Docket: 2004-2749(IT)G

BETWEEN:

HANMAR MOTOR CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on October 5, 2006, at London, Ontario,

By: The Honourable Justice E.A. Bowie

Appearances:

Counsel for the Appellant:	Keith M. Trussler
Counsel for the Respondent:	Josée Tremblay

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 1999 taxation year is dismissed, with costs.

Signed at Ottawa, Canada, this 16th day of October, 2007.

"E.A. Bowie"

Bowie J.

Citation: 2007TCC618
Date: 20071016
Docket: 2004-2749(IT)G

BETWEEN:

HANMAR MOTOR CORPORATION,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Bowie J.

[1] This appeal is from a reassessment for income tax for the taxation year 1999. In filing its 1999 return, the appellant claimed a loss carryforward from 1998. The Minister of National Revenue reduced the amount of that carryforward by disallowing the deduction in the 1998 taxation year of a payment in the amount of $252,297 made by the appellant in settlement of a dispute under the *Employment Standards Act*[1] of Ontario (the *ESA*). The appellant takes the position that it made the payment for the purpose of gaining or producing income, and that it was a payment on current account, and so is deductible in computing the appellant's income under the *Income Tax Act* (the *Act*) for the 1998 taxation year. The respondent's position is that the expenditure was capital in nature, or alternatively, if it was on current account, that it was not made for the purpose of gaining or producing income, and so it may not be deducted by reason of paragraph 18(1)(*b*), or alternatively, paragraph 18(1)(*a*), of the *Act*.

[2] The appellant is a manufacturer of motorized recreational vehicles of the kind known colloquially as motor homes, and it operates in Kitchener, Ontario. At the relevant time its shares were owned by Jeffrey Hanemaayer, and he and his father, Jacobus Hanemaayer, were the only directors. Jeffrey Hanemaayer and Jacobus Hanemaayer owned all the shares of Community Expansion Inc. (CEI), a real estate

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1 R.S.O. 1990 c. E.14.

holding company, and of 798894 Ontario Ltd. (798), which manufactured non-motorized recreational vehicles. The appellant owned all the shares of 1148346 Ontario Ltd. (114), an inactive holding company, and all the shares of 930943 Ontario Ltd. (930).

[3] 930 was also a manufacturer of non-motorized recreational vehicles, operating in Dunnville, Ontario. The appellant had a very significant investment in 930, by way of both equity and debt. It was managed, rather unsuccessfully, by a group of five directors who were not otherwise related to the Hanemaayers. CEI was, at the material time, the owner of premises in Dunnville that it leased to 930. 930 became insolvent and ceased operations in 1995, at which time CEI exercised its right of distraint as landlord in respect of the machinery and equipment of 930, much or all of which was subject to liens in favour of the appellant to secure indebtedness of some $900,000. The circumstances under which 930 ceased operations left its former employees with unsatisfied claims for unpaid wages, including vacation pay, severance pay and termination pay.

[4] The unpaid employees pursued the remedies available to them under the *ESA*, and on July 4, 1996 Jody Easson, an Employment Standards Officer, made two Orders under paragraph 65(1)(*c*) of the *ESA* requiring "the employer" to pay a total of $1,155,615.81 to the former employees of 930. Ms. Easson later amended this amount to $1,077,361.13 by a letter sent to the solicitor for the persons named as employers in the Orders.

[5] At that time, the relevant part of paragraph 65(1)(*c*) read as follows:

> 65(1) Where an employment standards officer finds that an employee is entitled to any wages from an employer, the officer may,
>
> …
>
> (*c*) issue an order in writing to the employer to pay forthwith to the Director in trust any wages to which an employee is entitled and such order shall provide in addition for payment by the employer to the Director of a penalty of 10 per cent of the wages or the sum of $100, whichever is the greater, …

Section 1 defined the term "wages" to include vacation pay and severance pay, and the term "employer" was given the following expanded definition:

> "employer" includes,

> (*a*) any owner, proprietor, manager, superintendent, overseer, receiver or trustee of any activity, business, work, trade occupation, profession, project or undertaking who has control or direction of, or is directly or indirectly responsible for, the employment of a person therein, and
>
> (*b*) any associated or related corporations, individuals, firms, syndicates or associations treated as one employer under section 12, where any one has control or direction of, or is directly or indirectly responsible for, the employment of a person therein,
>
> and includes a person who was an employer;

