Docket: 2017-4127(GST)I

BETWEEN:

MARILENA MENZIES,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 20, 2018, at Windsor, Ontario

Before: The Honourable Mr. Justice Randall S. Bocock

Appearances:

Agent for the Appellant:	Danny Branoff
Counsel for the Respondent:	Dominik Longchamps

JUDGMENT

IN ACCORDANCE WITH the reasons for judgment attached, the appeal is allowed with costs in accordance with the applicable Tariff, subject to the proviso that should there be any further dispute between the parties relating to costs, the Court will receive submissions thereon within 30 days.

Signed at Vancouver, British Columbia, this 25th day of January, 2019.

"R.S. Bocock"

Bocock J.

Citation: 2019TCC29
Date: 20190125
Docket: 2017-4127(GST)I

BETWEEN:

MARILENA MENZIES,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Bocock J.

I. INTRODUCTION AND FACTS

[1] Marilena Menzies ("Mrs. Menzies") was assessed on December 15, 2015, under subsection 325(1) of the *Excise Tax Act*, R.S.C., 1985, c. E-15 (the "ETA") in the amount of $39,773.55. Like its corresponding s.160 of the *Income Tax Act* (the "ITA"), subsection 325(1) holds the recipient ("transferee") of property received from a tax debtor ("transferor") jointly and severally liable to the Minister for the debtor's tax liability. The subsection is subject to certain conditions and limitations of engagement. These may be summarized as follows:

1) the transferor of the property must be liable (the "tax debtor") to the Minister;

2) there must be a transfer of property;

3) the transferee must be non-arms' length, a spouse automatically qualifies; and,

4) the extent of the liability is the amount by which the fair market value of the transferred property exceeds consideration tendered by the transferee, if any.

[2] In this appeal, Mrs. Menzies has conceded that the transferor was liable for certain tax liability under the *ETA*, and that she and the transferor, her husband of many years, were spouses. The primary issue before the Court is whether the value of the property transferred and received by Mrs. Menzies exceeded the fair market value of any consideration tendered by Mrs. Menzies. The secondary issue concerns the issue of the "transfer". Based upon the peculiar facts before the Court, there is an issue of whether a portion of the alleged transferred property was a transfer to or for Mrs. Menzies (or her benefit) within the meaning of subsection 325(1).

[3] The tax debt underpinning the assessment relates to the accountancy business of Mr. Menzies, CPA. His business has experienced financial straits during the expected peaks and troughs of the business cycle, well known to manufacturing cities, such as Windsor where the business is located. As a result, over the 30 years Mr. Menzies has been in private accountancy practice, periodic loans to fund working capital caused by delinquent receivables have been needed.

[4] These loans came from various sources: clients, business associates and financial institutions. Unlike one such loan from his mother, Mrs. Menzies asserts that the others were secured by mortgages against the family residence. Subject to an inexplicable and possibly determinative 3 month exception in 2003 (concerning the secondary issue), that residential property has been solely registered in the name of Mrs. Menzies. The original purchase money mortgage on the residence was approximately $30,000.00 advanced many years ago. By the end of 2015, the balance of the outstanding mortgage loans on the property exceeded $91,000.00. According to Mrs. Menzies this was because of the working capital deficiencies of the business. Mr. Menzies also testified that the accounting business serviced the debt of these third party mortgage loans through the direct payment of the blended payments of principal and interest each month.

[5] In levying the section 325 assessment against Mrs. Menzies, the Minister identified certain mortgage payments as the offending transfers: some $28,789.59 to National Bank of Canada ("NBC") and $10,984.28 to Canadian Western Trust ("Western Trust")(the "mortgage payments"). This total of $39,773.85 spanned the period from March 2013 to August 2015 (the "transfer period"). The GST/HST tax debt accumulated by Mr. Menzies' business between July 21, 2008 and May 31, 2013 totalled $50,626.76 (the "tax debt"). To repeat, after 2008, the mortgage payments (ie the transfers) were paid directly by Mr. Menzies to NBC and Western Trust. Before that, they were paid to Mrs. Menzies in the form of a modest salary ("wages"), who then paid the mortgages herself.

