Federal Court of Appeal | Cour d'appel fédérale

Date: 20230220

Dockets: A-234-21
A-235-21
A-236-21

Citation: 2023 FCA 38

[ENGLISH TRANSLATION]

CORAM: **NOËL C.J.**
DE MONTIGNY J.A.
LOCKE J.A.

BETWEEN:

MICHEL FOIX, NICOLAS SOUTY and SONIA LEBEL

Appellants

and

HIS MAJESTY THE KING

Respondent

Heard at Montréal, Quebec, on October 20, 2022.

Judgment delivered at Ottawa, Ontario, on February 20, 2023.

REASONS FOR JUDGMENT BY: NOËL C.J.

CONCURRED IN BY: DE MONTIGNY J.A.
LOCKE J.A.

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INTRODUCTION

[1] These are appeals from three decisions of the Tax Court of Canada (the Tax Court) (cited as 2021 TCC 52) confirming, on the basis of a single set of reasons authored by Justice Boyle (the trial judge), the reassessments made by the Minister of National Revenue pursuant to

subsection 84(2) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) in respect of Mr. Foix, Mr. Souty and Ms. Lebel (the appellants) for their 2012 taxation year.

[2] The appeals were consolidated by order dated November 23, 2021, docket A-234-21 being designated as the lead appeal. In conformity with this order, the present reasons will be filed in the lead appeal, and copies thereof will be filed as reasons for judgment in dockets A-235-21 and A-236-21.

[3] The main issue is whether funds or property of two corporations owned directly or indirectly by the appellants were "distributed or otherwise appropriated in any manner whatever" to or for the benefit of the appellants within the meaning of subsection 84(2) of the Act despite there allegedly being no impoverishment of the two target corporations. If so, the Court will also have to determine whether these distributions or appropriations occurred on the reorganization or the discontinuance of the business of these corporations.

[4] For the reasons that follow, I conclude that the appeals cannot succeed. First, the trial judge correctly concluded, based on the evidence presented before him, that the two target corporations were impoverished as a result of the indirect distribution of their funds and that the scope of subparagraph 84(2) is wide enough to counter this type of distribution. Second, the appellants have failed to demonstrate that the trial judge erred in concluding that the businesses of the target corporations were reorganized or discontinued for purposes of subsection 84(2).

FACTS

[5] It is appropriate to review the facts underlying the trial judge's decision in some detail.

[6] Watch4Net Solutions Inc. (W4N) was incorporated by Mr. Foix and Mr. Souty in 2000. It is the hybrid sale of this corporation's shares and assets in May 2012 that led to the reassessments that are the subject of these appeals.

[7] At all times prior to the hybrid sale, all of W4N's shares were directly or indirectly owned by Mr. Foix, Mr. Souty, their family trusts and their holding companies (TCC reasons, paras. 20–21).

[8] Mr. Souty held his shares of W4N directly. Mr. Souty's wife, Sonia Lebel, held her shares of W4N as a beneficiary of Fiducie Familiale Nicolas Souty 2007 (Fiducie Souty) (TCC reasons, para. 22). Finally, Mr. Foix held his shares of W4N through Virtuose Informatique Inc. (Virtuose). At the time of the hybrid sale, Virtuose's sole function was to hold shares of W4N for Mr. Foix (TCC reasons, para. 23).

[9] At the time of the hybrid sale, W4N had approximately 50 employees, two subsidiaries in Germany and England, and an annual income of around $15,000,000 (TCC reasons, paras. 28–29). Its main source of income rested in the exploitation of the Automated Performance Grapher software (the APG software) (TCC reasons, para. 5). This software monitors and manages the performance of networks, data centres and cloud infrastructures (TCC reasons, para. 43; Asset

and Share Purchase Agreement (Hybrid Sale Agreement), preamble, Appeal Book, vol. 3, at 1194). W4N also, as part of its business, developed, installed and maintained other software programs and offered IT advisory services (TCC reasons, para. 5).

[10] The EMC Corporation (EMC US) and the EMC Corporation of Canada (EMC Canada) (together, the EMC group) are the purchasers of W4N's assets and W4N's and Virtuose's shares. EMC Canada is the Canadian subsidiary of EMC US, a large American public corporation that had approximately 65,000 employees globally at the time of the hybrid sale (Transcript of Mr. Souty's testimony, Appeal Book, vol. 7, at 2970, lines 21–24 and at 2973, lines 25–27; TCC reasons, para. 30).

