Docket: 2012-1845(IT)G

BETWEEN:

THE ESTATE OF THE LATE EDWARD S. ROGERS,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 15, 2014, at Toronto, Ontario.

Before: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant:	Al Meghji Hemant Tilak Pooja Samtani
Counsel for the Respondent:	Samantha Hurst Naomi Goldstein

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is allowed and the reassessment is vacated in accordance with the attached reasons for judgment.

The parties will have until December 19, 2014 to arrive at an agreement on costs, failing which they are directed to file written submissions on costs no later than December 22, 2014. Such submissions are not to exceed five pages.

Signed at Toronto, Ontario, this 25th day of November 2014.

"Robert J. Hogan"

Hogan J.

Citation: 2014 TCC 348
Date: 20141125
Docket: 2012-1845(IT)G

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REASONS FOR JUDGMENT

Hogan J.

I. Overview

[1] The present case is an appeal from a reassessment made by the Minister of National Revenue (the "Minister") for the Appellant's 2007 taxation year. The dispute concerns the characterization of an amount (the "Surrender Payment") received by the taxpayer, Edward S. Rogers ("Mr. Rogers"), in that year. The Surrender Payment was made to Mr. Rogers by Rogers Communications Inc. ("RCI") in exchange for the surrender of options (the "Options") which had been granted to Mr. Rogers under RCI's employee stock option plan in 1997. The Appellant reported the Surrender Payment as a capital gain in his tax return for that year and accordingly included one half of the amount in his taxable income for that year.

[2] In 2011, the Minister reassessed the taxpayer to include the full Surrender Payment in income. This reassessment was defended by the Respondent on the basis of any of three alternative arguments, i.e.,: (i) that the amount was income from employment or an employment benefit under either section 5 or paragraph 6(1)(*a*) of the *Income Tax Act* (the "Act"); (ii) that the amount was a shareholder benefit taxable under subsection 15(1) of the Act; (iii) that the amount was a profit from an adventure in the nature of trade and taxable under subsection 9(1) of the Act.

[3] At trial, the Respondent abandoned the last of these arguments – namely, that the amount at issue is profit from an adventure in the nature of trade (the "Section 9 Argument") – on the basis that there was insufficient evidence. The only evidence tendered at trial was the Statement of Agreed Facts, the Joint Book of Documents and the Discovery Read-Ins.

[4] At the end of the hearing, I asked the parties for written submissions on the question of whether I can nevertheless consider the Section 9 Argument. After consideration of the parties' supplementary submissions, I decided that I am not bound by the Respondent's concession on this point for the reasons set out below.

II. Facts

[5] The parties filed a Statement of Agreed Facts which is summarized below.

[6] During all relevant periods, Mr. Rogers was the president and chief executive officer of RCI, a major Canadian diversified communications and media company. RCI had two classes of shares: Class A voting shares and Class B non-voting shares. Both classes of shares were listed on the Toronto Stock Exchange ("TSX"). The Class B shares were also listed on the New York Stock Exchange. On April 13, 2007, Mr. Rogers beneficially owned and controlled nearly 91% of RCI's issued and outstanding Class A shares. Therefore, Mr. Rogers and RCI were deemed not to deal at arm's length for the purposes of the Act.

[7] In 1996, RCI implemented a stock option plan (the "Plan") for the directors and key officers of RCI, including Mr. Rogers. The stated purpose of the Plan was to compensate the directors and key officers of RCI and its affiliates for their employment services and to enable them to acquire a proprietary interest in RCI through share options. The Plan was administered by the compensation committee of RCI's board of directors (the "Compensation Committee").

[8] On December 4, 1997, the board of directors of RCI granted Mr. Rogers an option to acquire Class B shares at an option price of $6.29 per share. On December 15, 2006, RCI's shareholders approved a resolution passed by RCI's board of directors effecting a two-for-one split of the Class B shares, which doubled the Options held by Mr. Rogers.

[9] Over the course of time, the terms of the Plan were amended in order to comply with various regulatory requirements, the one exception being an amendment on May 28, 2007 whereby RCI changed the Plan to allow a so-called share appreciation right ("SAR") to be attached to all new and previously granted

options. The SAR permitted an option holder to surrender all or a portion of an option to RCI for a cash payment equal to the "SAR Price". The SAR Price was equal to the average trading price of the Class B shares on the TSX for the business day on which the SAR was exercised, less the exercise price of the option. The exercise price of each option was fixed at the time the option was granted. Of note here is the fact that the Compensation Committee could refuse to allow an option holder to exercise a SAR, instead requiring him to exercise an option.

[10] On December 3, 2007, Mr. Rogers excised his SAR by surrendering the Options to RCI in exchange for the Surrender Payment. RCI did not withhold any amount and it did not issue a T4 slip to the Appellant with respect to the Surrender Payment. The Appellant reported the Surrender Payment as a capital gain in the 2007 taxation year.