Section 12 read:

> 12(1) Where before or after this *Act* comes into force, associated or related activities, businesses, works, trades, occupations, professions, projects or undertakings are or were carried on by or through more than one corporation, individual, firm, syndicate or association, or any combination thereof, and a person is or was an employee of any of such corporations, individuals, firms, syndicates or associations, or any combination thereof, such corporations, individuals, firms, syndicates or associations, or any combination thereof, shall be treated as one employer for the purposes of this *Act*, if the intent or effect of the arrangement is to defeat, either directly or indirectly, the true intent and purpose of this *Act*.
>
> 12(2) The corporations, individuals, firms, syndicates or associations treated as one employer shall be jointly and severally liable for any contravention of this *Act* and the regulations.

The "employer" was specified in the Orders to be 930943 Ontario Limited, Hanmar Motor Corporation, Community Expansion Inc., 1148346 Ontario Limited, Mr. Jeffrey Hanemaayer and Mr. Jacobus Hanemaayer. The named employers applied under section 68 of the *ESA* for a review of the Orders. Before that review was heard, a settlement was reached among the parties whereby the amount to be paid was reduced from $1,077,361.13 to $252,297, and the named employers agreed not to pursue the review of the Orders. On November 20, 1998, the Ontario Labour Relations Board issued a consent Order to implement this settlement. Before the end of the 1998 taxation year, the appellant satisfied that Order by making the payment of $252,297 that is the subject of this appeal.

[6] The issue before me is whether the amount of that payment may be deducted by the appellant in computing its profit or loss for the 1998 taxation year under the

Act. Of course, any such consideration must take into account the prohibitions found in paragraphs 18(1)(*a*) and (*b*). The relevant provisions of the *Act* are:

> 9(1) 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.
>
> 9(2) Subject to section 31, a taxpayer's loss for a taxation year from a business or property is the amount of the taxpayer's loss, if any, for the taxation year from that source computed by applying the provisions of this Act respecting computation of income from that source with such modifications as the circumstances require.
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> 18(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of
>
> (*a*) 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;
>
> (*b*) an outlay, loss or replacement of capital, a payment on account of capital or an allowance in respect of depreciation, obsolescence or depletion except as expressly permitted by this Part;

[7] I propose to approach the issues before me in the way adopted by Bowman, A.C.J., as he then was, in *International Colin Energy Corporation v. The Queen*.[2] He said there:

> 43 The approach outlined by Abbott J. [in *British Columbia Electric Railway Company Limited v. M.N.R.*, 58 DTC 1022 at pp. 1027-8] is one that has traditionally been followed. One first asks the question "Was the payment made for the purpose of gaining or producing income from a business or property?" If the answer is no the question whether it is on capital account is irrelevant. If the answer is yes the application of paragraph 18(1)(*b*) must be considered.

[8] The position of the appellant, as it was pleaded in its Notice of Appeal and argued at trial, is that it incorporated 930 in order to manufacture a product line that would be complementary to the product it was manufacturing at its plant in Kitchener. Mr. Hanemaayer testified that synergies arising from the co-ownership and operation of the firms would work to the economic advantage of both, and I accept that as being so. The argument, then, is that the appellant’s obligation to make

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2 2002 DTC 2185.

the payment was a legal obligation arising out of and in the ordinary course of the ownership of the shares of 930, and so was an expense incurred in the course of the appellant's business. It is the latter leap of logic that I cannot adopt.

[9] The Supreme Court pointed out in *Symes v. Canada*[3] that although paragraph 18(1)(*a*) may be somewhat tautologous, given that the computation of income or loss under section 9 is required is to be carried out in accordance with well accepted principles of business practice, it nevertheless is to be applied in accordance with its ordinary meaning. This was reinforced some years later in *Canderel Ltd v. Canada*,[4] where Iacobucci J. said at paragraph 32:

> … the determination of profit under s. 9(1) is a question of law, not of fact. Its legal determinants are two in number: first, any express provision of the *Income Tax Act* which dictates some specific treatment to be given to particular types of expenditures or receipts, **including the general limitation expressed in s. 18(1)(*a*)**, and second, established rules of law resulting from judicial interpretation over the years of these various provisions. (emphasis added)

In the present context, then, the question becomes this: did the appellant incur the obligation to make the payment for the purpose of gaining or producing income, either from its manufacturing business, or from the ownership of the shares of 930?

