Federal Court of Appeal

Cour d'appel fédérale

Date: 20130322

Dockets: A-463-11
A-464-11
A-465-11

Citation: 2013 FCA 88

CORAM: SHARLOW J.A.
TRUDEL J.A.
WEBB J.A.

BETWEEN:

JACK ST. ARNAUD, ALBERT PATENAUDE, HARRY BRAUN

Appellants

and

HER MAJESTY THE QUEEN

Respondent

Heard at Winnipeg, Manitoba on February 5, 2013.

Judgment delivered at Ottawa, Ontario, on March 22, 2013.

REASONS FOR JUDGMENT BY: WEBB J.A.

CONCURRED IN BY: TRUDEL J.A.
CONCURRING REASONS BY: SHARLOW J.A.

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<u>REASONS FOR JUDGMENT</u>

<u>WEBB J.A.</u>

[1] These are appeals from a decision of the Tax Court of Canada (2011 TCC 536). The three Appellants had been reassessed to include amounts in their income under subsection 146(9) of the *Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp.), (the Act) or subsection 146.3(4) of the Act on the basis that the trust governed by their registered retirement savings plan or registered retirement income fund, as the case may be, had acquired shares of certain private companies and that the fair market value of such shares was nil. Gross negligence penalties under subsection 163(2) of the Act had also been imposed. Since the Crown had conceded, prior to the hearing at the Tax Court, that

the penalties should not have been imposed, the appeals were allowed to delete the penalties, but were otherwise dismissed. For the reasons that follow I would allow the appeals.

[2] The Tax Court issued a common set of reasons. The appeals to this Court were consolidated by order of this Court dated May 4, 2012, with the appeal in Court file A-463-11 being designated as the principal appeal. The reasons which follow will be filed in Court file A-463-11. A copy will be filed as reasons for judgment in Court files A-464-11 and A-465-11.

[3] In these reasons a trust governed by a registered retirement savings plan will be referred to as an RRSP and a trust governed by a registered retirement income fund will be referred to as a RRIF. A reference to a registered plan will mean a trust governed by either a registered retirement savings plan or a registered retirement income fund.

Provisions of the Act

[4] Subsection 146(9) of the Act (which has not been amended since it was added to the Act in 1972) provides as follows:

(9) Where in a taxation year a trust governed by a registered retirement savings plan	(9) Lorsque, au cours d’une année d’imposition, une fiducie régie par un régime enregistré d’épargne-retraite :
(*a*) disposes of property for a consideration less than the fair market value of the property at the time of the disposition, or for no consideration, or	*a*) soit dispose de biens en échange d’une contrepartie d’une valeur inférieure à la juste valeur marchande que ces biens avaient au moment de la disposition, ou sans aucune contrepartie;
(*b*) acquires property for a consideration greater than the fair market value of the property at the	*b*) soit acquiert des biens en échange d’une contrepartie d’une valeur supérieure à la juste valeur marchande

time of the acquisition, the difference between the fair market value and the consideration, if any, shall be included in computing the income for the taxation year of the annuitant under the plan.

que ces biens avaient au moment de l'acquisition, toute différence entre cette juste valeur marchande et la contrepartie doit être incluse dans le calcul du revenu, pour l'année d'imposition, du rentier qui bénéficie de ce régime.

[5] Subsection 146.3(4) of the Act (which has not been amended since it was added to the Act in 1978) provides as follows:

(4) Where at any time in a taxation year a trust governed by a registered retirement income fund

(*a*) disposes of property for a consideration less than the fair market value of the property at the time of the disposition, or for no consideration, or

(*b*) acquires property for a consideration greater than the fair market value of the property at the time of the acquisition, 2 times the difference between that fair market value and the consideration, if any, shall be included in computing the income for the taxation year of the taxpayer who is the annuitant under the fund at that time.

(4) Lorsque, à un moment donné d'une année d'imposition, une fiducie régie par un fonds enregistré de revenu de retraite :

a) soit dispose de biens pour une contrepartie inférieure à la juste valeur marchande des biens au moment de la disposition, ou gratuitement;

b) soit acquiert des biens pour une contrepartie supérieure à la juste valeur marchande des biens au moment de l'acquisition, il doit être inclus dans le calcul du revenu, pour l'année d'imposition, du contribuable qui est le rentier en vertu du fonds à ce moment, 2 fois la différence entre cette juste valeur marchande et la contrepartie.

[6] While the conditions which must be met in order for subsections 146(9) and 146.3(4) of the Act to be applicable are identical, the consequences arising from the application of the two subsections are significantly different. If subsection 146(9) applies (where RRSP funds are used), the amount included in income is the difference between the consideration paid for the property and

its fair market value. But if funds in a RRIF are used, the amount included in income is ***two times*** this difference. Counsel for the Crown could not explain why there is such a significant difference if the funds held in a RRIF are used to acquire property. It might be questioned whether the requirement under subsection 146.3(4) of the Act to include two times the amount of such difference in income imposes a penalty and if so, whether the imposition of the penalty would be subject to a due diligence defence (*Yarrows v. Frowde Limited*, [1934] O.J. No. 272, paragraph 37 and *Consolidated Canadian Contractors Inc. v. Canada*, [1999] 1 F.C. 209). However, this issue was not raised in this appeal and I express no opinion on it.

