Federal Court of Appeal  Cour d'appel fédérale

Date: 20130425

Docket: A-143-12

Citation: 2013 FCA 110

CORAM: **SHARLOW J.A.**
TRUDEL J.A.
NEAR J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

DR. ROBERT G. MACDONALD

Respondent

Heard at Fredericton, New Brunswick, on March 18, 2013.

Judgment delivered at Ottawa, Ontario, on April 25, 2013.

REASONS FOR JUDGMENT BY: NEAR J.A.

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

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REASONS FOR JUDGMENT

NEAR J.A.

[1] The Crown appeals the April 17, 2012 judgment of the Tax Court of Canada (2012 TCC 123) in which the judge allowed the appeal of Dr. Robert G. MacDonald from a reassessment made pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp) for the 2002 tax year. The principal issue in this case is whether subsection 84(2) of the *Income Tax Act* applies to deem Dr. MacDonald to have received a dividend of approximately $500,000 as a result of transactions relating to the winding up of his corporation.

[2] For the reasons that follow, I would allow the Crown's appeal.

I. BACKGROUND

[3] Dr. MacDonald is a medical doctor who practised in New Brunswick until 2002, when he moved to the United States with the intention of establishing his residence there. He conducted his practise in New Brunswick under the auspices of Robert G. MacDonald Professional Corporation Ltd. ("PC"), of which he was the sole shareholder, director, and officer.

[4] In contemplation of his move, and on the advice of his accountant and counsel, Dr. MacDonald initiated a series of transactions to dismantle PC. As the judge states at paragraph 23 of his reasons, "a plan was devised whereby assets of PC would be liquidated and its shares would be sold to [Dr. MacDonald's] brother-in-law, J.S.". The plan was set out in a partial Agreed Statement of Facts filed in the Tax Court, and reproduced at paragraph 24 of the judge's reasons (footnotes omitted):

> a. 601798 NB Ltd. ("601 Ltd.") was incorporated by J.S. under the laws of New Brunswick on June 20, 2002. It acquired the shares in PC on June 25, 2002 from J.S. after J.S. had acquired them personally on that same day. The transactions are well documented and each transaction that occurred on June 25, 2002 identifies the time of execution. The transactions are thereby readily identifiable as being in a particular sequence.
>
> b. The purchase by J.S. of the PC shares was paid by delivery of a promissory note by J.S. to [Dr. MacDonald] (the "J.S. note"). The purchase price was set out as a formula that gave rise to a total consideration of $525,068.
>
> c. J.S. transferred the PC shares to 601 Ltd. in consideration of receiving shares in 601 Ltd. and a note payable by 601 Ltd. to J.S. in the amount of $525,068 (the "601 Ltd. note").

d. PC declared two dividends on June 25, 2002, one in the amount of $500,000 and the other in the amount of $10,000. On the same day, PC issued two cheques to 601 Ltd., as the PC shareholder at the time the dividend was declared, in partial payment of the $500,000 dividend. One was for $320,000 and the other was for $159,842. 601 Ltd. in turn endorsed the cheques to J.S. as partial payment of the 601 Ltd. note and J.S. in turn endorsed the cheques to [Dr. MacDonald] as partial payment of the J.S. note. [Dr. MacDonald] wrote a cheque to PC in the amount of an unrelated indebtedness to it, namely, $159,842. The cheques for $159,842 were off-setting and booked as such although never cashed. The cheque for $320,000 now held by [Dr. MacDonald] was never cashed or presented for payment at a bank but was booked as a payable to [Dr. MacDonald]. All such events occurred on June 25, 2002.

e. As noted, PC changed its name to 050509 N.B. Ltd. on June 26, 2002. This was consistent with PC ceasing to be a professional corporation due to [Dr. MacDonald] no longer being a shareholder of the company and his ceasing to practise medicine in New Brunswick. For the most part, I will continue to refer to this company as "PC".

f. PC declared a final dividend on September 1, 2002 to 601 Ltd. equal to the amount still owing on the 601 Ltd. note, namely $25,068. This amount plus the unpaid portion of the dividend declared on June 25, 2002 was, as an acknowledged indebtedness to J.S., booked by PC, on the direction of J.S., as an indebtedness to [Dr. MacDonald]. Such direction was in satisfaction of J.S.'s remaining obligation under the J.S. note.

g. On July 15, 2002, PC by cheque paid 601 Ltd. the amount of $10,000. The cheque was deposited on August 27, 2002.

h. PC prepared Articles of Dissolution on July 31, 2002 and it was officially dissolved on February 4, 2005.