[10] The expense in question here was incurred not only by the appellant, but also by its two shareholders, its two subsidiaries 930 and 114, and the related company CEI. There is no doubt that if the wages replaced by the payment had been paid by 930, then they would have been an expense of that company that it could properly have taken into account in computing its income. Similarly, if 930 had been in a position to satisfy the Order of the Employment Standards Officer, as later negotiated down to $252,297, and had it done so, that payment would have satisfied the joint requirements of section 9 and paragraph 18(1)(*a)*, In either of these events the amount would properly have been considered to be compensation paid by 930 for the labour of the workers employed by it in the production process, and so would have been deductible in the computation of profit.

[11] The same cannot be said of any other of the individuals or corporations that were made liable for the payment by their inclusion in the Order as employers. Their

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3 [1993] 4 S.C.R. 695 at para. 44.

4 [1998] 1 S.C.R. 147.

designation as employers is simply a statutory fiction created for the financial protection of 930's employees, and the fact that they are made liable under provincial law for certain debts of 930 does not carry with it any characterization of the debt, or of the payment of it, for commercial purposes. Since the decision of the Supreme Court in *British Columbia Power Corporation v. M.N.R.*[5] it has been clear that for an expenditure to be deductible, it need not be shown to have a nexus with any specific revenue. It is sufficient that the outlay in question is shown to have been made in the course of and for the purpose of carrying out the business of the firm. Expenses for the evaluation of takeover bids, and communications to shareholders in connection with them, have been held to meet the test of paragraph 18(1)(*a*),[6] because that is "… properly a part of the carrying on of the company's business of earning income …".[7] The test was put this way by Wilson J. in *Mattabi Mines Ltd. v. Ontario*:[8]

> The only thing that matters is that the expenditures were a legitimate expense made in the ordinary course of business with the intention that the company could generate a taxable income some time in the future.

In my view the payment that the appellant seeks to deduct cannot meet that test. The only evidence as to the reason for the inclusion of the appellant in the Orders as an "employer" is this statement by the Employment Standards Officer in an accompanying narrative:[9]

> Order to Pay issued.
>
> All companies noted above were named on the Order to Pay subject to Section 1 and 12 of the Employment Standards Act.
>
> Jeffrey Hanemaayer and Jacobus Hanemaayer are named personally on the Order to pay as they have common control and ownership of all companies named above

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5 67 DTC 5228.

6 *Boulangerie St-Augustine Inc. v. The Queen*, 95 DTC 164 (TCC) ; *BJ Services Company Canada v. The Queen*, 2004 DTC 2032 (TCC).

7 *British Columbia Power Corporation v. M.N.R., supra*, note 5 @ p. 5264.

8 [1988] 2 S.C.R. 175 @ p. 189.

9 Narrative, Exhibit A-1, Tab 14, p. 3.

> Section 1 defines employer and section 12 relates to related activities, etc. being treated as one employer.

Although somewhat cryptic, this "narrative" does establish that the inclusion of the appellant in the Orders to Pay derives not from any activity in the course of operating its own business, but simply as an incident of its ownership of the shares of 930, and as a consequence of it being one of the group of corporate entities owned and controlled by Jeffrey Hanemaayer and Jacobus Hanemaayer. I cannot discern even a remote connection between this payment, made under compulsion of statute to compensate the workers of the related company 930 for labour they performed for it, and the revenue earning process of the appellant. Paying the workers of 930 is no part of the business of the appellant.

