Docket: 2004-4185(IT)G

BETWEEN:

MARK A. SOCHATSKY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on 22 July 2009, at Edmonton, Alberta.

Before: The Honourable Justice Gaston Jorré

Appearances:

Counsel for the appellant:	Gordon D. Beck
Counsel for the respondent:	Gregory Perlinski Darcie Charlton

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JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2001 taxation year is dismissed, with costs to the respondent, in accordance with the attached reasons for judgment.

Signed at Ottawa, Ontario, this 23rd day of January 2011.

"Gaston Jorré"

Jorré J.

Citation: 2011 TCC 41
Date: 20110123
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BETWEEN:

MARK A. SOCHATSKY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Jorré J.

Introduction

[1] The appellant appeals from the reassessment of his 2001 taxation year. During that year he was employed by Northern Industrial Carriers Ltd. (Northern), a trucking business.

[2] Northern was a family company founded by his father. Both the appellant and his older brother, Simon, were shareholders and directors. Over the years the appellant carried out many functions in the company office and he was for many years the operations manager.

[3] Due to certain issues which began to arise in the late 1990s between the brothers, the appellant disposed of his interest in the company and left the company some time after the 2001 calendar year.

[4] In his 2001 income tax return the appellant reported, among other things, an amount of $3,000,000 million in employment income from Northern.

[5] The Minister of National Revenue (Minister) reassessed the appellant to add a further $700,000 in the employment income from Northern on the basis that the appellant received $3,700,000 in employment income. It is the $700,000 which is in dispute.

[6] In the notice of appeal the appellant took the position that ". . . the Minister erred in determining the Appellant realized employment income from [Northern] in an amount other than the amount set out in the amended T-4 slip the Appellant received from [Northern]", which amended T4 slip showed his employment income as $3,000,000.

[7] At trial it became apparent that the appellant's position was that Northern paid $350,000 to 966772 Alberta Ltd. (772) and $350,000 to 966779 Alberta Ltd. (779) for management services and that the appellant never earned or received the $700,000 in issue.

[8] In its amended reply the respondent takes the further position that the $700,000 in issue was properly taxable pursuant to subsection 56(2) of the *Income Tax Act* (*ITA*).

The facts

[9] The appellant testified about the origins of Northern, the reasons which led to his leaving Northern, his subsequent successful business activities and certain other unrelated businesses that he had.

[10] He testified that the handwritten T4 slip contained in his 2001 income tax return, Exhibit A-3, was the only T4 slip that he received from Northern. This T4 slip has "amended" written at the bottom right of the form and shows an employment income of $3,000,000 for the 2001 taxation year.[1]

[11] The appellant testified that his actual amount of employment income at Northern in 2001 was $3,000,000. While he was not sure exactly when he received this, he said that he received the amount less the tax withheld.

[12] The appellant identified a number of documents. I will refer to some of these documents below.

[1] The T4 in Exhibit A-6 is almost but not quite identical with the T4 contained in Exhibit A-3; in A-3 box 16 is empty whereas in A-6 there is an amount of $1,496.40. There is also the original T4 which will be discussed below.

[13] He testified that he set up 772 and 779.[2]

[14] The appellant also identified three cheques dated 18 June 2002.[3] All of these cheques were issued by Northern. The first and third cheques, each in the amount of $374,500 (i.e. $350,000 plus GST), were issued to 772 and 779. The second cheque was made out to the appellant and was for an amount of $1,555,812.16, an amount which is equal to $3,000,000 less the amounts withheld from the appellant's pay by Northern.

[15] The appellant also gave testimony and produced documents to show that 772 and 779 had each included $350,000 in computing their income and in computing their taxes for the fiscal years ending 30 April 2003 and 31 January 2003 respectively.

[16] The appellant stated that he became an employee of 772 and 779 after their incorporation. He did not work for 772 or 779 in 2001.

[17] It is also worth noting that there is a great deal with respect to which the appellant did not testify.

