Docket: 2003-1617(EI)

BETWEEN:

C&B WOODCRAFT LTD.,

Appellant,

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

Appeal heard on common evidence with the appeal of *Dario Virga* (2003-1615(EI)) on March 22, 2004 at Edmonton, Alberta

By: The Honourable Justice J.M. Woods

Appearances:

Counsel for the Appellant:	Deryk W. Coward
Counsel for the Respondent:	Dawn M. Taylor

JUDGMENT

The appeal of the decision of the Minister of National Revenue made under the Employment Insurance Act is allowed and the decision that Dario Virga was engaged in insurable employment by C&B Woodcraft Ltd. is vacated.

Signed at Ottawa, Canada, on this 29th day of June, 2004.

"J.M. Woods"

J.M. Woods J.

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DARIO VIRGA,

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Citation: 2004TCC477
Date:20040629
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Appellant,

and

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Respondent;

AND BETWEEN:

Docket: 2003-1615(EI)

DARIO VIRGA

and

THE MINISTER OF NATIONAL REVENUE,

Respondent.

REASONS FOR JUDGMENT

Woods J.

[1] These are appeals by Dario Virga and C&B Woodcraft Ltd. ("C&B") from a ruling of the Minister of National Revenue that Mr. Virga was engaged in insurable employment for purposes of the *Employment Insurance Act* during the period January 1, 2001 to June 3, 2002. The appeals were heard together on common evidence.

[2] Mr. Virga's parents, Carlo and Yolanda Virga, own all the shares of C&B, a corporation that operates a cabinet making business. Dario Virga is 28 years of age and has worked with his father in C&B since he was a young age. During the relevant period he was employed full time as a cabinet maker.

[3] For purposes of determining whether a person is engaged in insurable employment under the *Employment Insurance Act*, the employment of a person who is related to the employer, as Dario Virga was, is excluded unless the Minister is satisfied that the terms of employment are substantially similar to arm's length terms.

[4] This appeal arose as a result of an application for a refund of employment insurance premiums by Mr. Virga and C&B. The Minister concluded that the terms and conditions of the employment were substantially arm's length and ruled that the employment was insurable.

[5] This case was the first of four similar appeals that I heard in Edmonton, Alberta over a one week period. The individual appellants in all four cases were employed by corporations owned by their parents and all appeals arose as a result of refund applications. Mr. Deryk Coward of the law firm D'Arcy & Deacon was counsel for all the appellants and he informed me that he had hundreds of similar cases pending.

Statutory provisions

[6] The relevant statutory provisions are contained in paragraphs 5(2)(*i*) and 5(3)(*b*) of the *Employment Insurance Act* which read:

> (2) Insurable employment does not include
>
> …
>
> *i*) employment if the employer and employee are not dealing with each other at arm's length.
>
> (3) For the purposes of paragraph (2)(*i*),
>
> …
>
> (*b*) if the employer is, within the meaning of that Act, related to the employee, they are deemed to deal with each other at arm's length if the Minister of National Revenue is satisfied that, having regard to all the circumstances of the employment, including the remuneration paid, the terms and conditions, the duration and the nature and importance of the work performed, it is reasonable to conclude that they would have entered into a substantially similar contract of employment if they had been dealing with each other at arm's length.
>
> (emphasis added)

Scope of Paragraph 5(3)(*b*)

[7] The statutory scheme for determining whether a person related to the employer is engaged in insurable employment is not easy to decipher. One question that has arisen is whether the Minister's decision making power under these sections is final and what role the Tax Court has in reviewing these decisions.[1] Another question that has received less attention is how the legislation applies to a person who does not wish to be within the employment insurance scheme. I would make a few comments about this question before considering the facts of this particular case.

[8] If paragraphs 5(2)(i) and (3)(b) are read literally, a person who is related to the employer is deemed not to be insurable, the employee and employer are not required to pay premiums and the employee is not entitled to benefits - unless the Minister is satisfied that the employment terms are arm's length. Typically the Minister makes this determination when a person makes an application for employment insurance benefits. However, in this case, the Minister made the determination in the context of the requirement to pay premiums. Does paragraph 5(3)(b) contemplate that the Minister would make this kind of determination?