[7] The parties expressed different views on the interpretation of subsection 146(9) and 146.3(4) of the Act. The Crown's position is that the provisions should be interpreted and applied simply as they read and that any acquisition by an RRSP or a RRIF of property for an amount in excess of the fair market value of such property will result in an amount being included in the income of the annuitant as provided therein. The Appellants' position is that the provision should only apply if the acquisition of the property by the RRSP or RRIF is part of a scheme devised to allow an annuitant to extract funds from an RRSP or RRIF without paying tax on such amounts. However, it is clear that the above subsections only apply if an RRSP or a RRIF disposes of or acquires property. Since, for the reasons that follow, I have concluded that the RRSPs and RRIF did not acquire the property upon which the reassessments were based, it is not necessary to comment on the different views expressed by the parties in relation to the interpretation of these subsections.

Background

[8] In this case, the Appellants are innocent victims who lost significant amounts of money that

had been in their respective registered plans when an individual (or individuals) took the money that was supposed to have been invested in certain private companies. Each Appellant lost the entire amount that was paid from their respective registered plan, which, in Albert Patenaude's case, was his entire retirement fund. Not only did they lose significant amounts of money that was in their RRSPs, Jack St. Arnaud and Albert Patenaude were reassessed to include in their income the amount that was lost and Harry Braun was reassessed, as provided in subsection 146.3(4) of the Act, to include in his income two times the amount that he had lost.

[9] The Appellants were frustrated with the low returns that they were receiving on their investments in their registered plans. Each Appellant, separately through a friend of the particular Appellant, was introduced to the persons who were promoting Sonnum Capital Leasing Corp. (Sonnum) and Cuatro Corp. (Cuatro). The Appellants were each persuaded that they could achieve better returns if they were to acquire shares in either Sonnum or Cuatro. Sonnum was represented as being a company involved with a new machine that could make concrete building blocks at a job site and Cuatro was represented as a company that was making fibreboard but which was also planning to expand into the concrete building blocks business.

[10] In each case, the Appellants transferred funds to Olympia Trust and then provided Olympia Trust instructions to purchase shares. Each Appellant received a letter from Mohammed H. Khatri, CA, indicating that the fair market of the shares that were to be acquired was equal to the amount to be paid for such shares. The parties now agree that the fair market value of the shares of Sonnum and Cuatro was nil throughout the period in issue in this case.

[11] The amounts that each individual caused to be paid from his RRSP or RRIF and the shares that were to have been acquired were as follows:

Individual	Amount	Shares to be Acquired
Jack St. Arnaud	$42,000	42 preferred shares of Sonnum
Albert Patenaude	$78,700	31,480 common shares of Cuatro
Harry Braun	$10,000	4,000 common shares of Cuatro

[12] Jack St. Arnaud also paid $125,000 personally for preferred shares of Sonnum and Harry Braun's wife also caused her RRIF to pay $15,000 for shares of Sonnum.

[13] The position of the Crown is that the RRSPs or RRIF of the Appellants acquired the shares referred to above and that the fair market value of the shares was nil at the time that the shares were acquired. While there is no dispute that the fair market value of the shares of Sonnum and Cuatro was nil throughout the relevant period of time, whether the shares were acquired by the RRSPs and RRIF of the Appellants was a live issue. Since the Appellants were reassessed, pursuant to subsections 146(9) and 146.3(4) of the Act, on the basis that their RRSPs or RRIF acquired the shares of Sonnum or Cuatro, if these RRSPs and RRIF did not acquire these shares, the reassessments pursuant to these subsections cannot stand.

[14] The Tax Court judge appears to have concluded that the Appellants had agreed that the registered plans had acquired the shares in question. He stated at paragraph 3 of his reasons that "there is now no disagreement as to the material facts of these cases", and at paragraph 9 that "[t]hese share purchases took place in July and August of 2001 in the cases of Mr. Patenaude and Mr. Braun, and in January 2002 in the case of Mr. St. Arnaud".

[15] Approximately 1,000 pages of exhibits and 49 pages of discovery read-ins were submitted at the Tax Court hearing. There was no analysis of this large number of documents to determine if the Appellants' registered plans had acquired the shares in question.

[16] At the hearing of these appeals, counsel for the Appellants asserted that they have never accepted that the shares were acquired by their respective registered plans. During the Tax Court hearing, counsel for the Appellants also stated, with respect to the large number of documents that were being admitted by consent, that "the basis of the qualification, and I have stated it before but just to be clear, is that we are not admitting that the underlying corporate requirements were met to secure the validity of those documents". The responses of the Appellants to the Requests to Admit Facts also support this position as the Appellants refused to admit that the shares in question were acquired.