III. Is the Court Bound by the Respondent's Concession on the Section 9 Argument?

[11] The Appellant argues that I am bound by the Respondent's decision to drop the Section 9 Argument. First, the Appellant argues that it is not the role of the judge in a tax adjudication to frame and define the issues. Secondly, and more importantly, the Appellant contends that the Section 9 Argument is not properly before the Court because (i) it is an agreed fact that Mr. Rogers received the cash payment qua employee and (ii) the allegation that the Surrender Payment was profit from an adventure in the nature of trade is incompatible with this agreed fact. Additionally, the Appellant submits that the Section 9 Argument is not properly before the Court because (iii) the Court may only review the correctness of the reassessment by looking at the basis on which the Minister made the reassessment and (iv) considering the Section 9 Argument would amount to usurpation by the Court of the Minister's assessment power.

[12] The Respondent's position is that the Court may reject a party's abandonment of a position of law provided that the parties are invited to make further submissions on the issue. In support of her position, the Respondent cites *Labourer's International Union of North America, Local 527, Members' Training Trust Fund v. Canada*,[1] where Judge Bowman, as he then was, noted:

> Parties to an action may agree on certain facts and this agreement may form the basis for a judicial admission by which the presiding judge will be bound. Parties cannot, however, make a judicial admission on a point of law, because "the Court

[1] [1992] T.C.J. No. 466(QL), 92 DTC 2365 (p. 2369).

> may not be bound by error in an admission by the parties as to the law…" The court is not bound by concessions on points of law. . . .

[13] All three of the Appellant's parallel arguments rest, according to the Respondent, on a tendentious assertion that it is an "agreed fact" between the parties and an "implicit assumption" of the Minister that Mr. Rogers received the Surrender Payment qua employee. In fact, the Minister made no stated assumption to that effect, nor is this alleged fact contained in the Statement of Agreed Facts.

[14] The Appellant tends to conflate the granting of the Options with their subsequent surrender for cash, but these are two distinct events capable of distinct characterization. While the evidence shows that Mr. Rogers received the Options in his capacity as an employee of RCI, it does not logically follow from this that the Surrender Payment was likewise received by him qua employee. It is possible to characterize the grant of options in 1997 as having been received by Mr. Rogers qua employee while the subsequent disposition of those options in 2007 remains open to characterization as a transaction giving rise to a profit from an adventure in the nature of trade or to a capital gain. These are questions that need to be resolved after consideration by the Court.

[15] Although the trial proceeded on the basis of a Statement of Agreed Facts, this does not displace the judge's role as the person entrusted with making factual findings based on the documentary evidence and the Discovery Read-Ins.

[16] Whether the cash payment is profit from an adventure in the nature of trade is a question of mixed fact and law. In deciding the question, the Court must consider various factors, including:[2]

- the nature of the property;
- the length of the period of ownership;
- the frequency or number of other similar transactions by the taxpayer;
- the circumstances responsible for the sale of the property; and
- the taxpayer's motive in acquiring the asset.

In each case, the determination will involve analyzing and weighing all these facts or in light of the particular circumstances of the case. There is nothing in this case that would conclusively preclude the Court from considering whether section 9 of the Act could apply to the Surrender Payment.

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[2] See *Friesen v. Canada*, [1995] 3 S.C.R. 103; *Happy Valley Farms Ltd. v. The Queen*, 86 DTC 6421 (FCTD).

[17] The Appellant argues that, because the Respondent withdrew the Section 9 Argument at trial, further consideration of the argument would amount to the Court constructing its own basis for assessment.

[18] In support of this position, the Appellant relies primarily on *Lipson v. Canada*[3] for the proposition that the Court cannot consider a provision of the Act where the Minister was not prepared to argue as a matter of fact that the test for the application of that provision was met. Rothstein J., in his dissent in *Lipson*, attempted to resolve the parties' dispute on the basis of a section of the Act that both sides had maintained throughout the proceedings did not apply. The majority of the Supreme Court of Canada (the "SCC") held that such an approach was inappropriate.

[19] In the instant case, the Respondent pleaded the Section 9 Argument and advanced a case, in part through the Statement of Agreed Facts, that is, at least in principle, capable of supporting a section 9 argument. At trial, the Respondent abandoned such an argument on the basis of insufficient evidence only after all the evidence had been presented through the Statement of Agreed Facts. The Respondent's abandonment of her position therefore amounts to a conclusion of mixed fact and law. It cannot bind the Court as it is trite law that the Court cannot be bound by the parties' interpretation of a point of law. For these reasons, *Lipson* does not apply here.

[20] The Appellant argues that consideration of the Section 9 Argument is akin to usurping the Minister's assessment power and thereby depriving the taxpayer of the benefit of the limitation period. The assessment process involves ascertaining the facts, applying the law to those facts and determining and assessing tax on that basis. Since the Respondent abandoned the Section 9 Argument due to lack of evidence, the Appellant argues it would be akin to opening a new assessment process for the Court to consider the abandoned argument.