[6] The value or worth of Mrs. Menzies' wages as an employee of Alexander R. Menzies Management Inc. ("Menzies Co.") was very much in issue before the Court. Payment of the wages was historical and longstanding, at least since 2001. They were $18,000.00 per annum or $1500 a month. The wages were reported as income by Mrs. Menzies, deducted as a wage expense by Menzies Co. and accepted as such by the Minister in respect of both taxpayers over the course of a decade or more prior to the transfer period. Again, the wages were satisfied by payment of the mortgage payments to NBC and Western Trust.

II. ISSUES

A. Appellant's Submissions

[7] Both Mr. and Mrs. Menzies testified at the hearing. Mrs. Menzies' agent was Mr. Danny Branoff, a retired lawyer. The arguments marshalled in submissions during this informal appeal by Mr. Menzies and Mr. Branoff were as follows:

a) the mortgage payments arose from loans procured by Mr. Menzies for the purpose of his business and the payments to NBC and Western Trust were made to repay and service those loans solely for Mr. Menzies' and Menzies Co.'s benefit and pursuant to his legal obligations to those third parties;

b) the wages were in consideration of Mrs. Menzies' services provided to Menzies Co. in the form of consultation services *qua* officer of Menzies Co.; and,

c) the Minister's challenge of insufficient consideration or value tendered by Mrs. Menzies for her wages belies the longstanding existence and record of such payments and the Minister's own equally longstanding assessing position which allowed both a deduction of the wages for Menzies Co. and payment of taxes on such amounts by Mrs. Menzies.

B. Respondent's submissions

[8] The Respondent called no witnesses, but counsel extensively cross-examined both witnesses and submitted the following as argument to the Court:

1. there was no, or at least insufficient, consideration paid by Mrs. Menzies, as transferee, for the transferred property comprising the mortgage payments to NBC and Western Trust which were *per se* for her exclusive benefit;

2. there was no evidence before the Court to suggest that Mrs. Menzies' wages had a fair market value consideration of the $18,000 per annum paid, albeit indirectly, to her benefit; and,

3. Mrs. Menzies has the burden of proving the fair market value of consideration for the transfers and has not done so given the vague and uncertain evidence adduced which failed to demolish the assumptions.

III. The LAW

a) Statutory provision.

[9] The relevant excerpts from section 325 of the *ETA* provide as follows:

> **325(1) Tax liability re: transfers not at arm's length --**
>
> Where a person transfers property ….. to ….
>
> (a)….the transferor's spouse….
>
> ….the transferee and transferor are jointly and severally liable to pay under this Part an amount equal to the lesser of…..
>
> (d) the amount determined by the formula
>
> A-B
>
> where
>
> A is the amount, if any, by which the fair market value of the property….exceeds the fair market value at that time of the consideration given by the transferee for the transfer of the property….

b) the authorities

[10] In the leading authority concerning transferee liability relating to tax debtor non-arm's length transfers, Justice Sexton of the Federal Court of Appeal said in *Livingston v. Her Majesty The Queen*, 2008 FCA 89 at paragraph 9:

> **[9]** …in order for subsection 160(1) of the Act to apply, the following four criteria must be met:
>
> 1) There must be a transfer of property;
>
> 2) The parties must not be dealing at arm's length;
>
> 3) There must be no consideration or inadequate consideration flowing from the transferee to the transferor …. ; and
>
> 4) The transferor must be liable to pay tax under the Act at that time.

[11] Items 2 and 4 have not been challenged. As stated above, Items 1 and 3 are actively in dispute before the Court. Section 325 of the *ETA* and section 160 of the *ITA* are equivalent sections, at least to the extent of the conditions of engagement for non-arm's length transfers by tax debtors.