[17] In the Request to Admit served on Albert Patenaude, paragraph 16 stated as follows:

> 16. On or about July 9, 2001, the RRSP Trust, on behalf of the Appellant, purchased 31,480 Class A common shares of Cuatro Corp. for $2.50 per share for a total of $78,000.00;

[18] In the Response to Request to Admit, Albert Patenaude stated as follows:

> 5. Refuses to admit the truth of facts numbers 1, 10, 11, 16, 17, 18, 20, 21, 23, 25, 26, 27, 31, 33, 34, 35, 36, 37, 38, 39, 40, 42, 43, 44, 45, 46, 47, 58 for the reason that while documentation shows the various entities are purported to validly exist and the transactions described therein are purported to have occurred as described, the Appellant does not admit to the validity of the entities or the transactions described.

[19] For Harry Braun, the Request to Admit included a similar direct request to admit that his RRIF purchased shares, which prompted the same response as noted above.

[20] The Request to Admit for Jack St Arnaud included a direct request to admit that he had "purchased 125 Class C preferred shares of Sonnum Capital Leasing Corp. for $1,000.00 per share for a total of $125,000.00" for the shares that he thought he was purchasing personally. There is, however, no similar direct request to admit that his RRSP had acquired shares of Sonnum. Even though there was no request to admit that his RRSP had acquired shares of Sonnum, the same response noted above was provided in his Response to the Request to Admit.

[21] As a result it is clear that the Tax Court judge was mistaken when he did not undertake an analysis to determine if the shares had been acquired but instead concluded that the parties had agreed to all of the facts and in particular whether the registered plans had acquired the shares in question. It should also be noted that the question of whether the shares in this case were acquired can only be answered by applying the relevant provisions of the statute governing Sonnum and Cuatro. It will therefore necessary to review the record and the statute governing these corporations to determine whether the registered plans of the Appellants acquired the shares in question.

Did Jack St. Arnaud's RRSP Acquire Shares in Sonnum?

[22] Jack St. Arnaud entered into a Share Purchase Agreement with Sonnum dated January 25, 2002. In this agreement, Sonnum is defined as the "Seller". The recitals to this agreement provided as follows:

> WHEREAS:
>
> A. The Seller is the record owner and holder of the issued and outstanding shares of the capital stock of Sonnum Capital Leasing Corp. (the "Corporation"), a Canadian Controlled Private Corporation duly incorporated in Alberta; and

> B. The Purchaser desires to purchase shares of the Corporation held by the Seller (the "Stock"), and the Seller desires to sell the Stock, upon the terms and subject to the conditions hereinafter set forth;

[23] Sonnum was defined in the same agreement as both the Seller and the Corporation. The recitals clearly state that Sonnum is the record holder of shares in itself and the remainder of the agreement is written as an agreement of purchase and sale, not as an agreement for the issuance of shares from treasury. In particular, paragraph 3.3 of this agreement provides as follows:

> 3.… Seller hereby warrants and represents:
>
> …
>
> 3.3 The Seller is the lawful owner of the Stock, free and clear of all security interest, liens, encumbrances, equities and other charges.

[24] Sonnum was incorporated under the Alberta Business Corporations Act (ABCA). In 2002, subsection 32(1) of the ABCA provided as follows:

> 32(1) Except as provided in subsections (2) and sections 33 to 36, a corporation
>
> (a) shall not hold shares in itself or in its holding body corporate, and
>
> (b) shall not permit any of its subsidiary bodies corporate to acquire shares of the corporation.
>
> (2) Not more than 1% of the issued shares of each class of shares of a holding body corporate may be held by all the subsidiaries of the holding body corporate.

[25] Subsection 32(2) of the ABCA would not be applicable since the agreement did not state that a subsidiary of Sonnum was selling shares in Sonnum. Section 33 of the ABCA provides that a corporation may hold shares in itself as a legal representative provided that it does not have a beneficial interest in such shares. Sections 34, 35 and 36 of the ABCA apply to a corporation that is purchasing, redeeming or otherwise acquiring shares in itself. Therefore, none of these sections

would be applicable and Sonnum could not hold shares in itself under the ABCA. The Agreement could not be correct that Sonnum was the lawful owner of issued and outstanding shares in itself. It seems to me that Jack St. Arnaud's RRSP could not, therefore, acquire shares of Sonnum under this agreement.

[26] Even though Jack St. Arnaud's RRSP could not have acquired shares of Sonnum under this agreement, since it appears that the corporate records of Sonnum indicate that shares were issued to Jack St. Arnaud's RRSP, I will address the issue of whether the shares could be considered to be validly issued from treasury apart from this agreement.

[27] The document that purported to be a share certificate for 42 Class C Preferred shares of Sonnum issued to Olympia Trust Company in Trust for Jack St. Arnaud was dated April 19, 2002. According to the record, there were three classes of shares of Sonnum – Class A Common, Class B Common and Class C Preferred shares. Therefore, Sonnum had only one class of preferred shares – Class C Preferred shares. As noted above, the position of the Crown is that Jack St. Arnaud's RRSP had acquired these shares. All of the parties agreed that the shares of Sonnum and Cuatro were nil at all relevant times. For the purposes of subsection 146(9) of the Act, the relevant time is the time of the acquisition of the property. Therefore, if the shares were acquired by Jack St. Arnaud's RRSP, the shares would have been acquired on April 19, 2002 and the fair market value of such shares at that time would have been nil.

