

Docket: 2015-4744(IT)G

BETWEEN:

NORMAN CATLOS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Miriam Barkley*
2015-4745(IT)G and *Richard Aaron Barkley* 2015-4746(IT)G
on June 12, 2018, at London, Ontario

Before: The Honourable Justice B. Russell

Appearances:

Counsel for the Appellant: David J. Thompson
Counsel for the Respondent: Jack Warren

JUDGMENT

The appeal from the assessment raised August 21, 2014 under the *Income Tax Act* (Canada) for the Appellant's 2013 taxation year is dismissed, with one set of costs awarded to the Respondent.

Signed at Halifax, Nova Scotia, this 28th day of August 2018.

“B. Russell”

Russell J.

Docket: 2015-4745(IT)G

BETWEEN:

MIRIAM BARKLEY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Norman Catlos*
2015-4744(IT)G and *Richard Aaron Barkley* 2015-4746(IT)G
on June 12, 2018, at London, Ontario

Before: The Honourable Justice B. Russell

Appearances:

Counsel for the Appellant: David J. Thompson
Counsel for the Respondent: Jack Warren

JUDGMENT

The appeal from the assessment raised August 21, 2014 under the *Income Tax Act* (Canada) for the Appellant's 2013 taxation year is dismissed, with one set of costs awarded to the Respondent.

Signed at Halifax, Nova Scotia, this 28th day of August 2018.

“B. Russell”

Russell J.

Docket: 2015-4746(IT)G

BETWEEN:

RICHARD AARON BARKLEY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of *Norman Catlos*
2015-4744(IT)G and *Miriam Barkley* 2015-4745(IT)G
on June 12, 2018, at London, Ontario

Before: The Honourable Justice B. Russell

Appearances:

Counsel for the Appellant: David J. Thompson
Counsel for the Respondent: Jack Warren

JUDGMENT

The appeal from the assessment raised August 21, 2014 under the *Income Tax Act* (Canada) for the Appellant's 2013 taxation year is dismissed, with one set of costs awarded to the Respondent.

Signed at Halifax, Nova Scotia, this 28th day of August 2018.

“B. Russell”

Russell J.

Citation: 2018TCC177
Date: 20180828
Docket: 2015-4744(IT)G

BETWEEN:

NORMAN CATLOS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2015-4745(IT)G

AND BETWEEN:

MIRIAM BARKLEY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2015-4746(IT)G

AND BETWEEN:

RICHARD AARON ABARKLEY,

Appellant,

And

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Russell J.

Introduction:

[1] These three appeals of Mr. Catlos (Norman), Ms. Barkley (Miriam) and Mr. Barkley (Richard), arising out of the same transactions, were heard on common

evidence. Each appellant appeals denial by assessment raised by the Minister of National Revenue (Minister) of his/her 2013 taxation year claim for deduction of legal expenses per paragraph 8(1)(b) of the *Income Tax Act* (Canada) (Act). The denied legal expense deductions claimed by Norman, Miriam and Richard are respectively (rounded), \$74,030, \$74,030 and \$100,572.

Background:

[2] The appellants Norman and Miriam are Catlos family siblings and Miriam and Richard are married to each other. Richard and Norman are senior executives of a corporation named Tatra Corporation (Tatra), which is a holding company owning various operating companies, originating as the Catlos family business founded by Norman and Miriam's late father Peter Sr. Miriam has had a career of full time employment with Canada Post. The three appellants all are directors of Tatra. Miriam and Norman have two other siblings, Brian and Peter Jr. In April 2004 Peter Sr. gifted his Tatra shares to Miriam, giving her control of Tatra. By the end of 2004 Miriam owned 25,918.58 of the Tatra common shares while each of her three brothers - Norman, Brian and Peter Jr. - owned 3,708.58 such shares. Peter Sr. retained one such share. Tatra Class B shares were identically numerically distributed to these same shareholders with the exception of none being held by Peter Sr.

