Federal Court of Appeal

Cour d'appel fédérale

Date: 20111109

Docket: A-348-10

Citation: 2011 FCA 305

CORAM: **SHARLOW J.A.**
DAWSON J.A.
LAYDEN-STEVENSON J.A.

BETWEEN:

STANLEY LABOW

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Ottawa, Ontario, on October 4, 2011.

Judgment delivered at Ottawa, Ontario, on November 9, 2011.

REASONS FOR JUDGMENT BY: DAWSON J.A.

CONCURRED IN BY: SHARLOW J.A.
LAYDEN-STEVENSON J.A.

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REASONS FOR JUDGMENT

DAWSON J.A.

[1] Dr. Stanley Labow is a plastic surgeon. At the time relevant to this appeal he was chief of plastic and reconstructive surgery at the Ottawa Hospital, and an assistant professor of surgery at the University of Ottawa Faculty of Medicine. He also maintained a private medical practice which employed three people on a part-time basis. Two of the part-time employees were unrelated to Dr. Labow. They each worked half time. They booked patient appointments and operating room times and also were responsible for record keeping and general office correspondence. The third part-time employee was Dr. Labow's wife. She kept Dr. Labow's curriculum vitae up-to-date, ensured it was updated appropriately with the University, medical associations and accrediting

bodies, and looked after the financial aspects of the practice. Mrs. Labow's work for her husband required her to work about 20 hours per week, for which she was paid $20,000 per year. The other two part-time employees were paid much less per hour of work.

[2] On May 16, 2003, the Minister of National Revenue (Minister) issued notices of reassessment to Dr. Labow in respect of the 1996 to 1999 taxation years. It is agreed that these reassessments were all made beyond the normal reassessment period prescribed in subsection 152(3.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (Act).

[3] The reassessments issued as a result of Dr. Labow's participation in a Health and Welfare Insurance Plan (Plan). Dr. Labow's contributions to the Plan were held in a Health and Welfare Trust (Trust) administered by the Royal Bank of Canada Trust Company (Cayman) Limited as Trustee (Trustee). Under the Plan, Dr. Labow's wife was entitled to receive disability benefits if she was unable to work due to sickness or injuries from an accident. Dr. Labow's other part-time employees were not entitled to receive benefits under the Plan.

[4] Dr. Labow contributed $150,000.00 to the Trust in 1996 and $247,691.00 in 1997, and each year he deducted the amount of his contribution from the income of his medical practice. Dr. Labow's total contribution of $400,000.00 was almost double the amount that would have been required to provide disability benefits at the maximum level provided by the Plan.

[5] Thereafter, the Trust earned income. The amounts attributed to Dr. Labow's contribution to the Trust were:

Year	Amount
1997	$ 1,320.00
1998	$23,646.00
1999	$47,619.00

[6] In the reassessments, the Minister denied Dr. Labow the deductions from the income of his medical practice that he had claimed in the 1996 and 1997 taxation years as a result of the contributions he made to the Trust. The reassessments also included in Dr. Labow's income for each of the 1997, 1998 and 1999 taxation years, the income of the Trust attributed to Dr. Labow's contributions to it.

[7] Dr. Labow appealed the reassessments to the Tax Court of Canada (Tax Court). A judge of the Tax Court (Judge) dismissed the appeal with costs: 2010 TCC 408, 2010 DTC 1282. Dr. Labow now appeals from the decision of the Tax Court dismissing his appeal. A separate appeal is pending from the Judge's subsequent award of costs (court file number A-45-11).

The Decision of the Tax Court

[8] The relevant facts and the Judge's findings of fact and conclusions of law are amply set out in the Judge's reasons. For this appeal it is sufficient to note the Judge's conclusions that:

1. Dr. Labow did not contribute to the Plan for the purpose of gaining or producing income from his medical practice. The decision to participate was made for purely personal reasons.