[18] While he identified invoices dated 14 May 2002 from 772 and 779 to Northern, invoices stating "management services rendered", he did not testify as to any agreement for such services between 772 and 779, on the one hand, and Northern, on the other hand, nor did he testify that any management services were performed by him or by anyone else acting on behalf of 772 or 779 for the benefit of Northern.

[19] The appellant did not testify regarding how his 2001 remuneration from Northern was set.

[20] From the corporate documents filed as Exhibits R-1 and R-2 it is clear that 772 and 779 were incorporated on 27 December 2001 and that Brent S. Vander Ploeg was the first director of the corporations and remained the only director until 1 May 2002.[4] On 1 May 2002 the appellant became the sole director of 772 and Andrea Sochatsky, the appellant's spouse,[5] became the sole director of 779.

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[2] Transcript, page 32, lines 19-21.
[3] Exhibit A-9.
[4] 772 and 779 appear to have been "off the shelf" companies.
[5] See page 1 of Exhibit A-3 and page 1 of the T1 return contained in A-3; both show Andrea Sochatsky as the appellant's spouse.

[21] On 1 May 2002 the shares of 772 and 779 were first issued.[6] 772 and 779 were controlled by the appellant and his spouse respectively.[7]

[22] Exhibit A-8 is entitled "Northern Industrial Carriers Ltd. – Due to Shareholders – 31-May-02". The document[8] is in the form of a schedule, *portions of which* are reproduced below:

	. . .	Mark	. . .	(Mark) 966779 Alberta
Opening balance – May 31, 2001		–		–
Payment of 2001 bonus				
Bonus (original T4)		3,700,000.00		
Revise bonus on Mark to 966779 Alberta Ltd.		(700,000.00)		700,000.00
Income Tax		(1,442,691.44)		
. . .		. . .		. . .

[23] Raymond Liu, an accountant, testified. Mr. Liu started to work for the appellant in early 2002 and stopped working for the appellant two or three years later. He prepared the appellant's 2001 income tax return filed with the amended T4 showing employment income of $3,000,000.

[24] At the time that the appellant came to see him, he advised the appellant about the best structure for running a business and suggested that the appellant form corporations, one for the appellant and one for his spouse. He explained to the appellant the small business deduction limit.

[25] Gerald Telidetzki testified. He was the controller of Northern from November 2000 until June 2002. He explained that Northern had a May 31 year-end. His recollection was that the bonus paid to the appellant was paid out in the way that is common in smaller companies that is to say: the bonus was declared, source deductions were remitted and the balance was then lent back to the company.[9]

[26] He also testified that the appellant's brother Simon would have decided the amount of the appellant's bonus and that this determination would have been made between May and November 2001.[10] The total amount of the bonuses was a function

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[6] See the respective register of shareholders in Exhibits R-1 and R-2.
[7] Transcript, page 54, lines 13-19; page 55, lines 5-10.
[8] Mr. Telidetzki thought that this document would have been prepared by PricewaterhouseCoopers. The evidence provides no explanation as to why it shows $700,000 all going to 779 instead of half the amount to 772 and half to 779.
[9] Transcript, page 62, line 6, to page 63, line 1.
[10] *Ibid.*, page 63, lines 13-20.

of the profitability of the company and was determined so as to have corporate profits taxed at the small business rate; Simon then determined the split of the bonus between the brothers.[11]

[27] Mr. Telidetzki prepared a T4 for the appellant which is identified as Exhibit R-4; it shows the appellant's bonus as $3,700,000 for the 2001 taxation year. He also prepared a T4 summary for the company which shows the company paying employment income totalling $5,832,505.82.[12] Both the T4 and the T4 summary were sent in February 2002[13] to the Canada Revenue Agency (CRA). The amounts in question were determined in 2001.

[28] Mr. Telidetzki also testified that the relevant source deductions for all the bonuses were paid at the end of November 2001.[14] This testimony was uncontradicted.