[3] In September 2011 Brian and Peter Jr. launched a guardianship application in respect of Peter Sr. in the Ontario Superior Court of Justice against *inter alia* two of the three herein appellants being the applicants' siblings Miriam and Norman, alleging that Peter Sr.'s 2004 transfer of the majority of Tatra shares to Miriam in 2004, giving her control of Tatra, was improper. The two brothers in December 2011 obtained an interim injunction restraining Miriam from dealing with the disputed Tatra shares and restricting the three herein appellants, that is including Richard, as Tatra directors from disposing of Tatra corporate assets, and also restricting the three herein appellants from having Tatra pay any of them more than \$10,000 per month compensation. At this time Tatra was paying each of them as senior employees and or officers well in excess of that level of compensation.

[4] In March 2012 the Ontario Superior Court ordered a trial of the issue as to validity of the 2004 share transfer and as well ordered that Richard be joined with Miriam and Norman as a defendant. A statement of claim was filed. In October 2012 the herein appellants obtained an order setting aside the aforesaid interim injunction. The sought remedies, as pleaded, include an order for an accounting and disgorging and equitable tracing of all wages, bonuses, dividends and other

monies paid by Tatra to each of the individuals (the herein appellants) since the 2004 transfer.

[5] For their respective 2012 taxation years the appellants successfully claimed deduction under paragraph 8(1)(b) of their legal expenses in the Ontario Superior Court proceeding. The Minister apparently allowed the deductions in that year on the basis that the expenses were incurred in defending against the interim injunction, set aside in October 2012, which had restricted their 2012 income to \$10,000 per month. However, the legal fees incurred and claimed in respect of the 2013 taxation year were disallowed, hence bringing on these appeals.

Issue:

[6] The issue of course is whether the appealed assessments denying each appellant's 2013 taxation year claim for deduction of legal expenses per paragraph 8(1)(b) of the Act are valid.

Legal Analysis and Conclusion:

[7] Paragraph 8(1)(b) of the Act was amended in 2013, retroactive to 2001. The previous wording is what is noted in the jurisprudence cited by the parties. That previous wording is as follows:

Legal expenses of employee

(b) amounts paid by the taxpayer in the year as or on account of legal expenses incurred by the taxpayer to collect or establish a right to salary or wages owed to the taxpayer by the employer or former employer of the taxpayer;

[8] The current and applicable wording of paragraph 8(1)(b) for the 2013 taxation year is as follows:

Legal expenses of employee

(b) amounts paid by the taxpayer in the year as or on account of legal expenses incurred by the taxpayer to collect, or to establish a right to, an amount owed to the taxpayer that, if received by the taxpayer, would be required by this subdivision to be included in computing the taxpayer's income;

[9] The appellants submit that the provision is applicable to their respective claims for deduction on the basis that the core element of the sundry remedies sought in this litigation is disgorgement of all employee reportable earnings over

and above an unstated “reasonable” amount going back to 2004 and hence including the 2013 taxation year. The respondent submits that the provision has no application to the appellants as Tatra has already paid them their full amounts of remuneration for 2013 and paragraph 8(1)(b) does not apply to claims for recovery of excessively paid remuneration. The respondent urges also that an allegation such as unjust enrichment is incapable of transforming what is fundamentally a corporate claim for damages into an employee/employer dispute as to amount of salary owed, which is the focus of paragraph 8(1)(b).

[10] The amended statement of claim filed by the two brothers in April 2013 (the initiating statement of claim having been filed at an earlier date understood to have been in 2012) as litigation guardians of their father Peter Sr. as plaintiff claimed against Miriam a number of remedies including an order setting aside transfer of shares from Peter Sr. to her, an order for equitable accounting of all monies paid by Tatra to her since the 2004 transfer, “less any reasonable amounts payable to Miriam for services rendered to Tatra by Miriam during that time”, the resulting total being “Miriam’s Profit”, and an order “that Miriam disgorge and repay all of Miriam’s Profit to the Plaintiff”, and general and punitive damages.

[11] Likewise the amended statement of claim claimed against Norman a number of remedies including an order for equitable accounting of all monies paid by Tatra to him since the 2004 transfer, “less any reasonable amounts payable to Norman for services rendered to Tatra by Norman during that time”, the resulting total being “Norman’s Profit”, and an order “that Norman disgorge and repay all of Norman’s Profit to the Plaintiff”, and general and punitive damages.

