. Chamberlain, Translator

Docket: 2000-590(IT)G

BETWEEN:

LES CONSULTANTS PUB CRÉATION INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeals heard on common evidence with the appeals from
Louis Massicotte **(2000-587(IT)G)** on October 20 and 21, 2005,
in Québec, and on December 7, 2005, in Montréal, Quebec.

Before: The Honourable Justice Pierre Archambault

Appearances:

Counsel for the Appellant:	Richard Généreux
Counsel for the Respondent:	Nathalie Labbé

JUDGMENT

The appeals from the assessments under the *Income Tax Act* with respect to the taxation years ended December 31, 1994, and December 31, 1995, are dismissed.

The appeal from the assessment for the taxation year ended May 31, 1994, is allowed and the assessment is referred back to the Minister of National Revenue for review and reassessment on the ground that in computing its business income for the taxation year ended May 31, 1994, the Appellant is entitled to a deduction of $85,657, all in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, on this 14th day of November 2006.

"Pierre Archambault"

Archambault J.

Translation certified true
on this 20th day of December 2006.
Monica F. Chamberlain, Translator

Citation: 2006TCC618
Date: 20061114
Dockets: 2000-587(IT)G
2000-590(IT)G

BETWEEN:

LOUIS MASSICOTTE,
LES CONSULTANTS PUB CRÉATION INC.,

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

REASONS FOR JUDGMENT

Archambault J.

[1] In these appeals, the issue is primarily a business separation and the tax consequences of the operations related to it. Two businessmen, Louis Massicotte and Michel Audy, agreed in writing (**separation agreement**), on June 10, 1994, to divide up their direct or indirect participation in the following two corporations: Les Consultants Pub Création inc. (**Pub**) and L'Im-Média inc. (**Im-Média**). At the time of the division, Mr. Audy held shares in Pub and in Im-Media through an investment corporation called Gestion Cyrano Inc. (**Cyrano**).[1] Mr. Massicotte held his shares in Im-Média directly (Exhibit A-1, Tab 28) and his shares in Pub through Gestion Amadéus-Amadéus Ltée (**Amadéus**).[2] He had acquired the shares in Im-Média from Amadeus for one dollar several months earlier, that is, on October 1, 1993.[3] He also allegedly held directly the Pub shares in December 1990 (Exhibit A-1, Tab 19).

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[1] See especially Exhibit A-1, tabs 19 and 27.

[2] Amadéus was incorporated on October 24, 1990 (Exhibit I-2, Amadéus financial statements, Note 1).

[3] See especially Exhibit A-1, Tab 3, form T664, and Exhibit I-2, Amadéus financial statements, Note 3.

Assessments by the Minister

[2] For the 1993 taxation year, the Minister of National Revenue (the **Minister**) included in Mr. Massicotte's income a benefit of $44,650 under subsection 15(1) of the *Income Tax Act* (the **Act**). This amount corresponded to a credit added on June 30, 1993, to the Amadeus advances account for Mr. Massicotte without him having provided any consideration. For his part, Mr. Massicotte claims that this credit was given to him following his transfer to Amadeus of 4,465 Class C capital shares in Pub. He had previously acquired theses shares from Cyrano in consideration for a reduction of $44,650 in the balance of the sale price of Pub common shares (Class A) that he had sold to Cyrano in December 1990.

[3] In his assessment dated April 15, 1998, for the 1995 taxation year, the Minister included the sum of $240,000 in Mr. Massicotte's income as a benefit conferred under subsection 246(1) of the Act.[4] This amount corresponds to an adjusting entry dated December 31, 1995, in the Pub "employee advances" account[5] regarding Mr. Massicotte. According to Mr. Massicotte, the amount in question represents the value of a debt that he allegedly transferred to Pub in 1994. The debtor was either Mr. Audy or Cyrano and this obligation is recorded in the separation agreement, but there are no details to explain the nature or circumstances surrounding it. The Minister assumed that the debt had been transferred to Pub on December 31, 1995, because he determined that its fair market value was zero as of that date. In his Reply to the Notice of Appeal, the Minister assumed, as part of his audit, that the benefit had been conferred by Pub. As a result of a motion from the Respondent for permission to amend this reply, Tardif J. allowed a change whereby it was Amadéus —not Pub — that was to be deemed the party that had conferred the benefit on Mr. Massicotte. However, the burden of proof falls on the Respondent to establish this fact. Tardif J. stated the

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[4] The notice of assessment does not indicate under which provision the $240,000 of Pub funds were allocated to Mr. Massicotte's income. The auditor testified that she based herself on subsection 15(1) of the Act at the draft assessment stage. At the very last minute, she replaced that subsection with subs. 246(1) when finalizing her assessment. When the Appeals officer confirmed the assessment, strangely, he based his decision on subsection 15(1) of the Act! (Exhibit A-1, Tab 12.)

[5] See especially Exhibit A-1, Tab 42 (first and last pages). However, in the financial statements for Pub, the accountant described this account as a "loan from Louis Massicotte" (Exhibit A-1, Tab 8, financial statements, Note 5).

following: *"... the fact that the assessment is based on subsection 246(1) of the ITA has no effect on the burden of proof, which shall remain on the Appellants, except however as regards the new fact introduced by the amendment granted"*.[6]

[4] With respect to the appeals filed by Pub concerning the 1994 and 1995 taxation years, the only outstanding issue involves the Minister's disallowal of the deduction, for the year ended December 31, 1994, of the sum of $70,000 that Pub claims to have paid to Cyrano as a separation allowance. The Minister allowed that Pub could deduct the sum of $85,657, which had been paid to Cyrano as fees, in computing its income for the fiscal year ended May 31, 1994. Pub dropped its appeal concerning the taxation year ended December 31, 1995.

Background

- Sale of 50% of Pub by Massicotte to Cyrano

[5] Mr. Massicotte met Mr. Audy in 1985 when he was hired as an advertising creator by a company operating a radio station in Québec. At the time, Mr. Audy was the manager of the company. Two years later, Mr. Massicotte set up his own advertising agency, Pub,[7] and according to Mr. Massicotte, that agency was very successful.[8]

[6] In 1990, Mr. Audy approached Mr. Massicotte to join him at Pub. An agreement (**1990 contract of sale**) was reached on December 12, 1990, whereby Mr. Massicotte sold Cyrano 50% of the Class A shares in Pub for $350,000.[9] The

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6 Paragraph 41 of *Massicotte v. La Reine*, 2004 TCC 558.

7 In fact, Pub was incorporated under Part IA of the *Companies Act* on July 5, 1988 (Exhibit A-1, Tab 4, Note 1 of the May 31, 1994 Pub financial statements).

8 According to financial statements prepared by Coopers & Lybrand (Exhibit I-7), Pub realized a net profit of $12,701 in its first fiscal year (ended June 30, 1989) on revenues of $945,818, and $106,327 in its second year, on revenues of $1,795,941. See Table 1 below.

9 Exhibit A-1, Tab 19, articles 4 and 8. A price adjustment clause in the 1990 contract of sale states that the price of $350,000 is based on **retained earnings** of $119,000 (articles 13 and 14, page 3 of the 1990 contract of sale). According to the financial statements for June 30, 1990 (Exhibit I-7), retained earnings totalled $119,028. If the retained earnings, after payment of the $50,000 dividend, were ever less than $119,000, the $350,000 would be reduced by half of the difference between the new retained earnings and the $119,000 figure established at June 30, 1990.

sum of $50,000 was payable nine days later, and the balance of $300,000 was to be paid out of the dividends from Pub. The agreement provided for the payment of a $50,000 dividend within 90 days after June 30, 1991, and was to be taken from a [TRANSLATION] "dividend guaranteed...by [Pub] and [Mr. Massicotte] but was to be taken from the first $50,000 in profits from fiscal year 1990-91".[10] Paragraph 11 of the 1990 contract of sale stipulates that, beginning with the end of the fiscal year on June 30, 1992, Cyrano was required to pay Mr. Massicotte its entire share of the declared annual dividends (subject to certain adjustments), and that this would continue until the balance of the selling price was fully paid off, which was to be no later than September 30, 1997.[11] The unpaid balance did not bear any interest.[12]

[7] Under the terms of paragraph 17 of the 1990 contract of sale, the shares acquired by Cyrano were to be converted into Class B shares, a class of shares that enjoyed the same rights and privileges as the Class A shares.[13] It is strange that two

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[10] Article 10, p. 3 of the 1990 contract of sale. From all appearances, this dividend was paid to Cyrano by Pub in July 1991, because it appears in the financial statements of Pub for its fiscal year ended June 30, 1992 and does not appear in the statements of Cyrano for its fiscal year ended July 31, 1992. Payment of the $50,000 by Cyrano to Mr. Massicotte was not made until the 1992 fiscal year of Cyrano, perhaps in August or September 1991 (Exhibit I-1, Statement of changes in the financial situation, page 4 of Cyrano's financial statements and Exhibit I-8, Statement of Retained Earnings, page 3 of Pub's financial statements).

[11] Under a shareholder agreement, also signed on December 12, 1990 (**shareholder agreement**), Mr. Massicotte had the right to acquire the Pub shares held by Cyrano if ever a serious disagreement occurred prior to the earlier of October 1, 1993, or the date that more than 50% of the selling price of the shares is fully paid, (Exhibit A-1, Tab 14, Article 7).

[12] Article 8 of 1990 contract of sale.

[13] In actual fact, it appears that the opposite occurred: the A shares were held by Cyrano and the B shares were held by Amadéus (see Exhibit I-1, Cyrano financial statements, Note 3, p. 5). According to the financial statements of Pub that were prepared by Samson Bélair on August 19, 1992, for the fiscal period ending June 30, 1992 (Exhibit I-8) and the financial statements for the fiscal period ending June 30, 1990 (Exhibit I-7), the share capital of Pub was allegedly amended between July 1, 1990, and August 19, 1992, to create two identical classes, which corresponds with what was in the shareholder agreement. Three hundred and fifty Class A shares were issued for a paid-in capital of $50, and 350 Class B shares were issued for a paid-in capital of $50, but this description of the attributes of these two classes of shares does not correspond with the description of what was in the articles of amendment dated August 14, 1991 (Exhibit A-1, Tab 21). Specifically, the Class B shares are entitled to a non-cumulative dividend of 8%. Pub financial statements, dated September 26, 1994, for

classes of shares were created with the same rights. How can there be two separate classes of shares if they both have exactly the same rights and privileges? Clearly this situation was designed to allow dividends to be declared in favour of Cyrano or Amadéus, and no one else. In a way, this arrangement allowed Mr. Massicotte's share of the profits to be paid to him through Cyrano as the proceeds from the sale of his shares, for which Mr. Massicotte could claim the capital gains exemption of $500,000. This arrangement could be described as a forward strip,[14] and also made it possible to convert the salary of one of the shareholders into a dividend, without having to do it for the other shareholder.

[8] One other curious fact--Mr. Massicotte apparently received more than the agreed-upon sale price of $350,000 from Cyrano for the Pub shares. According to a document faxed by J. M. Fortin [15] to the Minister's auditor, Mr. Massicotte allegedly received a total of $383,294, or $50,000 a few days after signing, $50,000 in 1991, $40,461 representing the total amount paid "through CP" (i.e., Pub) between August 1, 1992, and December 31, 1992, $150,683 paid under the same conditions in 1993, $47,500 also paid in the same manner in 1994, and $44,650 representing the value of the 4,465 Class C shares given in repayment (no mention of date) (Exhibit A-1, Tab 38).

- Management of Pub

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the fiscal period ended May 31, 1994, provide the same description of the capital stock as is provided by Samson Bélair. These statements were prepared by Léon Chabot (a C.A., but stricken from membership in the order for, according to him, failure to pay his membership dues).

In addition to class A and B shares, there are class C, D and E shares. The Class C shares are described in the Pub financial statements, prepared by Samson Bélair (Exhibit I-8) as being entitled to a "preferred" cumulative dividend of 8%. These shares have no voting rights and are non-participating with respect to the remaining assets. They are redeemable for their face value of ten dollars. This description appears in all financial statements between 1991 and 1995. However, according to the articles of amendment, the dividends are payable at the discretion of the directors.

[14] That is, a tax-free stripping of future Pub surpluses. See also comments below regarding the inflated nature of the price paid by Cyrano (paragraph 72).

[15] Mr. Massicotte gave this solicitor a power of attorney on June 29, 1997 to represent him in dealings with the Minister regarding the audit of the 1993, 1994 and 1995 taxation years (Exhibit A-1, Tab 10).

[9] Under the terms of article 12 of the shareholder agreement, the shareholders were also to be compensated (Exhibit A-1, Tab 14). According to Mr. Massicotte, they were originally supposed to receive salaries of $115,000, plus possible bonuses of $10,000, for a total of $125,000 even if, in his case, he did not have to devote more than 25 to 30 hours of work a week to the operations of Pub. According to Mr. Audy, each of the two partners received a salary of $100,000. It appears that Mr. Audy's compensation was paid to Cyrano in the form of fees, even though Mr. Audy acted as Vice-president and General Manager of Pub: $83,930 and $271,339 were paid out in this manner in 1992 and 1993, respectively (Exhibit I-1, financial statements of Cyrano, Note 8). When Pub's financial situation worsened, Mr. Massicotte apparently agreed, on August 1, 1992, to allow his salary to be reduced to approximately $15,000 or $25,000.[16] For the 1993, 1994 and 1995 taxation years, Mr. Massicotte's income-tax returns do not show any employment income from Pub or Im-Média (Exhibit A-1, Tabs 1, 3 and 10). He indicated that he had agreed to this salary reduction in order to allow Pub to declare dividends to Cyrano to help pay off the balance of the sale price of the Pub shares sold to Cyrano. However, these agreements do not appear to have had the desired results, since Pub suffered a loss of $111,342 in the fiscal year ending June 30, 1993. As can be seen below in Table 1, Pub paid out just $3,300 in dividends in 1993, and did not pay any at all in 1994! However, it apparently paid $85,657 in fees to Cyrano in 1994 (according to paragraphs 18(f) and (g) of the amended Reply to the Notice of Appeal in the Pub file) and the Minister, at the start of the hearing, conceded that they could be deducted from Pub's income for 1994.

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[16] See the repayment agreement, Exhibit A-1, Tab 22. That agreement stipulates that it is in the interests of both parties that the remainder of the sale price of the Pub shares be paid off as quickly as possible. In it, the parties agreed that the compensation to be paid to Louis Massicotte by Pub will be reduced by $100,000 for fiscal year 1992-1993 and that a special dividend of $100,000 will be paid to Cyrano by Pub. The agreement also stipulates the following: [TRANSLATION] "*Because Massicotte's salary reduction will translate into an additional tax liability for Pub, the share of the annual profit after the special $100,000 dividend payable to each of the shareholders will take this into account. Cyrano's share will be increased and Amadeus's share will be reduced by 50% of the aforementioned income tax*" (page 2 of the agreement). There is also the option to continue the agreement for the 1993-1994 fiscal year.

On the same day, August 1, 1992, a purchase of services agreement was also signed by the same parties. That agreement states that Cyrano will receive a special dividend from Pub over and above its normal share of 50%. It describes the purchase of services, but is sketchy with regard to the conditions.