[9] To date this court has accepted, albeit reluctantly, that the Minister has the power to make a determination under paragraph 5(3)(b) to require premiums. The statute been considered to be broad enough as a matter of strict construction to give the Minister this power: see *Hoobanoff Logging Ltd.* v. *M.N.R.*, [1999] T.C.J. 856 (T.C.C.). The following is from Deputy Judge Porter's decision:

> I am of the view that the law enables him to do that in the appropriate circumstances, but that such is hardly consistent with the intent of the amendments made to the Unemployment Insurance Act in 1990 when this discretion was first introduced. …
>
> Nonetheless, as a matter of strict interpretation of the law, I am satisfied that the legal capacity for the Minister to do this exists.
>
> (paragraphs 11 and 12)

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[1] Some of the more recent decisions of the Federal Court of Appeal that discuss this are *Legare v. M.N.R.*, [1999] F.C.J. No. 878 (F.C.A.), *Valente v. M.N.R.*, [2003] F.C.J. No. 418 (F.C.A.), *Perusse v. M.N.R.*, [2003] F.C.J. No. 310 (F.C.A.) and *Quigley v. M.N.R.*, [2003] F.C.J. No. 1789 (F.C.A.).

[10] The legislative history suggests that paragraph 5(3)(b) was enacted as a relieving measure so that persons would not be denied employment insurance benefits unless the denial could be justified on a basis other than the relationship between the parties. Prior to the enactment of paragraph 5(3)(b) in 1990, a person who was employed by a spouse was simply excluded from the employment insurance scheme. In the case of *Canada v. Druken*, [1989] 2 F.C. 24 (F.C.A.), this exclusion was held to be discriminatory and contrary to the Human Rights Act. As a result, the provision was struck down and held to be unenforceable. The *Druken* decision led to an amendment to the legislation shortly thereafter. The new provision, now in paragraph 5(3)(b), ensures that a person will not be denied employment insurance benefits if the employment terms are essentially arm's length terms.[2]

[11] When one looks at the legislative history and the statutory provisions together, I would have thought that the scheme was that persons related to their employer would not be eligible for employment insurance unless they could satisfy the Minister that they should qualify based on the arm's length test that is provided in paragraph 5(3)(b). If this is the statutory scheme, then under the so-called modern approach to statutory construction, paragraphs 5(2)(i) and 5(3)(b) should not be interpreted in a manner that Parliament did not intend. As a result I have some doubt that paragraph 5(3)(b) gives the Minister the power to mandate that someone who is related to the employer should pay employment insurance premiums.

[12] Not only is this Ministerial power not clear on the words of the statute, but the fact that the power is partly discretionary makes it quite unfair in a self-assessing system. Persons must decide whether to pay premiums and risk that the Minister will refuse benefits. On the other hand, if they do not pay premiums, the Minister can require premiums on a retroactive basis.

[13] For these reasons, it is not clear to me that Parliament intended the Minister to have the type of power that was exercised in this case. It is not necessary that I make a finding on this, however, because of the conclusion that I have reached on the particular facts of this case.

The Minister's determination

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[2] For a good description of the legislative history, see *Thivierge v. M.N.R.*, [1994] T.C.J. No. 876 (T.C.C.).

[14] The Minister concluded that Dario Virga was engaged in insurable employment because the terms and conditions of his employment were substantially similar to arm's length terms. The facts upon which the Minister relied are set out as assumptions of fact in the pleadings and are attached as an appendix to these reasons. The employment relationship that the Minister assumed in making his determination was typical of an arm's length relationship – an hourly wage was paid for a regular work week and the employer provided the tools needed for the job and reimbursement for fuel expended in the course of employment. A more fulsome picture of the employment, however, emerged at the hearing.

[15] Dario Virga was the only person to testify. He stated that he decided not to have his father testify because of his father's age and poor English. This was troublesome because the son's testimony was somewhat inconsistent with answers contained in an audit questionnaire signed by both he and his father. I have, therefore, approached Mr. Virga's testimony with some caution. Nevertheless it is not surprising to me that there would be some inconsistencies. One does not have a very clear picture of a relationship by looking at short answers in a questionnaire.

[16] Even approaching Mr. Virga's testimony with caution, I conclude that the Minister did not take into account several facts that should have had a bearing on his decision. Some of these are:

- The Minister assumed that Mr. Virga apprenticed with C&B. This is accurate but the Minister did not consider that Mr. Virga only recently undertook this training;

- The Minister assumed that C&B had arm's length employees and that they received annual bonuses, like Mr. Virga. However, the Minister did not appreciate that Mr. Virga's bonuses were much greater than those paid to the arm's length employees. Mr. Virga received a few thousand dollars whereby the arm's length employees received only about $100.
- The Minister assumed that Mr. Virga completed timesheets but he failed to recognize that Mr. Virga usually only recorded hours worked during the regular shop hours and that he was generally not paid for overtime.

- The Minister assumed that C&B reimbursed Mr. Virga for his fuel expenses but he did not appreciate that not all employment related expenses were reimbursed. There was no compensation for Mr. Virga's use of his own tools, cell phone and car expenses other than fuel.

- The Minister did not take into account that Mr. Virga did some entertaining of clients at dinner parties. I have given this factor very little weight because there was no evidence to show whether this entertaining was primarily business or personal.