2. The reassessments were justified under subparagraph 152(4)(*a*)(i) of the Act because Dr. Labow had made misrepresentations that were attributable to wilful blindness, or carelessness or neglect. The first misrepresentation was characterized as follows:

> There is nothing in either return that would reveal to the reader that these amounts described as salary expense include contributions to a trust to fund a plan for his wife, the purpose of which had nothing to do with gaining or producing income.

The second misrepresentation was Dr. Labow's failure to include the income attributed to him from the Trust in his tax return each year.

3. The income received from the Trust was deemed to form part of Dr. Labow's income pursuant to subsection 75(2) of the Act because the Plan provided that on the termination of Dr. Labow's participation in the Plan, the trust funds were to be refunded to him. For the 1999 taxation year, paragraph 75(3)(*b*) of the Act did not exclude the operation of subsection 75(2) because the Trust did not provide benefits to Dr. Labow's wife "because of her office or employment" as required for paragraph 75(3)(*b*) to apply.

4. Reassessment outside the normal time period was also justified under subparagraph 152(4)(*b*)(iii) of the Act because the income earned on the Trust was a consequence of a transaction or transactions involving Dr. Labow and a non-

resident person with whom he was not dealing at arm's length. Dr. Labow and the Trust were not operating at arm's length because both Dr. Labow and his solicitor could remove and replace the Trustee. It followed that Dr. Labow was found to control the Trust.

The Issues

[9] The issues raised on this appeal are whether the Judge erred in determining that:

1. the Minister was entitled to reassess Dr. Labow pursuant to subparagraph 152(4)(*b*)(iii) of the Act after the normal reassessment period?
2. the Minister was entitled to reassess Dr. Labow pursuant to subparagraph 152(4)(*a*)(i) of the Act after the normal reassessment period?
3. Dr. Labow's contributions to the Trust in respect of the Plan were not deductible in computing the profit of his medical practice?
4. the gross earnings of the Trust on Dr. Labow's account in the 1997, 1998 and 1999 taxation years were taxable in his hands as net interest income under subsection 75(2) of the Act?

Consideration of the Issues

1. Subparagraph 152(4)(*b*)(iii) of the Act

[10] Subparagraph 152(4)(*b*)(iii) of the Act provides:

152. (4) The Minister may at any time make an assessment, reassessment or additional assessment of tax for a	152. (4) Le ministre peut établir une cotisation, une nouvelle cotisation ou une cotisation supplémentaire

taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer's normal reassessment period in respect of the year only if	concernant l'impôt pour une année d'imposition, ainsi que les intérêts ou les pénalités, qui sont payables par un contribuable en vertu de la présente partie ou donner avis par écrit qu'aucun impôt n'est payable pour l'année à toute personne qui a produit une déclaration de revenu pour une année d'imposition. Pareille cotisation ne peut être établie après l'expiration de la période normale de nouvelle cotisation applicable au contribuable pour l'année que dans les cas suivants :
[…]	. . .
(b) the assessment, reassessment or additional assessment is made before the day that is 3 years after the end of the normal reassessment period for the taxpayer in respect of the year and	b) la cotisation est établie avant le jour qui suit de trois ans la fin de la période normale de nouvelle cotisation applicable au contribuable pour l'année et, selon le cas :
[…]	. . .
(iii) is made as a consequence of a transaction involving the taxpayer and a non-resident person with whom the taxpayer was not dealing at arm's length, [emphasis added]	(iii) est établie par suite de la conclusion d'une opération entre le contribuable et une personne non résidente avec laquelle il avait un lien de dépendance, [Non souligné dans l'original.]

[11] Dr. Labow argues that the Judge erred in his application of this provision to the facts before him because:

a. The Judge failed to determine the residence of the Trust.

b. The "transaction" relied upon by the Judge was Dr. Labow's contribution to the Trust made to obtain disability benefits for his wife. However, the dividend income, interest income and

taxable capital gains of the Trust, which were reassessed in Dr. Labow's income under subparagraph 152(4)(*b*)(iii) of the Act, were not part of the performance of this transaction.

c. The Judge erred when he concluded that both Dr. Labow and his solicitor could replace the Trustee.

d. The Judge erred when he found that the ability to replace the Trustee constituted control of the Trust.

e. The Judge erred by limiting the legal test for non-arm's length dealing to the issue of control. The Judge was required to consider whether there was a common directing mind.