[28] In paragraph 1 of the Valuation Report for the shares of Sonnum prepared for the Department of Justice, the valuator noted that the dates for the determination of fair market value were the dates of the share issuances between June 18, 2001 and March 3, 2004. In his Conclusion (upon which the Crown relies), the valuator went further and stated that:

> 68. It is my view, based upon the information reviewed, and subject to the scope limitations, assumptions, qualifications and restrictions noted in this report, that ***the fair market value of [Sonnum] was always nil*** during the period from June 18, 2001 to May 31, 2004 and, therefore, the fair market value of all classes of common and preferred shares on a class basis and per share basis was nil upon issuance at all issue dates between June 18, 2001 and March 3, 2004.
>
> (emphasis added)

[29] Schedule 1 (a) to this report is an Estimated En Bloc Fair Market Value of Sonnum as of May 31, 2002 (approximately 42 days after April 19, 2002). The total liabilities (after taking into account a GST refund) were $38,749. On page 17 of this report, the valuator concludes that Sonnum is a holding company with no active business operating assets or operations and that the fair market value of Sonnum should be determined using the liquidation approach. Since Sonnum was a holding company with no operations, it would seem logical that there would not be any significant change in its liabilities from April 19, 2002 to May 31, 2002.

[30] According to schedule 6 to the Valuation Report, during the period from August 15, 2001 to April 19, 2002 (based on the ledgers of Sonnum), Sonnum had issued 1,411 Class C preferred shares at $1,000 per share. This would mean that Sonnum should have received $1,411,000 during this period.

[31] In total, according to the ledgers as summarized in Schedule 6 of the Valuation Report, Sonnum would have issued approximately $2.3 million in Class C preferred shares during the period from August 15, 2001 to March 2004. It seems to me that the only logical basis upon which it could be found that the fair market value of Sonnum was always nil throughout this period (and in particular on April 19, 2002), would be if either Sonnum never received the money or if Sonnum only received the cash as agent for the person who absconded with the money. In either event, Sonnum did not receive the money on its own account. If Sonnum would have been the beneficial recipient of the money, then at the time that at least some of the shares were issued, the fair market value of the shares would not have been nil. By relying on this conclusion that the fair market value of Sonnum was always nil throughout the period, the Minister of National Revenue (Minister) must be taken to have assumed implicitly that, in one way or another, the money that was supposed to have been used to acquire shares was not used for this purpose.

[32] Subsections 27(3) and (5) of the ABCA in 2002 provided that:

> 27(3) A share shall not be issued until the consideration for the share is fully paid in money or in property or past service that is not less in value than the fair equivalent of the money that the corporation would have received if the share had been issued for money.
> …
>
> (5) For the purposes of this section, "property" does not include a promissory note or promise to pay given by the allottee.

[33] If Sonnum either did not receive the money, or received it simply as a conduit for the for the person who disappeared with the money, then the shares of Sonnum could not have been validly issued. It follows that the corporate records of Sonnum and the documents that were printed as share certificates did not reflect validly issued shares of Sonnum.

[34] I have also considered whether Jack St. Arnaud's RRSP may have acquired a right to a return of the money. Even though such a right could be property as defined in the Act, this was not the property that was identified by the Crown as the property that was acquired by the RRSP. In any event, there was no valuation or agreement on the fair market value of this right. The valuator did note that four annuitants were able to get their money back after they indicated that they did not want the shares of Sonnum, although at least one of the persons had to threaten Sonnum with legal action and it took almost two years from the time when the retraction right was exercised. This would suggest that the right to have a refund of the amount that was paid may have had a fair market value that was greater than nil.

[35] I conclude that the evidence contradicts the Minister's assumption that Jack St. Arnaud's RRSP acquired shares of Sonnum and therefore, the Minister's reassessment of Jack St. Arnaud under subsection 146(9) of the Act, cannot stand.

Did Albert Patenaude's RRSP and Harry Braun's RRIF Acquire Shares in Cuatro?

[36] Albert Patenaude and Harry Braun were each reassessed on the basis that their registered plans had acquired shares of Cuatro and that the fair market value of the shares of Cuatro, at the time that these shares were acquired, was nil. Harry Braun entered into a Share Purchase Agreement with Celestine Investments Inc. (Celestine) dated May 17, 2001 and Albert Patenaude entered into a Share Purchase Agreement with Celestine dated June 7, 2001.