[12] Likewise the amended statement of claim claimed against Richard a number of remedies including an order for equitable accounting of all monies paid by Tatra to him since the 2004 transfer, “less any reasonable amounts payable to Richard for services rendered to Tatra by Richard during that time”, the resulting total being “Richard’s Profit”, and an order, “that Richard disgorge and repay all of Richard’s Profit to the Plaintiff”, and general and punitive damages.

[13] The amended statement of claim asserted also that the remedies were claimed “based on the Defendants’ breaches of their fiduciary duties to [the Plaintiff] arising from the [2004 share transfer to Miriam] and their subsequent enrichment therefrom during a period when they were in a clear conflict of interest between their duties to the Plaintiff and their self interest in keeping the shares and the benefits the Defendants enjoyed as a result.” The amended statement of claim

also asserted claims at paras. 42 through 47 thereof under the heading “The Defendants’ Unjust Enrichment from the Transfer”.

[14] In *Fenwick v. R.*, 2008 FCA 370 the Federal Court of Appeal (FCA) upheld a Tax Court decision of Woods, J. as she then was (2008 TCC 243), respecting interpretation and application of paragraph 8(1)(b). In that matter, not substantively dis-similar to this, the appellant was the sole director and CEO of an Ontario numbered company (Company) that manufactured and distributed automotive brake pads. The business had been founded by the appellant’s father and uncle. The appellant had received all voting shares and his sisters had some non-voting shares, because it was thought he (the appellant) alone would actively manage the business.

[15] The sisters sued, citing lack of financial information and the taking away from the Company of a corporate opportunity through the appellant setting up his own separate company to pursue that opportunity instead. Woods J. found that central to the 93 page statement of claim and its large number of alleged improper actions was the claim that the appellant had paid excessive remuneration to himself and also had diverted a corporate opportunity from the Company to himself. The Tax Court found that this was not a situation within the scope of paragraph 8(1)(b) (as it was then worded).

[16] On appeal to the FCA, that court agreed with the Tax Court’s dismissal of the appeal. In particular the FCA, per Sharlow, JA, made certain relevant observations. Before I go into those, I first address that this case dealt with the previous version of paragraph 8(1)(b). Both that previous version and the current and applicable version to the appeals at bar are set out above. They are quite similar. The marginal note “legal expenses of employee” remains intact.

[17] The only differences in the wording of the two provisions are twofold. First, “salary or wage” has been replaced by “an amount”. Second, “by the employer or former employer of the taxpayer” has been replaced with “that, if received by the taxpayer, would be required by this subdivision to be included in computing the taxpayer’s income.” The subdivision referred to is Subdivision a of Division B of Part I of the Act, headed “Income or Loss from an Office or Employment”, encompassing sections 5 through 8 of the Act.

[18] In my view the change in wording has some effect. Changing the reference to salary or wage to an amount that would be reportable as income from employment or an office brings additionally into the fold gratuities and other

remuneration per section 5, benefits and other income as identified in section 6, and stock options income per section 7. (Section 8 itself deals with deductions from office or employment income.)

[19] In the appeals at bar we did not see an exhaustive listing of types of income received from Tatra by the three appellants over the years, but in any event paragraph 8(1)(b) now covers a full range of types of income from employment or office than it did when just pertaining to salary and wages. And in any event none of the four parties in the three appeals at bar raised any issue of this nature.

[20] This is only here relevant insofar as paragraph 8(1)(b) jurisprudence including *Fenwick* that I shall now continue to discuss, happen to deal with the prior form of wording - in place until 2013 when then the new wording was applied retroactively to 2001.

[21] I have described the factual circumstances in *Fenwick*, which are suggestive of the factual scenario in the present three appeals. First, Sharlow, JA observed at paragraph 7 of her reasons for judgment that she was in agreement with Woods, J. that this provision “has a relatively narrow scope”, within the bounds of its actual wording. Nevertheless the FCA justice did accept for purposes of the appeal before her, without deciding, the conclusion of Woods, J. that the provision should be applicable not just for a taxpayer seeking payment of salary or wages from an employer or former employer, but as well in situations where the employer or former employer was seeking return of such income.