[12] For the following reasons, I conclude that the Judge did not err as alleged when he found the reassessment to be authorized under subparagraph 152(4)(*b*)(iii) of the Act.

[13] First, while it is correct that the Judge did not make a specific finding with respect to the residence of the Trust, I am satisfied that the residence of the Trust was not put in issue on a timely basis by Dr. Labow. One of the Minister's assumptions was that the Trust was resident in the Cayman Islands. Dr. Labow did not join issue with the Minister on this point, nor did he lead evidence to challenge the assumption that the Trust was a foreign resident. The T1141 form Dr. Labow filed in 1998 and put in evidence stated that the Trust's country of residence was the Cayman Islands.

[14] During the oral argument of this appeal, counsel for Dr. Labow stated that the issue of the control of the Trust only surfaced in final argument in the Tax Court. In response to a new

submission made on the Minister's behalf, counsel attempted to argue that the Trust was resident in Canada. In my view, this submission is untenable in view of paragraph 16(j) of the Minister's Further Amended Reply where the Minister assumed:

> Non-arm's length – 152(4)(b)(iii)
>
> j) at no time during the relevant period did the Appellant deal at arm's length with the Trust;
>
> i) the Appellant could at any time and for any reason whatsoever cease participation in the plan and have the remaining balance in the fund returned to the Appellant;
>
> ii) the Appellant could replace the Trustee simply by providing written notice;
>
> iii) the Appellant and the Trustee could amend the Memorandum of Agreement by mutual agreement.

Contrary to his counsel's submissions, Dr. Labow ought to have known that control of the Trust was in issue. Counsel for Dr. Labow could not then attempt to raise the issue of the residence of the Trust in closing argument.

[15] Second, the Judge correctly recognized that for subparagraph 152(4)(*b*)(iii) to apply, the reassessment must have been "made as a consequence of a transaction involving the taxpayer and a non-resident person." I see no error in his conclusion that the trust income was the direct result of the contributions to the Trust. The contributions were one or more transactions involving Dr. Labow and the Trust. The income was earned on the subject matter of those transactions.

[16] Third, whether Dr. Labow and his solicitor could replace the Trustee was a question of law to be determined by interpreting the trust instrument. As the Judge correctly noted, Article 5 (c) of the trust instrument permits an employer to replace the Trustee:

> The Employer, upon giving one (1) month's written notice to the Trustee may replace the Trustee provided that such notice shall state the name of the new Trustee or Trustees who have been appointed in place of the Trustee so removed;

[17] The trust instrument defines an "Employer" to be a participating employer or any person authorized by the participating employer to replace the Trustee. The Judge found that in 1998 Dr. Labow's solicitor exercised his power to remove the Trustee at Dr. Labow's behest.

[18] The Judge made no error when he interpreted the trust instrument.

[19] Fourth, the finding that Dr. Labow controlled the Trust was a finding made in the context of determining whether Dr. Labow and the Trust were dealing with each other at arm's length. The jurisprudence is settled that when entities are controlled directly or indirectly by the same person, whether the person is an individual or corporation, the entities do not deal at arm's length. See, for example, *Minister of National Revenue v. Sheldon's Engineering Ltd.*, [1955] S.C.R. 637 at page 644.

[20] In the context of a trust, this Court has held that where a settler has the power to demand the retirement of the trustee the settler, for practical and legal purposes, controls the trust. See, for example, *Robson Leather Company Ltd. v. Minister of National Revenue* (1977), 14 N.R. 598 at

pages 611 and 612. The Judge did not err in his application of *Robson Leather Company* to the facts before him.