[37] Celestine was defined as the "Seller" in each of the agreements. The recitals and the

representation and warranty contained in paragraph 3.3 of the agreements are identical for each agreement and these are as follows:

> WHEREAS:
>
> A. The Seller is the record owner and holder of the issued and outstanding shares of the capital stock of Cuatro Corp. (the "Corporation"), a Canadian Controlled Private Corporation duly incorporated in Alberta; and
>
> B. The Purchaser desires to purchase shares of the Corporation held by the Seller (the "Stock"), and the Seller desires to sell the Stock, upon the terms and subject to the conditions hereinafter set forth;
>
> …
>
> 3. … Seller hereby warrants and represents:
>
> …
>
> 3.3 The Seller is the lawful owner of the Stock, free and clear of all security interest, liens, encumbrances, equities and other charges.

[38] It is reasonable to conclude from the record that Cuatro was incorporated under the ABCA. Section 49 of the ABCA imposes an obligation on a corporation to maintain a securities register identifying the persons to whom securities (shares or debt obligations – section 1 of the ABCA) have been issued. Section 50 of the ABCA provides that the corporation may treat the registered owner exclusively as the person entitled to the rights and powers associated with the security. It was reasonable for the Minister to review the corporate records of Cuatro to determine who owned shares of Cuatro at any particular time.

[39] In the Tax Court pleadings no assumption is made by the Minister that Celestine owned any shares of Cuatro. The Minister stated, in reassessing these Appellants, that it was assumed that "Celestine Investments Inc. is not identified as the owner of any shares of Cuatro Corp. in either the minute book or the securities register of Cuatro Corp.".

[40] It is trite law that a person cannot sell what that person does not own. Since the record does not disclose any evidence that Celestine owned any shares of Cuatro (and actually supports a finding that Celestine did not own any shares of Cuatro), it necessarily follows that Harry Braun's RRIF and Albert Patenaude's RRSP could not have acquired shares of Cuatro from Celestine.

[41] Since a person can acquire shares of a corporation from either an existing shareholder or from treasury and since the reassessment was based on Harry Braun's RRIF and Albert Patenaude's RRSP having acquired shares of Cuatro, I have considered whether the record would support a finding that the shares of Cuatro could be otherwise considered to be validly issued to this RRIF and RRSP from treasury. There is a schedule to the valuation report prepared for the shares of Cuatro which lists the issued shares of Cuatro and which includes a reference to the share certificates for the shares in question.

[42] In the Valuation Report for the shares of Cuatro prepared by the valuator retained by the Department of Justice, the following is stated at page 11:

> 40. It is a reasonable assumption that Cuatro Corp.'s involvement in the business of panel boards made of straw had never moved beyond the hypothetical because:
>
> a. the report relied upon by Mohammed Khatri in preparing his valuation for Cuatro Corp. was in fact simply a copy of a report prepared by Evans & Evans, Inc. for another corporation, Cuatro U.S.A. Inc., which had been tampered with to make it appear as if it were a report prepared for Cuatro Corp.;
>
> b. this report, *Cuatro Corp. Estimate of Potential Market Value* dated September 15, 2000 and attributed to Evans & Evans, Inc., was issued on Evans & Evans, Inc. letterhead without their permission;
>
> c. there was no information or basis supporting that Cuatro Corp. was engaged in such a business other than representations made by Cuatro Corp.'s promoters;

d. Cuatro Corp. received little to no cash from gross issue proceeds of $545,500.00*; and

e. Cuatro Corp. loaned out more than $356,000.00 to related parties and recorded no capital or research related assets.

(* denotes a footnote reference that was in the original text but which has not been included here)

[43] At the end of paragraph d., there is a footnote reference to note 2 of Schedule 2 to the Valuation Report. Schedule 2 is a listing of the Share Capital Issued by Cuatro. This note states as follows:

> 2. The above listing of shares issued to investors is taken from records prepared by Mohammed Khatri. 218,200 such shares are listed as being issued. This totals $545,500 at $2.50/share as disclosed on Cuatro Corp.'s December 31, 2001 balance sheet, part of which is reproduced as Schedule 3. Based on the balance sheet, testimony of Mohammed Khatri and discussions with Murray Bond and the CRA Tax Avoidance Auditor, Ken Cameron, it appears that only a small amount, if any, of the cash paid for the share capital was ever deposited into the Cuatro Corp. bank account. Murray Bond claims that Cuatro Corp. only received about $31,000. The CRA Tax Avoidance Auditor considers that no funds were ever received because Murray Bond is unable to provide evidence of receipt of any amount.

[44] This listing of shares includes the shares that the Minister assumed were acquired by Harry Braun's RRIF and Albert Patenaude's RRSP. Excerpts from the discovery examination of Kenneth Cameron (the auditor for the Canada Revenue Agency referred to above) were submitted at the hearing. These excerpts confirm that the Canada Revenue Agency's tracing of the funds (as far as they could trace such funds) revealed that the money did not go to Cuatro. The flow of funds (that were to have been used to purchase shares of Cuatro) to other corporations (and not to Cuatro) is also reflected in the assumptions made by the Minister in the Tax Court pleadings.