[5] The judge held that the share sale was carried out "by way of a non-arm's length series of transactions designed to give [Dr. MacDonald] access to essentially all of the assets of PC" (reasons, at paragraph 8), and that this series of transactions was effected during the course of the winding up of PC's business (reasons, at paragraphs 84-85). In the months leading up to June 25, 2002, Dr. MacDonald "caused PC to liquidate its investments" (reasons, at paragraph 24, note 10), and, at all times, 601 Ltd. was an inactive holding company (reasons, at paragraph 24, note 12).

[6] In filing his income tax return for 2002, Dr. MacDonald treated the amount of $525,068 as proceeds of disposition of his PC shares, resulting in a capital gain. That capital gain was offset with capital losses realized in 2002 and prior years. The Minister reassessed on the basis that subsection 84(2) of the *Income Tax Act* applied. The result was that the $525,068, less the $101 paid-up capital of the shares sold, was taxed as a dividend. Dr. MacDonald successfully appealed the reassessment to the Tax Court.

II. THE TAX COURT'S JUDGMENT

[7] The Tax Court considered two primary issues: (i) whether subsection 84(2) applied to the transactions; and (ii) whether, in the alternative, the general anti-avoidance rule (GAAR) in section 245 of the *Income Tax Act* applied to achieve the same result.

Subsection 84(2)

[8] Subsection 84(2) reads as follows:

84. (2) Where funds or property of a corporation resident in Canada have at any time after March 31, 1977 been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of any class of shares in its capital stock, on the winding-up, discontinuance or reorganization of its business, the corporation shall be deemed to have paid at that time a dividend on the shares of that class equal to the amount, if any, by which	84. (2) Lorsque des fonds ou des biens d'une société résidant au Canada ont, à un moment donné après le 31 mars 1977, été distribués ou autrement attribués, de quelque façon que ce soit, aux actionnaires ou au profit des actionnaires de tout catégorie d'actions de son capital-actions, lors de la liquidation, de la cessation de l'exploitation ou de la réorganisation de son entreprise, la société est réputée avoir versé au moment donné un dividende sur les actions de cette catégorie, égal à l'excédent éventuel du

	montant ou de la valeur visés à l'alinéa *a*) sur le montant visé à l'alinéa *b*):
(*a*) the amount or value of the funds or property distributed or appropriated, as the case may be,	*a*) le montant ou la valeur des fonds ou des biens distribués ou attribués, selon le cas;
exceeds	
(*b*) the amount, if any, by which the paid-up capital in respect of the shares of that class is reduced on the distribution or appropriation, as the case may be,	*b*) le montant éventuel de la réduction, lors de la distribution ou de l'attribution, selon le cas, du capital versé relatif aux actions de cette catégorie;
and a dividend shall be deemed to have been received at that time by each person who held any of the issued shares at that time equal to that proportion of the amount of the excess that the number of the shares of that class held by the person immediately before that time is of the number of the issued shares of that class outstanding immediately before that time.	chacune des personnes qui détenaient au moment donné une ou plusieurs des actions émises est réputée avoir reçu à ce moment un dividende égal à la fraction de l'excédent représentée par le rapport existant entre le nombre d'actions de cette catégorie qu'elle détenait immédiatement avant ce moment et le nombre d'actions émises de cette catégorie qui étaient en circulation immédiatement avant ce moment.

[9] The judge held that subsection 84(2) of the *Income Tax Act* did not apply to Dr. MacDonald's transactions because he received the funds in question in his capacity as creditor, rather than as shareholder. He narrowly construed the provision, concluding that its scope "was not intended to cover payments arising as consideration on a share sale" (at paragraph 49). He reasoned that the provision "ensures that it is only a shareholder at the time of the distribution or appropriation who can be deemed to be the recipient of a dividend" (at paragraph 50) and that "[t]he

express language of 'in any manner whatever' does not redirect to whom the dividend was paid" (at paragraph 48).