[21] Finally, the Judge did not err by limiting the legal test for determining the existence of non-arm's length dealing to the issue of control. It is correct that when determining the existence of a non-arm's length relationship, courts generally consider whether: (i) there was a common mind directing the bargaining for both parties; (ii) they were acting in concert without separate interests; and (iii) one party exercised *de facto* control over the other. However, not all of these criteria need be satisfied, nor are these criteria necessarily exhaustive: *Canada v. Remai Estate*, 2009 FCA 340, 396 N.R. 351 at paragraph 32.

[22] To conclude on the first issue, the Judge did not err when he found, at paragraph 46 of his reasons, that the "Minister was therefore empowered by subparagraph 152(4)(*b*)(iii) to reassess at any time up to three years following the normal three-year reassessment period."

[23] While Dr. Labow argues that this finding relates only to the inclusion of the Trust earnings in Dr. Labow's income under subsection 75(2) of the Act, in oral argument counsel for the Minister submitted that the Judge's finding would also apply to authorize the reassessment of the deductions from income.

[24] I agree. For subparagraph 152(4)(*b*)(iii) to apply, the reassessment must be made "as a consequence of a transaction involving the taxpayer and a non-resident person with whom the

taxpayer was not dealing at arm's length." The Judge did not err in finding the receipt of income from the trust was a consequence of a transaction or transactions involving Dr. Labow and the non-resident Trust with which Dr. Labow did not deal at arm's length. The transactions were the two contributions Dr. Labow made to the Trust to obtain disability benefits for his wife. Implicit in the finding that the receipt of income was a consequence of transactions between Dr. Labow and the Trust is the finding that the two contributions were themselves transactions between Dr. Labow and the Trust. It follows that the reassessments disallowing the deductibility of the contributions were a consequence of these transactions and so were authorized under subparagraph 152(4)(*b*)(iii) of the Act.

2. Subparagraph 152(4)(*a*)(i) of the Act

[25] Having found that the Minister was entitled to reassess under paragraph 152(4)(*b*)(iii) of the Act, it is not necessary to consider Dr. Labow's arguments about the Judge's application of subparagraph 152(4)(*a*)(i) of the Act. Particularly, no view is expressed as to whether, as Dr. Labow argues, the Judge erred by relying upon misrepresentations not pled by the Minister in order to support the Minister's reliance upon subparagraph 152(4)(*a*)(i).

3. The deductibility of Dr. Labow's contributions to the Plan

[26] Paragraph 18(1)(*a*) of the Act provides that no outlay or expense may be deducted from the income of a taxpayer unless it was made or incurred for the purpose of gaining or producing income from a business or property. The purpose of an expenditure is a question of fact to be

decided with due regard to all of the circumstances: *Symes v. Canada*, [1993] 4 S.C.R. 695 at page 736.

[27] In the present case, for reasons which are well-explained, the Judge found as a fact that the monies paid to the Trust were not expended for the purpose of gaining or producing income. No palpable or overriding error has been alleged or established with respect to this finding of fact.

[28] Instead, Dr. Labow argues that the Judge made a number of errors of law in reaching his conclusion about the purpose for which Dr. Labow contributed to the Plan. However, contrary to Dr. Labow's submissions, in *Symes* the Supreme Court of Canada confirmed that the determination of the purpose for which an expense was incurred is not a question of mixed fact and law, but rather is a question of fact. As the Judge did not err when reaching his finding of fact concerning the purpose for which the contributions were made, there is no need to consider the errors of law asserted by Dr. Labow.

4. The treatment of the earnings of the Trust

[29] Dr. Labow asserts that the Judge committed a number of errors when he determined that for the 1997, 1998 and 1999 taxation years the capital gains, dividend income and interest income of the Trust should be included as net interest income of Dr. Labow pursuant to subsection 75(2) of the Act. He also complains that he should have been entitled to deduct charges made by the Trustee to the Trust in 1997, 1998 and 1999.

[30] In my view, Dr. Labow cannot succeed in challenging the inclusion of the Trust income or the exclusion of charges for the following reasons.