IV. ANALYSIS AND DECISION

[12] The appeal is allowed on three bases. Cumulatively, on the basis of the evidence, the Minister's assumptions have been demolished concerning the following: Mr. Menzies' distinct, primary obligations for certain of the transfers, the existence of business loans made by Mrs. Menzies to Mr. Menzies' business and longstanding and sufficient consideration tendered by Mrs. Menzies for her wages.

a) the assessment deconstructed

[13] In her reply, the Minister made the following assumptions of fact, although some are mixed assumptions of fact and law:

> w) the mortgage payments increased the equity of the home owned by the appellant;
>
> x) no consideration flowed from the appellant to Mr. Menzies for the mortgage payments;

y) the mortgage payments were not made to reimburse a loan given by the appellant to Mr. Menzies;

z) the mortgage payments were not made in lieu of salary to the appellant; and

aa) the mortgage with [Western Trust] was never in default.

[14] There is no question in the Court's mind that the Minister focused on the issue of whether the re-directed mortgage payments, asserted to be paid in lieu of wages, were of sufficient consideration to offset the fair market value of the transfers. Revealed below are the reasons why such a focus was likely quantitatively irrelevant and more or less obscured the basic legal and transactional nature of the transactions between Mr. and Mrs. Menzies.

[15] More generally, the confusion is perhaps understandable. Loans from non-arms' length parties are the lifeblood of small businesses, whether in small service, professional or merchandizing industries. From afar, they can appear non-commercial, non-sensical and illogical. In fact, they may well be. Without the close affinity, blood relationship and/or spousal bond, such arrangements would not occur. In the absence of such loans, sweat labour, 18 hour work days and 80 hour work weeks would also disappear along with many such small, frequently self-employed businesses. But the satisfaction and pride in such ownership of work product and independent accomplishment carries on. And the friendly debt of relatives, friends and even co-workers, existential to such small businesses, marches along with such labours of love. As is seen below, specifically, it takes on well disguised and slightly inexplicable forms, methods and justifications.

[16] Similarly, the evidence and level of documentation because of that very affinity is often vague, non-existent or insufficient. Ironically, it is this very non-arm's length proximity that constitutes a condition of engagement for section 325 of the *ETA* and section 160 of the *ITA*. On one hand, the "arm up" of a close relative or friend, through informality, familiarity and trust, may attract the "long reach" of section 325 or 160 because of the intrinsic lack of documentation, clarity and certainty.

[17] Justice Favreau of this Court, in addressing an advocative rush to dismiss and generalize all such informal and "under-documented" arrangements as insufficient, stated in *Connolly v HMQ* , 2016 TCC 139, stated:

[26] In *Pelletier, supra*, after having listed the irregularities from the evidence before the Court, I further addressed the taxpayer's credibility:

> [16] The contradictions referred to in the two preceding paragraphs seriously undermine the credibility of the Appellant. I am not persuaded at all that the three cheques payable to Mr. Farrell for a total amount of $1,155 constituted partial reimbursement of loans and I am inclined to think that they could very well reflect loans made by the Appellant to Mr. Farrell. In view of the insufficiency of the evidence offered by the Appellant, the assessment must stand. It was the Appellant's responsibility to keep proper records of her own personal transactions.

[27] I would say that one should abstain from concluding that documentary evidence is always necessary, as it is well recognized that verbal contract may be as valid as if it was set out in writing. However, the difficulty of establishing the existence of such a verbal contract will lie on the testimonial evidence submitted by a witness – thus his or her credibility.

[28] As Sheridan J. stated in *Pickard v. Canada*, 2010 TCC 535:

> [15] Applying the principles from Livingston, Waugh and Raphael to the present case, the onus is on Mrs. Pickard to establish the fair market value of the consideration given for the amounts deposited in her account pursuant to a legally binding agreement and further, that there is a correspondence between that value and the amounts reported as income. That is a difficult onus to meet, especially in a non-arm's length transaction where one of the parties to the alleged agreement does not testify, where there is an absence of corroborating documentary evidence and where, to the extent records do exist, their accuracy is questionable.