[29] On or around 23 April 2002 Mr. Telidetzki spoke with the appellant and was instructed by the appellant that $700,000 of the $3,700,000 was to be channelled to a company that the appellant had set up and was to be characterized as consulting fees.[15] Later in April an amended T4 was prepared; the amounts withheld on the T4 were not changed. He also stated that from the perspective of the company the change did not affect the deductibility of the amounts.

[30] Prior to that conversation he was not aware of the consulting fees or consulting companies.[16]

[31] Mr. Telidetzki considered that while Simon could determine the bonuses, the appellant did not have the authority to determine his bonus. However, he did consider that the appellant had the authority to tell him to channel the $700,000 to a numbered company.

[32] While it was suggested to Mr. Telidetzki that the $3,700,000 or the $3,000,000 plus $700,000 related to a later year, I am satisfied that Mr. Telidetzki's evidence was

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[11] *Ibid.*, page 69, line 20, to page 70, line 15.
[12] This document is identified as Exhibit R-5.
[13] Although in testimony Mr. Telidetzki said these two documents were sent in February 2001, that is clearly a slip; Exhibit R-5 is signed 28 February 2002 and the receipt stamp of the CRA on the document is dated 5 March 2002.
[14] Transcript, page 81, lines 6-8. It is worth remembering that subsection 78(4) of the *ITA* will deny deductibility of any salary wages or other remuneration where the amount is unpaid on the day that is 180 days after the end of the taxation year in which the expense was incurred.
[15] *Ibid.*, page 65, line 12, to page 66, line 24; page 72, lines 1-9.
[16] *Ibid.*, page 66, lines 15-19.

quite clear that the $3,700,000 bonus related to the company's year ending 31 May 2001.[17]

[33] Diane Major, an appeals officer with the CRA, testified.

[34] Ms. Major testified that the CRA received what have been entered as Exhibits R-4 and R-5 from Northern. R-4 is a T4 showing the appellant as having received $3,700,000. R-5 is a T4 summary signed 28 February 2002 and received on 5 March 2002. R-5 also shows the total employment income paid by the company to its employees as $5,832,505.82.

[35] She explained that the appellant's return was originally assessed as filed based on the amended T4 included with the return that showed $3,000,000 in employment income.

[36] Subsequently, as a result of the T4 matching program the appellant was reassessed.

[37] Only later did the company file an amended T4 summary, dated 15 March 2004, reflecting a $700,000 reduction in employment income paid. The 15 March 2004 cover letter from Northern with the amended T4 summary states that they were unable to find an amended T4 summary and that they completed an amended T4 summary showing the revised balance of wages recorded in their books.[18] The amended T4 summary shows the total employment income paid as $5,132,505.82, an amount of $700,000 less than the original.

[38] I also note that there is no dispute as to the inclusion of $3,000,000 of the bonus in the appellant's 2001 income.[19]

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[17] I am satisfied of this considering Mr. Telidetzki's testimony as a whole, including his re-examination and his testimony that the remittance of the source deductions on the bonuses was made in November 2001. In particular, I am satisfied that Exhibit A-19 only shows that corrections were made at the end of Northern's 31 May 2002 year; A-19 does not show that the bonuses were in relation to Northern's 31 May 2002 year. I also note that all the T4s – whether original or amended – and T4 summaries in evidence are shown as being for the 2001 taxation year. The appellant also pointed to the June 2002 cheques from Northern to the appellant, 772 and 779 in support of his contention that the bonuses were really bonuses relating to Northern's 2002 taxation year; however, the date of the cheques does not tell us what period the bonus relates to.

[18] Exhibit R-7.

[19] See the appellant's 2001 T1 tax return, Exhibit A-4, at the second page and at the unnumbered page headed "2001 Slip Summary".