[21] The Appellant has no direct authority for this argument. With respect, I consider it to be without merit as this is a circumstance where the Respondent pleaded and advanced an argument which it later withdrew on the basis of its own interpretation of an issue of mixed fact and law. All the evidence has been presented. The Court has not requested that the Respondent present further evidence. Rather, it is the Appellant that is asking the Court to consider itself bound by the Respondent's concession on a point of law even though it is trite law that the Court cannot be bound by such a concession.

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[3] 2009 SCC 1, [2009] 1 S.C.R. 3.

IV. Issue

[22] The main issue is the proper treatment of the Surrender Payment under the Act. The question is: does the carve-out in paragraph 7(3)(*a*) apply to preclude the Surrender Payment from being a benefit taxable under section 6, notwithstanding the fact that the Surrender Payment is not taxable under section 7 because of Mr. Rogers' non-arm's length relationship with RCI? In the alternative, can the Surrender Payment be characterized as "salary, wages and other remuneration" under section 5, or as a shareholder benefit under subsection 15(1) of the Act? In the further alternative, is the Surrender Payment taxable under subsection 9(1) of the Act?

V. Positions of the Parties

[23] The Respondent submits that Mr. Rogers received the Surrender Payment in respect of, in the course of, or by virtue of his office or employment as a director of RCI and therefore, the Minister properly included the entire Surrender Payment in income pursuant to paragraph 6(1)(*a*) or section 5 of the Act. The Respondent asserts that paragraph 7(3)(*a*) of the Act does not apply to the Surrender Payment because RCI did not agree to sell or issue securities to Mr. Rogers when he surrendered the Options.

[24] The Respondent puts forward two further alternative positions regarding the Surrender Payment. First, the Surrender Payment was a shareholder benefit fully includable in income under subsection 15(1) of the Act. Second, the Surrender Payment was business income from an adventure in the nature of trade.

[25] Not surprisingly, the Appellant does not see it quite the same way. The Appellant argues that the Surrender Payment was not taxable as income from employment because it was not "salary, wages and other remuneration" under section 5, and that paragraph 7(3)(*a*) applies to deem it not to be an employment benefit for the purposes of section 6 of the Act.

[26] As to the alternative arguments, the Appellant argues that they are without merit because the evidence shows that the Options and the SAR were granted to Mr. Rogers qua employee and there is no evidence to show that Mr. Rogers dealt with the Options with a trading intent.

VI. Law and Analysis

A. Is the Surrender Payment Taxable as Employment Income?

[27] Sections 5 through 7 of the Act determine a taxpayer's income from an office or employment. Subsection 5(1) states simply that a taxpayer's income for a taxation year from an office or employment is the "salary, wages and other remuneration, including gratuities, received by the taxpayer in the year." Section 6 operates to include in the computation of the income of an employee or officer the value of various ancillary benefits which are commonly associated with an office or employment.

[28] Section 7 of the Act sets out the ground rules for the taxation of benefits specifically derived from the exercise or disposition of stock options in the course of employment. The purpose of section 7 is, among other things, to defer recognition of employment benefits from the exercise or disposition of stock options until they are received in their entirety and quantifiable. Section 7 was enacted to provide a complete scheme for the taxation of stock options. It provides rules regarding when the benefit is subject to tax and with respect to the form of taxation. Coupled with the one-half deduction under section 110 of the Act, it affords a more favourable tax treatment than that applicable to other employment benefits.

[29] In the absence of section 7 of the Act, the timing of the taxation of stock option benefits would be a vexing issue. But for section 7, benefits enjoyed under stock options could be taxed at various points, including the following: at the date of the grant, at the date of vesting, or upon exercise. Section 7 deals with this issue, as it provides that the benefit is income from employment and identifies the point in time at which such income is deemed to have been realized. Generally, this point in time is when the employee exercises the option or transfers the option to an arm's length person.

[30] Section 7 of the Act sets out very detailed rules for determining amounts to be included under section 6 as an employee benefit in respect of the exercise or disposition of stock options. Of those rules, paragraph 7(1)(*b*) applies where an employee disposes of his right to shares, taking cash instead of the shares. The relevant portions of paragraph 7(1)(*b*) are reproduced below:

> Agreement to issue securities to employees
>
> 7(1) Subject to subsection (1.1), where a particular qualifying person has agreed to sell or issue securities of the particular qualifying person (or of a qualifying person with which the particular qualifying person does not deal at arm's length) to an employee of the particular qualifying person (or of a qualifying person with which the particular qualifying person does not deal at arm's length),

. . .