[10] An analysis of the financial statements of Pub and Im-Média adduced in evidence reveals the following information:

TABLE 1[17]

Pub		**As at June 30**					**May 31** [18]	**Dec. 31.**	
		89	**90**	**91**	**92**	**93**	**94**	**94**	**95**
Revenues		945,818	1,795,941	2,259,254	3,012,996	2,694,987	1,197,004	623,600	861,043
Profits		15,501	131,327	186,082	7,406	(126,063)	(66,840)	131,714	42,274
After-tax profit		12,701	106,327	149,082	3,300	(111,342)	(54,809)	131,714	30,243
Retained earnings		12,701	119,028	268,110	122,300	7,658	(47,151)	88,493	118,736
dividends	Cl. A	Ø	Ø	Ø	50,000	1,650[19]	Ø	Ø	Ø
	Cl. B			Ø	99,110[20]	1,650	Ø	Ø	Ø
	Cl. C				Ø	Ø	Ø	Ø	Ø
TOTAL					149,110	3,300	–	–	–
Shares	Cl. A	100	100[21]	50	50	50	50	50	50
	Cl. B			50	50	50	50	50	50
	Cl. C				99,110	185,410[22]	185,410	185,410	185,410

17 Exhibits I-7, I-8 and A-1 (tabs 4, 6 and 8).

18 Fiscal year shortened because control of Pub was acquired by Amadéus.

19 Exhibit I-1, Statement of changes in financial position, page 4 of Cyrano's financial statements. According to memo from Mr. Bureau, "director of finance" for Pub, to Sylvain Trudel, Pub's solicitor, regarding the updating of Pub records (**Pub memo**), this dividend was reportedly declared on July 1, 1992 (Exhibit A-1, Tab 26).

20 The dividend of $99,110 paid out by Pub in fiscal year 1992 was paid on the 350 Class B shares held by Amadéus (Exhibit I-8, Pub financial statements, p. 3) and that amount was reinvested by Amadéus on July 1, 1991, in the Class C shares (*ibid.*, p. 8, and Pub memo, Exhibit A-1, Tab 26). These shares are not included on the Cyrano balance sheet for the fiscal years ending July 31, 1992 or 1993 (Exhibit I-1, Cyrano financial statements, Note 3, p. 5).

This dividend of $99,110 corresponds to a profit figure of $127,325 prior to the application of a rate of 22.16% ($99,110 divided by (1 – 0.2216)). Therefore this amount could represent a salary of $127,325 which Pub could have paid to Mr. Massicotte, which would have created an operating loss, but was apparently instead converted into a dividend.

21 According to the financial statements for Pub as at June 30, 1990, the share capital of Pub included 100 Class A shares, or essentially, common shares, and Class B shares, essentially preferred shares, which featured primarily an 8% non-cumulative dividend, voting rights, participation rights and the fact that they were redeemable at their face value of five dollars (Exhibit I-7, Note 6 of the financial statements).

22 In 1993, 8,630 Class C shares were issued for a consideration of $86,300; this included 4,465 shares in exchange for consideration of $44,650 issued to Cyrano and apparently 4,165 shares in exchange for consideration of $41,650 issued to Amadéus (Exhibit A-1, Tab 26). The reasons for this subscription were not revealed at the hearing. Mr. Audy did not recall that Cyrano had purchased the shares in question. The issue was allegedly financed in part by two dividends of $1,650. Cyrano and Amadéus therefore apparently

TABLE 2[23]

Im-Média		**30 June 93**	**31 May 94**[24]	**31 May 95**[25]
Revenues		276,970	444 ,428	1,301,798
Profits		(53,667)	10,410	63,899
After-tax profit		(53,667)	10,410	59,003
Retained earnings		(75,446)	(65,045)	(19,301)
Shares	Cl. A	1,000	1,000	1,000
	Cl. B		Ø	Ø
	Cl. C		Ø	Ø

- Credit to "Shareholder Advances" account of Amadéus

[11] According to Mr. Massicotte, Cyrano allegedly transferred to him its 4,465 Class C Pub shares on July 1, 1993, in partial payment for what Cyrano owed him for his Class A shares in Pub.[26] Mr. Massicotte then allegedly transferred them to Amadéus. Pub's accountant made the following adjusting entries for the Amadéus fiscal year ended June 30, 1993 (Exhibit A-1, Tab 40):

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supplied the remainder, that is, $43,000 for the first, and $40,000 for the second. Further, according to the Pub memo, 330 Class C shares were reportedly issued by Pub to Amadéus in consideration for $3,300 paid for out of the dividend received on July 1, 1992. This transaction does not correspond with reality because the dividend was paid out of the Class A and Class B shares (Exhibit I-1, Cyrano financial statements, p. 4, and Exhibit A-1, Tab 26) and the Cyrano financial statements show, at July 31, 1993, an investment consisting of the acquisition of 4,465 Class C shares of Pub for $44,650 (Exhibit I-1, financial statements, pp. 4 and 5). The same memo also indicates that Cyrano had subscribed to 1,800 Class C shares for $18,000 on December 1, 1993. According to Mr. Massicotte, this is an(other) error, because those shares were supposed to be transferred to Amadéus on July 1, 1993, as indicated in the memo. It was more likely on December 1, 1992, rather than December 1, 1993, because the 4,465 Class C shares are shown on the Cyrano balance sheet as of July 31, 1993 (Exhibit I-1, Statement of change in financial position, p. 4 of the Cyrano financial statements, prepared by Poissant Thibault - Peat Marwick Thorne (**KPMG**)).

23 Exhibits I-3 and I-4.

24 Fiscal year shortened because control of the company was acquired by Mr. Audy.

25 Cyrano and Im-Média were merged on June 1, 1994.

26 Page 23 of Vol. II of the transcript, Question No. 94.

	13		
Investment in Pub		43,000.00	
L. Massicotte			43,000
(transfer of shares held by Cyrano to L.M. and from him to Amadeus)			
	14		
Investment in Pub		1,650	
L. Massicotte			1,650
(transfer of pr. shares from L.M. to Amadeus)			

[12] Mr. Bureau stated the following in the Pub memo sent to Sylvain Trudel: [TRANSLATION] "*1993 By agreement, the shares held by Cyrano ($43,000)*[27] *are transferred to Amadéus in consideration for the remainder of the sale price owed by Cyrano to Louis Massicotte. Dated July 1, 1993"* (Exhibit A-1, Tab 26). This memo indicates that other transactions or events must be taken into account, and these include an annual meeting of the shareholders and directors on "September 28" (1993) and the adoption of the "1993-1994 budget". The document bears the initials of Mr. Massicotte and Mr. Audy, but is not dated. Since the transfer did not take place until "July 1, 1993", that is, immediately after the end of Amadeus's 1993 fiscal year, it is strange that these shares would have been shown on the Amadeus balance sheet for the fiscal year ended June 30, 1993, and that the "shareholder advances" account, which showed a debit of $41,452 as of June 30, 1992, showed a credit of $7,321 as of June 30, 1993 (Exhibit I-2)!

[13] Further, it does not appear that the Pub memo was acted upon by the transfer, on July 1, 1993, of the 4,465 Class C shares. First, according to the financial statements of Cyrano as at July 31, 1993, which were prepared by KPMG, Cyrano still held the 4,465 Class C shares (Exhibit I-1, Note 3 of financial statements). Then, the transfer apparently was only carried out according to the terms of a contract of sale dated May 30, 1994, whereby Cyrano sold Amadéus not only these shares, but also its 350 Class A shares, all for one dollar. An excerpt from the minutes of a meeting of the Cyrano board of directors authorized Mr. Audy, on that same date, to sign the necessary documents for the sale of all these shares (Exhibit A-1, Tab 29).

[14] As far as the Minister's auditor is concerned, the adjusting entries in the books of Amadéus relating to the transfer of the Class C preferred shares do not

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[27] It is curious to note that only the transfer of the 4,300 Class C shares (which represents an investment of $43,000) from Cyrano to Massicotte is mentioned in this memo and in the adjusting entries, whereas Massicotte claims that Cyrano transferred 4,465 shares to him.

correspond with an actual transfer that was made in 1993, because the transfer did not occur until May 30, 1994, according to the contract of sale between Cyrano, "the vendor", and Amadéus, "the purchaser" (Exhibit A-1, Tab 27). Also, the auditor did not recognize that the reduction in the price of the shares sold to Cyrano by Mr. Massicotte in 1990 represented the consideration given for the preferred shares because, as stated in the document from Mr. Fortin (Exhibit A-1, Tab 38), Mr. Massicotte apparently received $33,294 over and above the amount that was owed to him for these shares. According to the auditor, it is unusual for a person to pay more than what they owe. She pointed out that the 1990 contract of sale did not provide for any interest on the unpaid balance of the sale price, and so the excess amount cannot represent interest.

- Separation of Massicotte and Audy

[15] According to an addendum to the shareholder agreement, dated September 29, 1993, the parties agreed that the value of the Pub common shares with voting rights was $500,000 (or $250,000 for each of the two shareholders) — and not more than $700,000, as was the case at the time the shares were purchased in 1990 — for purposes of redemption under the terms of the shareholder agreement (Exhibit A-1, Tab 24). Mr. Massicotte stated that at the time, relations between him and Mr. Audy had become strained. The two shareholders no longer shared the same philosophy regarding how the business should be run. An atmosphere of mistrust had even settled in between them. Mr. Audy complained that Mr. Massicotte was spending too much of his time on other activities and not enough was devoted to Pub and Im-Média. As we saw earlier, the financial situation at the time was not the best, either. According to Table 1, Pub suffered a pre-tax loss of $126,063 as at June 30, 1993,[28] and the situation did not improve in the eleven months of the following fiscal year because, by May 31, 1994, losses had reached $66,840. Business income declined, going from $2,694,987 at June 30, 1993, to $1,197,004 at May 31, 1994.

[16] On June 10, 1994, Messrs. Massicotte and Audy, Amadéus, Cyrano and, as intervenors, Pub and Im-Média, signed the separation agreement which provided primarily for the sale, by Cyrano, for [TRANSLATION] "one dollar per share", of its shares in Pub [TRANSLATION] "to MASSICOTTE, AMADÉUS, or any other entity(ies) that they may designate". In addition, Cyrano or Mr. Audy agreed to

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[28] There would also apparently have been a loss for the June 30, 1992, fiscal year if Mr. Massicotte's salary had not been converted into a dividend of $99,110 (see Note 20).

acquire all the shares in Im-Média held by Mr. Massicotte for the sum of $70,000. Articles 2 and 3 of this agreement (Exhibit A-1, Tab 30) read as follows:

> [TRANSLATION]
> **2. SALE OF PUB SHARES**
> CYRANO shall sell, effective this date, for the sum of one dollar per share, all its shares in PUB to MASSICOTTE, AMADEUS, or any other entity(ies) that they may designate. Effective this date, CYRANO and AUDY and IM-MEDIA shall return to PUB any assets or property belonging to it and will settle any invoices or account-to-account transfers as quickly as possible.
>
> **3. SALE OF IM-MEDIA SHARES AND DISCHARGE OF DEBT**
> CYRANO, AUDY agree to acquire all the shares held in Im-Media by MASSICOTTE since October 1993 for the sum of $70,000, thereby cancelling any previous agreement previous to this agreement binding the parties, and more particularly the non-competition clause binding CYRANO and AUDY to MASSICOTTE in the shareholder agreement of CONSULTANTS PUB CREATION INC. AUDY and CYRANO acknowledge owing the capital sum of two hundred and forty thousand dollars ($240,000), in the form of a note payable, to MASSICOTTE and or AMADEUS. This sale and this discharge of debt cannot be considered to be complete until CYRANO and AUDY have officially met the following conditions, with the exception of any exchanges described in clauses 3.1 and 3.4 (these must be completed within the next 18 months):[29]
>
> **3.1 LEASE**
> Audy and CYRANO guarantee to AMADEUS and MASSICOTTE that PUB shall be fully released from any commitments related to its current lease with PARC SAMUEL HOLLAND, and this effective from July 1, 1994. Accordingly, AUDY and CYRANO shall enter into negotiations with, and secure the cancellation of the existing PUB lease with, PARC SAMUEL HOLLAND.
>
> Any outstanding rent prior to July 1994 (up to a maximum of $35,000) shall be jointly assumed by PUB and IM-MEDIA-CYRANO, but it may be paid in full by PUB in the form of an exchange delivered to SSQ and (or) PARC SAMUEL HOLLAND. These exchanges of services, negotiated by AUDY with SSQ, shall be usable by SSQ at a rate of 50% on any order, excluding media placements, until the remainder is fully used. AUDY, CYRANO and IM-MEDIA guarantee to reimburse PUB, in the form of barter contracts to be defined and agreed to by

[29] In light of the many grammatical errors in this [French-language version of the] text, it is difficult to determine what should be happening within 18 months. Does this refer to conditions, exchanges or the agreement? According to Mr. Massicotte, the author of this document, the term "*ceux-ci*" [in English "these"] refers to the exchanges described in Clauses 3.1 and 3.4, which were required to be fulfilled within a period of 18 months.

PUB, for one-half of the exchange credit that PUB issues to SSQ, up to a maximum of $17,500.

3.2 LINE OF CREDIT
IM-MEDIA, CYRANO and AUDY shall assume a $100,000 debt that was contracted by PUB with the CAISSE QUEBEC EST, by reducing PUB's existing line of credit in an amount equivalent to AUDY's existing surety of the same amount.

3.3 IM-MEDIA – DROUIN LOAN
CYRANO-AUDY guarantee to MASSICOTTE that he shall be fully released from its endorsement of the loan that IM-MEDIA has with YVAN DROUIN, as confirmed in writing by YVAN DROUIN.

3.4 EXCHANGES GUARANTEED
Effective this date, AUDY, CYRANO or IM-MEDIA agree to pay to MASSICOTTE or his corporations $18,000 worth of barter contracts, to be defined and agreed to by MASSICOTTE.

Further, an amount totalling $20,000 shall be paid to MASSICOTTE or one of his corporations in the form of barter contracts to be defined and agreed to by MASSICOTTE.

3.5 TRANSITION AND NON-COMPETITION
AUDY, CYRANO and IM-MEDIA agree to a 60-day transition period beginning July 1, 1994, to allow PUB to retain its clients and to allow the transfer of PUB files in which AUDY, CYRANO and IM-MEDIA are involved to take place at no risk to PUB.

[Emphasis added.]

- Credit to PUB "employee advances" account

[17] Even if virtually all of the conditions related to the payment of the $240,000 appear to concern only Pub and this amount was supposed to be paid to "Massicotte and (or) Amadéus", Mr. Massicotte felt that it was owed to him. The promissory note referred to in Article 3 of the separation agreement was not submitted. Since he required money to cover his personal needs beginning from the summer of 1994 on, Mr. Massicotte asked Pub to "advance" him the following amounts as payment towards his "salary": $48,553 in 1994, $143,500 in 1995 and $47,947 in 1996, for a total of $240,000. These figures were not contested by the Respondent.