Analysis

[39] Before turning to the appellant's argument I will state the following findings of fact:

(a) Given that 772 and 779 were incorporated on 27 December 2001, that the appellant and his spouse took control of and became the directors of a 772 and 779 on 1 May 2002 and that time flows only in one direction, it is impossible for 772 and 779 to have furnished any services to Northern prior to calendar year 2002.

(b) Further, given that Mr. Telidetzki's testimony that prior to his 23 April 2002 conversation with the appellant he had never heard of any consulting fees or consulting companies, that I was presented with no evidence that 772 or 779 provided any services to Northern, that the appellant simply identified the invoices of 14 May 2002 from 772 and 779, each for $350,000 plus GST, to Northern for "management services rendered" but did not testify as to the existence of any agreement for services and that, if 772 and 779 had provided services for the amounts of $350,000 billed, those services would have had to have been provided between 1 May and 14 May 2002, I find that no services were provided by 772 and 779 to Northern in relation to the 14 May 2002 invoices.

(c) Northern decided to pay the appellant a bonus of $3,700,000 for the work he did during Northern's taxation year ending 31 May 2001. The $3,700,000 bonus was declared no later than the end of November 2001. At the end of November, the withholdings on the $3,700,000 amount were withheld and remitted to the CRA and the balance of the bonus was credited to the shareholder account. [20]

(d) The appellant simply instructed Mr. Telidetzki to pay (i) $350,000 of his 2001 bonus to 772 and (ii) another $350,000 of his 2001 bonus to 779.

[20] This conclusion is based on the testimony of Mr. Telidetzki which I accept, see paragraphs 25 to 28, and is corroborated by Exhibit A-8, a statement of what is due to shareholders, where it is clear that the $3,700,000 bonus to the appellant relates to 2001 and was credited to his shareholder account prior to the end of Northern's fiscal year ending 31 May 2002.

[40] Counsel for the appellant submitted that:

> . . . at the end of the day the issue before this Court is simple and straightforward. Was the Minister correct to have added to the Appellant's income on reassessment an amount that had been paid to another person, and that person reported the amount as income and paid tax on that income. Put another way, do all of the circumstances of this appeal warrant the Minister receiving tax twice on the same income.[21]

[41] The appellant further submitted that what had happened was legitimate tax planning, that the appellant as a director had the legal capacity to bind Northern to contracts and that, after obtaining professional advice in early 2002, the appellant did have Northern enter into contracts with 772 and 779 which resulted in the payment of $350,000 to each of 772 and 779.

[42] I am not sure how these arguments assist the appellant.

[43] With respect to double taxation, there is no general rule against the taxation of the same amount in the hands of two different taxpayers. Perhaps the most common example of this is when profits of a corporation which are taxed in the hands of the corporation are taxed again in the hands of the shareholder when they are paid out as dividends.[22]

[44] In addition, in this case one wonders why 772 and 779 each included $350,000 in their income. While the assessments of 772 and 779 are not before me, it may well be that those two companies should not each have included $350,000 in their income.

[45] Individuals are free to plan their affairs. However, the so-called “tax planning” of April and May 2002 could not change the character of what already happened; given that, it does not matter whether the appellant could bind Northern or not.

[46] The appellant also argued that the bonuses were with respect to Northern’s 2002 taxation year. As I have already found, the bonuses were clearly in relation to Northern’s taxation year ending 31 May 2001.

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[21] Transcript, page 100, lines 7-15.
[22] Subject of course to the dividend tax credit.

[47] The appellant then reviewed the requirements of subsection 56(2) of the *ITA*:

> **(2) Indirect payments** — A payment or transfer of property made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person . . . shall be included in computing the taxpayer's income to the extent that it would be if the payment or transfer had been made to the taxpayer.

[48] There are four elements required by subsection 56(2):

(a) that a payment or transfer of property be made by one person to a person other than the taxpayer;
(b) that it be done at the direction of or with the concurrence of the taxpayer;
(c) that the payment or transfer be for the benefit of either the taxpayer or some other person the taxpayer wished to have the benefit conferred upon;
(d) that the payment or transfer would have been included in the taxpayer's income if he had received it.