> (*b*) if the employee has transferred or otherwise disposed of rights under the agreement in respect of some or all of the securities to a person with whom the employee was dealing at arm's length, a benefit equal to the amount, if any, by which
>
> (i) the value of the consideration for the disposition
>
> exceeds
>
> (ii) the amount, if any, paid by the employee to acquire those rights
>
> shall be deemed to have been received, in the taxation year in which the employee made the disposition, by the employee because of the employee's employment;

. . .

[Emphasis added.]

[31] Of note is the fact that paragraph 7(1)(*b*) of the Act requires that the employee deal at arm's length with the person to whom that employee disposes of the stock options. In this case, Mr. Rogers surrendered the Options to RCI, a person with which he was not at arm's length. Therefore, the transaction is not caught by paragraph 7(1)(*b*) of the Act, or any of the other paragraphs of section 7. Therein lies the issue.

[32] According to the Appellant, paragraph 7(3)(*a*) precludes the application of paragraph 6(1)(*a*) of the Act because paragraph 7(3)(*a*) deems the Surrender Payment not to be a benefit received or enjoyed by Mr. Rogers, except as provided for in section 7.

[33] The Appellant directs my attention to the recent decision of the Federal Court of Appeal (the "FCA") in *Canada v. Quinco Financial Inc.*[4] There, the FCA held:

> There may be cases where precisely-worded provisions or their interaction creates an advantage or a windfall for a registrant under the Act. But we do not interpret taxation provisions in a tendentious or result-oriented way to enhance the federal treasury: *Shell Canada*, *supra* at paragraphs 39 and 40. Instead, absent words allowing us to address situations of abuse or windfall, where the provisions are precisely-worded, clear and unambiguous, they must be given their plain effect.

[4] 2014 FCA 108, at para. 9.

[34] The Respondent's position is that any portion of an employment benefit not included in income by virtue of section 7 should be included in income under section 6 of the Act. In support of this, the Respondent directs me to this Court's decision in *Dundas v. M.N.R.*[5] There, the taxpayer had received an amount from his employer in settlement of the cancellation of a stock option agreement. The taxpayer maintained that the amount constituted damages on account of the breach of the stock option agreement and was therefore a capital gain. Judge Rip, as he then was, held that the amount was deemed by paragraph 7(1)(*b*) to be an income amount. Judge Rip discussed section 7 of the Act as follows:

> Subsection 7(3) states that where a corporation has agreed to sell or issue shares of its capital stock to an employee no benefit shall be *deemed* to have been received by the employee under or by virtue of the agreement for purposes of Part I of the Act except as provided for by section 7. Subsection 7(3) applies to deemed benefits and provides that such benefits arising from a Stock Option Agreement are taxable only if they meet the conditions contained in section 7. Subsection 7(3) therefore provides that only benefits deemed to be received or enjoyed by an employee under or by virtue of a stock option plan in accordance with section 7 are included in income for purposes of subsection 5(1). Or inversely, if a benefit is to be included in employment income of an employee under subsection 7(1) or 7(1.1), then by virtue of subsection 7(3) no part of the benefit received under or by virtue of the agreement contemplated in subsection 7(1) and 7(1.1) may be included in employment income under another provision in Part I of the Act.
>
> Therefore if an employee receives a benefit from his employer otherwise than under or by virtue of an agreement contemplated in subsections 7(1) or 7(1.1), he is liable to include the value or amount in his income by virtue of section 6.[6]
>
> [Emphasis added.]

[35] On the basis of Judge Rip's reasoning in *Dundas*, the Respondent invites me to adopt the proposition that paragraph 7(3)(*a*) applies only if one of the enumerated circumstances in subsection 7(1) of the Act exists. I observe that the circumstances leading to the cancellation of the option in *Dundas* were very different than the circumstances giving rise to the receipt of the Surrender Payment in the instant case. In *Dundas*, the stock options were cancelled pursuant to the terms of a merger agreement. This was done in violation of the terms of the stock option plan that provided that the options were to survive any merger. In the instant case, the Surrender Payment was made under or pursuant to the terms of the Options, which included the SAR feature.

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[5] 90 DTC 1529.
[6] *Ibid*. at pp. 1539-1540.

[36] As authority for the position that section 7 trumps sections 5 and 6 of the Act, the Appellant cites the decision in *M.N.R. v. Chrysler Canada Ltd. et al.*[7] There, the Federal Court – Trial Division was tasked with determining whether Chrysler's Employee Stock Ownership Plan ("ESOP") was to be considered as an "employee benefit plan" within the meaning of subsection 248(1) of the Act or as a stock option under section 7 of the Act. Strayer J. ruled that the ESOP was both a stock option plan and an employee benefit plan. Noting the rule of statutory interpretation providing that specific provisions take priority over general ones, the Court concluded that section 7 had priority over section 6 of the Act, which, as a result, did not apply. Strayer J. concluded as follows:

> Where there are such benefits taxable in accordance with section 7, the Act itself appears to give that section "priority". Where an agreement exists such as described in subsection 7(1), paragraph 7(3)(*a*) provides that:
>
> > (*a*) no benefit shall be deemed to have been received or enjoyed by the employee under or by virtue of the agreement for the purpose of this Part except as provided by this section. . . .
>
> The reference is to Part I of the Act. Part I includes subsection 5(1), a general provision for taxing "salary, wages and other remuneration . . ." from employment, and subsection 6(1) which taxes various amounts received as income from employment including those received from an employee benefit plan. In applying either of those taxing sections one would be obliged, by the terms of paragraph 7(3)(*a*), to treat the benefits gained by the employees as being the amount calculated in accordance with paragraph 7(1)(*a*), such amount being received in the year determined in accordance with paragraph 7(2)(*a*) (namely in the year when the trustee commenced to hold the shares).[8]

[37] In further support of this view, counsel for the Appellant referred me to the decision of Judge Bowman, as he then was, in *Bowens v. The Queen*.[9] There, the Crown had argued that paragraph 7(1)(*b*) applied to a disposition of options by a taxpayer to a third party. In the alternative, the Crown relied on section 6. In *obiter*, Judge Bowman commented that the application of section 7 trumps section 6 of the Act. He stated the following:

> The alternative position under section 6 was not pressed with vigour, and rightly so, in my view, in light of paragraph 7(3)(*a*). The grant by DEB of the options to the appellant was the type of agreement contemplated by subsection 7(3) and this

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[7] 92 DTC 6346.
[8] *Ibid*. at p. 6348.
[9] 94 DTC 1853.

> fact alone displaces section 6. As it happens, however, paragraph 7(1)(*b*) was inapplicable. This in itself does not of course propel the taxpayer into section 6.[10]

[38] I agree with the reasoning endorsed in *Chrysler* and *Bowens*. A textual, contextual and purposive reading of section 7 of the Act leads me to conclude that this provision is meant to provide a complete code for the taxing of benefits arising under or because of a stock option agreement. The text of paragraph 7(3)(*a*) is clear and unambiguous: it deems an employee to have neither received nor enjoyed any benefit under or because of a stock option agreement, except as provided by that section. The relevant provision reads as follows:

> 7(3) If a particular qualifying person has agreed to sell or issue securities of the particular person, or of a qualifying person with which it does not deal at arm's length, to an employee of the particular person or of a qualifying person with which it does not deal at arm's length,
>
> > (*a*) except as provided by this section, the employee is deemed to have neither received nor enjoyed any benefit under or because of the agreement;
> >
> > . . .
>
> [Emphasis added.]

[39] If the carve-out in section 7(3)(*a*) is interpreted in a narrow fashion, as the Respondent argued it should be – that is it only applies if the benefit is subject to tax under subsection 7(1) of the Act – it would mean that a non-arm's length transfer could become immediately taxable notwithstanding the fact that section 7 specifically provided that this should not be the case. For example, paragraph 7(1)(*b*) of the Act allows an employee to transfer options to his or her holding corporation for a consideration without there being immediate taxation. However, when the holding corporation exercises the options or disposes of them to an arm's length person, the benefit is subject to tax in the hands of the employee. If I accept the Respondent's interpretation, the benefit in the above example would be subject to double taxation.

[40] The Appellant notes the subsequent amendments to section 7 that have closed this loophole. Effective March 4, 2010, subsection 7(1) was amended to include new paragraph 7(1)(*b*.1) of the Act, which effectively covers the issue at bar. Essentially, an employee is deemed to have received an employment benefit when the employee disposes of rights under a stock option agreement to an employer with which the employee does not deal at arm's length. The amendment

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[10] *Ibid*. at pp. 1857-1858.

was made effective on a prospective basis. The Appellant suggests that the amendment serves to confirm that no other provision in section 7 applied to the Surrender Payment at the relevant time. I agree with this interpretation.

[41] Another of the Respondent's submissions is that paragraph 7(3)(*a*) does not apply to the Surrender Payment because it was not the case that RCI "agreed to sell or issue securities" to the Appellant when he surrendered his Options. Rather, he received cash in lieu of exercising those Options.

[42] In my opinion, the Respondent's arguments overlook the broad wording of subsection 7(3) of the Act. The provision provides that, except as provided in section 7, an employee "is deemed to have neither received nor enjoyed any benefit under or because of an agreement" whereby an employer has agreed to issue shares to its employees. Subsection 7(1) covers benefits that arise because options are exercised and shares are received by the employee and benefits that arise because the employee disposes of rights under an agreement to a person with whom the employee is dealing at arm's length. Subsection 7(3) is meant to exclude benefits arising from the non-arm's length exercise and disposition of options.