(Emphasis added)

[29] I would nonetheless note that such onus is not insurmountable.

[30] Even if it is preferable that all agreements be put in writing, it is not up to this Court to dictate so. As the appellant was able to provide credible evidence of the existence of such an consideration in exchange of the funds from her common-law partner that were deposited in her bank account.

[31] ….. The evidence revealed that, during those years, the appellant had effectively advanced funds to Mr. MacVicar for both businesses and for his personal expenses.

[32] Under the terms of the verbal agreement, he had the legal obligation to reimburse her common-law partner. The considerations were in the form of

> advances and loans for his painting business' payroll, rent and his miscellaneous businesses and personal expenses.

[18] What is to be undertaken by this Court is a review of the evidence, bearing in mind the exigencies of how non-arm's length parties deal with one another both in good faith and genuine goodwill when assisting a related, passionate entrepreneur and with blind loyalty and a "blind eye" when the Minister's collection efforts are being "thwarted". The goal is to discern between the two situations based upon the credibility of the witnesses. In doing so, (in)consistency, the attitude, poise and bearing of the witness, disingenuous motive, and the overall fabric of the evidence must be weighed on the balance of probabilities: *Nichols v The Queen*, 2009 TCC 334.

b) the NBC mortgage payments: who were the obligors?

[19] The amounts of the mortgage payments to NBC were $28,789.59. This amount comprises almost three-quarters of the sum contained in the identified section 325 transfers. Critical to the asserted transfer to Mrs. Menzies is the concept that Mr. Menzies made a payment on Mrs. Menzies behalf to NBC for which he otherwise had no obligation, at law, to make. If he had an obligation to make the payment to the third party mortgagee, independent of Mrs. Menzies' obligation, and he paid same, the Minister cannot argue that it was a transfer solely to or for Mrs. Menzies. As to that issue, under Ontario law and the evidence before the Court, Mr. Menzies was an "original mortgagor" or chargor *per se*. He was obligated to pay the debt principally, just as Mrs. Menzies was. This ground was factually enunciated in Mrs. Menzies' notice of appeal. In Ontario, this is true as a matter of law if Mr. Menzies was a title owner and granted the mortgage which secured the debt. This would not be the case if Mr. Menzies were merely a surety or guarantor on a contingent debt which was not yet due or demanded: *MacLeod v. HMQ*, 2012 TCC 379 at paragraph 17. The evidence shows that, at the time the conventional and not collateral mortgage/charge was granted to NBC, Mr. and Mrs. Menzies were joint tenants of the residential property. Both granted and delivered the mortgage/charge, jointly and severally, to NBC. The Ontario *Mortgages Act*, R.S.O. 1990, c. M. 40, specifically addresses Mr. Menzies' continuing relationship with NBC, the mortgagee;

> **Mortgagee's right of action**
>
> **20 (1)** In this section,

> **"original mortgagor"** means any person who by virtue of privity of contract with the mortgagee is personally liable to the mortgagee to pay the whole or any part of the money secured by the mortgage.
>
> **Right of mortgagee to recover personal judgment**
>
> **(2)** Despite any stipulation to the contrary in a mortgage, where a mortgagor has conveyed and transferred the equity of redemption to a grantee under such circumstances that the grantee is by express covenant or otherwise obligated to indemnify the mortgagor with respect to the mortgage, the mortgagee has the right to recover from the grantee the amount of the mortgage debt in respect of which the grantee is obligated to indemnify the mortgagor; provided that the right of the mortgagee to recover the amount of the mortgage debt under this section from the grantee of the equity of redemption shall as against such grantee terminate on the registration of a grant or transfer of the equity of redemption by such grantee to another person unless prior to such registration an action has been commenced to enforce the right of the mortgagee.
>
> **Limit of right of action**
>
> **(3)** Where a mortgagee has the right to recover the whole or any part of money secured by a mortgage from an original mortgagor and also has a right by virtue of this section to recover from a grantee of the equity of redemption from a mortgagor, if the mortgagee recovers judgment for the amount of the mortgage debt against the original mortgagor, the mortgagee thereupon forever ceases to have a right to recover under this section from a grantee, and if the mortgagee recovers judgment under this section against a grantee the mortgagee thereupon forever ceases to have a right to recover from the original affect judgment against the other original mortgagor or mortgagors. R.S.O. 1990, c. M.40, s. 20.