[49] Before going any further, I should say that I did not understand the appellant to be disputing that these four conditions were met.

[50] Subject to one point not raised at trial, to which I shall return below, these four conditions are clearly met. There was (i) a payment of money to 772 and to 779, (ii) the payments were done at the direction of the appellant, (iii) the appellant clearly wished to confer a benefit on 772 and 779, companies he or his spouse controlled, and (iv) he would have been taxable on the $700,000 if he had received it.

[51] The appellant's primary argument, as I understand it, turned on the existence of a fifth requirement in subsection 56(2).

[52] While there has been some debate regarding the fifth element, it is not necessary for me to review that debate.

[53] This requirement was set out by Marceau J.A. in *Winter v. The Queen*:[23]

> . . . It seems to me, however, that when the doctrine of "constructive receipt" is not clearly involved, because the taxpayer had no entitlement to the payment being made or the property being transferred, it is fair to infer that subsection 56(2) may receive application only if the benefit conferred is not directly taxable in the hands of the transferee. . . .

[54] In this case the appellant did have a pre-existing entitlement to the $700,000 and chose to have half that amount paid to 772 and half that amount paid to 779. Accordingly, to the extent such a requirement exists, the fifth requirement could not have any application here.

[55] This would dispose of the case as argued by the appellant and result in the appeal being dismissed.

[56] However, I concluded that this left two major questions unanswered.[24] Accordingly, I asked the Registry to write to the parties and ask for further submissions on two points.

[57] First, assuming that subsection 56(2) were otherwise applicable, I asked for submissions on whether the $700,000 was assessed in the correct year?[25]

[58] Secondly, I asked for submissions on the original assessing position, simply that the appellant received the $700,000 amount in 2001 and was taxable thereon.

[59] With respect to the year, subsection 56(2) reads, in part:

> **(2) Indirect payments** — A payment . . . shall be included in computing the taxpayer's income to the extent that it would be if the payment or transfer had been made to the taxpayer.
>
> [Emphasis added.]

[60] Employment income is taxed on a cash basis. The payments to 772 and 779 were made in calendar year 2002 by means of the cheques dated 18 June 2002.

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[23] 90 DTC 6681 (FCA), at 6684.

[24] Given the nature of the questions, I do not see how I could reasonably ignore them.

[25] For reasons that will become apparent in the discussion below, I could not conceive of how subsection 56(2) could bring the amount into income in the year 2001 if the subsection applied in this case.

[61] Subsection 56(2) can only apply if the $700,000 in issue has not already been paid to the appellant.[26]

[62] Accordingly, assuming the $700,000 bonus had not been paid to the appellant prior to 18 June 2002, the appellant would, under subsection 56(2), be taxable "to the extent"[27] that he would have been if Northern had paid the $700,000 to him.

[63] Clearly the appellant would be taxable on the $700,000 since he would be taxable on the amount if he had received it directly — when?

[64] Given the employment income is on a cash basis I cannot see how subsection 56(2) could be read as including the amount in any year other than 2002 (I am still assuming that the appellant had not been paid prior to 18 June 2002).[28] If the appellant were paid the $700,000 prior to 18 June 2002, subsection 56(2) would have no application and the appellant would simply be taxed on the amount when it was paid to him by Northern.

[65] On the question of the year, the respondent took the position that because the correct year was not in dispute the evidentiary record before the Court was incomplete, and that if the Court were to pursue the issue the respondent should be entitled to further discovery and to lead further evidence.