[11] EMC US was a licensed reseller of the APG software. It also competed with W4N by using a similar though less powerful software (TCC reasons, paras. 30–31).

[12] In September 2006, EMC US made its first offer to acquire W4N for an amount ranging between $3,000,000 and $5,000,000. Mr. Foix and Mr. Souty turned down this offer because they believed that it was too low (TCC reasons, para. 32). In November 2011, EMC US again offered to acquire W4N after proposing to buy an exclusive licence for the APG software a few weeks earlier (TCC reasons, para. 34). Following negotiations, the parties agreed around the end of January 2012 on the sale of all of W4N's shares for US$50,000,000 (TCC reasons, para. 35). The transaction was ultimately carried out in Canadian dollars at a time when both currencies were at par (Hybrid Sale Agreement, clause 1.3(c), Appeal Book, vol. 3, at 1205).

[13] According to the agreement, the EMC group agreed that W4N could distribute the excess cash that it had on hand to its shareholders prior to the sale (TCC reasons, para. 35). The letter of interest that documents the agreement is dated January 20, 2012, and was signed by Mr. Foix on January 23, 2012. It contains the following passage (Appeal Book, vol. 4, at 1804):

> We have agreed that the Company [W4N] may distribute (in a manner that will not be reflected as an expense on any post-Closing income statement of the Company or EMC) excess cash to its stockholders prior to Closing, provided that the Company retains a mutually agreed upon amount of net working capital as of the Closing…

[14] In March 2012, EMC US prepared a draft of a share purchase contract ("Share Purchase Agreement"), which highlights the interest of the EMC group as to the amount of excess cash that the appellants could be authorized to withdraw (TCC reasons, paras. 37 and 61). The following terms were defined in the draft: Excess Cash Amount, Closing Cash Target Amount, Closing Cash Balance and Estimated Closing Cash Balance. The terms Closing Cash Balance and Estimated Closing Cash Balance are annotated as follows: "W4N to confirm" (Share Purchase Agreement, clause 1.1, Closing Cash Balance and Estimated Closing Cash Balance definitions, Appeal Book, vol. 4, at 1407 and 1409). The Share Purchase Agreement provided for a post-closing reconciliation between the target amount and the actual amount of the excess at closing. Comparable provisions are also found in the Hybrid Sale Agreement that was later entered into (TCC reasons, para. 37).

[15] The Share Purchase Agreement contemplated a pre-closing reorganization that was also of interest to the EMC group. Its terms and conditions were to be set out in Schedule 9.1 of the Share Purchase Agreement, but this schedule is blank and instead includes the note "To be discussed" (Share Purchase Agreement, Schedule 9.1, Appeal Book, vol. 4, at 1459). Clause 2 of

the Share Purchase Agreement also contains the following note: “Parties to discuss Pre-Closing Reorganization” (Appeal Book, vol. 4, at 1415). The documents pertaining to this reorganization were to be provided to the purchaser in accordance with clause 9.1(r) of the Share Purchase Agreement (Appeal Book, vol. 4, at 1442; TCC reasons, para. 37).

[16] In April 2012, the parties agreed to convert the proposed transaction into a hybrid sale of W4N’s shares and assets. In the process, the total purchase price of W4N’s assets and shares increased to over $70,000,000 (Transcript of the examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3195, lines 21–23; see also the Memorandum of the appellants, para. 21). The evidence does not indicate who suggested this change (TCC reasons, para. 38). According to the terms of the Hybrid Sale Agreement, which was governed by the laws of Quebec (Hybrid Sale Agreement, clause 19.6, Appeal Book, vol. 3, at 1272), W4N was to sell to EMC US its most significant assets, namely, its intellectual property pertaining to the APG software, its ongoing contracts (except those concluded with customers located in Canada), the shares of its subsidiaries, as well as all of the goodwill associated with its business. The remaining assets—contracts concluded with a customer located in Canada, machinery, equipment, furnishings, supplies, inventory, accounts receivable, claims, cash, cash equivalents, etc.—would remain the property of W4N (TCC reasons, para. 43; Hybrid Sale Agreement, clause 1.1, Purchased Contract and Purchased Customer Contract definitions, Appeal Book, vol. 3, at 1203; clauses 2.3(a) and 2.4(e), Appeal Book, vol. 3, at 1207–1208). EMC Canada would then purchase all of W4N’s capital stock directly from the shareholders. The final version of the Hybrid Sale Agreement is not dated, but took effect “as of” May 24, 2012 (TCC reasons, para. 40).