[22] Now that is a bit of a different proposition in the context of the present wording where “employer or former employer” is not specified. I am not ready to say that this provision now can mean that a third party to the employment or office holding relationship, seeking from the appellants, as in the appeals at bar, disgorgement of their income from office or employment likewise comes under the paragraph 8(1)(b) umbrella. That would move the entire focus of paragraph 8(1)(b) away from the office holding or employment relationship.

[23] I am supported in this view by the FCA statement at paragraph 11 that, “In my view the allegations of unjust enrichment are not capable of transforming what is fundamentally a corporate claim for damages into an employee/employer dispute about the amount of salary owed.” Or, cast in the language of the current version of paragraph 8(1)(b), a dispute in the context of the office of employment relationship as to what amount of income is owed with respect to that office or employment. Further, in the appeals at bar the amended statement of claim naming the herein

appellants as defendants specifically pleads unjust enrichment, which the FCA has stated (quoted above) goes beyond the scope of paragraph 8(1)(b) when advanced in a corporate claim context as distinguished from the narrower context of the individual's specific work relationship as officer or employee.

[24] Further, as referenced by the FCA in paragraphs 5 and 6 of its reasons for judgment, the argument in *Fenwick* by the taxpayer that "he had to prove the remuneration he received was reasonable in order to prove that he was legally entitled to receive and retain it" so as to qualify for deductible legal fees, was too broad an interpretation of that provision. That argument is similar here - the appellants are defending against a claim for disgorgement of all payments to them from Tatra, of which two are employees and officers and one is an officer (director), less any such payments to which they would be reasonably entitled. Just as in *Fenwick*, I think that takes the parties beyond the scope of paragraph 8(1)(b).

[25] I refer also to paragraph 8 of *Fenwick*. There the FCA makes a distinction between "litigation involving a claim for damages involving disputes other than those arising from the terms of employment, merely because the defendant's entitlement to particular remuneration is an element of the claim". I consider the same distinction can be made respecting the appeals at bar, and the language difference of paragraph 8(1)(b) would not alter that conclusion. Thus again I think, in line with *Fenwick*, that paragraph 8(1)(b) does not extend to circumstances such as in the appeals at bar.

[26] I should add, in reference to paragraph 9 of the FCA reasons for judgment my concurrence with the observation that the essential nature of claims must be *identified from* the pleadings themselves, as opposed to from a source such as testimony of counsel to the litigation, constituting opinion evidence, and possibly of a non-independent nature. Accordingly my analysis herein has focused on content of the pleadings, in particular the amended statement of claim.

[27] Also, the FCA at paragraph 10 of its reasons found that it was reasonably open for Woods, J. to have denied, as she did, paragraph 8(1)(b) relief to the taxpayer on the basis that the claim he was defending against extended beyond the basis of the employee/employer relationship. Likewise in the appeals at issue, and echoing observations above, the claims the appellants are defending against arise quite differently - from allegations of unjust enrichment and breach of fiduciary obligations.

[28] Accordingly on the basis of *Fenwick*, and notwithstanding the able submissions of Mr. Thompson for the appellants, I conclude that the claimed legal expenses reach beyond the scope of paragraph 8(1)(b), which “has a relatively narrow scope” and as such it does not extend to corporate claims with manifold remedies sought on such bases as unjust enrichment and breach of fiduciary obligation.

[29] The three appeals are each dismissed, with one set of costs awarded to the respondent.

Signed at Halifax, Nova Scotia, this 28th day of August 2018.

“B. Russell”

Russell J.

CITATION: 2018TCC177
COURT FILE NO.: 2015-4744(IT)G
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REASONS FOR JUDGMENT BY: The Honourable Justice B. Russell
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APPEARANCES:

Counsel for the Appellant: David J. Thompson
Counsel for the Respondent: Jack Warren

COUNSEL OF RECORD:

For the Appellant:

Name: David J. Thompson

Firm: David J. Thompson Professional Corporatic
Lawyer

For the Respondent:

Nathalie G. Drouin
Deputy Attorney General of Canada
Ottawa, Canada