[10] The judge considered *McNichol v. Canada*, [1997] T.C.J. No. 5 and *RMM Canadian Enterprises Inc. and Equilease Corporation v. Her Majesty the Queen*, 97 D.T.C. 302, and adopted what he termed the "*McNichol* approach," which looks to section 245 when subsection 84(2) does not apply on a strict construction of its language (reasons, at paragraph 59).

GAAR

[11] The judge held that, while there was an avoidance transaction that gave rise to a tax benefit, this avoidance did not constitute an abuse of the *Income Tax Act*.

III. ISSUES

[12] Two issues are raised in this appeal:

i. Whether the judge erred in law in finding that subsection 84(2) of the *Income Tax Act* does not apply on the facts of this case; and

ii. Alternatively, whether the judge erred in law in finding that the GAAR does not apply on the facts of this case.

[13] For the reasons that follow, I have concluded that the judge erred in finding that subsection 84(2) does not apply. Having reached that conclusion, it is not necessary to comment on the other issue, and I decline to do so.

IV. STANDARD OF REVIEW

[14] As stated at paragraph 44 of *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, "[t]he textual, contextual and purposive interpretation of specific provisions of the *Income Tax Act* is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive." Whether the judge properly interpreted subsection 84(2) of the *Income Tax Act* is thus a question of law, to be reviewed for correctness (*Housen v. Nikolaisen*, 2002 SCC 33 at paragraph 8). If properly interpreted, the judge's application of the provision to the facts ought to be shown deference; if improperly interpreted, the judge's application to the facts may amount to an error of law, in which case it should be shown no deference (*Housen* at paras. 26-37).

V. ANALYSIS

Subsection 84(2) of the *Income Tax Act*

[15] There is "no doubt today that all statutes, including the *Income Tax Act* must be interpreted in a textual, contextual and purposive way. However, the particularity and detail of many tax provisions have often led to an emphasis on textual interpretation" (*Canada Trustco* at paragraph 11). This case turns on the interpretation of the opening words of subsection 84(2). The entire section is quoted above, but for ease of reference, the opening words are reproduced here (my underlining):

84. (2) Where funds or property of a corporation resident in Canada have …	84. (2) Lorsque des fonds ou des biens d'une société résidant au Canada ont …

been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of any class of shares in its capital stock, on the winding-up, discontinuance or reorganization of its business, the corporation shall be deemed to have paid at that time a dividend on the shares of that class equal to …,	été distribués ou autrement attribués, de quelque façon que ce soit, aux actionnaires ou au profit des actionnaires de tout catégorie d'actions de son capital-actions, lors de la liquidation, de la cessation de l'exploitation ou de la réorganisation de son entreprise, la société est réputée avoir versé au moment donné un dividende sur les actions de cette catégorie, égal à […].

[16] The Crown contends that the judge erred in holding that subsection 84(2) does not apply, arguing at paragraph 30 of its memorandum that his conclusion "defies the wording of s. 84(2) which looks to the how and why and in 'whatever manner' the corporate funds find their way into the respondent's hands on the dissolution or wind-up of his corporation and is inconsistent with the jurisprudence dealing with the provision."

[17] A plain reading of the text reveals several elements that are necessary for its application: (1) a Canadian resident corporation that is (2) winding-up, discontinuing or reorganizing; (3) a distribution or appropriation of the corporation's funds or property in any manner whatever; (4) to or for the benefit of its shareholders.

[18] The facts that are potentially relevant to the application of subsection 84(2) are undisputed. First, PC was a Canadian resident corporation. Second, the series of transactions described above was intended to achieve the termination of PC, and did so. Third, at the commencement of the series of transactions, Dr. MacDonald was the sole shareholder of PC, which had cash or near cash of approximately $500,000. Fourth, by the end of the series of transactions, the money had become the property of Dr. MacDonald, except for the $10,000 retained by J.S. The question is whether,

because of the manner in which the money moved from PC to Dr. MacDonald, his receipt of that money falls within the scope of subsection 84(2).