[18] Since he did not want to put Mr. Audy and Cyrano on official notice to pay the $240,000, because they were continuing to make payments on the line of

credit, Mr. Massicotte apparently chose instead to transfer this debt to Pub in October or November 1994, following a decision by him and Mr. Chabot, and he apparently told Mr. Chabot to [TRANSLATION] "*do whatever you have to do to transfer the debt*" to Pub. [30] Mr. Chabot contradicted this version from Mr. Massicotte. According to him, it was Mr. Massicotte, and he alone, who had decided to make this transfer. If he failed to make an accounting entry for the December 31, 1994, fiscal period, it was because it was too late. We note that this accountant has been working for Mr. Massicotte and his various corporations since the spring of 1994. Also, he was present at the negotiations regarding the separation of Messrs. Massicotte and Audy, which took place on June 10, 1994. Since the balance in the Pub advances account was in a credit position,[31] the accounting entry showing the transfer could be made for the following fiscal period, and this is why he did not do it until the end of the 1995 fiscal period. Therefore, we must believe that he was not aware of this transfer until after the end of the 1994 year and, in all likelihood, after having prepared Pub's financial statements for December 31, 1994.[32]

[19] Mr. Massicotte, Amadéus and Pub waited until May 3, 1996, to place Mr. Audy and Im-Média on notice that they were required to pay them the $240,000 because of their failure to comply with the commitments made in the separation agreement. According to Mr. Massicotte, business was good for Im-Média in the fall of 1994, as can be seen from reading certain magazines from the Québec area carrying advertising that had been prepared by Im-Média.[33]

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30 Page 120 of Vol. II of the transcript.

31 See tabs 39 and 42 of Exhibit A-1 for an analysis of the advances; it shows that the account was in a credit position of $24,294. However, the advances account is not shown in Pub's financial statements dated December 31, 1994. The auditor assumed that it had been merged with another balance sheet item. The item titled "Louis Massicotte advance" appears in Note 5 of the financial statements dated December 31, 1995, but there is no information given for the previous year! It was unnecessary to transfer the $240,000 debt in order to avoid application of subsection 15(2) of the Act. The auditor indicated that she had never received a reconciliation of the Pub advances account that relates to Mr. Massicotte. See Exhibit A-1, Tab 42.

32 Also, the Minister's auditor confirmed that no one had ever informed her that the $240,000 should have been taxed in 1994, as opposed to 1995. At the time, the 1994 taxation year was not statute-barred.

33 According to Mr. Massicotte, the Im-Média financial statements confirm that the company was financially sound (Exhibits I-3 and I-4). For 1993, they show a loss of $53,667, while

[20] Since Mr. Audy and Im-Média adopted the position that they had met all conditions in the separation agreement and did not comply with the formal notice, the solicitors for Mr. Massicotte instituted an action before the Quebec Superior Court one year later, on June 10, 1997. Even though the action was entered on behalf of Louis Massicotte, Amadéus and Pub, and even though, at the time, the debt had been transferred to Pub in 1994 or 1995, the court was asked to order Mr. Audy and Im-Média to pay the $240,000 [TRANSLATION] "to the plaintiff Louis Massicotte"! Mr. Massicotte stated that he did not remember if he had informed his lawyer that the debt had been transferred to Pub.[34] The lawsuit never yielded any results because Im-Média made an assignment in bankruptcy on February 11, 1998, and Mr. Audy did the same a few days later, on February 16, 1998.[35] Strangely enough, the person shown as the bankruptcy creditor for this amount is also Mr. Massicotte, and not Pub.

[21] Finally, expert witness Lucie Demers testified in connection with the valuation of the $240,000 debt as of December 31, 1995. Essentially, she determined that the debt was valueless [TRANSLATION] "because of the negative value of the debtors' net assets" (valuation report, Exhibit I-6, p. 12). For purposes of her valuation, she had assumed that the $240,000 was owed by Mr. Audy and Im-Média. She did not take into consideration the impact that would result from a

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statements for 1994 and 1995 show profits of $10,401 and $63,899, respectively (see also Table 2 above).

34 The lawsuit also claimed an additional amount of $28,000 for unpaid "barter credits" and $17,500 in connection with the lease with Parc Samuel Holland. What is strange is that Mr. Massicotte stated at the hearing that the Pub lease had been settled in accordance with the separation agreement during the summer of 1994. It is also rather strange that in this lawsuit Mr. Massicotte did not seek cancellation of the sale of Im-Média shares. In fact, Article 3 of the separation agreement provided that that sale was not to be considered completed until Cyrano had officially fulfilled the conditions set out in the separation agreement. What is even stranger is that the sum of $240,000 was owed [TRANSLATION] "to MASSICOTTE and/or AMADÉUS". Is it possible that this amount belonged to Amadéus? If it was Mr. Massicotte who transferred the debt to Pub, did Mr. Massicotte appropriate an asset that belonged to Amadéus?

35 Exhibit A-1, Tab 36. Mr. Audy explained the circumstances surrounding these bankruptcies. One employee allegedly fraudulently appropriated approximately $170,000 worth of GST/QST that Im-Média owed to the tax authorities. Among the debts listed in the bankruptcy of Im-Média, there is the sum of $70,500 representing the balance of the line of credit, $28,000 for unpaid services and the sum of $240,000.

contestation of this debt by Mr. Audy or the conditional nature of the obligation of the debtors who owed the debt.

- $70,000 separation allowance

[22] While the separation agreement is silent on the question of a separation allowance for Cyrano or Mr. Audy, Mr. Massicotte maintained that Pub had agreed on June 10, 1994, to pay this type of allowance to Cyrano. Mr. Audy, for his part, claimed that he had never asked for or received this type of allowance. It must be pointed out that the Minister, after considering the inclusion of this amount in Cyrano's income, decided in the end not to include it. The auditor explained that she had not seen any supporting documents or bank deposit for Cyrano, as was normally the case for fees received by Cyrano. Furthermore, she found it difficult to explain how Pub would have paid such an allowance, given Mr. Massicotte's dissatisfaction with Mr. Audy's performance. Mr. Massicotte did acknowledge that he had not received a separation allowance from Im-Média. According to him, his compensation was the sum of $70,000 he received for his shares.

Analysis

[23] The relevant provisions of the Act that relate to the resolution of this dispute are the following. First, there are those that deal with the taxation of a benefit, specifically paragraph 6(1)(*a*) and subsections 15(1), (2), (2.1), (2.6) and 246(1) of the Act:

> **6.** (1) **Amounts to be included as income from office or employment**
> There shall be included in computing the income of a taxpayer for a taxation year as income from an office or employment such of the following amounts as are applicable
>
> (*a*) Value of benefits - the value of board, lodging and other benefits of any kind whatever received or enjoyed by the taxpayer in the year in respect of, in the course of, or by virtue of an office or employment, except any benefit
>
> ...
>
> 15(1) **Benefit conferred on shareholder — 15.** (1) Where at any time in a taxation year a benefit is conferred on a shareholder, or on a person in contemplation of the person becoming a shareholder, by a corporation otherwise than by ...
> the amount or value thereof shall, except to the extent that it is deemed by section 84 to be a dividend, be included in computing the income of the shareholder for the year.

...

15(2) **Shareholder debt** — Where a person (other than a corporation resident in Canada) or a partnership (other than a partnership each member of which is a corporation resident in Canada) is

(*a*) a shareholder of a particular corporation,
(*b*) connected with a shareholder of a particular corporation, or
(*c*) a member of a partnership, or a beneficiary of a trust, that is a shareholder of a particular corporation

and the person or partnership has in a taxation year received a loan from or has become indebted to the particular corporation, any other corporation related to the particular corporation or a partnership of which the particular corporation or a corporation related to the particular corporation is a member, the amount of the loan or indebtedness is included in computing the income for the year of the person or partnership.

15(2.1) **Persons connected with a shareholder** — For the purposes of subsection 15(2), a person is connected with a shareholder of a particular corporation if that person does not deal at arm's length with the shareholder and if that person is a person other than

(*a*) a foreign affiliate of the particular corporation; or

(*b*) a foreign affiliate of a person resident in Canada with which the particular corporation does not deal at arm's length.

15(2.6) **When s. 15(2) not to apply -- repayment within one year** — Subsection 15(2) does not apply to a loan or an indebtedness repaid within one year after the end of the taxation year of the lender or creditor in which the loan was made or the indebtedness arose, where it is established, by subsequent events or otherwise, that the repayment was not part of a series of loans or other transactions and repayments.

246(1) **Benefit conferred on a person**— Where at any time a person confers a benefit, either directly or indirectly, by any means whatever, on a taxpayer, the amount of the benefit shall, to the extent that it is not otherwise included in the taxpayer's income or taxable income earned in Canada under Part I and would be included in the taxpayer's income if the amount of the benefit were a payment made directly by the person to the taxpayer and if the taxpayer were resident in Canada, be

(*a*) included in computing the taxpayer's income or taxable income earned in Canada under Part I for the taxation year that includes that time; or

> (*b*) where the taxpayer is a non-resident person, deemed for the purposes of Part XIII to be a payment made at that time to the taxpayer in respect of property, services or otherwise, depending on the nature of the benefit.
>
> [Emphasis added.]

[24] With respect to the $70,000 claim for a separation allowance, it is essentially a case of applying subsection 9(1) and paragraph 18(1)(*a*) of the Act. These two provisions read as follows:

> 9(1) **Income** — Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.
>
> 18(1) **General limitations**— In computing the income of a taxpayer from a business or property no deduction shall be made in respect of
>
> (*a*) **General limitation** — an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;
>
> [Emphasis added.]

[25] In her initial Reply to the Notice of Appeal, the Respondent advanced an "alternative argument", namely that Pub had conferred a benefit of $240,000 on Mr. Massicotte as an employee, pursuant to paragraph 6(1)(*a*) of the Act. At the hearing before Tardif J. for the motion to amend her reply, the Respondent had announced that she would be withdrawing this "alternative argument". The reasons for this decision are unclear.

[26] At the start of the hearing, a great deal of time was required to clearly identify the issues involved, because the pleadings of each of the parties did not seem particularly clear to me. It was clear from the position of counsel for Mr. Massicotte that section 246 could not be applied here with respect to the $240,000 credited to the "employee advances" account, because this is a remainderman provision that only applies if the benefit is not taxable under Part I of the Act. This is the exchange that took place at the start of the hearing:

> [TRANSLATION]
> HIS HONOUR: So, based on your reasoning, paragraph 6(1)(*a*) will apply before section 246?
>
> Mr. GÉNÉREUX: It's obvious.

HIS HONOUR: It is?

Mr. GÉNÉREUX: It's obvious.

[Vol. I of transcript, page 143]

HIS HONOUR: Okay. So, if it's taxable….

Mr. GÉNÉREUX: It would be under 6(1)(*a*), employee benefit, because we're dealing with an appropriation, and if there is an appropriation, it would be by the employee, but otherwise, it would necessarily be a capital gain and nothing else because, then, at that time, there would be a disposition of a property, the cost of which, there are human costs involved there, and also personal costs in connection with that, and we intend to prove that to you, but as to a tax cost, there is none.

[Vol. I of transcript, pages 50-51. Emphasis added.]

[27] I fully agree with counsel on this interpretation. In fact, if I were to find that there was a benefit arising out of the transfer of the $240,000 debt in 1995 and that that benefit had been conferred on Mr. Massicotte by virtue of his office or employment, it is clear that section 246 would not be applicable.

[28] Being a master in matters of law, I then raised the possibility that I could justify the assessment for 1995 basing myself on paragraph 6(1)(*a*) of the Act. However, in order to respect the rule of procedural fairness, I had to assure myself that the taxpayer was not caught off guard. Counsel for the Appellants then confirmed that such was not the case:

[TRANSLATION]
Mr. GÉNÉREUX: I'm not surprised by that, we have already said this in our pleadings.

HIS HONOUR: Yes.

Mr. GÉNÉREUX: All that I was saying at the time was that they had to have the burden of proof on them and then they decided to drop the matter because I was saying that they had the burden of proof for that, because that was not the basis for the assessment—they were changing the very basis of the assessment and, even according to the Court of Appeal, even if subsection 152(9) did not cover that, and now, today, given what has been done, in my opinion, the fact that they have abandoned their position, they no longer wish to plead, and I based myself on that point in coming here today, if we still want to maintain that this was an employee benefit, I said, I think, that procedural fairness would be tainted, and all the more so since I wonder if they could argue that position because the return has

> been statute-barred and this is an attack against the very basis of the assessment that is in dispute here, but that having been said, when you ask yourself the question, how can the Court be prevented from ruling, even in the absence of any arguments being put forth, because they have dropped the issue, I, I don't have the precedents in front of me but I have several cases where, especially those that went to appeal, your honour, I agree but …
>
> (Vol. I of Transcript, p. 33)

[29] Further, as counsel for the Appellants has already mentioned himself, it is clear that the amount that was credited in the accounting records of Pub following the transfer of the $240,000 debt was credited to the "employee advances" account. During his testimony, Mr. Massicotte acknowledged not only that he was the President and Director of Pub, and therefore held an office for purposes of the Act, but also that the advances made to him by Pub had been made as payments towards his salary! Moreover, counsel for the Appellants willingly acknowledged that Mr. Massicotte was an employee: [TRANSLATION] "*Finally, it has been admitted for purposes of this case that Mr. Massicotte was the manager and the employee of Pub Création at any relevant point for purposes of this case."* (para. 7 of "Appellants' additional submission"). Therefore, he argues, if Pub conferred a benefit on Mr. Massicotte that benefit was conferred on him by virtue of an office or an employment.

> [TRANSLATION]
> HIS HONOUR: ... And you stated that ... your colleague could argue that it is taxable and if it were taxable, it would inevitably be 6(1)(*a*) ....
>
> ...
>
> Mr. GÉNÉREUX:... given that we're talking about a credit to the "employee" account, the benefit to the employee seems to me to be the other possible argument.
>
> [Vol. I of Transcript, page 60.]

[30] In his oral submission, counsel for the Appellants argued that the Court could not confirm the Minister's assessment using as a basis paragraph 6(1)(*a*) of the Act because it would then be a new basis for the assessment and it could not be validly established due to the fact that the return had become statute-barred. I then asked that written comments be submitted to me, and these were sent to me by counsel for the Appellants on February 3, 2006, and by counsel for the Respondent on March 15, 2006; the reply from the Appellants to the supplementary arguments

of the Respondent was sent on April 5, 2006. This is what counsel for the Appellants wrote in his supplementary arguments:

> [TRANSLATION]
> 9. Can a capital gain be taxed in the hands of the Appellant for his 1995 taxation year? According to paragraph 39(1)(*a*) of the ITA, a capital gain is the gain realized by a taxpayer "to the extent of the amount thereof that would not, … be included in computing the taxpayer's income for the year or any other taxation year"). The issue of whether any of this gain would otherwise be included in computing Mr. Massicotte's income for the year or for any other year is a question of both fact and law. It has been respectfully submitted that the Court must allow the appeal by Mr. Massicotte and vacate the assessment at issue if it considers that the $240,000 is to be included in computing the taxpayer's income for 1995 or for any other year pursuant to paragraph 6(1)(*a*) of the ITA. In effect, the Crown withdrew its argument under paragraph 6(1)(*a*) of the ITA because it had nothing to do with the basis for the assessment at issue. In fact, what we have here is a reassessment outside the normal assessment period provided for in subsection 152(4) of the ITA;
>
> 10. In *Pedwell v. Canada* (C.A.), [2000] 4 F.C. 616, 2000 CanLII 17141 (F.C.A.), 2000-06-12, A-703-98, the Federal Court of Appeal ruled that the Tax Court of Canada does not have the power to uphold an assessment on any basis other than the one used by the Minister once the statutory period has run out. Here is an excerpt from that ruling:
>
> > [15] While the parties referred to a number of older authorities on the issue, *Continental Bank* now makes it clear (subject to subsection 152(9) [*Income Tax Act*, R.S.C., 1985 (5th Supp.), c. 1 (as am. by S.C. 1999, c. 22, s. 63.1)] which applies to appeals disposed of after June 17, 1999 and is not relevant here in any event) that the Minister is bound by his basis of assessment. While this case does not involve the Minister advancing a different basis of assessment, I think the principle in *Continental Bank* is applicable to a judicial determination on a basis different from that in the notice of reassessment.
> >
> > [16] First, if the Crown is not able to change the basis of reassessment after a limitation period expires, the Tax Court is not in any different position. The same prejudice to the taxpayer results--the deprivation of the benefit of the limitation period. It is not open to that Court or indeed this Court, to construct its own basis of assessment when that has

> not been the basis of the Minister's reassessment of the taxpayer.