[43] In the instant case, it is incontrovertible that RCI had agreed to issue or sell shares to Mr. Rogers. The grant of the SAR to Mr. Rogers did not negate RCI's undertaking to issue shares. It was an added feature which allowed Mr. Rogers' to elect to dispose of the Options in exchange for the Surrender Payment. In this context, the Surrender Payment was a benefit received by the Appellant under or because of the Option Agreement. It would have been taxable under subsection 7(1) of the Act had RCI and the Appellant been dealing at arm's length.

[44] That leads to the Respondent's next submission, which is that if the Surrender Payment is not taxable under section 6 then it is "salary, wages and other remuneration" and is accordingly to be included in income under subsection 5(1) of the Act. That provision reads as follows:

> 5(1) Subject to this Part, a taxpayer's income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year.

[45] The Appellant submits that the Surrender Payment is not "salary" or "wages" because it was neither a fixed payment for regular work nor a periodic payment for the labour or services of an employee. So the question becomes: can the Surrender Payment be characterized as "salary, wages and other remuneration?" In my view, no.

[46] The terms "salary", "wages" and "other remuneration" are not defined for the purposes of section 5. The ordinary meaning of the terms "salary" and "wage" connote a periodic and fixed payment by an employer to an employee for work or for services rendered. The Surrender Payment does not fall within that meaning.

[47] At trial and in written submissions, counsel for the Appellant directed my attention to the decision in *Hale v. The Queen*.[11] There, the taxpayer exercised an SAR attached to stock options that had been granted to him while he was resident and employed in Canada. He exercised the SAR after becoming a resident of the United Kingdom. The issue was whether the SAR payment to him was "other similar remuneration" within the meaning of article 15(1) of the Canada-United Kingdom Tax Convention (the "Treaty"). The Federal Court concluded that the SAR payment constituted a benefit received by virtue of the taxpayer's employment as described in section 7(1)(*b*) and was not "remuneration" for the purposes of the Treaty. Relying on *McNeill v. Canada,* [1987] 1 F.C. 119, 86 DTC 6477, the Federal Court held that "[i]t must therefore be concluded that the words salaries, wages and other remuneration unavoidably correspond to a sum of money received in return for the provision of services." In *Hale*, the Court also relied to a great extent upon the FCA's decision in *Hurd v. The Queen*,[12] a case in which it was similarly concluded that a benefit consisting of the difference between the value of shares when acquired on the exercise of a stock option and the price paid for them under the option is not "other remuneration" for the purposes of section 5 of the Act.

[48] I agree with the Appellant. The Surrender Payment is not properly characterized as "salary, wages and other remuneration." Again, this is in accordance with the text, context and purpose of sections 5 through 7 of the Act.

B. Is the Surrender Payment a Shareholder Benefit?

[49] The Respondent's alternative position is that the Surrender Payment, if not taxable under paragraph 6(1)(*a*) and section 5 of the Act, was a shareholder benefit that would be included in income under subsection 15(1).

[50] Both parties referred me to the decision of Judge Bowman, as he then was, in *Del Grande v. The Queen*.[13] In that case, the taxpayer was an officer and 25% shareholder of two corporations with respect to whose shares he was granted options to purchase. The options were worthless at the time they were granted in

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11 90 DTC 6481 (FCTD), affirmed 92 DTC 6473 (FCA).
12 [1982] 1 F.C. 554, 81 DTC 5140, [1981] C.T.C. 209.
13 93 DTC 133.

1982. When he exercised those options over three years later, the shares had a fair market value of $171,738. By reassessment, the Minister added the amount of $171,738 to the appellant's income in 1985 on the basis that the appellant had received a "benefit or advantage" within the meaning of paragraph 15(1)(*c*). On appeal, Judge Bowman held that there was no benefit conferred on the appellant in 1985 since the companies were doing no more than honouring a commitment which had previously been made. Moreover, any benefit received by the appellant was received not by virtue of his being a shareholder but rather by virtue of his position as an officer or director of the companies.

[51] In the Respondent's view, the facts of the instant case distinguish it from *Del Grande*. First, the Appellant was the controlling shareholder of RCI. He held nearly 91% of the Class A voting shares. The Respondent suggests that the Appellant caused the SAR to be approved by the shareholders. Given his shareholding, the outcome of the vote to approve the amendment to the Plan granting the SAR was a foregone conclusion.

[52] In my opinion, the Respondent fails to take into account the fact that Mr. Rogers gave up something of equal value to receive the Surrender Payment. The Surrender Payment reflected the "in-the-money value" of the Options. It was consideration for the cancellation of the unexercised Options. Viewed in this light, the Surrender Payment can hardly be described as a "benefit" taxable under subsection 15(1) of the Act.

C. Was the Surrender of the Options an Adventure in the Nature of Trade?

[53] In the decision *Baird v. Canada*,[14] the FCA conducted a comprehensive review of the meaning of "an adventure or concern in the nature of trade" in the context of the disposition of shares of a public company.