[45] As noted above, section 27 of the ABCA provides that shares cannot be issued until the consideration is fully paid. The valuator who prepared the Valuation Report for the shares of Cuatro noted this requirement in footnote 1 in Schedule 2 of his report. Since the evidence in the record and the Crown's position was that Cuatro had not received any of the money that the various investors had paid for shares, there could be no basis on which a finding could be made that Harry Braund's RRIF or Albert Patenaude's RRSP acquired shares of Cuatro from treasury.

[46] Any rights that may have been acquired by these registered plans as a result of the agreement with Celestine may have been property for the purposes of the Act. However, the reassessments were based on the registered plans having acquired shares of Cuatro, not on these plans having acquired rights to damages or rescission.

[47] It would therefore follow that the Minister's reassessment of Harry Braun under subsection 146.3(4) of the Act and Albert Patenaude under subsection 146(9) of the Act cannot stand.

Conclusion

[48] I would allow the appeals, set aside the judgment of the Tax Court and vacate the reassessments issued against Jack St. Arnaud, Albert Patenaude and Harry Braun. I would award each Appellant his own costs in this Court and in the Tax Court.

"Wyman W. Webb"
J.A.

"I agree,
Johanne Trudel J.A."

CONCURRING REASONS

SHARLOW J.A.

[49] I agree with the disposition of these appeals proposed by my colleague Justice Webb, substantially for the reasons he has stated. However, unlike him, I have concluded that it is appropriate to deal with the Appellants' alternative argument relating to the interpretation of subsections 146(9) and 146.3(4) of the Act. For the following reasons, I have concluded that the interpretation proposed by the Appellants is correct.

[50] My analysis must begin with a brief sketch of the relevant statutory scheme, and its purpose. Section 146 of the Act defines a "retirement savings plan" as a contract between an individual (the "annuitant") and an appropriately licensed financial institution under which the annuitant invests money with the institution to fund the annuitant's retirement income in accordance with the terms of the plan. Typically, the funds are held in trust to facilitate investment, and the trust is referred to as being "governed by" the plan. Some retirement savings plans are described as "locked-in", signifying that the annuitant cannot receive payments under the plan prior to a stipulated retirement date, except in specified circumstances. The terms of a retirement savings plan may permit the annuitant to direct the investments made with the funds held in trust pursuant to the plan.

[51] A retirement savings plan with terms and conditions meeting certain statutory requirements may be "registered" with the Minister – thus becoming a "registered retirement savings plan". As long as the plan is registered, the annuitant may claim income tax deductions for amounts contributed to the plan (within stipulated limits), and income and gains on the contributed funds accumulate within the trust free of income tax. If the trust suffers a loss on its investments, the

amount of money available to fund the annuitant's retirement income is reduced accordingly, but there is no tax relief for any such loss.

[52] With certain exceptions that are not relevant to these appeals, any benefit the annuitant receives from an RRSP is taxed in the hands of the annuitant pursuant to subsection 146(8), which reads in relevant part as follows:

146. (8) There shall be included in computing a taxpayer's income for a taxation year the total of all amounts received by the taxpayer in the year as benefits out of or under registered retirement savings plans […].	146. (8) Est inclus dans le calcul du revenu d'un contribuable pour une année d'imposition le total des montants qu'il a reçus au cours de l'année à titre de prestations dans le cadre de régimes enregistrés d'épargne-retraite […]

Subsection 146(8) applies to amounts the annuitant withdraws from the RRSP, as well as any retirement income paid to the annuitant from the RRSP.

[53] Because the purpose of an RRSP is to fund the annuitant's retirement income, it cannot remain in existence indefinitely. When the annuitant reaches a certain age (now 71), contributions must cease. The annuitant must then take one of three steps. One option is to withdraw all funds held in the RRSP (which would be taxable in the hands of the annuitant). Alternatively, the annuitant may direct the funds held in the RRSP to be used to acquire a life annuity or a fixed term annuity under which periodic payments are made to the annuitant (in which case the annuity payments would be taxable in the hands of the annuitant when received). The third option for the annuitant is to direct that the funds be transferred to a registered retirement income fund as defined in section 146.3 of the Act.

[54] If the last mentioned option is chosen, income and gains continue to accumulate within the trust free of tax, and the annuitant may direct their investment. However, a certain portion of the funds held in trust must be paid annually to the annuitant, with the result that the funds held in trust will decline over time. Subject to certain exceptions that are not relevant to these appeals, the annuitant is subject to income tax on all such payments, as well as any other benefits received by the annuitant out of the RRIF, pursuant to subsection 146.3(5). That provision reads in relevant part as follows:

146.3 (5) There shall be included in computing the income of a taxpayer for a taxation year all amounts received by the taxpayer in the year out of or under a registered retirement income fund […].	146.3 (5) Il doit être inclus dans le calcul du revenu d'un contribuable pour une année d'imposition les sommes qu'il a reçues au cours de l'année dans le cadre d'un fonds enregistré de revenu de retraite […].

[55] Sections 146 and 146.3 contain detailed rules relating to the investments that may be made by an RRSP or a RRIF. The acquisition of non-qualified investments is deterred by provisions that impose a tax on the annuitant equal to the value of any non-qualified investment acquired.