[17] The reorganization of W4N's and Virtuose's capital stock unfolded in accordance with the Hybrid Sale Agreement (Hybrid Sale Agreement, Prior Reorganization definition, Appeal Book, vol. 3, at 1202; Exhibit C, Appeal Book, vol. 3, at 1303). The relevant transactions took place between April 24 and May 30, 2012, and are set out in the appendix to the trial decision.

[18] The hybrid sale occurred between 11:30 p.m. on May 30 and 12:30 a.m. on May 31, 2012 (TCC reasons, para. 41). The preamble to the Hybrid Sale Agreement sets out four steps (Appeal Book, vol. 3, at 1194–1195). It is appropriate to review each of these steps in order to understand why the trial judge described the transactions as "indirect, structured, simultaneous and inter-related" (TCC reasons, para. 58).

[19] The four steps unfolded as follows:

(i) The Fiducie Closing took place at 11:30 p.m. on May 30, 2012. As part of this step, EMC Canada purchased the W4N shares held by Fiducie Foix and Fiducie Souty. In exchange for the shares, EMC Canada issued and delivered two promissory notes to Fiducie Foix and Fiducie Souty (the Fiducie Share Notes) of $2,489,591 each (TCC reasons, para. 45; Hybrid Sale Agreement, clause 1.1, Fiducie Closing Date definition, Appeal Book, vol. 3, at 1198; clause 2.2(a), Appeal Book, vol. 3, at 1206; Exhibit G, Appeal Book, vol. 3, at 1370–1373).

(ii) The Asset Closing happened 15 minutes later, at 11:45 p.m. At that time, EMC US purchased W4N's intellectual property, certain of its contracts and its goodwill (Hybrid Sale Agreement, clause 1.1, Asset Closing Effective Time definition, Appeal Book, vol. 3, at 1195; clause 2.3, Appeal Book, vol. 3, at 1207). In exchange for these assets,

EMC US issued and delivered to W4N (i) two Capital Dividend Promissory Notes, each in the amount of $11,000,000, and (ii) a Balance Note in the amount of $19,750,000. EMC US also assumed the equivalent of $2,300,000 of W4N's liabilities. The total consideration for the assets therefore stood at $44,050,000 (Hybrid Sale Agreement, clause 1.1, Total Asset Consideration definition, Appeal Book, vol. 3, at 1204; clause 2.5, Appeal Book, vol. 3, at 1208; clause 2.8, Appeal Book, vol. 3, at 1208–1209; Exhibit A, Appeal Book, vol. 3, at 1292–1293; Exhibit B, Appeal Book, vol. 3, at 1295–1300; Transaction Escrow Agreement, clause 6, Appeal Book, vol. 3, at 1350).

(iii) The Change of Control Closing occurred at 12:15 a.m. on May 31. At that time, EMC Canada purchased 550 Class D shares from both Mr. Souty and Virtuose, for a total of 1,100 Class D shares; thereby gaining control of W4N. In exchange for the shares, EMC Canada issued and delivered to Mr. Souty and Virtuose two Change of Control Share Notes of $550 each (Hybrid Sale Agreement, clause 1.1, Change of Control Closing Effective Time, Change of Control Closing Date and Total Change of Control Share Consideration definitions, Appeal Book, vol. 3, at 1196 and 1204; clauses 2.10(a) and 2.10(b), Appeal Book, vol. 3, at 1209; Exhibit I, Appeal Book, vol. 3, at 1377–1380; Transaction Escrow Agreement, clause 8, Appeal Book, vol. 3, at 1350).

(iv) The Final Closing was completed 15 minutes later, at 12:30 a.m. At that time, EMC Canada purchased the remainder of W4N's shares, as well as all of Virtuose's shares (Hybrid Sale Agreement, clause 1.1, Final Closing Effective Time definition, Appeal Book, vol. 3, at 1198; clause 2.12, Appeal Book, vol. 3, at 1209). In exchange for the shares, EMC Canada paid $13,189,796—i.e., the Total Final Share Consideration—to

W4N's and Virtuose's shareholders (Hybrid Sale Agreement, clause 2.12, Appeal Book, vol. 3, at 1209).