[31] First, Dr. Labow did not raise the issue of the proper characterization of the income received from the Trust in his notice of appeal. He simply denied that the Trust earned the amounts reassessed. Further, after the Minister set out in her reply her assumption that the Trust produced income in the amount specified in the notices of reassessment, Dr. Labow's amended answer, at paragraph 13, simply pleaded that the Minister had failed to provide any reason for declining to apply subsection 75(3) of the Act. Dr. Labow's bare denial that the Trust earned the amount assessed for each year was insufficient to raise the issue of the proper characterization of the income.

[32] Second, there was no proper evidentiary basis to establish whether income was received as capital gains, dividend income, interest or combination of the three. While a schedule of investment transactions was tendered as an exhibit, no evidence was produced to explain the document. For example, there was no explanation as to why some amounts earned from trading in shares were characterized as a capital gain rather than income. In view of Dr. Labow's concern that the Trustee engaged in overly frequent, non-conservative trading, evidence should have been adduced as to the Trustee's reasons for choosing particular shares, the length of time they were held and the reasons for their sale.

[33] Similarly, while Dr. Labow did put in issue his entitlement to deduct fees charged by the Trustee, evidence with respect to those amounts was lacking. Again, while the amounts charged were set out in the schedule of investment transactions, there was no evidence about the charges. For example, no explanation was provided as to whether the income as stated was net of the Trustee's expenses. It is not for this Court on appeal to re-try factual issues not properly addressed at trial.

[34] Finally, Dr. Labow argues that the Judge erred by failing to apply the excepting provision in paragraph 75(3)(*b*) of the Act. Paragraph 75(3)(*b*) provides:

75. (3) Subsection 75(2) does not apply to property held in a taxation year	75. (3) Le paragraphe (2) ne s'applique pas à un bien détenu au cours d'une année d'imposition par l'une des fiducies suivantes :
[…]	. . .
(b) by an employee trust, a related segregated fund trust (within the meaning assigned by paragraph 138.1(1)(a)), a trust described in paragraph (a.1) of the definition "trust" in subsection 108(1), or a trust described in paragraph 149(1)(y); [emphasis added]	b) une fiducie créée à l'égard du fonds réservé, au sens de l'alinéa 138.1(1)a), une fiducie visée à l'alinéa a.1) de la définition de « fiducie » au paragraphe 108(1) ou une fiducie visée à l'alinéa 149(1)y); [Non souligné dans l'original.]

[35] The Judge did not err by failing to apply this provision for the reasons given by the Judge. At paragraph 47 he wrote:

> […] The appellant argues that the trust property is excluded from the operation of subsection 75(2) by paragraph 75(3)(b) because it is a trust described in paragraph (a.1) of the definition of trust in subsection 108(1). This exclusion would apply only to the last year under appeal.

> A trust … all or substantially all of the property of which is held for the purpose of providing benefits to individuals each of whom is provided with benefits in respect of, or because of, an office or employment or former office or employment of any individual.
>
> In my view, this trust cannot meet that definition for the simple reason that, as I have found above, if the purpose of the plan was to provide any benefits to Rosalind Labow, then those benefits were not provided to her because of her office or employment, but because she was married to the appellant. Consequently, subsection 75(2) applies, and the income of the trust is taxable to Dr. Labow. [emphasis added and footnote omitted]

[36] During oral argument of this appeal, counsel for Dr. Labow argued that the Judge erred by only considering the phrase "because of, an office or employment". Counsel argued that the Judge failed to consider whether the benefits were provided "in respect of"' Dr. Labow's wife's office or employment. However, given the Judge's finding of fact that the benefits were provided because of Dr. Labow's wife's marital status, it cannot be said the benefits were provided either "because of" or "in respect of" her office or employment.

Conclusion

[37] For these reasons, I would dismiss this appeal with costs.

"Eleanor R. Dawson"
J.A.

"I agree.
K. Sharlow J.A."

"I agree.
Carolyn Layden-Stevenson J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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