[66] In support of this the respondent stated that if evidence were reopened, it expected that it would be able to demonstrate certain facts.[29]

[67] However, with some quite minor exceptions almost all the facts that the respondent alleges that it expects it would be able to demonstrate, if it had further

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[26] It is clear from the wording of the subsection that the payment or transfer must be from someone other than the appellant and that that other person must at the time of the transfer or payment be more than the mere holder of the appellant's property who is transferring it at the direction of the appellant. For example, if a bank holding Mr. A's funds transfers them to Mr. B at A's direction, subsection 56(2) can have no application since Mr. A would not be taxable if he received the funds. Similarly, if an employer has fulfilled his obligation to pay A, but A has allowed the employer to hold the funds by lending them back to the employer, then subsection 56(2) would have no application if A later directed that the funds be paid to B since A could receive the funds back from the employer without being taxed on them; on the other hand, if an employer owes A unpaid remuneration and A directs that the employer pay the unpaid remuneration to B, subsection 56(2) can have application since A would be taxable if he received the funds.

[27] The French language text reads: ". . . dans la mesure . . .".

[28] To do otherwise would mean that for some unexplained reason subsection 56(2) had the effect of speeding up the receipt of employment income to the year it accrued even if it would be taxed in a later year if it had simply been paid directly to the employee instead of the third party.

[29] See paragraphs 6 to 8 of the respondent's written submissions of 15 October 2010.

discovery and led further evidence, were in fact established in the evidence before me and set out above.[30]

[68] The facts in question that were established before me are relevant to the question whether the appellant was paid $700,000 in 2001 and should be taxed thereon apart from subsection 56(2). I am at a loss to understand how this evidence would assist the respondent in arguing that the appellant should be taxed under subsection 56(2); logically, if the appellant was paid in 2001 then the appellant was paid prior to the cheques of 18 June 2002 and subsection 56(2) can have no application.

[69] In the circumstances, as I do not see how allowing the respondent further discovery and the right to lead further evidence could make a difference, it is appropriate for me to make a decision on the question of the year without ordering any further discoveries or a reopening of the evidence. [31]

[70] As a result, I conclude that *if* the appellant had not been paid prior to 18 June 2002 and consequently subsection 56(2) were applicable, then the $700,000 amount would have to be included in the appellant's 2002 taxation year.

[71] I now turn to the question whether, apart from subsection 56(2), the $700,000 should in any event be included in the appellant's income. This turns on whether the bonus was paid to the appellant or, put in a slightly different way, received by the appellant, in 2001.

[72] I note that the Minister assumed that "[i]n 2001, the Appellant received not less than $3,700,000 by virtue of his employment with Northern . . .".[32]

[73] The appellant's submission was that the $700,000 was not received in 2001. The appellant argued that Northern only decided to pay the bonuses in the spring of 2002, that the $700,000 was not paid until the two cheques of 18 June 2002 were issued and that Exhibit A-8, which shows the amounts due to shareholders on 31 May 2002, corroborates this insofar as it showed a balance owing in the appellant's shareholder account of $1,535,674.97 on 31 May 2002.

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[30] With respect to paragraph 8g. of the respondent's written submissions of 15 October 2010: that the appellant did not raise the issue of the correct year. The issue was not raised in the notice of appeal nor was it raised at trial. I raised the issue after the hearing and asked the Registry to write to the parties and seek submissions on the issue.

[31] Generally, where a party has been taken by surprise with respect to an issue, as is the case here, either the party should be allowed to undertake further discovery and to lead new evidence if it wishes to do so, or the issue should not be pursued, depending on considerations of cost, convenience and fairness, including the possible use of an appropriate cost order.

[32] See amended reply, paragraph 6e).

[74] I would note that I do not agree that the decision to pay the bonus was made in the spring of 2002. Earlier in these reasons I have already made a finding that that decision was made in 2001.

[75] The fact that Northern paid $350,000 to 772 and $350,000 to 779 by cheques dated 18 June 2002 does not in itself answer the question when the appellant was paid since the payments are equally consistent with two possibilities: (i) Northern was fulfilling its liability to pay the appellant or (ii) Northern had already paid the appellant and was simply making a payment on his behalf.