[20] As is discussed below, the issue surrounding what became of the debt evidenced by the Balance Note (see subpara. 19(ii) above) is at the heart of the debate before us. The Hybrid Sale Agreement and the Transaction Escrow Agreement provide for the payment by the EMC group of all promissory notes at 12:30 a.m. on May 31, except the Balance Note. Here is how each of the notes was processed at Final Closing at 12:30 a.m. on May 31:

(i) The two notes that were issued for the shares held by Fiducie Foix and Fiducie Souty were paid by the Transaction Escrow Agent (Escrow Agent) (Hybrid Sale Agreement, clause 2.13(a), Appeal Book, vol. 3, at 1210; Transaction Escrow Agreement, clause 11, Appeal Book, vol. 3, at 1350–1351; Schedule G, Appeal Book, vol. 3, at 1367–1368). The Escrow Agent then marked both notes as "Cancelled" before returning them to "the Purchasers" (Transaction Escrow Agreement, clause 11, Appeal Book, vol. 3, at 1350–1351; Hybrid Sale Agreement, clause 2.13(b), Appeal Book, vol. 3, at 1210). This term includes both EMC US and EMC Canada (Transaction Escrow Agreement, Appeal Book, vol. 3, at 1349) and, as for all notes except for the two Capital Dividend Promissory Notes, no indication is made as to which of the two corporations is to receive the cancelled notes.

(ii) The two Capital Dividend Promissory Notes of $11,000,000 held by Gestion Souty and Mr. Foix were paid by the Escrow Agent (Hybrid Sale Agreement, clause 2.13(e), Appeal Book, vol. 3, at 1210; Exhibit H, Appeal Book, vol. 3, at 1375; Transaction Escrow Agreement, clause 11, Appeal Book, vol. 3, at 1350–1351). The Escrow Agent then

marked both notes as “Cancelled” before returning them to EMC Canada (Hybrid Sale Agreement, clause 10.1(d)(v)(D), Appeal Book, vol. 3, at 1251; Transaction Escrow Agreement, clause 11, Appeal Book, vol. 3, at 1350–1351).

(iii) The two Change of Control Share Notes held by Mr. Souty and Virtuose were paid by the Escrow Agent (Hybrid Sale Agreement, clause 1.1, Total Change of Control Share Consideration definition, Appeal Book, vol. 3, at 1204; clause 2.13(c), Appeal Book, vol. 3, at 1210; Transaction Escrow Agreement, clause 11, Appeal Book, vol. 3, at 1350–1351; Schedule G, Appeal Book, vol. 3, at 1367). The Escrow Agent marked both notes as “Cancelled” before returning them to “the Purchasers” (Transaction Escrow Agreement, clause 11, Appeal Book, vol. 3, at 1350–1351; Hybrid Sale Agreement, clause 2.13(d), Appeal Book, vol. 3, at 1210).

(iv) In contrast with the other notes, the Hybrid Sale Agreement and the Transaction Escrow Agreement do not provide that the Balance Note will be paid to its holder (TCC reasons, second paragraph of subpara. 45(ii) and para. 64, note 3). Indeed, clause 2.2(c) of the Hybrid Sale Agreement stipulates that upon the Fiducie Closing at 11:30 p.m., the EMC group will transfer to the Escrow Agent the amount required to pay (i) the Total Fiducie Consideration ($4,979,182); (ii) the two Capital Dividend Promissory Notes ($22,000,000); (iii) the Total Change of Control Share Consideration ($1,100); and (iv) the Total Final Share Consideration ($13,189,796) (Hybrid Sale Agreement, clause 1.1, Fiducie Closing Date definition, Appeal Book, vol. 3, at 1198; clause 2.2(c), Appeal Book, vol. 3, at 1207). However, the Hybrid Sale Agreement does not provide for the transfer of the amount required in order to pay the Balance Note (Hybrid Sale Agreement, clause 2.2(c), Appeal Book, vol. 3, at 1207; clause 2.11, Appeal Book, vol. 3,

at 1209). Similarly, Schedule G of the Transaction Escrow Agreement does not provide for the transfer of the $19,750,000 amount reflected by the Balance Note as it does for the debts evidenced by the other notes (Appeal Book, vol. 3, at 1367–1368). Yet clause 11 of the Transaction Escrow Agreement provides that at 12:30 a.m. on May 31, 2012, the Escrow Agent is to return all of the notes—including the Balance Note—to "the Purchasers" after marking them as "Cancelled" (Appeal Book, vol. 3, at 1350–1351). Despite this mention, W4N's unaudited financial statements for the period ending at close of day on May 31, 2012—i.e., after the hybrid sale was completed—show a receivable in the amount of $22,050,000, which amount, by all indications, is constituted by the debt evidenced by the Balance Note ($19,750,000) and the W4N liabilities ($2,300,000) that were assumed by EMC US (see subpara. 19(ii) above).