[TRANSLATION]

11. The Federal Court of Appeal confirmed this principle in a very recent decision, *Rezek v. Canada*, 2005 FCA 227 (CanLII), 2005-06-17, A-462-03;A-463-03;A-464-03;A-465-03;A-466-03:

> [58] Finally, the convertible hedge as a separate identifiable property constituted a new basis of assessment created by the judge in 2003. The Minister's limitation period for assessing had expired at the latest in 1998. The judge rejected the Minister's partnership basis of assessment and did not make a determination on the Minister's principal/agent basis of assessment, except in the case of Mrs. Scott. Absent the convertible hedge as a separate property finding, the appeals of the spouses would have been allowed. Therefore, the convertible hedge as a separate identifiable property constituted an impermissible new basis of assessment after the limitation period for assessing had expired (see *Pedwell v. Canada* (C.A.), [2000] 4 F.C. 616 at paragraphs 13 to 16).
>
> [Emphasis added by counsel.]

...

[TRANSLATION]

13. In the case at bar, it is respectfully submitted that the Crown abandoned the argument based on paragraph 6(1)(*a*) of the ITA since it was incompatible with the basis of the assessment under subsection 246(1) of the ITA. The Respondent could not cite paragraph 6(1)(*a*) of the ITA because it was essentially a reassessment (another basis) and the taxation years at issue had become statute-barred. Further, the employee benefit must be included in the year in which the amounts are received by the taxpayer. The Crown therefore made a strategic decision in withdrawing its argument based on paragraph 6(1)(*a*) of the ITA. Furthermore, it is interesting to point out the words of the auditor, Christiane Desroches, in her examination-in-chief (hearing of October 21, 2005, afternoon, p. 33). Below are a number of excerpts from the examination in which the auditor was also of the opinion that the employee benefits should be included in the year in which the amounts were received:

...

14. In her pleading, the Respondent's representative, Ms. Labbé, seemed to argue that a benefit under paragraph 6(1)(*a*) of the ITA must be included

in the year in which it is receivable. This proposal is incompatible with the state of the law. In this regard, we refer the Court to *MNR v. Rousseau*, 60 DTC 1236 (Tab 19 of the Appellants' book of authorities). The Honourable Judge Bowman stated as follows in *Dudek v. The Queen*, 2003 TCC 157 (CanLII), 2003-03-2, 2002-1693(IT)I:

> [2] For reasons that are unclear to me, the employer issued him a T4A for the year 2000 showing a retiring allowance of $14,900.00. This I find unconscionable. I suppose they did it because they thought they would get the deduction earlier. Whatever their reason, it is contrary to the facts. The Tax Department, on the other hand, says, "Well, it says 2000 on their form, therefore it must be 2000". In my view, the Tax Department should have taxed him in the year 2001. This is one example of the CCRA's mindless application of forms. They say, "The T4A says 2000; therefore, it must clearly be 2000". Well, they are wrong. The authority for this proposition, that retiring allowances and income from employment are taxable when received and not when receivable, is a decision of the Exchequer Court by Mr. Justice Fournier in *M.N.R. v. Rousseau*, 60 DTC 1236. For the last 40 odd years it has been accepted as good law in support of the proposition that employment income is taxed on a "received" basis, and not a "receivable" basis.

[Emphasis added by counsel.]

[TRANSLATION]

15. Ms. Labbé, representing the Attorney General of Canada, withdrew her argument based on paragraph 6(1)(*a*) of the ITA (employee benefit) during the proceedings. In fact, that argument had been specifically pleaded by the Crown in its Reply to the Notice of Appeal, but was subsequently withdrawn. In so doing, the Crown committed to not attempt to support the assessment at issue based on a purported employee benefit;

...

17. In *Canderel Ltd v. Canada*, the Crown had admitted during the proceedings that the expense at issue had not been paid "as capital", but the Crown requested an amendment to the Reply to the Notice of Appeal in order that it might argue that the expense at issue was a capital expense which could not be claimed under paragraph 18(1)(*b*) of the ITA, could not be deducted (except what is allowed under 20(1)(*b*)). It appears that Mr. Justice Décary of the Federal Court of Appeal expressed the opinion that even if the new argument were allowed by the Court, the Crown's admission prevented it from winning its case because it had not sought

leave to withdraw this admission. Here is how Décary J.A. expressed himself on this point:

> Furthermore, the proposed amendment, while drafted 'in the alternative', is obviously not an alternative argument. The Trial Judge would logically dispose of the capital expenditure issue it before disposing of the timing issue. As conceded by counsel for the appellant, the Trial Judge, were he to deal first with the proposed issue as might be expected, would not even be in a position to rule in favour of the appellant on that issue because the appellant had admitted that the expenses were not an account of capital and had not sought leave to withdraw the admission. Counsel recognized, and I quote: 'The amendment cannot stand with the admission'. He expressed, however, the opinion that the motion to amend implicitly constitutes a motion to withdraw the admission. We cannot agree. The case-law is clear: an admission may be withdrawn, but with leave of the Court, and we simply cannot find in this instance that leave was implicitly sought, assuming for the sake of discussion that it could have been so.
>
> With an admission on file which is inconsistent and irreconcilable with the proposed amendment, what will the Trial Judge and the respondent do if the proposed amendment is granted? On what basis will the respondent prepare itself for the continuation of the trial? How can it rely on an admission the appellant obviously intends to ignore? How can an alternative argument be made when such argument is contrary to admissions agreed upon by both parties and upon which the trial proceeded and which have not been withdrawn? Surely, such an embarrassing pleading constitutes an 'injustice' within the meaning of the rule respecting amendments and does not in any way help in determining the real question in controversy.

[Emphasis added by counsel.]

[TRANSLATION]

18. To summarize, the Court should allow the appeal by Mr. Massicotte for 1995 because the Respondent has not demonstrated that a benefit was conferred by Gestion Amadéus-Amadéus on Mr. Massicotte in accordance with subsection 246(1) of the ITA.

[Emphasis added, except as otherwise indicated.]

[31] In her written comments, counsel for the Respondent stated as follows:

> [TRANSLATION]
> 9. However, the Respondent contends that the Court has the authority to maintain the assessment made with respect to Mr. Massicotte based on a section of the Act or a different argument from the one used by the Minister in support of his assessment.
>
> 10. To illustrate this, the Respondent refers to the decision by Tardif J.T.C.C. in *Trudel-Leblanc*, which was affirmed by the Federal Court of Appeal. In that case, the only issue before the Tax Court of Canada was who should report the income from the sale of medication: the pharmacist or Trugesvi corporation, of which the pharmacist was the sole shareholder?
> ...
>
> 11. The Minister had taxed the income in the hands of the pharmacist. The only ground for supporting the assessments was the fact that the *Pharmacy Act* stipulated that only a pharmacist could purchase or sell medications and own a pharmacy. Therefore, from 1994 to 1998, a corporation, even though it was held by a pharmacist, was unable to purchase or to sell medication as part of its operations.
>
> ...
>
> 12. Tardif J.T.C.C. ruled that the reason given by the Minister in support of the assessments was not sufficient to amend or to confirm the assessments under appeal. However, the judge maintained the assessments on the ground that, based on the evidence presented, it was the pharmacist who had earned the income from the sale of medications and not the corporation. In so ruling, the Honourable Judge set out the following principles:
>
> > 16. The correctness of the assessments must be determined on the basis of the facts and circumstances relating to the allocation of the said incomes and, as the Appellant has argued, in accordance with the Income Tax Act.
> >
> > …
> >
> > 28. Can the assessments that are the subject of this appeal be vacated because of the auditor's admission that the process

> leading to the assessment originated when it was noted that the *Pharmacy Act* had not been complied with?
>
> 29. The only question at issue is whether the assessments were correct or not under the *Income Tax Act*.

[TRANSLATION]

13. Ms. Trudel-Leblanc appealed this decision before the Federal Court of Appeal. Basing herself on *Pedwell*, she argued that the Tax Court of Canada did not have the power to maintain the assessments for a reason other than the one given by the Minister.

14. The Federal Court of Appeal affirmed the decision by Tardif J.T.C.C. It pointed out the difference with *Pedwell*, indicating that Tardif J. did not refer to a transaction other than the one used by the Minister in issuing the assessments. Tardif J.T.C.C's finding was based on evidence adduced at trial by Ms. Trudel-Leblanc herself. The Federal Court of Appeal pointed out that Ms. Trudel-Leblanc had had the opportunity to make known her viewpoint with regard to the debate before the Tax Court of Canada. As a result, she did not suffer any prejudice.

> ...

15. It should be noted that in *Pedwell*, which was cited by Ms. Trudel-Leblanc, the Federal Court of Appeal ruled that the Tax Court of Canada could not broaden the scope of an assessment to include transactions that the Minister had not considered in making the original assessment. The Respondent argues that *Pedwell* does not apply in this case. In effect, if the Court decides that the benefit was conferred on Mr. Massicotte under paragraph 6(1)(*a*), and not under subsection 246(1), it will do so based on evidence adduced at trial. We should note that this evidence had been taken for granted by the Minister in making the assessment at issue here, and the Appellants are aware of its existence. Therefore, the Appellants suffer no prejudice, a fact which they acknowledged at the hearing held on December 7, 2005.

16. The Respondent is also relying on the words of Bowman J. in *Labourer's International Union of North America, Local 527 Members' Training Trust Fund v. Canada*, [1992] T.C.J. No. 466. Basing himself on the Supreme Court of Canada decision in *C. (G.) v. V. F. (T.)*, Bowman J. stated that the Court is not bound by the concessions made by the parties on a question of law. This is what Bowman J. wrote on the subject:

> Parties to an action may agree on certain facts and this agreement may form the basis for a judicial admission by which the presiding judge will be bound. Parties cannot, however, make a judicial admission on a point of law, because "the Court may not be bound by error in an admission by the parties as to the law...". The court is not bound by concessions on points of law. In *C. (G.) v. V. F. (T.)*, … Beetz J., delivering the unanimous judgment of the Supreme Court of Canada, stated:
>
> > At the hearing, counsel for the appellants conceded that the award of custody to a third person would amount to a declaration of partial deprivation and that it was therefore necessary to establish the existence of serious cause within the meaning of art. 654 C.C.Q. for giving custody to someone other than the person having parental authority. This concession on a point of law is not binding on the Court.
> >
> > ...

[TRANSLATION]

17. Bowman J. continued, pointing out that the Court is the master interpreter of the law, and the parties cannot dictate to it which principles of law should be applied. He wrote as follows:

> The issue of the validity of this trust is a question of law because it must be determined in accordance with principles of law and because it is an issue of standing which, in itself, is a question of law. Despite submissions made by counsel for the Respondent, parties to an action cannot make a judicial admission on a point of law. …Moreover, even where an issue does not go to the court's jurisdiction or the standing of one of the parties, the court must still decide the case on the basis of the law. It cannot fulfil that obligation if it is forced to accept without question doubtful propositions of law, or to base its determinations on flawed legal premises or an ill-conceived articulation of the issues merely because of some agreement between the parties. The Tax Court of Canada has original jurisdiction over areas governed by public statutes of wide application. The effect of its judgments in many instances goes beyond the narrow dispute between the Minister and the particular taxpayer. Its judgments bear upon the interpretation of fiscal statutes and

> their application to taxpayers generally. Moreover, a decision in favour of a particular appellant will result in a payment out of the Consolidated Revenue Fund not otherwise authorized by Parliament. … This court is a court of law; it is not a private arbitration tribunal to which the parties can dictate the law.
>
> ...
>
> [TRANSLATION]
> 26. In the case at bar, the Respondent maintains that the benefit received or enjoyed by Mr. Massicotte was a credit of $240,000 to his "Advances" account with Consultants Pub Création. In consideration for this credit, Mr. Massicotte transferred a debt to the company, the fair market value of which was zero. These transactions were carried out using adjusting entries on December 31, 1995 (Tab 42) and it was during the 1995 taxation year that the $240,000 benefit was received or Mr. Massicotte took advantage of a benefit of $240,000 pursuant to the terms of paragraph 6(1)(*a*) of the Act.
>
> [Emphasis added.]

[32] I believe that the position defended by counsel for the Respondent is well founded. In my view, the basis of the assessment is the fact that Mr. Massicotte received or enjoyed a benefit. The fact that the Minister clumsily justified his assessment, citing section 246 or subsection 15(1), rather than paragraph 6(1)(*a*) of the Act as the basis, cannot be considered to constitute a new basis for the assessment. It is true that the conditions for applying these sections are not entirely the same. Specifically, as was seen earlier, in order for section 246 to apply, the benefit must not be includable in income under any of the provisions of Part I of the Act. In order for subsection 15(1) of the Act to apply, Mr. Massicotte would have had to have been a Pub shareholder, which is not the case: Amadéus is the sole shareholder of Pub. It is evident from the file that the benefit could be included in Mr. Massicotte's income under paragraph 6(1)(*a*) of the Act. Moreover, that was one of the points made by counsel for Mr. Massicotte in arguing in favour of the non-applicability of section 246 of the Act. He himself acknowledged that Mr. Massicotte was an employee and that the amount was credited to the "employee advances" account. This can be seen clearly in the documentary evidence that he himself adduced (Exhibit A-1, Tab 42). At the very start of the hearing, he acknowledged that he was not surprised by such an argument. In addition, he indicated that his position had earlier been that the burden of proof was on the Respondent with respect to the existence of the elements needed to support the application of paragraph 6(1)(*a*) of the Act.