[19] The judge focused his analysis on the legal character of what Dr. MacDonald received in the course of the series of transactions described above. I paraphrase as follows his summary of the legal nature and consequences of the transactions: When J.S. purchased the PC shares from Dr. MacDonald, J.S. became the only shareholder of PC but he owed Dr. MacDonald $525,068 for the purchase price. When 601 Ltd. later purchased the PC shares from J.S., 601 Ltd. became the only shareholder of PC, but it owed J.S. $525,068 for the purchase price. When PC made a distribution of its corporate assets by way of dividend, only 601 Ltd. was entitled to receive the distribution. Looking through the various exchanges of cheques, what Dr. MacDonald finally received, as a matter of law, was not a corporate distribution at all (much less a corporate distribution from PC), but an amount paid to discharge a debt that was owed to him. The judge reasoned that because Dr. MacDonald did not receive a corporate distribution or appropriation from PC, subsection 84(2) had no application.

[20] The Crown argues that, in determining whether subsection 84(2) applies, the focus should be on the words "in any manner whatever". The money that was originally the property of PC, in fact, ended up in the hands of Dr. MacDonald by means of the series of transactions described above, which were designed to achieve that very result.

[21] In my view, a textual, contextual and purposive analysis of subsection 84(2) leads the Court to look to: (i) who initiated the winding-up, discontinuance or reorganization of the business; (ii)

who received the funds or property of the corporation at the end of that winding-up, discontinuance or reorganization; and (iii) the circumstances in which the purported distributions took place. This approach is consistent with the jurisprudence interpreting this provision and provides the consistency of approach with respect to subsection 84(2) spoken to by both parties to this appeal.

[22] The cases interpreting subsection 84(2) are instructive. In *Merritt v. Canada (Minister of National Revenue)*, [1941] Ex. C.R. 175, rev'd on other grounds [1942] 2 D.L.R. 465, for example, the appellant was a shareholder of Securities Loan & Savings Company ("the Security Company"). As part of its winding up, the Security Company sold its assets and business as a going concern to Premier Trust Company, in exchange for which the shareholders of the Security Company were to receive either shares in Premier Trust Company or cash. The appellant opted to receive a combination of cash and shares in the Trust Company, and the Exchequer Court upheld the Minister's assessment that her portion of the undistributed surplus of the Security Company fell within the scope of the predecessor to subsection 84(2), which was similarly worded (subsection 19(1) of the *War Income Tax Act*, R.S.C., 1927, c. 97, as amended by 1 Edw. VIII, c. 38, s. 11), and was thus taxable as a dividend. It is noteworthy that in so holding, the Exchequer Court looked at the circumstances of the transactions on the winding-up of the Security Company and held that "[i]t is immaterial … that the consideration received by the appellant for her shares happened to reach her directly from the Premier Company [the third party facilitator] and not through the medium of the Security Company" (at paragraph 7).

[23] The facts in *Smythe v. Canada (Minister of National Revenue)*, [1970] S.C.R. 64 were similar to those in *Merritt* in that the "old company" sold its assets to a new company, in

consideration of which the shareholders of the old company received shares in the new company and debentures. The complex series of transactions in that case also involved two intermediary "dividend-stripping" companies that bought the shares of the old company for cash and otherwise facilitated the transactions for a fee. The issue was the application of another similarly worded predecessor to subsection 84(2) of the *Income Tax Act* (subsection 81(1) of the *Income Tax Act*, R.S.C. 1952, c. 148).

[24] The Supreme Court of Canada's main concern with the transactions in that case was that, "when the old company transferred its assets to the new company, the total consideration should have been received by the old company" rather than by the shareholders of the old company (at page 72). In holding that the predecessor to subsection 84(2) "clearly applied", the Court again looked at the circumstances of the transactions at the end of the winding-up to conclude that the transactions were artificial and that their sole purpose was "to distribute or appropriate to the shareholders the 'undistributed income on hand' of the old company" (at page 69).