[21] On June 1, 2012, the day following the hybrid sale, W4N, Virtuose and EMC Canada amalgamated and—with the exception of Virtuose, which, from that moment on, ceased to act as a holding company—continued to operate under the name EMC Canada (the Successor Corporation). From that moment on, EMC US exploited the APG software globally under its name and through its worldwide subsidiaries, including W4N's former subsidiaries, and the remaining components of W4N's business became part of the Successor Corporation's business (TCC reasons, para. 47).

[22] In the tax returns filed for their 2012 taxation year, each of the appellants reported a capital gain from the sale of W4N's and Virtuose's shares and claimed the capital gains deduction provided for under subsection 110.6(2.1) of the Act so as to fully offset the gain. The

entitlement to this deduction is not in issue; only the application of subsection 84(2) in order to transform the gains into dividends is (Transcript of the cross-examination of Mr. Séguin, Appeal Book, vol. 7, at 3463, lines 17–28 and at 3464, lines 1–14).

[23] On April 4, 2017, the Minister of National Revenue issued reassessments with respect to Mr. Foix's, Mr. Souty's and Ms. Lebel's 2012 taxation year, treating the following amounts as deemed dividends:

(i) for Ms. Lebel, $1,590,705 attributed to her as part of the amount of $2,481,412 received by Fiducie Souty from EMC Canada upon the Fiducie Closing for the sale of its W4N Class F shares (TCC reasons, subpara. 44(iii); Amended Reply to the Notice of Appeal, subpara. 28(p)vii), Appeal Book, vol. 1, at 0113; Memorandum of the Crown, paras. 20i) and ii));

(ii) for Mr. Souty, $800,450 received from EMC Canada upon the Final Closing for the sale of his W4N Class D and E shares (TCC reasons, subpara. 44(ii)); and

(iii) for Mr. Foix, $800,000 received from EMC Canada upon the Final Closing for the sale of his Virtuose Class A and C shares (TCC reasons, subpara. 44(i)).

Each of the reassessments assumes that an amount at least equal to these sums was distributed to or otherwise appropriated by the appellants.

[24] The appellants appealed these reassessments on the basis that the conditions for the application of subsection 84(2) were not met.

THE TAX COURT DECISION

[25] The trial judge held otherwise. He set out two cumulative conditions in order to determine whether subsection 84(2) applies on the facts of this case: (i) Were funds or property "distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders" of W4N? (ii) If so, did the distribution or appropriation occur "on the winding-up, discontinuance or reorganization" of W4N's business?

[26] In order to find that the first condition was met, the trial judge first gave subsection 84(2) a broad scope, stating that courts take a fungible approach to cash and cash equivalents owned by a corporation when they are faced with transactions that are "indirect, structured, simultaneous and inter-related". In particular, he relied on *Canada v. MacDonald*, 2013 FCA 110 [*MacDonald* (FCA)], reversing *MacDonald v. The Queen*, 2012 TCC 123 [*MacDonald* (TCC)]; *RMM Canadian Enterprises Inc. v. Canada*, [1997] T.C.J. No. 302 (QL) [*RMM Equilease*]; *Smythe et al. v. Minister of National Revenue*, [1970] S.C.R. 64 [*Smythe*]; and *Merritt v. Minister of National Revenue*, [1941] Ex. C.R. 175 [*Merritt* (Ex C)], aff'd in part by *Minister of National Revenue v. Merritt*, [1942] S.C.R. 269 (S.C.C.) [*Merritt* (SCC)]. In his view, this line of cases interprets the scope of subsection 84(2) to be sufficiently large to target "indirect" distributions of funds or property (TCC reasons, para. 58). In so saying, he drew a distinction between the present case and *Canada v. Vaillancourt-Tremblay*, 2010 FCA 119 [*Vaillancourt-Tremblay*], where it was held that the fungible approach did not extend to newly issued securities of a public company that were never owned by the target corporation (TCC reasons, para. 58).

[27] The trial judge found that this broad interpretation is justified in this case because the appellants, with the assistance of the EMC group, initiated and executed a series of transactions that were all carried out in contemplation of one another in order to extract W4N's excess cash (TCC reasons, para. 60 *in fine*, paras 62–64).