[56] It may be that the qualified investment rules are intended generally to encourage sound investment decisions and discourage foolish ones, but none of them say so expressly. As a matter of tax policy, that might be explained by the fact that a certain number of unwise investment decisions are inevitable when taxpayers are given the legal right to direct the investment of their own retirement funds.

[57] When a retirement fund suffers a loss because of an unwise investment decision, the loss is borne by the taxpayer who made or authorized the decision, but there are no fiscal consequences.

There is no provision that increases the annuitant's economic burden by taxing the amount of the loss (in the case of an RRSP) or twice that amount (in the case of a RRIF). In these cases, that tax burden has been imposed in respect of amounts that were taken from an RRSP or a RRIF and disappeared with no trace, contrary to the intention and express authorization of the annuitant. It is not alleged that any of the Appellants received or benefited in any way from the payments. On the contrary, it is common ground that they did not.

[58] The imposition of tax in these cases is based on subsections 146(9) and 146.3(4). These provisions are quoted in the reasons of Justice Webb, but they are reproduced here for ease of reference:

RRSP	*REER*
146. (9) Where in a taxation year a trust governed by a registered retirement savings plan	146. (9) Lorsque, au cours d'une année d'imposition, une fiducie régie par un régime enregistré d'épargne-retraite :
(*a*) disposes of property for a consideration less than the fair market value of the property at the time of the disposition, or for no consideration, or	*a*) soit dispose de biens en échange d'une contrepartie d'une valeur inférieure à la juste valeur marchande que ces biens avaient au moment de la disposition, ou sans aucune contrepartie;
(*b*) acquires property for a consideration greater than the fair market value of the property at the time of the acquisition, the difference between the fair market value and the consideration, if any, shall be included in computing the income for the taxation year of the annuitant under the plan.	*b*) soit acquiert des biens en échange d'une contrepartie d'une valeur supérieure à la juste valeur marchande que ces biens avaient au moment de l'acquisition, toute différence entre cette juste valeur marchande et la contrepartie doit être incluse dans le calcul du revenu, pour l'année d'imposition, du rentier qui bénéficie de ce régime.

RRIF	*FERR*
146.3 (4) Where at any time in a taxation year a trust governed by a registered retirement income fund	146.3 (4) Lorsque, à un moment donné d'une année d'imposition, une fiducie régie par un fonds enregistré de revenu de retraite :
(*a*) disposes of property for a consideration less than the fair market value of the property at the time of the disposition, or for no consideration, or	*a*) soit dispose de biens pour une contrepartie inférieure à la juste valeur marchande des biens au moment de la disposition, ou gratuitement;
(*b*) acquires property for a consideration greater than the fair market value of the property at the time of the acquisition, 2 times the difference between that fair market value and the consideration, if any, shall be included in computing the income for the taxation year of the taxpayer who is the annuitant under the fund at that time.	*b*) soit acquiert des biens pour une contrepartie supérieure à la juste valeur marchande des biens au moment de l'acquisition, il doit être inclus dans le calcul du revenu, pour l'année d'imposition, du contribuable qui est le rentier en vertu du fonds à ce moment, 2 fois la différence entre cette juste valeur marchande et la contrepartie.

[59] The Crown argues that these provisions should be interpreted literally. However, a literal interpretation of a statute cannot be accepted without further examination. In interpreting any statutory provision, even one that appears to be clear on its face, it is necessary to consider its context and purpose by reading the provisions of the statute "as a harmonious whole" (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at paragraph 10).

[60] There is a debate between the parties as to the purpose of subsections 146(9) and 146.3(4). The difference between their positions may be illustrated by a simple example.

[61] Imagine the case of Mary, who is the annuitant under an RRSP holding investments worth $1 million. Under the statutory scheme relating to RRSPs, those investments are meant to be used to finance Mary's retirement income. Mary becomes aware of an investment opportunity with a new company that would be a "qualified investment" for an RRSP. She engages advisers who, after a period of due diligence, conclude honestly and with reason that the investment has a fair market value of $800,000. Relying on their advice, Mary directs the trust to use $800,000 of her retirement fund to purchase the investment. It is subsequently learned that the advisors were mistaken (though not negligently so), and in fact the fair market value of the investment was only $600,000 at the time of purchase. The economic result of Mary's investment decision based on their advice was, on paper, an immediate $200,000 loss to the annuitant's retirement fund (I call it a paper loss because the investment might become valuable if the company eventually succeeds.). Under the Crown's interpretation of paragraph 146(9)(*b*), Mary must also include $200,000 in her income for the year in which the investment was purchased. Assuming Mary's tax rate is 30%, she suffers a permanent economic loss of $60,000.

[62] What justification can be offered to impose a $60,000 tax on Mary in these circumstances? The Crown says it is justified by the need to deter improvident investments made with after-tax dollars. If so, that would tend to suggest that subsections 146(9) and 146.3(4) are not intended to apply to an investment decision taken with reasonable care. But the Crown does not accept that the application of subsections 146(9) or 146.3(4) depends in any way upon the reason or motivation for the transaction, or the care taken by the decision maker.