[33] At any rate, even if justifying the assessment using paragraph 6(1)(*a*) could be considered a new basis, the first reason for eliminating the argument from counsel for Mr. Massicotte based on the approach in *Pedwell v. Canada* (C.A.), [2000] 4 F.C. 616, 2000 CanLII 17141, which followed the rule set out in *Continental Bank of Canada v. Canada*, [1998] 2 S.C.R. 358, 98 DTC 6501, is that Parliament quickly amended the Act to reject the approach of the Supreme Court of Canada. In effect, it added subsection 152(9), which applies to appeals resolved after June 17, 1999, and reads as follows:

> **152(9) Alternative basis for assessment**— The Minister may advance an alternative argument in support of an assessment at any time after the normal reassessment period unless, on an appeal under this Act
>
> (*a*) there is relevant evidence that the taxpayer is no longer able to adduce without the leave of the court; and
>
> (*b*) it is not appropriate in the circumstances for the court to order that the evidence be adduced.
>
> [Emphasis added.]

[34] Even if the Minister's reassessment for 1995 was dated April 15, 1998, Mr. Massicotte's appeal is resolved as of the date of this judgment, which is more than seven years after the coming into force of subsection 152(9) of the Act. Here are the remarks concerning this subsection in the explanatory notes for the 1999 bill (Bill C-72; S.C. 1999, c. 22, s. 63.1):

> New subsection 152(9) of the Act is intended to ensure that the Minister of National Revenue may advance alternative arguments in support of an income tax assessment after the normal reassessment period has expired. This amendment is proposed in light of remarks by the Supreme Court of Canada in the case of *The Queen v. Continental Bank of Canada* to the effect that the Crown is not permitted to advance a new basis for assessment after the limitation period has expired.
>
> The limitations found in paragraphs 152(9)(*a*) and (*b*) are intended to import the Court protection afforded to taxpayers that an alternative argument cannot be advanced to the prejudice of the right of a taxpayer to introduce relevant evidence to rebut the argument.
>
> Subsection 152(9) is subject to other limitations in the Act, including subsection 152(5) which prevents the Minister from including amounts in a taxpayer's income which were not included prior to the expiration of the taxpayer's normal reassessment period.

> This subsection applies to appeals disposed of after Royal Assent.

[Emphasis added.]

[35] We should also point out that the decision in *Pedwell* was handed down by the Federal Court of Appeal on June 12, 2000, in connection with a decision by the Tax Court of Canada that had been rendered before June 17, 1999, namely on October 29, 1998 (*Pedwell v. Canada*, [1998] T.C.C. No. 982 (QL), 99 DTC 63). *Rezek v. Canada*, 2005 FCA 227 (CanLII), involved an appeal from a judgement of this Court rendered on September 9, 2003 (*Hayes v. The Queen*, 2003 TCC 93 (CanLII), [2004] 1 T.C.C. 2605, 2003 DTC 1205), but makes no mention of subsection 152(9) of the Act, unlike *Pedwell*. In my opinion, the approach taken in *Rezek* is not in compliance with the new legislative provision in effect for all appeals resolved after June 17, 1999.

[36] We should also point out that other decisions by the Federal Court of Appeal adopt a different approach from the one used in *Rezek* and in *Pedwell*. Obviously, there is *Trudel-Leblanc v. Canada*, [2004] F.C.A. No. 480 (QL), which was referred to in the written comments by counsel for the Respondent. She nicely summarized the relevant facts in that case. There is one other decision by the Federal Court of Appeal that deserves mention, namely *Smithkline Beecham Animal Health Inc. v. Canada*, [2000] F.C.A. No. 270 (QL), 2000 DTC 6141. In it, Sharlow J.A. confirmed that Bonner J.T.C.C. of this Court was correct to qualify the proposed amendment to the proceedings as an alternative argument in support of the assessment and stated that subsection 152(9) of the Act allowed the alternative argument to be raised.

[37] It is interesting to point out the following remarks by Bonner J.T.C.C. in *Smith Kline Beecham Animal Health Inc. v. Canada*, [1999] T.C.C. No. 762 (QL), a decision handed down on November 4, 1999, at paragraphs 14 to 16 of his reasons for order:

> 14 In my view *Continental Bank* was never authority for the proposition that the Minister is, when defending an appeal from an assessment after the expiry of the subsection 152(4) period, confined within a conceptual prison called "basis of assessment" comprising only the facts and statutory provisions relied upon by the assessor [the Minister]. In my view *Continental Bank* is an application of the long standing rule governing litigation in appellate courts which rule prevents litigants from raising points on appeal which were not pleaded and argued in the trial court.

> Appellate courts cannot be expected to deal with a new issue on appeal resting on an evidentiary record which is deficient by reason of the failure to plead and direct evidence to that issue. Here the Respondent seeks leave to amend well before the commencement of the trial. The situation is in no way analogous to *Continental Bank*.
>
> 15 Furthermore, nothing said in *Continental Bank* suggests that subsection 152(4) has a bearing on the amendment which the Respondent seeks. Subsection 152(4) restricts the right of the Minister to "...reassess or make additional assessments, or assess tax, interest or penalties...". The amendment now in question would not effect a reassessment of tax. Rather it is an attempt to defend the existing assessment of tax by asserting that, on the facts already pleaded, liability is imposed by a provision of the Act other than that relied on by the assessor [the Minister].
>
> 16 It is long settled law that the validity of an assessment depends on the application of the statute to the facts and not on the assessor's [the Minister's] analysis. It is, I believe, unlikely that it was the intention of the Court in *Continental Bank* (*supra*) to overrule decisions such as *Minden* (*supra*) and *Riendeau* (*supra*) without referring to them. Accordingly, I am of the opinion that nothing said in *Continental Bank* can apply to prevent the Minister from relying on section 245 in the present case.
>
> [Emphasis added.]

[38] We should remember that Thorson P. wrote in *M.N.R. v. Minden*, 62 DTC 1044, at page 1050:

> ...In considering an appeal from an income tax assessment the Court is concerned with the validity of the assessment, not the correctness of the reasons assigned by the Minister for making it. An assessment may be valid although the reason assigned by the Minister for making it may be erroneous. This has been abundantly established.
>
> [Emphasis added.]

[39] It should also be pointed out that the Federal Court of Appeal wrote the following in *Canada v. Riendeau*, [1991] F.C.A. No. 559 (QL), [1991] 2 C.T.C. 64, 91 DTC 5416:

> In the present case, the amounts assessed remained the same throughout. What is disputed is that the assessments were originally said to have been made on the basis of repealed subsection 74(5) of the Act which, the appellant says, rendered the assessments invalid notwithstanding that the Minister afterward corrected this mistake by confirming the assessments on the basis of sections 3 and 9 of the Act.
>
> In our view, the Minister's mental process in making an assessment cannot affect a taxpayer's liability to pay the tax imposed by the Act itself. He may correct a

> mistake. The trial Judge was right in rejecting the appellant's argument and in determining that the Minister was entitled to confirm the reassessments in question.
>
> [Emphasis added.]

[40] Finally, two other Tax Court of Canada decisions deserve mention-- *Sauvé v. The Queen,* 2000 DTC 2003 [English version], and *Blanchette v. The Queen,* 2003 DTC 875. In the first one, the Minister had included in the taxpayer's income, as a taxable capital gain, 50% of an amount of interest. Dussault J.T.C.C. wrote, at page 2005:

> …[T]he amount added as business income included only the $6,000 in compensatory damages and the interest received on that amount (minus the legal fees paid). In addition, only the interest received on the capital invested, minus the legal fees paid (representing 50 per cent of the amount of the interest) was considered a capital gain, seventy-five per cent of which was included in the taxpayers' income. This approach, of course, was clearly wrong, but, relying on subsection 152(9) of the Act, counsel for the Minister argued that the amount received was actually includable interest. He acknowledged, of course, that the amount of the assessment could not be increased in any way. ...
>
> On this question, which is something of a preliminary one, I believe that the respondent can indeed rely on the provisions of the new subsection 152(9) to advance a new argument in support of the assessment, which means -- as has been held many times -- in support of the very amount of tax assessed. …
>
> [Emphasis added.]

[41] And at page 2006, Dussault J.T.C.C. added:

> ... Since the assessments made cannot be varied by adding extra amounts to make up for the fact that only 75 percent of the net amount received as interest on the reimbursed capital invested was included in income, I can only conclude that the amount that was included in income and that represented interest must in fact remain as income.
>
> [Emphasis added.]

[42] In *Blanchette* Garon C.J.T.C. also applied the same interpretation of subsection 152(9) of the Act to allow the Minister to raise alternative arguments in his Reply to the Notice of Appeal. In that case, the Department had disallowed the claim for certain expenses, assuming that the corporation existed but that its partners were silent partners. In his Reply to the Notice of Appeal, the Minister raised a new argument in support of his assessment. He maintained that the

corporation did not exist; the taxpayers objected to this alternative argument because they felt that this was a new basis for the assessment. Here is how Garon C. J. expressed himself at paragraphs 20 and 21 of his decision:

> [20] In my view, the Minister of National Revenue is entitled in the instant case to argue that the partnerships in question are non-existent and that, if they do exist, they are limited partnerships. This evidence, if accepted by the judge, would establish that the assessed amount is not too high. The respondent is not asking that the Minister of National Revenue be authorized to amend the assessments or, if I may put it in more technical terms, is not asking that the appeals be dismissed and that the assessments be referred back to the Minister of National Revenue for reconsideration and reassessment. ...
>
> [21] If I accepted the proposition put forward by the applicants, it would follow that the respondent could advance an alternative argument under subsection 152(9) of the Act--and present any evidence supporting it--only if the effect of that argument would be to justify the specific amount of the assessment under appeal. If it led to the determination of an amount of tax greater than that assessed, if only by a few dollars, that argument would be inadmissible. To accept such a proposition, it seems to me, would be to introduce an arbitrary and artificial element into the assessment appeals system. Furthermore, subsection 152(9) of the Act is general in scope; it does not make the presentation of an alternative argument in support of an assessment conditional on that argument's resulting in a determination corresponding exactly to the amount of the assessment under appeal.

[43] To summarize, what is at issue is the amount of tax determined in the assessment. If this amount can be justified by other provisions of the Act, it is possible to do so. The purpose of the exercise is to ensure that the amount of tax determined by the Minister is justified in law. Canadian taxpayers need pay only what they are required to pay under the Act. The fact that one of the Minister's auditors may have erred with respect to the justification for her assessment does not necessarily mean that it is incorrect. Adopting an excessively procedural approach would make it possible for the wealthiest taxpayers to resort to the services of the cleverest tax lawyers, who could, by pleading procedural considerations, successfully contest assessments even if, in law, those assessments were otherwise well founded. In that situation, all Canadian taxpayers would be forced to make up for the shortfall resulting from this approach.

[44] If this procedural approach were to be applied to the facts in this appeal, would tax fairness and justice be well served if the outcome would be to allow a taxpayer to appropriate $240,000 from his own corporation, without having to pay any tax at all, while the other Canadian taxpayers are obliged to pay income tax when they receive either a salary or dividends from their corporations?

[45] It must be remembered that the role of a judge is to ensure that assessments made by the Minister comply with the Act. If, on his own authority, a judge cited a section of the Act or a legal principle that allowed a taxpayer to successfully contest a Minister's assessment, it is my view that few persons would be opposed. Therefore, why should a judge refrain from citing this type of rule or statutory provision in order to justify a Minister's assessment? The fundamental role of a judge is to remain impartial. In my view, if a judge were to intervene only when such an action had the potential to prove advantageous for a taxpayer, that action would go against his or her duty to remain impartial.

[46] I believe that the approach that I am adopting is consistent with the one described by Rinfret J. of the Court of Queen's Bench (now the Quebec Court of Appeal) in *Poulin v. Laliberté*, [1953] Q.B. 8, at pages 9 and 10:

> [TRANSLATION]
> The issue is this: What exactly is justice?
>
> Must a judge listen to the testimony, hear the arguments and limit himself to ruling solely on the basis of the evidence and the arguments that are presented to him by the counsel for the parties, all without uttering a word?
>
> If he notices that, through inability or ignorance, a counsel inadvertently fails to present a piece of evidence or make an argument, must the judge render a decision that he knows to be inequitable for the parties?
>
> Must the client suffer as a result of the ineptitude of his counsel?
>
> Some would say yes; they are of the school that the judge must keep strictly and steadfastly to what is presented to him and that it is the counsel, not the judge, who are in charge of the trial.
>
> The other theory maintains, on the contrary, that the only person in charge of the trial is the judge and it is up to the judge to direct it in the best interests of justice. To do this, the judge must consider all the facts, even those that others, for one reason or another, have failed to present; he must raise questions of law, even if they are not presented to him, provided that, in each case, he allows the parties or their counsel an opportunity to debate them.
>
> The law or, if we will, justice is not a matter of surprises or *technicalities*.
>
> It is the judge's duty to shed as much light as possible on the issue, rectify the situation and compensate for the lawyer's ineptness or ignorance, as required. This is how I understand justice.

> However, the judge must not cause the parties to lose their vested rights, and it is by exercising his discretion that he can ensure that they are protected.
>
> [Emphasis added.]

[47] Author Jean-Claude Royer, in *La preuve civile*, 2nd ed., Cowansville, Quebec: Les Éditions Yvon Blais inc., 1995, favours this approach:

> [TRANSLATION]
> **204** — *Conclusion* — The courts have generally adopted the interventionist theory set forth by Rinfret J. That doctrine favours seeking greater justice, even if it brings harm to the accusatory and contradictory trial system. Moreover, it corresponds more to modern social ideas inspired by a more objective conception of the law, which has led to a legislative evolution destined to increase the role of the judge.
>
> [Emphasis added.]

[48] It is important to stress that a judge's intervention must take place within the framework of acquired rights, as was noted in *Poulin*, and respect the rule of procedural fairness. If an alternative argument is put forward, the other party must not be caught by surprise and must be given an opportunity to either adduce the facts as evidence, or to argue against this alternative argument. Obviously, in this context, the judge must remain faithful to his duty of impartiality. He cannot become counsel for one of the two parties. By politely approaching the various witnesses with an openness of spirit, and, while seeking the truth, being as vigilant with respect to the witnesses of one party as to the other, he will be able to discharge his duty of impartiality.

[49] At the start of the hearing, I asked counsel for Mr. Massicotte if there was a problem with respect to the relevant taxation year regarding the inclusion of the benefit that could result from the transfer of the $240,000. If there were to be a taxable benefit pursuant to section 246 of the Act, he was not contesting the fact that 1995 was the relevant year. However, his position changed in the event there were to be a taxable benefit pursuant to paragraph 6(1)(*a*) of the Act.

[50] The position defended by this counsel is that taxation of employment income must necessarily be based on the actual receipt of funds by the employee. To support his position, he cited *M.N.R. v. Rousseau*, 60 DTC 1236, French reasons at p. 1241, and *Phillips v. Canada*, [1994] T.C.C. No. 597 (QL), 95 DTC 194, which confirm that compensation paid to an employee is only taxable when received by the employee. Accordingly, a bonus promised by an employer does not

have to be included in the employee's income if the employee did not actually receive it.