[20] Lest these concepts remain too arcane in their prose, they were updated when the same province modernized its land registration scheme in the mid-1980s. The *Land Registration Reform Act,* RSO 1990, c. L.4, also provides that a titled owner provides a direct implied covenant to pay all moneys secured under the charge. Section 7 of that Act provides:

> Charge: implied covenants
>
> **7** (1) A charge in the prescribed form shall be deemed to include the following covenants by the chargor, for the chargor and the chargor's successors, with the chargee and the chargee's successors and assigns:
>
> Usual covenants
>
> 1. In a charge of freehold or leasehold land by the beneficial owner:

> i. That the chargor or the chargor's successors will pay, in the manner provided by the charge, the money and interest it secures, and will pay the taxes assessed against the land.

[21] The parcel register reflecting historical title to the property was adduced into evidence by Respondent's counsel during his cross-examination of Mrs. Menzies. While a standard transfer was executed by both Mrs. and Mr. Menzies in favour of just Mrs. Menzies, that occurred after the mortgage was granted to NBC. Immediately prior to granting the mortgage, Mr. Menzies was a registered owner to the extent of a fee simple absolute estate in his own right, along with Mrs. Menzies.

[22] There was no notation on the parcel register to suggest there was any release or limitation of Mr. Menzies' direct obligation to NBC. By virtue of the above-noted legislation (itself a codification of the common law), he remained liable as an original mortgagor on the covenant to pay: *Falconbridge on Mortgages*, 4th edition, at paragraph 14.3. As such, the Court can conclude, notwithstanding the transfer of his interest in the property after granting the mortgage, Mr. Menzies remained primarily liable on his covenant to pay the NBC mortgage payments, namely the obligation to pay interest, principal and taxes. Such payments were not payments to a non-arm's length transferee or a third party for Mrs. Menzies' benefit, but payments to an arm's length creditor of Mr. Menzies in satisfaction of his binding, primary covenant to pay NBC. Based upon the evidence of the payments, this is exactly what he, and for the record not Mrs. Menzies, directly did to NBC after 2008 in satisfaction of his primary liability to NBC.

c) the reason for the mortgage loans

[23] Quite apart from Mr. Menzies' obligation under the NBC mortgage, the purposes of both conventional (and not collateral) mortgage loans were to fund working capital of Mr. Menzies' business. Evidence existed to support this. Debt continuity schedules, solicitors' trust ledgers and disbursement directions were produced dating back to the late 90's which showed the provenance of this assertion. Principal amounts advanced under the secured loans by various lenders, and there were many, were ultimately advanced and directed to Mr. Menzies for working capital and not to Mrs. Menzies as purchase moneys for the property or improvements to it.