[54] In that case, the appellant was granted options to acquire shares of his employer, BCE Emergis. The appellant exercised the options and acquired the shares. The appellant sold the shares in two transactions and incurred losses totalling a little over $1,000,000. The Appellant claimed the losses as non-capital losses. The Minister reassessed on the basis that the losses were capital losses.

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[14] 2010 FCA 35, 2010 DTC 5035.

[55] Margeson J. dismissed the appeal. The appellant appealed to the FCA on the grounds that the losses stemmed from an adventure in the nature of trade.

[56] Nadon J. A. adopted, at paragraph 14, the following definition of "adventure or concern in the nature of trade" provided, at page 333, in *Principles of Canadian Income Tax Law* (5th ed. (Toronto: Thomson Carswell, 2005) by Peter W. Hogg, Joanne E. Magee and Jinyan Li): "An adventure or concern in the nature of trade is an isolated transaction (which lacks the frequency or system of a trade) in which the taxpayer buys property with the intention of selling it at a profit and then sells it (normally at a profit, but sometimes at a loss)."

[57] Nadon J. A. then goes on to review the SCC's decision in *Friesen*.[15] He observes:

> In *Friesen v. Canada*, [1995] 3 S.C.R. 103, Major J., writing for a majority of the Supreme Court of Canada, remarked at page 115 that the concept of an adventure in the nature of trade is a judicial creation designed to determine which purchase and sale transactions are of a business nature and which are of a capital nature. Major J. then made the point that for a purchase and sale to constitute an adventure in the nature of trade, there had to be a "scheme for profit-making". In his view, there was a requirement for the taxpayer to have had an intention of gaining a profit from his transaction and, in that regard, he referred to Interpretation Bulletin IT-459: "Adventure or Concern in the Nature of Trade" (Sept. 8, 1980), which sets out the relevant tests found in the case law for a determination of whether a transaction constitutes an adventure in the nature of trade. Paragraph 4 of IT-459 provides as follows:
>
> > In determining whether a particular transaction is an adventure or concern in the nature of trade the Courts have emphasized that all the circumstances of the transaction must be considered and that no single criterion can be formulated. Generally, however, the principal tests that have been applied are as follows:
> >
> > 1. whether the taxpayer dealt with the property acquired by him in the same way as a dealer in such property ordinarily would deal with it;
> >
> > 2. whether the nature and quantity of the property excludes the possibility that its sale was the realization of an investment or was otherwise of a capital nature, or that it could have been disposed of other than in a transaction of a trading nature; and
> >
> > 3. whether the taxpayer's intention, as established or deduced, is consistent with other evidence pointing to a trading motivation.

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15 *Ibid*. at para. 15.

[58] He also considered the SCC's decision in *Irrigation Industries Ltd. v. Minister of National Revenue*.[16] In that case, the issue was whether a purchase of shares from treasury and a subsequent disposition of the shares for profit constituted "an adventure or concern in the nature of trade."

[59] In reviewing that decision, Nadon J. A. remarks as follows:

> In disposing of the issue before the Court in that case, Martland J. made a number of comments which remain relevant to this day. First, he indicated at paragraph 13 of his Reasons that he found it difficult to conceive that any purchaser of securities did not have "some intention of disposing of them if their value appreciates to the point where their sale appears to be financially desirable". He then said that if the intention to sell shares at a profit was dispositive of the issue, "then any purchase and sale of securities must constitute an adventure in the nature of trade, ...". He therefore indicated that the issue of whether an isolated transaction of shares constituted an adventure in the nature of trade could not "be determined solely" on the basis of whether the purchaser intended to sell his shares if a profit could be made. . . .[17]

[60] In summary, in light of on the above, to determine whether a particular transaction is an adventure or concern in the nature of trade, all of the circumstances of the transaction must be considered. The principal tests that have been applied can be summarized in the following questions: (i) did the taxpayer deal with the property acquired by him in the same manner as a trader in such property ordinarily would deal with it? (ii) was the nature of the property such that the taxpayer could only have disposed of it in a transaction of a trading nature? and (iii) did the taxpayer intend at the time of the acquisition of the property to resell it at a profit?

Is the SAR Separate Property?

[61] Before applying these tests, I must deal with a novel issue raised by the Respondent in her written submissions on the Section 9 Argument. The Respondent argues that the amendments to the Plan which added the SAR fundamentally altered the nature of the Options.

[62] The essence of the Respondent's argument is that the SAR must be viewed as a right that is distinct from the Options such that the disposition of the SAR gave rise to an income amount.

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16 [1962] S.C.R. 346.

17 *Supra* note 14 at para. 19.

[63] With respect, I disagree with this proposition. As noted earlier, the granting of the SAR did not negate RCI'S promise to issue shares under the terms of the Plan. The SAR had no function or force independent of the Options. It was an added feature that allowed Mr. Rogers to elect to surrender the Options for a consideration that was the Surrender Payment.