[51] However, the issue here is not the extent to which the compensation (salary and bonus) received by Mr. Massicotte constitutes income to which section 5 of the Act applies. Instead, we must determine here whether an employee or an officeholder received or enjoyed a benefit by virtue of his office or employment, pursuant to paragraph 6(1)(*a*) of the Act. In my view, the approach that must be used here is the one used by the Federal Court of Appeal in *Kennedy v. Canada*, [1973] F.C. 839. In that decision, the Court of Appeal was forced to apply subsection 8(1) of the *Income Tax Act* (R.S.C. 1952, c. 148), which, as of 1972 became subsection 15(1) of the *Act*. Here is how Jackett C. J. expressed himself on the significance of a benefit given to a shareholder, within the meaning of subsection 8(1) (now 15(1) of the Act):

> 10 A preliminary point should be mentioned in connection with 1965. As has already been indicated, the assessment was based on the assumption that the appellant purchased a property worth $344,000 from his own company for $259,000 and that payment of the price was effected by the appellant assuming mortgages in the sum of $311,000 and being given back a promissory note for $53,000. The appellant says that, even if these factual assumptions are all correct, to the extent of the amount of $53,000 the benefit has not been "conferred" until the money is in fact paid and none of it was paid in 1965. In support of this contention, the appellant relies on authorities regarding the question as to when amounts such as dividends, interest and rent become "income" for purposes of income tax legislation. In my opinion, the question involved in that sort of case is not the same as the problem under section 8(1). In the case of "income", it is assumed, in the absence of special provision, that Parliament intends the tax to attach when the amount is paid and not when the liability is created. (The courts naturally react against taxation before the income amount is in the taxpayer's possession.) Here, the question is when a "benefit" has been "conferred" within the meaning of those words in section 8(1). In my view, when a debt is created from a company to a shareholder for no consideration or inadequate consideration, a benefit is conferred. (The amount of the benefit may be a question for valuation depending on the nature of the company.) On the other hand, when a debt is paid, assuming it was well secured, no benefit is conferred because the creditor has merely received that to which he is entitled. I am, therefore, of the opinion that the $53,000 promissory note must be taken into account for the purposes of section 8(1) in the year in which it created an indebtedness from the company to the appellant, namely, 1965.
>
> [Emphasis added.]

[52] Paragraph 6(1)(*a*) of the Act refers not to a benefit conferred, but to a benefit received, by a taxpayer or enjoyed by a taxpayer but there is no incompatibility

between these expressions. On the contrary, one is the reverse of the other. When there is a question of a benefit conferred, the situation has to be looked at from the viewpoint of the provider of the benefit. When there is a question of the receipt or enjoyment of a benefit, it has to be looked at from the viewpoint of the receiver of the benefit. In other words, if a benefit was conferred by one person on another, this means that the receiver received it or enjoyed it. Therefore, to the extent that Mr. Massicotte's transfer of the $240,000 debt to Pub was made in return for consideration, the value of which exceeds the fair market value of the debt, there is a benefit that has been conferred directly by Pub, and that benefit was received or enjoyed by Mr. Massicotte from the very instant that an obligation to pay the consideration arose.

[53] Further, counsel for Mr. Massicotte argues that his client acted in good faith and had no intention of profiting from the transaction in question. He bases himself on *Robinson v. M.N.R.*, 93 DTC 254, a ruling in which Rowe D.J.T.C.C. of this Court ruled that the taxpayer had no intention of appropriating $64,022 in company funds for his own use. Here is what Rowe D.J.T.C.C. stated at pages 257 and 258:

> Subsection 15(1) contemplates an appropriation for the benefit of a shareholder and/or a benefit or advantage *conferred on* a shareholder *by* a corporation. The Appellant was the sole shareholder of the corporation and must either be responsible for taking unto himself or setting aside for a special purpose something of value from the corporation or, as the directing mind of the corporation, be responsible for the bestowing or granting of a benefit, and at the same time in his personal capacity agree to accept it and adapt it for his own use. Although it is the same mind operating in both instances, the Appellant while wearing his shareholder's hat did nothing consistent with taking, or appropriating a benefit, and, as Director and President, when exercising control over the corporation, did not intend to have conferred anything on himself, and as a putative recipient, he was an unwilling and uninformed beneficiary. The accountants, in erroneously recording a transaction, were not acting pursuant to any direction to achieve such an end on behalf of either the corporation or the Appellant as a shareholder. Clearly, the record keeping was not in accord with the facts and ran counter to the intent of the Appellant at the outset when he undertook to correct an error by depositing into the corporate bank account funds which truly belonged to it. He was discharging his duty as trustee made necessary by the inadvertent act of the payor in making him the payee of the cheque. ...
>
> In order for there to have been an appropriation,[36] the Appellant must have "appropriated". *Black's Law Dictionary*, Sixth Edition, defines "appropriate" as:

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[36] It must be noted that the terms "appropriation" and "appropriated" do not appear in the English version of subsection 15(1) of the Act.

> To make a thing one's own; to make a thing the subject of property; to exercise dominion over an object to the extent, and for the purpose, of making it subserve one's own proper use or pleasure.
>
> It is apparent that the words used in subsection 15(1) refer to some form of action with a strong component of intent and certainly cannot be seen to embrace an event that is the result of mutual mistake between the parties, that is, the shareholder and the corporation, when the mistake is the result of an act or omission of a third party operating in good faith but on a faulty premise.
>
> [Emphasis added.]

[54] Obviously, if an accountant makes an adjusting entry that does not correspond with reality and, as a result, that entry is erroneous, in such circumstances the provisions such as those found in paragraph 6(1)(*a*) or subsection 15(1) of the Act cannot be applied. On the other hand, there is no question here of any accounting errors. In this situation, the adjusting entries on the books of Amadéus and of Pub were made based on instructions from Mr. Massicotte or one of his employees, Mr. Bureau, apparently to avoid the application of subsection 15(2), as allowed under subsection 15(2.6) of the Act when advances are repaid within one year following the taxation year in which the debt was created.[37]

[55] In my view, in order for paragraph 6(1)(*a*) of the Act to apply, it is not a requirement that the taxpayer had intended to confer a benefit upon himself. That is not a requirement that was dictated by the federal Parliament. Objectively speaking, if it can be determined that a benefit was conferred on a person or – if we look at it from another angle—that the person received or enjoyed that benefit, the amount of any such benefit must be included in income to the extent that the other conditions set out in the relevant sections are met.

[56] Now, we need to apply these rules and this approach to the relevant facts in this appeal.

(A) The $240,000 credit to the "employee advances" account in 1995

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[37] Unlike subsection 15(1), subsection 15(2) of the Act can apply here even if Mr. Massicotte is an employee of Pub and is not one of its shareholders because he, Pub, and Amadéus do not operate at arm's length. (See paragraphs 15(2), (2.1) and (2.4) of the Act.)

- Contradictory evidence and credibility of key witnesses

[57] The appeals by Mr. Massicotte and by Pub raise serious issues of credibility. The Court heard contradictory evidence from the two former partners, Messrs. Massicotte and Audy. In general, the testimony from Mr. Massicotte was much less credible than that of Mr. Audy.

[58] According to Mr. Massicotte, the $240,000 amount described in Article 3 of the separation agreement was compensation that took into account several items, including, primarily, the $240,000 salary (that is, two times $120,000[38]) that he allegedly waived in 1993 and 1994, compensation of $200,000 on account of the early departure of Mr. Audy[39] and compensation of $50,000 for Mr. Audy's failure to comply with the non-competition agreement[40] and for alleged harm to the reputation of Mr. Massicotte and alleged moral damages.[41] All this represents a great deal of money (at least $490,000) as well as a staggering number of possible explanations! But which of these explanations actually applies to what the parties agreed to on June 10, 1994? The explanations appear to have been provided after the fact. In Mr. Audy's case, he claims that the $240,000 represented the outstanding amount that Cyrano owed Mr. Massicotte for the Pub shares acquired in 1990. This balance allegedly resulted after the payment of the first $50,000 several days after the contract was signed, followed by the payment out of the dividend of $50,000 paid out in July 1991, leaving a balance of $250,000. (A further $10,000 may have

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38 He testified that his salary was $125,000 (See paragraph 9 above).

39 Article 33 of the shareholder agreement (Exhibit A-1, Tab 14).

40 In the event that a Pub shareholder voluntarily withdraws, Article 28 of the shareholder agreement provides that that shareholder must not have any contact whatsoever with any of the clients of Pub for six months following his withdrawal. Liquidated damages of $50,000 are indicated.

41 During her testimony the Minister's auditor confirmed that Mr. Massicotte had initially indicated to her that the $240,000 represented the loss in value of Amadéus, which had been calculated as representing one-half of the shareholder assets (assets minus liabilities). The auditor at the time stated that she had not understood the relevance, either of the loss in value, because Mr. Audy held no interest in that company, or the calculation of the loss. She was subsequently informed that the $240,000 represented damages provided for in the shareholder agreement. Mention was also made to her of the loss of salary that Mr. Massicotte had been obliged to incur.

been paid at some other point after July 31, 1993.[42]) The parties intended that Cyrano be released from the obligation to pay off this balance.

[59] Mr. Massicotte stated that not only was he fully paid for the shares, but he also received $33,294 over and above what was due him. Further, no interest was payable on the unpaid balance. All this raises doubts regarding the accuracy of Mr. Massicotte's story!

[60] One other reason that gives cause for doubting the accuracy of Mr. Massicotte's story, according to which nothing was owed to him with respect to the balance of the proceeds of the sale of Pub shares to Cyrano, is that Cyrano's obligation to pay off this balance on or before September 30, 1997, was limited to its share of the dividends paid out by Pub. Because for several years Pub had suffered losses or earned little in the way of profit, it is not surprising that Pub paid out little in the way of dividends to Cyrano. As seen in Table 1 and notes 10, 19 and 20 above, the only dividends Pub paid to Cyrano between 1990 and 1995 were the one for $50,000 in July 1991, and the one for $1,650 in July 1992. How would Cyrano have been able to pay out $40,461 from August 1, 1992 to December 31, 1992, $150,683 in 1993 and $47,500 in 1994?[43] Furthermore, Cyrano had no interest in paying off the balance of the sale price because it bore no interest. It is therefore plausible that Mr. Audy's version of the facts is the correct one.

[61] In addition, Mr. Audy's story is supported by the Cyrano financial statements prepared by KPMG, which show that at July 31, 1992, and at July 31, 1993, long-term debt for the Pub shares amounted to $250,000![44] Finally, at the time Mr. Audy testified, he was not even aware of the alleged $383,294 that his company, Cyrano, had apparently paid for these shares!

[62] Both former partners stated during their testimony that they had sold their shares by signing two share sales agreements on May 30, 1994, one for the shares

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[42] Obviously, if one were to take into account an additional payment of $44,650 made by transferring the 4,465 Class C shares, these figures would not balance.

[43] Since the separation agreement is dated June 10, 1994, we must assume that this latter sum had been paid prior to June 10, 1994.

[44] See Exhibit I-1, financial statements, Note 5. We should add that in Cyrano's financial statements dated May 31, 1995 (Exhibit I-4), we see that as of May 31, 1994, the $250,000 debt to Mr. Massicotte is not mentioned. Apart from institutional corporate debts, there was only $70,000 left owing to the shareholder.

in Im-Média, between Mr. Massicotte (vendor) and Mr. Audy (purchaser), the other for the Pub shares, between Cyrano (vendor) and Amadéus (purchaser). At the very least, they misled one another by making such statements because, from all appearances, both agreements were backdated. Even if it states that the closing date [TRANSLATION] "*shall be May 30, 1994, at 2:00 p.m.*" for the sale of the Pub shares by Cyrano, and [TRANSLATION] *"at 3:00 p.m."* for the sale of the Im-Média shares by Mr. Massicotte, and the parties declared that [TRANSLATION] "*they have signed at Québec, this 30th day of May, 1994*" (Exhibit A-1, tabs 27 and 28, Article 2 and *in fine*), Mr. Massicotte acknowledged, prior to the start of the arguments, that they may have been signed after June 10, 1994. The clues were too numerous to be able to deny such a finding of fact.

[63] First, in the separation agreement dated June 10, 1994, drafted by Mr. Massicotte himself, the parties agreed specifically that Cyrano would sell [TRANSLATION] "*effective this date*", all Pub shares that it held to [TRANSLATION] "*Massicotte, Amadéus, or any other entity(ies) that they may name"*. If the sale of the Pub shares by Cyrano to Amadéus had actually taken place on May 30, 1994, how is it that on June 10, that is, 11 days later, no one knows if the shares will be sold to Mr. Massicotte, to Amadéus or to any other entity that they may name? How is it possible to stipulate that the sale takes place "effective this date", that is, June 10, 1994, if the sale has already taken place on May 30, 1994? Similarly, in paragraph 3 of the separation agreement "Cyrano, Audy" agree to acquire all the shares in Im-Média held by Mr. Massicotte for the sum of $70,000, whereas according to one of the agreements dated May 30, 1994, it was Mr. Audy who acquired the 500 Class A shares in Im-Média. Why did the agreement not read "*Mr. Massicotte sells"* these shares effective this date? [TRANSLATION] "*Agree to acquire*" seems to indicate that the sale had not even taken place on June 10, 1994!

[64] It is more than likely that the sales agreements were drawn up after June 10, 1994, and then backdated to May 30, 1994, to accommodate the rules regarding corporate changes of control, according to which a new fiscal year begins whenever such a change is made. It was more convenient for the parties and their accountants that the acquisition of control of Pub by Amadéus and of Im-Média by Mr. Audy take place at the end of May (or thereabouts) than in June, when they finalized the separation agreement.

[65] One other requirement that does not conform to reality is the one in the agreement concerning the sale of the Im-Média shares, whereby the vendor, Mr. Massicotte, acknowledges that he received the $70,000 sale price on May 30, 1994. The evidence showed instead that Mr. Massicotte received this

amount in two equal payments, one on June 21, 1994 and the other on July 14, 1994. The funds required for these two payments came from Pub, in two cheques, for $35,000 each, which it gave in two steps to the accountant for Mr. Audy and Cyrano.[45] It had to be done this way because Pub did not have sufficient funds in the bank to pay the $70,000.

[66] Furthermore, even though Mr. Audy signed the agreement to purchase the Im-Média shares at the stated price of $70,000 (Exhibit A-1, tabs 28 and 30), he claims that it does not reflect reality, because he stated that the Pub and Im-Média shares were worth only one dollar, the only amount that had been agreed upon. It was Mr. Massicotte who had allegedly asked that the price for the Im-Média shares be shown as $70,000. This $70,000 sale price was paid by means of the $70,000 payment that Pub made to the accountant (in all likelihood on behalf of Cyrano or Mr. Audy), the amount which Mr. Massicotte described as a severance allowance. Mr. Audy stated that he had agreed to go along with this ruse after having been assured by his accountant that it was not an illegal transaction.

[67] In presenting his arguments, counsel for Mr. Massicotte attacked Mr. Audy's credibility because Mr. Audy had allegedly contradicted himself in the following portions of his testimony. The questions being asked involved Article 3 of the separation agreement, specifically the 18-month period and the commitments referred to in that article. According to Mr. Audy, the 18-month period applied only to the exchanges referred to in articles 3.1 and 3.4 of that agreement:

> [TRANSLATION]
>
> Q. As far as you were concerned, then, when it states: *these must be settled within 18 months,* as far as you were concerned, that meant what? Was it 3.1 and 3.4? How do you interpret that?
>
> A. No. In my mind, when I read this document again, that did not refer to 3.1 and 3.4 but to 3.2, and to 3.3.
>
> [Vol. IV of the transcript, page 23.]