[17] These factors together paint a rather different picture from what the Minister had assumed. For this reason, I have concluded that the Minister's decision is not supportable.

Are employment terms arm's length?

[18] The arm's length test in paragraph 5(3)(*b*) requires a comparison of the actual terms and conditions of employment to what they might be if Mr. Virga and C&B were dealing at arm's length. The employment terms of the arm's length employees are perhaps the most relevant evidence but this is of limited assistance here because there is no evidence that the arm's length employees were employed in a similar capacity to Mr. Virga. Mr. Virga was a responsible and trusted employee, capable of dealing with customers, providing estimates and potentially being the successor to his father.

[19] Another arm's length comparison that was made at the hearing was whether Mr. Virga would work under similar terms and conditions if he were working for The Home Depot. This comparison similarly is of little assistance because the working conditions at a large retail chain such as The Home Depot are bound to be much different than the conditions at a small family run business. The essential question is whether Mr. Virga would have similar employment terms if he and C&B were dealing at arm's length, not if Mr. Virga was employed by a hypothetical employer.

[20] There is therefore little evidence to assist with the arm's length comparison and the comparison must largely be determined based on common sense. The appellants argue that Mr. Virga was given more responsibility than an arm's length employee. I think that it is a reasonable assumption that in a small business a father would have more trust in a son and give him more responsibility in dealing with the business affairs, especially financial matters such as estimating, than an arm's length employee. The appellants also argue that Mr. Virga would not have worked overtime without pay and used his own tools and cell phone without reimbursement. I also think that this is a fair argument. Mr. Virga was paid as if he worked regular hours whereas in fact there was considerable work to be done outside those hours for which Mr. Virga was not paid. If he had been dealing at arm's length with C&B, he would

not have been as willing to contribute to the business as he did without sufficient compensation.

[21] For these reasons, I conclude that Mr. Virga's terms and conditions of employment are not substantially similar to what they would be if he had been dealing at arm's length with his employer.

Conclusion

[22] The appeals are allowed and the decision of the Minister that Dario Virga was engaged in insurable employment is vacated.

Signed at Ottawa, Canada, this 29th day of June, 2004.

"J.M. Woods"

J.M. Woods J.

APPENDIX

Assumptions of Fact

In so deciding as he did, the Minister relied on the following assumptions of fact:

(a) the Appellant is in the cabinet making business;

(b) Carlo Virga (hereinafter "the Shareholder") was the major shareholder of the Appellant during the period under review (the Period);

(c) the Worker is the son of the Shareholder;

(d) the Worker and the Appellant are related to each other within the meaning of the Income Tax Act, R.S.C. 1985 (5th Supp.) c. 1, as amended (the "Act");

(e) the Worker [Dario Virga] was hired as a cabinet maker and did his apprenticeship with the Appellant;

(f) the Worker has worked for the Appellant for over 7 years;

(g) the Worker also installed cabinets and did not estimating;

(h) the Worker earned a set hourly wage;

(i) the Worker earned $10.00 per hour;

(j) the Worker was paid bi-weekly by cheque;

(k) the Worker also received a yearly bonus;

(l) arm's length employees of the Appellant were paid by the hour and received yearly bonuses;

(m) the Worker's wage was comparable with the Appellant's arm's length employees;

(n) the Appellant issued the following T4 amounts to the Worker:

2001	$22,535
2000	$21,804
1999	$21,794
1998	$16,903
1997	$16,086

(o) deduction for Canada Pension Plan contributions, employment insurance premiums and Income Tax were withheld from the Worker's wages;

(p) the Worker normally worked during the Appellant's business hours;

(q) the Worker normally worked 40 hours per week and some occasional overtime;

(r) the Worker kept track of his hours and completed timesheets;

(s) the Appellant had the right to control and supervise the Worker;

(t) the Shareholder made all of the major decisions;

(u) the Shareholder assigned work to the Worker;

(v) the Worker notified the Appellant of any leave required;

(w) the Shareholder normally did the estimating and any estimates completed by the Worker were reviewed by the Shareholder;

(x) the Appellant provided all of the tools and equipment required including saws, staple guns, woodworking equipment and the work location;

(y) the Worker did not have financial investment in the Appellant during the Period;

(z) the Appellant reimbursed the Worker for fuel expenses incurred while travelling to do estimates;

(aa) the Shareholder stated that an arm's length worker would not have any authority, would require instruction and would not do estimating;

(bb) the Minister considered all of the relevant facts that were made available to the Minister, including the remuneration paid, the terms and conditions, the duration and the nature and importance of the work performed, and

(cc) the Minister was satisfied that it was reasonable to conclude that the Worker and the Appellant would have entered into a substantially similar contract of employment if they had been dealing with each other at arm's length.

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APPEARANCES:

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