[64] Its sole purpose was to allow for the disposition of the Options instead of their simply being exercised, which latter would have resulted in greater share dilution. For these reasons, the SAR cannot be considered separate property.

Mr. Rogers' Conduct

[65] Applying the tests outlined in *Baird*, the first question is whether Mr. Rogers dealt with the Options in the same way as a dealer would.

[66] The Respondent says the answer to that question is yes because Mr. Rogers waited until the last possible day to dispose of his Options in consideration of the Surrender Payment.

[67] With respect, I disagree with the Respondent's portrayal of how traders deal with options. Traders use options for a variety of purposes. The Options held by Mr. Rogers are commonly referred to as call options. A call option allows a holder to buy a security at a fixed price within a specific period of time.

[68] A call option also allows a trader to leverage his bet that the underlying securities will rise in value over a short period of time. A trader does this by risking only the option price rather than employing capital equal to the full price of the security.

[69] In most cases, a trader will dispose of the option when he is satisfied with the increase in the money value or profit to be realized through the sale of the option. Mr. Rogers did not behave in this manner. He held the Options right up to the last moment and surrendered them when they were about to expire.

(1) Nature of the Property

[70] The Options were incapable of providing income, often considered a hallmark of capital property. This alone, however, is not sufficient to preclude the Options from being capital property. Support for this proposition can be found in section 49 of the Act, which regulates, *inter alia*, the tax treatment of options that

are exercised or have expired. Section 49 of the Act[18] is found in Part I, Division B, Subdivision c entitled "Taxable Capital Gains and Allowable Capital Losses". Section 49 recognizes that options to acquire property may be capital property depending on the circumstances surrounding the acquisition and disposition of the options.

(2) Mr. Rogers' Intent

[71] The evidence shows that Mr. Rogers held the Options for ten years and surrendered them to RCI for the Surrender Payment shortly before the Options expired.

[72] When the Options were granted to Mr. Rogers, the Plan did not provide for a SAR. I surmise that, but for the addition of the SAR almost ten years after the grant of the Options, Mr. Rogers would have eventually exercised the Options and added the additional shares to his considerable shareholdings in RCI. The Respondent accepts that, had he done so, the shares received by Mr. Rogers would have been capital property and a taxable capital gain or loss would have been realized or incurred on a subsequent disposition of the shares.[19] There is nothing in the record to suggest that Mr. Rogers acquired the Options with the intent of disposing of them or the underlying shares for cash.

[73] In light of the above, I am satisfied that the Surrender Payment was not profit from an adventure in the nature of trade.

(3) New Argument

[74] On August 29, 2014, almost three and a half months after the hearing of this appeal, the Appellant brought a motion for leave to amend its Notice of Appeal in order to put forward a new argument (the "New Argument"), namely that Mr. Rogers mistakenly treated the Surrender Payment as a capital gain. According to the Appellant, this New Argument merits my consideration because it is based on the outcome in *Mathieu c. La Reine*,[20] a recent decision of this Court released on June 27, 2014.

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[18] Subsection 49(2) provides that a corporation that has granted an option for a consideration realizes a capital gain when the option expires. Subsection 49(3) provides that the exercise of an option is deemed not to be a disposition of property by the option holder.

[19] Respondent's Written Submissions dated August 29, 2014 at paras. 30(d) and (e).

[20] 2014 CCI 207, 2014 DTC 1165.

[75] I dismissed the Appellant's motion for the reasons outlined in my order, which I will not repeat here. However, I would like to make two observations. First, in *Mathieu*, the Court did not address the question whether the surrender of the options by the appellant therein gave rise to a capital gain. This issue was not raised by the parties nor was it considered by the Court.

[76] While subsection 7(3) of the Act deems there to be no benefit when options are disposed of, this deeming provision applies only for the purposes of section 6 of the Act. It is important to note that a capital gain is not defined in the Act as a gain arising or resulting from the disposition of capital property. Instead, subsection 39(1) defines a capital gain broadly as "the taxpayer's gain . . . from the disposition of any property" other than property specifically excluded under that provision ("Excluded Property").[21] Recognizing the potential for overlap with other sections of the Act, the legislator chose to specifically exclude gains that are otherwise included in income under section 3.

[77] In the case at bar, Mr. Rogers realized a gain from the disposition of the Options. The Options are property. They are not Excluded Property. Because of subsection 7(3) of the Act, no part of the gain was otherwise included in income under section 3. Therefore, the gain is a capital gain for the purpose of section 39. Consequently, Mr. Rogers was correct in considering that he realized a capital gain corresponding to the amount of the Surrender Payment received as proceeds of disposition for his Options.

[78] For all of these reasons, the appeal is allowed and the reassessment is vacated.

Signed at Toronto, Ontario, this 25th day of November 2014.

"Robert J. Hogan"

Hogan J.

[21] Subparagraphs 39(1)(*a*)(i) to (v) of the Act list types of property that are specifically excluded under that definition.

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