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[45] First, Pub paid the accountant $35,000 on June 17, 1994; the accountant cashed the cheque on June 20, 1994, and deposited it in his trust account. The accountant issued a cheque for $35,000 payable to Mr. Massicotte on the same day, and Mr. Massicotte cashed it the following day and gave the amount to Pub. Pub then issued another cheque for $35,000, payable to the accountant, on June 30, 1994, and the accountant cashed it on July 13, 1994, and issued a cheque for $35,000 payable to Mr. Massicotte, dated July 12, 1994, but cashed on July 14, 1994 (Exhibit A-2).

[68] Further on, in talking about exchanges (of services) that he had offered Mr. Massicotte, Mr. Audy said this:

> [TRANSLATION]
> Q. Was any part agreed to?
>
> A. There was a small part that was agreed to and it was that clause where we had more than eighteen (18) months to close it.
>
> [Vol. IV of the transcript, p. 30.]

[69] In my opinion, we should not see here an indication of bad faith on the part of Mr. Audy. Given the wording of Article 3, which is far from being clearly written by Mr. Massicotte, one can easily understand that he was misled with regard to the scope of this article. Further, the nervousness which often accompanies a witness testifying in court could also explain this misinterpretation of the agreement. Also, I needed Mr. Massicotte's explanation before I myself was able to understand the 18-month period that applied to the exchanges provided for in articles 3.1 and 3.4.

[70] When he testified, Mr. Audy denied having told the Minister's auditor that the $70,000 paid by Pub to Cyrano was a gift. Counsel for Mr. Massicotte asked that a portion of the audit report from the Im-Média file (company that was merged with Cyrano) be read to Mr. Audy. In it the auditor stated that she could not accept the argument that the $70,000 represented a gift, because these were [TRANSLATION] "*two arm's-length parties that were bickering*" (Q. 1168, p. 299, Vol. 2 of the transcript). Counsel for Mr. Massicotte saw in that response a contradiction with Mr. Audy's testimony, but it was never established that Mr. Audy was present at the meeting with the auditor. Also, the auditor only identified one person who was present at the meeting, a tax expert for Mr. Audy. Therefore, there is no evidence that Mr. Audy made such a statement and that he contradicted himself.

[71] In my view, none of the portions selected by counsel for Mr. Massicotte is probative with regard to Mr. Audy's lack of credibility. However, all the evidence shows that it is not easy to grant a great deal of credibility to some of the statements by Mr. Massicotte or to certain of the documents that he prepared.

- Nature of the $240,000 debt

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[72] Regarding the various contradictory accounts of the true nature of the $240,000, Mr. Audy's account appears to me to be more plausible than Mr. Massicotte's. It is difficult to believe that Mr. Massicotte would have received $33,294 over and above what he was entitled to. I believe rather that the discharge of the debt described in Article 3 of the separation agreement referred to the balance of the selling price of the Pub shares to Cyrano in 1990. It is entirely plausible that in 1990 Mr. Massicotte had inflated the value of the Pub shares sold to Cyrano to $350,000 in order to perform a term strip and that, given the failure of their partnership, he had to waive the unpaid balance of the selling price of those shares. Further, Mr. Audy stated that the price had been inflated. According to him, it was easy to manipulate the revenues of an advertising firm by adding or not adding revenues at the end of the fiscal year. We should add that the sale of 50% of the Pub shares in December 1990 by Mr. Massicotte to Cyrano for $350,000 reveals a market value of $700,000 for all the common shares of Pub (the Class A shares), for a ratio of 5.9 to 1, compared with the retained earnings of $119,000. The after-tax profits realized by Pub for its first two fiscal years were $12,701 for 1989 and $106,327 for 1990 (or $119,028 in total). The ratio therefore rises to 6.6 to 1, compared with the 1990 profits, and to 11.8 to 1, for the average profits for the first two fiscal years of Pub. These ratios in my view are very high[46] for well-established businesses similar to Pub and, therefore, even higher for a company that has only been in operation for two years!

[73] However, it is possible that Mr. Massicotte may have wanted to ensure that writing off his $240,000 debt consisting of the balance of the 1990 sale price of his shares was in effect a writing-off only to the extent that Mr. Audy was successful in having the lease cancelled, where he would ensure that Mr. Massicotte was released from his backing of the loan made by Im-Média, and where Im-Média, Cyrano and Mr. Audy would assume their share of Pub's $200,000 line of credit from which Mr. Audy and Cyrano, from all appearances, benefited within the framework of the company's operations. We need to remember that a substantial amount of fees was paid to Cyrano during this period.[47]

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[46] A ratio of 11.8 to 1 represents a capitalization rate of 8.5%, which is a very low rate of return for the risks inherent in the operation of this type of advertising agency!

[47] Given Mr. Massicotte's habit of asking Pub to advance him funds to cover his personal expenses (rather than taking a salary from Pub for his work) and to repay the advances by transferring all sorts of assets, it would not be surprising that one of the reasons for creating this conditional debt was to enable him, using a future transfer to Pub, to create the illusion of repaying his Pub advances.

[74] Further, the separation agreement was not intended to create a debt in favour of Pub and Mr. Massicotte. Instead, it was designed to release Mr. Audy and Cyrano from one such debt. This release, as we saw earlier, depends on several conditions being met. If the $240,000 amount really represented compensation for the salary which Mr. Massicotte claims to have waived (the first reason mentioned by Mr. Massicotte in his testimony at the hearing),[48] why would he have waived it if Mr. Audy and/or Cyrano were able to keep their commitments that are set out in Article 3 of the separation agreement? According to Mr. Audy, meeting these commitments did not pose a problem.

[75] Also, the discharge is worded strangely. It is contained in Article 3, entitled [TRANSLATION] "Sale of shares Im-Média and discharge of debt", which deals with the sale of the Im-Média shares, and not in Article 2, which deals with the shares in Pub, the primary beneficiary of the discharge conditions. Also, Article 2 does not specify the nature of this debt. Therefore, all parties are free to put forward their own contradictory interpretations on that issue.

- Date of transfer of the $240,000 debt

[76] Mr. Massicotte contends that the transfer of the $240,000 debt to Pub took place in late 1994 or early 1995 with the help of Mr. Chabot, his accountant, but Mr. Chabot denies being involved in the decision to make this transfer. In my view, if the adjusting entry was not made for the fiscal year ending on December 31, 1994, it was because Mr. Chabot had not been told about the transfer, at least until the first few months of 1995. Also, the Minister assumed that the transfer of the debt took place on December 31, 1995; it was therefore up to Mr. Massicotte to produce evidence to the contrary. The evidence that he provided was not sufficient to demolish this assumption on the part of the Minister.[49] There was no legal transaction to give effect to the transfer. Faced with a lack of

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48 But not the one that was first mentioned to the auditor at the time of the audit.

49 Strangely, counsel for Mr. Massicotte did not contest the use of calendar year 1995 as the relevant year governing the inclusion of this benefit under Section 246 of the Act. However, he argued that the value of the debt must be assessed at what it was in the fall of 1994. In my view, the value used for the debt that Mr. Massicotte transferred to Pub must be its value at the time of the transfer.

probative evidence, I conclude that the debt was transferred on December 31, 1995.[50]

- Fair market value of the $240,000 debt

[77] Unfortunately for him, Mr. Massicotte did not supply any expert witnesses to counter the assessment of the Minister's expert or to justify a market value of $240,000 for the debt as of December 31, 1995. In my view, he did not do this because no credible assessor would have been able to confirm as high a value! Furthermore, I believe that the zero value set by the Respondent's expert is rather reasonable. Obviously, there is the possibility that the debt is worth slightly more. Gamblers are prepared to purchase lottery tickets even though the chances of winning are much lower than the chances Pub had of recovering a portion of the $240,000. In my view, $1,000 represents an arbitrary figure that is far removed from the $240,000 figure defended by Mr. Massicotte, but it still has the advantage of being higher than the zero value used by the Minister. It is important to remember that this value was based strictly on the inability of the debtors to discharge an obligation to pay $240,000, and this was because of the negative value of their respective net assets.

[78] Counsel for Mr. Massicotte indeed attempted to attack the probative value of this opinion by stating that the assessment of the ability of the debtors to pay had been based strictly on net assets, and not on existing assets. Obviously, any attempt to value an asset is a perilous exercise. This is even truer when one is dealing with a debt such as the one that is at issue here, but I will point out here that the expert had assumed that the $240,000 debt corresponded to a debt of Mr. Audy or of Cyrano, and that she did not take into account the potentially litigious nature of the debt or its conditional nature.[51] Cyrano and Mr. Audy have always felt, since June 10, 1994, that this amount would never be paid. The fact that the sale price of the Pub shares was inflated in 1990 supports such a position. According to Mr. Audy,

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50 Counsel for the Respondent suggested one explanation for the December 31, 1995 date: it corresponds essentially with the end of the 18-month period referred to in the June 1994 agreement. In my view, the most likely reason that the debt was transferred at the end of 1995 is that on that date Mr. Massicotte owed Pub $114,642 and, in order to avoid application of subsection 15(2) of the Act, he needed to repay this amount.

51 The formal demand to pay the sum of $240,000 that was issued in May 1996 had been ignored by Cyrano and by Mr. Audy. Further, the action instituted in June 1997 did not result in recovery of the $240,000 either, but these facts are irrelevant, since they occurred after the valuation date.

all the conditions necessary for the discharge of this debt to take place would be realized and, apart from the one relating to the repayment by Cyrano of its share of the line of credit, had indeed been realized. Up until the time of its bankruptcy, Cyrano (which later became Im-Média) was making regular payments on this debt.[52] It is not necessary to decide here the extent to which the claims of Mr. Audy and Cyrano were well founded. In any case, the claim for payment of this conditional debt could be contested by Mr. Audy and, in order to obtain payment, legal proceedings could be required. Who would have paid $240,000 for this type of debt under these circumstances? In view of the high costs associated with seeking remedy through the courts and the delays that this would involve, and in view of the fact that the debt bore no interest, the value of the debt was greatly diminished.

[79] Counsel for Mr. Massicotte placed a great deal of emphasis on the fact that it was in the best interests of Pub to acquire this debt in order to facilitate repayment of the $100,000 line of credit. In my view, these interests go no further than the payment to Mr. Massicotte of an amount greater than the value of his debt. No one spends $240,000 to get $68,000. Under the terms of the separation agreement, Pub was already entitled to require that Cyrano and Mr. Audy assume responsibility for repaying the line of credit up to a maximum of $100,000.

- Nature of the $240,000 benefit conferred on Mr. Massicotte

[80] Mr. Massicotte confirmed that the advances recorded by Pub in the "employee advances" account (Exhibit A-1, Tab 39) were paid to him between May 1994 and December 1996. These advances represent payments towards his salary. As a result of the transfer of the $240,000 debt, Mr. Massicotte hoped to repay the advances and avoid, under subsection 15(2.6), the taxation provided for in subsection 15(2) of the Act. In effect, as a result of the adjusting entries made on December 31, 1995, his account had a credit balance of $125,358, and then it

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[52] According to Mr. Massicotte, Mr. Audy failed to comply with numerous commitments in the separation agreement. He claims that the three problematic areas were: the non-competition clause, the clause relating to the line of credit and the clause that involved the exchange of services. In order to justify his assertion regarding the non-competition clause, he stated that he had surprised Mr. Audy in the process of taking away certain Pub documents relating to some of his clients. Also, Amadéus was never released from its line-of-credit obligation, because it was forced to assume $68,000 in debt at the end of 1998. In addition, the value of the services offered in exchange was ridiculous. Consequently, according to Mr. Massicotte, he was owed the sum of $240,000.

was Pub who owed money to Mr. Massicotte. Here is the reconciliation done by the auditor using data that she was able to obtain, with a great deal of difficulty, from Pub (Exhibit A-1, Tab 42, p. 1):

Reconciliation of this amount with the accounting records of Consultants Pub Création Inc

Employee Advances account #11 490 – balance before adjustment				106,985.57 See p. 2
A/E # 3471	31/12/1995	Employee Advances	- 2 343.85	
A/E # 3472	31/12/1995	Employee Advances	10 000.00	
A/E # 3473	31/12/1995	Employee Advances	- 240 000.00	- 232 343.85
Employee Advances account #11 490 – balance after adjustments				- 125 358.28

[81] This credit balance is shown on Pub's balance sheet at December 31, 1995.[53] The financial statements were approved by Mr. Massicotte because he was the sole director of Pub in March 1996,[54] and he attached them to Pub's return of income, which he signed as President on March 15, 1996.

[82] Since I consider the $240,000 debt to be worth $1,000 at the time of the transfer in December 1995, and Pub credited Mr. Massicotte's employee advances account with $240,000, Pub therefore conferred a benefit of $239,000 on him. In my view, this amount must be included in Mr. Massicotte's income under paragraph 6(1)(*a*) of the Act. This is a benefit that Mr. Massicotte received in 1995. His estate grew by $239,000 at the time of this transfer. How can it be argued that he did not "receive" or "enjoy" a benefit under such circumstances when the $240,000 credit repaid $114,642 ($106,986 + $10,000 − $2,344), which was the balance in the advances account prior to this credit, and created a credit balance of $125,358.28 which Mr. Massicotte could withdraw from Pub whenever he wanted, just as if it were a deposit in a bank or credit union? This is in fact what Mr. Massicotte did.

[83] It must be remembered that as a result of the transfer of his debt Mr. Massicotte realized a capital gain of $1,000, because he received proceeds of disposition in the amount of $240,000, from which must be deducted his tax cost

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53 Exhibit A-1, Tab 8, Note 5 of the financial statements.

54 It must be noted that the review engagement report signed by accountant Chabot is dated March 15, 1995. Obviously, this is an error.

(adjusted cost base) of zero[55] and the sum of $239,000, which must be reported as income from an employment. Three quarters of the capital gain must be included in his income as a taxable capital gain, pursuant to section 38 of the Act.

(B) $44,650 credit in 1993

[84] Mr. Massicotte's assessment for 1993 included in his income a benefit arising out of a $44,650 credit from Amadéus to the shareholder advances account (Mr. Massicotte, in this case). According to Mr. Massicotte, this credit corresponds to the consideration paid by Amadéus for the transfer of the 4,465 Class C preferred shares which Mr. Massicotte had previously acquired from Cyrano.

[85] Obviously, if we were to rely solely on the May 30, 1994, sale agreement, the transfer of these shares would not have occurred in 1993, but in May 1994. Further, it would have been made directly from Cyrano to Amadéus, but we know that this agreement was backdated and that it was apparently drawn up pursuant to the June 10, 1994, agreement. What is troubling is the fact that Cyrano apparently sold all its shares in Pub for one dollar, under this same agreement. However, the separation agreement does not provide any details as to which shares were included in [TRANSLATION] "all the shares" held by Cyrano. If, in the mind of Cyrano, the only shares it had left were the 350 Class A shares, the provision that the sale was for the sum of one dollar per share, or $350, could be almost consistent with the statement by Mr. Audy, who stated that the Pub shares were not worth more than one dollar. Since Mr. Massicotte drew up the separation agreement, it is highly possible that he gave poor expression to the agreement by the parties when he stated [TRANSLATION] "one dollar per share" rather than "$1.00" for [TRANSLATION] "all the common and preferred shares", as was stated in the May 30, 1994 sales agreement (Exhibit A-1, Tab 27, p. 2). At the time the agreement was signed, Mr. Audy should have seen that he was not being given the sum of $350 and, if he had truly been entitled to that amount, he would certainly have found the error. Since that does not appear to have happened, I have concluded that one dollar for all the common (Class A) shares was the agreed-upon price.