[12] I am not overlooking the synergies that Mr. Hanemaayer referred to in his evidence, but there can be no synergies after 930 has become insolvent and ceased operations, as happened before this liability was incurred by the coming into existence of the Order of the Employment Standards Officer. Even if any such synergies could be said to have survived the insolvency of 930, the payment could not qualify as an amount laid out for the purpose of gaining or producing income. At best, it is a payment that the appellant was required by law to make as an incident of its ownership of the shares of 930, together with 930's inability to meet its wage obligations. An Order under section 12 of the *ESA* can only be made if the Officer has concluded that either the intent or the effect of the arrangement among the persons named as employer was to defeat the intent of that statute. In the present context, the intent of the *ESA* is to protect the employees of 930 in respect of their right to wages as defined in section 1. It is difficult to see how, in this context, a payment by the appellant in satisfaction of the Order, as amended by the agreement, could, or could be intended to, gain or produce income for the appellant from its business. It is an outlay that was quite unconnected with the production of revenue for the appellant, and therefore could only have the result of reducing its profit for the relevant period by the amount of the payment.

[13] Nor, by 1996, could the outlay have contributed to the production of any income for the appellant from the shares of 930. By that time 930 was insolvent, it had ceased operations, and its fixed assets had been subject to distraint by CEI. The shares were, undoubtedly, not capable of producing any income. The appellant could not change that state of affairs by making the payment that it was obliged by law to make.

[14] The appellant put a great deal of reliance on two decisions of this Court, *International Colin Energy Corporation v. The Queen*,[10] and *BJ Services Company Canada v. The Queen.*[11] Both of those cases dealt with deductibility of certain payments made in the course of what ultimately turned out to be the amalgamation of the taxpayer with another corporate entity. These circumstances, however, bear no similarity to the present case. It has long been established that these types of expenditures are not barred by paragraph 18(1)(*a*): see *British Columbia Power Corporation v. M.N.R.*[12]

[15] Having found the amount not to be one paid for the purpose of gaining or producing income, it is not necessary for me to deal with the Crown's argument that the payment was one made on account of capital. If I had to decide that point, however, I would be inclined to accede to the argument of counsel for the respondent that the payment, being an involuntary one imposed by law on the appellant because of its ownership of the shares of 930, is properly viewed as an incident of ownership of the shares, and so capital in nature.

[16] There are two other matters on which I should comment, although they were not raised by the parties in argument. The first is a matter of timing. The appellant claims the deduction in the taxation year 1998, which is the year in which it made the payment. It seems clear to me, however, that the liability first arose when Ms. Easson made her Orders in July 1996. When the Orders were signed, the appellant, along with the other named employers, became liable "… to pay forthwith to the Director in trust …" $1,155,615.81, that being the amount ascertained by Ms. Easson in her Orders This is not a case like *M.N.R. v. Benaby Realties Ltd.*,[13] where the amount of the proceeds of disposition upon an expropriation was not required to be taken into income until the taxpayer and the expropriating authority had arrived at an agreement as to the compensation to be paid, as there was no ascertained amount to which the taxpayer was entitled before that event. In the present case, the debt was created by the Orders and the terms of the *ESA*. That the amount was later reduced in settlement of the review application does not affect the fact that there was liability for

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10 *Supra*, note 2.

11 2004 DTC 2032; 2003 TCC 900.

12 *Supra*, note 5.

13 67 DTC 5275.

the full amount during the interim period. I invited submissions from counsel on this issue during the hearing of the appeal, but neither of them chose to address the point.

[17] The other issue that was not addressed by counsel at the hearing is the effect of subsection 12(2) of the *ESA*, which provides for joint and several liability of the various individuals and entities named as employer in the Orders. Although the payment was made by the appellant to satisfy the debt, it would have been entitled to contribution from the other named employers.[14] In view of the conclusion that I have reached as to the first issue, however, it is not necessary to consider either of these issues further.

[18] The appeal will be dismissed, with costs.

Signed at Ottawa, Canada, this 16th day of October, 2007.

"E.A. Bowie"

Bowie J.

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[14] *Husky Oil Operations Ld. V. M.N.R.*, [1995] 3 S.C.R. 453; *Crawford and Falconbridge: Banking and Bills of Exchange:* 8th ed. by Bradley Crawford. Toronto: Canada Law Book, 1986, vol. 2, at pages 1839-40.

CITATION:	2007TCC618
COURT FILE NO.:	2004-2749(IT)G
STYLE OF CAUSE:	HANMAR MOTOR CORPORATION and HER MAJESTY THE QUEEN
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DATE OF JUDGMENT:	October 16, 2007

APPEARANCES:

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