[24] On balance, the Court gives credence to these contemporaneously created documents and cheque references. They evidence the friendly debt advanced by Mrs. Menzies, sometimes even jointly with her husband (to wit: the NBC mortgage), to fund Mr. Menzies' business. This is specifically true with the Western Trust mortgage, and the payments thereunder which comprise the other alleged transfer of property. To that end, several related pieces of evidence stand out. Such mortgage secured a self-directed RSP loan, further evidence of the friendly debt phenomenon described above. As such, it was not a collateral mortgage at all, but a conventional mortgage loan of blended principal and interest. Second, the lawyer's trust ledger disbursing the loan referenced a shareholder advance by Mrs. Menzies to the business. This is not perfect, but remains cogent evidence of consideration tendered by Mrs. Menzies for the subsequent and related re-directed third party payments by Mr. Menzies of interest and repayable principal under the Western Trust mortgage. Lastly, other proceeds advanced under this mortgage repaid the principal balance of a recorded business loan previously advanced by a third party lender to Mr. Menzies' business. In short, this evidence cumulatively allows the Court to conclude that Mrs. Menzies lent Mr. Menzies the moneys advanced under the Western Trust mortgage for his business. These sums were sufficient consideration for the subsequent payments of principal and interest, in turn, made by Mr. Menzies to Western Trust.

d) the wages: longstanding, but vague

[25] Although the Court is satisfied that the Minister's assumptions have been demolished concerning the mortgage payments to NBC and Western Trust being personal transfers to Mrs. Menzies, and not repayments of business loans, nonetheless, some consideration of the recorded wages will be given.

[26] With respect to the value of the wages, the Minister cannot have it both ways. She cannot perennially assess as filed both the transferee and transferor on the basis that the wages were supportable as a wage expense of Menzies Co. and taxable income to Mrs. Menzies and, thereafter, when it suits, reject that position. To be clear, such an irreconcilable assessing position does not concern different taxpayers or even different expense items of the same taxpayer. If it did, certainly the Minister is neither obligated nor exhorted to be consistent.

[27] However, this inconsistent treatment concerns identical payments. For more than a decade, the wages, their value, the quantum, the payor and the payee were considered acceptable. What changed? Only, that the accrual of a tax debt by Mr. Menzies appeared. The nature of the transactions, the amounts, the accounting

efforts and even the satisfaction of the wages through the re-directed mortgage payments had been longstanding, consistent and accepted prior to the transfer period. The value and consideration was never questioned. The payments had been accounted for and reflected through cash disbursement journal entries. No amount appears to have been overpaid during the transfer period. The evidence was not perfect, but, on balance, it meets directly the suggestion that Mrs. Menzies tendered no consideration for the wages she received. As an aside, given the existence of the NBC and Western Trust business loans, it is ironic that confusion arose by recording such amounts as wage income in Mrs. Menzies' hands, rather than as a simple repayment of principal and interest by the business directly to its creditors under the loans which Mrs. Menzies procured and advanced for her husband's business.

[28] Although not determinative, there was no departure, invention or deception mounted against the purpose of s. 325, namely to prevent attempts by either party to thwart the Minister's collection of a tax debt. For 15 years, the arrangement was acceptable and consistent. Its longstanding existence, notwithstanding the later revealed tax debt, is *prima facie* evidence of approximate, if not exact, consideration tendered by Mrs. Menzies. As such, on this ground *per se,* the Court is prepared to accept Mrs. Menzies' evidence of sufficient consideration. However, given the existence of the business loans above, it is superfluous.

V. CONCLUSION

[29] For the reasons stated, the appeal is allowed with costs payable to the appellant in accordance with the applicable Tariff. Should there be any further dispute between the parties relating to costs, the Court will receive submissions within 30 days.

Signed at Vancouver, British Columbia, this 25th day of January, 2019.

"R.S. Bocock"

Bocock J.

CITATION:	2019TCC29
COURT FILE NO.:	2017-4127(GST)I
STYLE OF CAUSE:	MARILENA MENZIES AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Windsor, Ontario
DATE OF HEARING:	November 20, 2018
REASONS FOR JUDGMENT BY:	The Honourable Mr. Justice Randall S. Bocock
DATE OF JUDGMENT:	January 25, 2019

APPEARANCES:

Agent for the Appellant:	Danny Branoff
Counsel for the Respondent:	Dominik Longchamps

COUNSEL OF RECORD:

For the Appellant:

Name:

Firm:

For the Respondent: Nathalie G. Drouin
Deputy Attorney General of Canada
Ottawa, Canada