[86] However, I cannot come to the same conclusion with respect to the 4,465 Pub Class C shares. According to the separation agreement, Cyrano agreed to personally pay down a portion of the Pub line of credit, that is, $100,000. If this debt is removed from its balance sheet, Pub's book value was no longer -$47,151

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[55] Admission from counsel to Mr. Massicotte regarding paragraph 17(p) of the amended Reply to the Notice of Appeal.

(See Table 1 above). Since the 4,465 Class C shares are shown on the books of Cyrano and the indicated cost is $44,650, one must assume that this cost was borne by Cyrano, even if Mr. Audy was unable to remember having invested this amount in Pub through Cyrano. Further, even if he did not remember that Cyrano had transferred $43,000 worth of shares (Class C preferred) [TRANSLATION] "*to Amadeus in consideration of the remainder of the sale price owed by Cyrano to Louis Massicotte. Dated July 1, 1993"*, he recognized his initials beside this notation on the Pub memo (Exhibit A-1, Tab 26) and stated: [TRANSLATION] "*Well, I don't remember, but I initialled it, and so it must be*" (Vol. IV of the transcript, page 160). It is therefore unlikely that these shares would have been transferred for just one dollar. We need to remember, also, that the issued and paid-up capital of Pub included preferred shares worth $185,410 (Exhibit A-1, Tab 4, Note 6 of the Pub financial statements). Therefore, it appears to me more likely that the account given by Mr. Massicotte and confirmed by Mr. Audy is correct, that is, that Cyrano had agreed to transfer its 4,465 Class C shares in Pub to Mr. Massicotte in repayment of the outstanding balance of the sale price of the Pub shares. Since these shares had a paid-up capital and value of $44,650, Cyrano would therefore have paid in all $144,650 for the 350 Pub Class A shares, which appears to me a more reasonable price than the $350,000 figure that had been agreed upon in the 1990 contract of sale.

[87] The most plausible explanation in support of the transfer of the 4,465 preferred Class C shares by Cyrano to Amadéus for one dollar in May 1994 is that this transfer only gave effect to the transfer described in the Pub memo. I therefore conclude that the $44,650 credited to the shareholder advances account of Amadéus was in consideration of the transfer by Mr. Massicotte of the 4,465 Class C shares to Amadéus, contrary to what had been assumed by the Minister. Since the Reply to the Notice of Appeal is silent with respect to the fair market value of these shares as of the transfer date, and since I am unable to determine on the basis of the evidence adduced, a fair market value that is different from the amount credited to the shareholder advances account at Amadéus, I can only conclude that subsection 15(1) of the Act applies here.

[88] However, the transfer date is, from all appearances, after June 30, 1993, contrary to what is indicated in the financial statements of Amadéus. First, the Pub memo itself shows July 1, 1993 as the date of the transfer to Amadéus. The same transfer date appears in another memo from Mr. Bureau to Mr. Trudel regarding the updating of Amadeus's [TRANSLATION] "company book" (**Amadéus memo**) (Exhibit A-1, Tab 25). This memo — like the Pub memo — is undated, but the

invoice is similar to the one in the Pub memo. Also, much of the wording in the two documents is similar.

[89] Further, these two memos were, from all appearances, issued after July 1,1993, because they describe transactions or events that occurred on December 16, 1993, in the case of the Amadéus memo, and on September 28 (1993), in the case of the Pub memo, which was the date of the annual shareholders' meeting.

[90] Therefore, it is likely that the Pub memo was drafted and initialled after September 28 (1993), and that the one for Amadéus was drafted after December 16, 1993. These memos—even the one concerning Pub, which has been initialled— do not establish that there had been an agreement among the parties on July 1, 1993, or at any other date. Furthermore, it is even possible that these memos were written in 1994, after the separation agreement of June 10, 1994, in order to update the Pub minute book before making the distribution provided for by this agreement, and that the transfer of the 4,465 shares did not take place until 1994. In addition, the updating covered the period from 1991 to 1993. One fact is clear—the 4,465 Class C shares appear on the Cyrano balance sheet as at July 31, 1993.

[91] If, as I believe, the transfer of the 4,465 Class C shares did not take place until after July 31, 1993, probably in 1994, the credit recorded in the Amadeus shareholder advances account on June 30, 1993, does not reflect reality. Therefore, instead of a credit balance of $7,321, the advances account had a negative balance of $37,329 ($7,321 – $44,650), which, from all appearances, could have given rise to the application of subsection 15(2) of the Act. It is possible to avoid including in the income of an individual, such as Mr. Massicotte, a loan from a corporation, such as Amadéus, with which the individual has a non-arm's-length relationship provided the individual repays the corporation in the taxation year following the one in which the loan was granted. It is therefore possible that a portion of the debit balance of $41,452 at June 30, 1992, would have had to have been included in Mr. Massicotte's income for the year(s) in which the amount was paid to him. The only thing that we can be sure of is that we are not dealing with the year 1993, but rather with a year prior to 1993, and that year is not covered by the appeals before the Court. Therefore, subsection 15(2) of the Act cannot be used to support the addition of the sum of $44,650 to Mr. Massicotte's income for 1993. The assessment for 1993 is therefore incorrect.

(C) Claim by Pub for severance payment for the fiscal year ending December 31, 1994

[92] In my view, in order to determine whether Pub is permitted to claim the $70,000 expense in computing its income for its fiscal year ended December 31, 1994, it is necessary to determine the true nature of the amount. Mr. Massicotte argued that it was paid out as a severance payment to Cyrano because of the departure of Mr. Audy, who had been the General Manager of Pub. This amount was part of the arrangements regarding the severance of the interests held by Messrs. Audy and Massicotte in Pub and Im-Média.

[93] Mr. Audy denies that he and Cyrano received any such allowance. In support of his argument, he pointed to the fact that the Im-Média shares were not worth $70,000. If he had agreed to pay $70,000, it was out of a sense of courtesy to Mr. Massicotte and because Pub had previously given him the same amount. Also, the [TRANSLATION] "commitment discharge agreement", dated June 10, 1994, which is the same date as the separation agreement, establishes a direct link between the payment from Pub to Cyrano and the payment from Audy to Massicotte (Exhibit A-1, Tab 31). The $70,000 payment by Audy to Massicotte for the alleged purchase price of the Im-Média shares was conditional upon payment of that amount by Pub to Cyrano. In fact, this amount was never even given to Cyrano—it simply passed through the trust account of its accountants.

[94] In order to determine who is telling the truth and thereby determine the true nature of the $70,000 paid by Pub to Cyrano, let us examine the versions of the facts put forward by each of the former partners.

- Value of Pub shares and value of Im-Média shares

[95] Mr. Massicotte claims that he had asked Cyrano for $100,000 for his shares in Im-Média, but in the end he agreed to accept $70,000 because this was the amount of the unused balance of his capital-gains exemption. Again according to Mr. Massicotte, his (common) shares in Im-Média were worth $70,000 at the time he sold them to Mr. Audy in June 1994, which means that all the Im-Média shares were worth $140,000, whereas the same shares had been worth one dollar when Mr. Massicotte acquired them from Amadéus on October 1, 1993, just eight months previously. He justified this sudden increase in the value of these shares by his personal involvement in the operations of Im-Média, in particular by helping to obtain a certain advertising contract with a magazine. According to Mr. Massicotte, that contract, which was to enable Im-Média to realize substantial

profits, was allegedly signed in or around December 1993 or January 1994. The contract was supposed to start on August 31, likely 1994, and result in a tripling of Im-Média sales for 1995, and increase the value of all the common shares to $140,000!

[96] No evidence was adduced to corroborate Mr. Massicotte's testimony regarding this wonderful contract. Nor were there any commercial valuation experts come forth to testify in support of this type of valuation. Even after Im-Média merged with Cyrano on June 1, 1994, Im-Média remained in a deficit position at May 31, 1995, with a deficit of $19,301. It is true that revenues at Im-Média rose substantially by May 31, 1995, compared with May 31, 1994. They multiplied 2.93 times but a large increase in revenues is no guarantee of profitability. By way of example, we could cite the fact that Pub revenues for 1993 were nearly triple what they had been in 1989, but Pub earned profits of $15,501 in 1989 and suffered a loss of $126,063 in 1993. We should add that the profitability of advertising firms seems subject to numerous vagaries, because, as can be seen from an examination of Pub's financial statements, its (after-tax) profits, which were $106,327 in 1990, actually rose to $149,082 in 1991, but fell to $3,300 in 1992, and turned to losses of $111,342 in 1993 and $54,809 in 1994.

[97] Mr. Audy argued that the Im-Média shares were not worth more than one dollar. He felt that the Pub shares and the Im-Média shares were worth the same amount and Amadéus paid Cyrano just one dollar for the Pub shares. At first glance, this point of view seems justified because both companies were losing money at the time. In the case of Pub, the deficit at May 31, 1994, was $47,151 (Table 1) and Im-Média's deficit at May 31, 1994 (i.e. before the merger) was $65,045 (Table 2).[56] If we deduct from Pub's liabilities the $100,000 which Cyrano was supposed to assume under the terms of the separation agreement, Pub's value would go from a negative value of $47,151 to a positive value of $52,849. However, Cyrano, which had no apparent relationship to Mr. Massicotte or Amadéus, agreed to sell its Pub shares to Amadéus for one dollar. With respect to Im-Média, there is no evidence that Mr. Massicotte or anyone else had assumed a portion of its indebtedness. Its deficit therefore remained at $65,045. From this admittedly incomplete analysis, the Pub shares appear to be worth more than the Im-Média shares. Amadéus acquired the Pub shares for one dollar. In my view, Mr. Audy's valuation of the Im-Média shares appears much more probative, and this is the one that I will use.

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[56] This deficit stood at $75,446 at June 30, 1993, for Im-Média, while Pub had an undistributed surplus of $7,658 for the same period.

- Severance allowance

[98] Mr. Audy stated that he had never asked for a separation allowance when he severed his ties with Mr. Massicotte or when he left Pub. During the audit, one of Pub's representatives had initially told the auditor that the amount was for fees (for services) owed to Cyrano. It was not until later that the $70,000 was described as a severance allowance. There is no evidence that Mr. Audy suffered any prejudice or that he was entitled to a severance allowance. It must also be added that there was no written agreement and therefore nothing to document the reasons for the payment of this type of amount to Cyrano by Pub. Strangely, there is no mention in the separation agreement of the payment of this $70,000 by Pub as a severance allowance! Nor is there any release showing that Mr. Audy or Cyrano waived any lawsuits for damages resulting from Mr. Audy's cessation of employment as General Manager of Pub after the partners separated. It is most unusual to pay a severance allowance without first obtaining a release.

[99] I believe that it was out of courtesy, as he stated, that Mr. Audy agreed to the arrangement put into place by Mr. Massicotte, an arrangement whereby Pub paid Cyrano the $70,000 to finance the payment of this alleged price of $70,000 for the Im-Média shares. This arrangement allowed Mr. Massicotte to withdraw $70,000 from Pub on a tax-free basis, using his capital-gains exemption. Furthermore, Mr. Massicotte admitted that this figure matched his remaining capital-gains exemption. Obviously, if a severance allowance had actually been paid to him, Mr. Audy or Cyrano would have had to include it in their income, which, from all appearances, neither Mr. Audy nor Cyrano were prepared to accept. Mr. Massicotte was therefore able in this manner to appropriate $70,000 from Pub. In my view, the Minister could very well have considered the $70,000 as a benefit received from Pub in 1994, which Mr. Massicotte reported as the proceeds of disposition of his shares in Im-Média. This is what the Minister's auditor had intended to do for the 1993 taxation year, the year in which Mr. Massicotte came into possession of these same Im-Média shares for one dollar. The auditor had stated that she proposed adding $70,000 to Mr. Massicotte's income under subsection 15(1) of the Act because she felt the shares were worth $70,000 in October 1993 and Amadéus had conferred on him a taxable benefit. Although the analysis and the relevant taxation year are different, the result would have been the same.

[100] In conclusion, Pub has not succeeded in proving, on a balance of probabilities, that this sum represented an expense that was incurred for the

purpose of earning income from a business. On the contrary, I believe that Mr. Massicotte appropriated to himself the sum of $70,000 by simulating a sale of Im-Média shares for $70,000. The payment by Pub of this amount was part of the scheme.

[101] In my view, it is not necessary to use subsection 246(1) of the Act to include the $239,000 benefit in Mr. Massicotte's income because paragraph 6(1)(*a*) of the Act requires that the amount of the benefit be included. If I was wrong to conclude thusly, I would conclude that this benefit should be included under subsection 246(1) of the Act. I would then conclude without any hesitation whatsoever that the $239,000 benefit was conferred indirectly on Mr. Massicotte by Amadeus, and that if Amadeus had done it directly, the value of the benefit would have been included in Mr. Massicotte's income, under subsection 15(1) of the Act. Mr. Massicotte, as a shareholder, controlled Amadéus, and Amadéus controlled Pub. Also, during the period that Pub was held jointly by Amadéus and Cyrano, any decisions regarding the allocation of Pub income among its shareholders, whether this be in the form of salaries, bonuses, dividends, or some other form, had to be taken by the shareholders under the terms of Article 49 of the shareholder agreement. It is true that at the time the debt was transferred to Pub by Mr. Massicotte, Amadéus was the sole shareholder in Pub and that the shareholder agreement was null and void. On the other hand, Article 49 provides a very good illustration of the role played by the shareholders in the management of Pub, and it is entirely reasonable to believe that this method of operation continued, even after the two shareholders parted ways. Further, the December 31, 1995, financial statements show that Pub owed Mr. Massicotte $125,358 (Exhibit A-1, Tab 8, Note 5 of the financial statements) and these financial statements were sent to the shareholder of Pub, namely Amadéus, which was required to approve them.

[102] For all the above reasons, the appeals by Pub relating to the taxation years ended December 31, 1994 and December 31, 1995, are dismissed. Mr. Massicotte's appeal of the assessment for the 1993 taxation year and his appeal of the assessment for the 1995 taxation year, as well as the appeal by Pub of the assessment for the taxation year ending on May 31, 1994 are allowed. These assessments are referred back to the Minister for review and reassessment based on the assumption, in Mr. Massicotte's case, that the benefit of $44,650 is to be excluded from his income for 1993, that for 1995 the employment benefit is to be reduced to $239,000 and that $750 is to be included as a taxable capital gain for that year, and, in the case of Pub, that it is entitled, in computing its business income for the taxation year ending May 31, 1994, to a deduction of $85,657.

103] At the request of counsel for Mr. Massicotte, costs can be covered under a separate order.

Signed at Ottawa, Canada, this 14th day of November 2006.

"Pierre Archambault"

Archambault J.

Translation certified true
on this 20th day of December 2006.
Monica F. Chamberlain, Translator

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