[25] Contrary to the judge's assertions, *McNichol* is readily distinguishable from the case at hand. In *McNichol*, the shareholders of Bec sold their shares to Beformac, a holding company, for less than their book value. To fund the purchase, Beformac obtained a loan from a bank, secured against the amount of money Bec held in its account (which was, incidentally, its only asset). Bec and Beformac amalgamated five days after the share sale, and the loan from the bank was repaid two weeks later. The Tax Court held that subsection 84(2) of the *Income Tax Act* did not apply because it could not be said that any of Bec's funds found their way into the shareholder's hands. Specifically, the financing of the share purchase came from the bank, and Bec's assets remained

deposited in its bank account for some time after the amalgamation. It is clear that the same cannot be said of Dr. MacDonald's case. Indeed, PC's property ended up in his hands and the entire series of events was designed and executed to achieve this result.

[26] Subsection 84(2) was held to apply in *RMM*. The namesake of that case was a holding company created for the express purpose of buying the shares of Equilease Limited and its wholly owned subsidiary (together, "EL"), a company that was winding up into its American parent, Equilease Corporation ("EC"). RMM obtained a loan from a bank, secured on the assets of EL, to fund the purchase of the shares, the price of which was equal to the total assets held by EL (primarily cash and an income tax refund). Three days after the share sale closed, RMM repaid the loan from the funds of EL. RMM later endorsed the tax refunds and interest thereon to EC. RMM was paid $10,000 to cover its legal fees.

[27] Justice Bowman, as he then was, determined that RMM was an "instrumentality" used to effect the distribution of property to the shareholder, EC, and stated his conclusion with respect to subsection 84(2) in very clear terms at page 308 (my underlining):

> The words "distributed or otherwise appropriated *in any manner whatever* on the winding-up, discontinuance or reorganization of its business" are words of the widest import, and cover a large variety of ways in which corporate funds can end up in a shareholder's hands. See *Merritt* (*supra*); *Smythe et al. v. M.N.R.*, 69 DTC 5361 (S.C.C.). They were unquestionably received on the winding-up or discontinuance of EL's business and it is impossible to say that the funds that found their way into EC's hands were not on any realistic view of the matter EL's funds, notwithstanding the brief intervention of the bank and RMM.

[28] The winding-up of the business of a corporation is a process. The judge here recognized in his decision that "'on the winding up' as used in subsection 84(2) refers to a course of events that

are part of the winding-up process" (reasons, at paragraph 84). He further specifically determined that "the sale of the shares here does not exist in a vacuum: each transaction, from beginning to end, was entered into and completed in contemplation of each other" (reasons, at paragraph 109). And yet, he concluded that subsection 84(2) did not apply. In my respectful view, the judge erred in focusing exclusively on the legal character of the various transactions in the series, which led him to fail to give effect to the statutory phrase "in any manner whatever". His interpretation is not consistent with *Merritt*, *Smythe*, or *RMM*.

[29] In this case, at the end of the winding up, all of PC's money (net of the $10,000 compensation to the accommodating brother-in-law) ended up through circuitous means in the hands of Dr. MacDonald, the original and sole shareholder of PC who was both the driving force behind, and the beneficiary of, the transactions. In my view, the only reasonable conclusion is that subsection 84(2) applies, as the Crown contends.

[30] Consequently, I would allow the appeal, set aside the judgment of the Tax Court and, rendering the judgment that should have been rendered, dismiss Dr. MacDonald's appeal from the 2002 reassessment. The Crown is entitled to its costs in this Court and in the Tax Court.

"D.G. Near"
J.A.

"I agree
K. Sharlow J.A."

"I agree
Johanne Trudel J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-143-12
APPEAL FROM A JUDGMENT OF THE HONOURABLE MR. JUSTICE J.E. HERSHFIELD DATED APRIL 17, 2013, NO. 2009-1(IT)G	
STYLE OF CAUSE:	Her Majesty the Queen v. Dr. Robert G. MacDonald
PLACE OF HEARING:	Fredericton, New Brunswick
DATE OF HEARING:	March 18, 2013
REASONS FOR JUDGMENT BY:	Near J.A.
CONCURRED IN BY:	Sharlow J.A. Trudel J.A.
DATED:	April 25, 2013

APPEARANCES:

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J. Paul M. Harquail	FOR THE RESPONDENT

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