[63] The Crown's argument as to the purpose of subsections 146(9) and 146.3(4) is based on the assumption that it is necessarily improvident to dispose of property for less than its fair market value, or to acquire property for more than its fair market value. That may or may not be a sound assumption, but for present purposes I accept it. In my view, it is not rational to conclude that the purpose of subsections 146(9) and 146.3(4) is to deter improvident investments, while at the same time denying that the application of those provisions may be avoided by establishing that reasonable care was taken to ascertain the fair market value of the property. This casts doubt on the validity of the Crown's proposed literal interpretation of subsections 146(9) and 146.3(4).

[64] The Appellants propose a different understanding of the purpose of subsections 146(9) and 146.3(4). They argue that it is reasonable to infer that Parliament assumed that if an RRSP or a RRIF is authorized to dispose of property for proceeds known to be less than its fair market value, or to acquire property at a cost known to be greater than its fair market value, the reason must be that the annuitant or someone connected to the annuitant has arranged to recover the resulting loss in whole or in part through a collateral arrangement. On that basis, they argue that the interpretation of these provisions is subject, by necessary implication, to the existence of such a collateral arrangement that is intended to avoid the tax that would have been imposed if the annuitant had simply withdrawn funds from the RRSP or the RRIF.

[65] Suppose that Mary authorized her RRSP to use $800,000 of her retirement fund to purchase an asset that she knew to be worth $600,000, and also entered into a collateral arrangement under which she recovered, by indirect or circuitous means, all or part of the $200,000 overpayment. In that case, the same $200,000 will have been lost to Mary's retirement fund, but there are two other

significant consequences. First, Mary will have recovered, through the collateral arrangement, a share of the $200,000 loss. Second, Mary will have saved $60,000 by avoiding the statutory provisions requiring her to pay tax on any amount she received from her RRSP. In my view, there is a rational basis for concluding that the tax imposed by subsections 146(9) and 146.3(4) was intended to deter this kind of transaction. That favours the Appellants' proposed interpretation of those provisions.

[66] Given a choice between the interpretation proposed by the Appellants and the interpretation proposed by the Crown, I accept the former and conclude that paragraphs 146(9)(*b*) and 146.3(4)(*b*) do not apply in this case.

[67] In conclusion, I observe that the Minister has numerous statutory tools to deter what might be seen as abuses of the statutory scheme for registered plans. I do not propose to mention them all, but I will mention one, paragraph 207.05(2)(*c*), which came into effect on March 23, 2011. It imposes a tax equal to the amount of an "RRSP strip", a defined term that would include the kind of transaction described in the second example above. That definition reads as follows:

> "RRSP strip", in respect of a RRIF or RRSP, means an amount used or obtained by the controlling individual of the RRIF or RRSP, or a person who does not deal at arm's length with the controlling individual, as part of a transaction or event or a series of transactions or events one of the main purposes of which is to enable the controlling individual, or a person who does not deal at arm's length with the controlling individual, to use or obtain the benefit of property held in connection with the RRIF or RRSP, but

> « somme découlant d'un dépouillement de REER » Relativement à un FERR ou à un REER, toute somme utilisée ou obtenue par le particulier contrôlant du FERR ou du REER, ou par une personne avec laquelle celui-ci a un lien de dépendance, dans le cadre d'une opération ou d'un événement, ou d'une série d'opérations ou d'événements, dont l'un des objets principaux consiste à permettre au particulier contrôlant ou à une personne avec laquelle il a un lien de

does not include an amount that is	dépendance d'utiliser un bien détenu dans le cadre du FERR ou du REER ou d'en tirer profit. En est exclue toute somme qui, selon le cas :
(*a*) included in the income of the controlling individual or their spouse or common-law partner under section 146 or 146.3;	*a*) est incluse dans le revenu du particulier contrôlant ou de son époux ou conjoint de fait en application des articles 146 ou 146.3;
(*b*) an excluded withdrawal under section 146.01 or 146.02;	*b*) est un retrait exclu en vertu des articles 146.01 ou 146.02;
(*c*) described in subsection 146(16) or 146.3(14.2); or	*c*) est visée aux paragraphes 146(16) ou 146.3 (14.2);
(*d*) the principal amount of a debt obligation that is a prescribed excluded property.	*d*) représente le principal d'une créance qui est un bien exclu visé par règlement.

[68] Finally, I note that in addition to the many anti-avoidance provisions relating specifically to registered plans, an abusive tax avoidance scheme involving a registered plan could be subject to the general anti-avoidance rule in section 245 of the Act. It came into force on September 13, 1988.

"K. Sharlow"

J.A.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKETS:	A-463-11 A-464-11 A-465-11
STYLE OF CAUSE:	ARNAUD ET AL v QUEEN
PLACE OF HEARING:	Winnipeg, Manitoba
DATE OF HEARING:	February 5, 2013
REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY: **CONCURRING REASONS BY:**	TRUDEL J.A. SHARLOW J.A.
DATED:	March 22 2013

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