[76] Nor does the fact that there was a balance owing in the appellant's shareholder account of $1,535,674.97 on 31 May 2002 in itself answer the question, although it is an *indicia* that the appellant had been paid on or before 31 May 2002. When one examines Exhibit A-8, it is clear that on or before 31 May 2002 part of the $3,700,000 has been withheld and remitted and the balance had become a liability from Northern to the appellant in his capacity as a shareholder. This is all consistent with the testimony of Mr. Telidetzki.

[77] The respondent argued that there was "constructive receipt" of the $700,000 by the appellant in 2001 insofar as the employer had done everything it had to do to pay the employee.

[78] At chapter 5.3 of *Principles of Canadian Income Tax Law*, seventh edition, 2010, Hogg, Magee and Li explain:

> **(c) — Constructive receipt**
>
> In order to constitute a "receipt" of money for tax law purposes, is it necessary for the taxpayer to "actually touch or feel it, or have it in his bank account?" The Court answered in *Jean-Paul Morin v. The Queen* (1975):
>
> > We regret to say that this proposition seems to us absolutely inadmissible, because the word "receive" obviously means to get or to derive benefit from something, to enjoy its advantages without necessarily having it in one's hands.
>
> When money is paid by an employer to a third party for the benefit of the taxpayer, the payment constituted constructive receipt in the hands of the taxpayer. For example, in *Blenkarn v. Minister of National Revenue* (1963) where the money to pay the taxpayer's salary in 1960 was available, but he voluntarily chose not to be paid until 1961, he was considered to have actually received the money. The payment was held to be "received" as soon as he had an unconditional right to be paid, which was in 1960.
>
> [Citations omitted.]

[79] Given the facts of this case, in particular:

(a) in 2001 there was a decision to pay the $3,700,000 bonus, taxes were withheld on the entire bonus and were remitted to the CRA and there was a loan back of the balance after withholdings to the company. The loan became a liability from the company to the appellant in his capacity as a shareholder;

(b) Northern was a family firm and the appellant was a shareholder, director and very senior manager. There was no suggestion in the evidence that the declaration of the bonus, the withholding, the remission of the withholdings and the loan back of the balance of his bonus after withholdings as a shareholder loan to Northern, were done against the appellant's wishes, without his knowledge or without his consent. Indeed, as a shareholder he benefited from Northern "bonusing down"[33] its corporate profits in order to reduce its taxes since the practical result is to reduce the total tax paid at the corporate and the personal level on profits ultimately paid out. For the "bonusing down" to achieve its objective, the bonuses have to be paid within 180 days of Northern's 31 May 2001 year-end given subsection 78(4). In such circumstances one would not normally expect a person to oppose the payment of the bonus;

(c) the first T4 prepared by Northern for the appellant and sent to the CRA was for $3,700,000; only later did Northern send a T4 for $3,000,000 to the CRA. I also note that there has been no suggestion that the first $3,000,000 of the $3,700,000 was not received by the appellant as income in 2001 and yet the first $3,000,000 of the $3,700,000 was treated in virtually the same manner apart from the fact that it was paid by cheque to the appellant on 18 June 2002 instead of being paid to 772 or 779;

I am satisfied that in 2001, Northern did all it needed to do in order to pay the appellant and the appellant received payment, once the withholdings were made and remitted and the balance, after withholdings, of the $3,700,000 bonus was loaned back to Northern thereby becoming a liability from Northern to the appellant in his capacity as a shareholder.[34]

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[33] As the practice was referred to by counsel for the appellant and Mr. Telidetzki. See the transcript, page 70, lines 6 to 8.

[34] In reaching this conclusion I am not unmindful of the comments of Bowman J., as he then was, in *Phillips v. The Queen*, 95 DTC 194 (TCC), where at paragraph 19 he states:

> Nor can I accept that the mere bookkeeping entry of moving the amount of bonus owing to Mr. Phillips from "bonus payable" to "due to shareholder" connotes receipt. Accounting entries are supposed to reflect reality, not create it and, as Lord [Lindley] said in *Gresham Life [Assurance] Society Ltd. v. Bishop*, [1902] 4 TC 464 at 476:

Conclusion

> But to constitute a receipt of anything there must be a person to receive and a person from whom he receives and something received by the former from the latter, and in this case that something must be a sum of money. A mere entry in an account which does not represent such a transaction does not prove any receipt, whatever else it may be worth.

Phillips appears to be a rather unusual case with "unilluminating and confusing" accounting and is quite different from this one on its facts.

I agree that "[a]ccounting entries are supposed to reflect reality, not create it". Erroneous or false booking entries do not create facts; accounting entries may however be evidence of facts — consider, for example, section 30 of the *Canada Evidence Act* — evidence to be considered along with any other evidence as was done in the *Phillips* case.

Here we have a very different evidentiary situation. We have not only the fact that the balance of the bonus after withholding was shown as a shareholder loan, we have the evidence of Mr. Telidetzki as to the withholdings and the loan back of the balance of the bonus and we have a whole course of conduct including the company having remitted withholdings on the entire $3,700,000 bonus.

I do not read *Phillips* as requiring that there always be actual receipt in the form of cash, a cheque or an electronic transfer deposited to one's account. There can be constructive receipt of remuneration although it is always a question of fact whether that has occurred. The quoted passage in *Phillips* is a reminder that an accounting entry is evidence and not a fact.

It is interesting to review the context of the quoted passage of *Gresham*. *Gresham* is a House of Lords decision in 1902. Under the *Income Tax Act*, 1842, *Gresham* was taxable on interest *received* in the United Kingdom. It operated in the United Kingdom and other countries and its head office was in London. As I understand the facts, the company drew up its financial statements on a worldwide basis (see the fifth paragraph of the judgment by Lord Lindley) which showed the company as having received a certain amount of interest. It was not disputed that much of that interest was never brought to the United Kingdom. The revenue sought to tax the company on the whole of the interest shown in its financial statements. Not surprisingly the House of Lords held that financial statements showing what the company earned in interest on a worldwide basis did convert all of that interest into interest received in the United Kingdom whether or not it had in fact been received in the United Kingdom.

I am also not unmindful of *Morrison v. The Queen*, 2010 TCC 429, a decision of Webb J. The circumstances of *Morrison* are rather unique and quite different from those in this appeal.

The appellants sold part of their interest in a software development company. At the time of sale they had certain accrued salaries. As part of the agreement by which the Morrisons sold part of their shares it was agreed that just before closing the company would pay to the Morrisons the net accrued salary after withholdings and the Morrisons would then advance to the company the net amount they received. It was further agreed that the company would repay these advances without interest but only to the extent that certain investment tax credits were received by the company.

In particular, I note that, although on the books the amounts in the issue were credited to the shareholder accounts, pursuant to the agreement of purchase and sale the company was not in fact liable to the Morrisons for the amounts that had been credited at the time the amounts were credited. At the time any amount was credited, the company's liability to the Morrisons for any particular amount was contingent and would only become definitive if and when the company received certain investment tax credits. As such, the credit entries to the Morrisons' shareholder accounts simply did not reflect a payment. They merely reflected a contingent liability and should not have been entered as a liability to the shareholders.

This is completely distinguishable from the situation before me.

Given that these facts here are similar to what is common practice among many small corporations in terms of declaring bonuses, then remitting withholdings and paying out bonuses which are loaned back as shareholder loans just before the expiry of the 180 days after the company's year-end, I suspect that many small corporations would find that they were offside of subsection 78(4) of the *ITA*, were facts such as these not sufficient to constitute receipt by the employee. If I am wrong in my conclusion many of these small companies would have to take a number of additional steps that they do not currently take in order to successfully "bonus down".

[80] For these reasons the appeal will be dismissed with costs to the respondent.

Signed at Ottawa, Ontario, this 23rd day of January 2011.

"Gaston Jorré"

Jorré J.

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