[28] In the trial judge's view, it is clear that the indirect distribution of W4N's funds to the appellants was made possible by the role that the EMC group played as a facilitator (TCC reasons, para. 63). This group approved both the prior reorganization and the amount of excess cash that could be withdrawn from W4N by its shareholders without requiring an adjustment at closing (TCC reasons, para. 61).

[29] The trial judge pointed to evidence on the record showing that the EMC group acted as a facilitator. In particular, he noted (i) the letter of January 20, 2012, in which the parties agreed that W4N would distribute to its shareholders the excess cash, i.e., the funds that exceeded what was needed to operate the business (TCC reasons, para. 60); (ii) the Share Purchase Agreement, in which the definition of Closing Cash Balance and the exhibit concerning the pre-closing reorganization include, respectively, the annotations "W4N to confirm" and "To be discussed"; and (iii) the fact that the steps of the pre-closing reorganization are set out in the Hybrid Sale Agreement (TCC reasons, para. 61).

[30] In finding that the EMC group assisted the appellants, the trial judge rejected Mr. Foix's and Mr. Souty's testimony that the EMC group had no interest in any transaction related to the withdrawal of W4N's excess cash and that the EMC group alone sought to convert the

transaction into a hybrid sale (TCC reasons, paras. 37–38 and 61). He also expressed having "significant doubts" as to the reliability and the credibility of their testimony regarding (TCC reasons, para. 14; see also para. 38):

> … (i) EMC's intentions, (ii) EMC's role in how the proposed transaction evolved between EMC's initial November 2011 offer and the structure agreed to in late April or May of 2012, (iii) EMC's interest in moving from the Share Purchase Agreement structure it originally proposed and drafted to the final hybrid Asset and Share Purchase Agreement Structure, (iv) EMC's interest (or alleged disinterest) in the pre-acquisition reorganization of the shareholdings and capital structure of W4N ...

Despite their testimony to the contrary, the trial judge found that part of the transactions that facilitated the withdrawal of the excess cash was in fact initiated and led by Mr. Foix, Mr. Souty and their advisors (TCC reasons, para. 62).

[31] In order to find that the second condition was also met, the trial judge first construed the word "reorganization" not as a legal term, but as a commercial term that presupposes the conclusion of the conduct of the business in one form and its continuance in a different form (TCC reasons, paras. 65–68, citing *Merritt* (Ex C) at 182, aff'd on this point by *Merritt* (SCC) at 274; *Smythe*; *MacDonald* (FCA), para. 28; *Kennedy v. M.N.R.*, [1972] 72 D.T.C. 6357 (Trial Division) [*Kennedy* (FCTD)] at 6362, aff'd on this point by *Kennedy v. M.N.R.*, 73 D.T.C. 5359 (Appeal Division of the Federal Court) [*Kennedy* (FCA)], para. 8; *McMullen v. The Queen*, 2007 TCC 16, paras. 18–19; and *Descarries v. The Queen*, 2014 TCC 75 [*Descarries*], paras. 32–34).

[32] Relying on his understanding of the applicable test, he found that W4N's business was reorganized on two occasions. First, W4N reorganized its business and its capital structure in the course of the reorganization that preceded the hybrid sale. Second, W4N's business could no

longer be exploited as it was before the amalgamation, because its business was continued by two different entities: EMC US and the Successor Corporation. According to the trial judge, subsection 84(2) is only concerned with that part of the business that was continued by W4N's Successor Corporation. It follows that W4N's business was reorganized on that account as well (TCC reasons, para. 73).

[33] In any event, the trial judge held that the evidence before him did not allow him to find, on a balance of probabilities, that EMC US continued to carry on W4N's business in the same manner and in the same form after the amalgamation (TCC reasons, paras. 48–49 and 73).

[34] The trial judge found that the second condition was also met in the case of Virtuose because after the hybrid sale and Virtuose's amalgamation with W4N and EMC Canada, the Successor Corporation ceased to perform its only function, namely, holding W4N shares for Mr. Foix as a holding company (TCC reasons, para. 50). It follows that Virtuose's business was discontinued within the meaning of subsection 84(2).

POSITION OF THE PARTIES

– *The appellants*

[35] The appellants first emphasize that the general anti-avoidance rule (GAAR) (subsection 245(2) of the Act) was not invoked. They add that no sham has been alleged and that the figures are not in question (Memorandum of the appellants, para. 8).

[36] The appellants claim that the trial judge made two errors. First, the trial judge erred in holding that they received funds or property from W4N and Virtuose when neither of these corporations was impoverished in the course of the transactions (Memorandum of the appellants, para. 5).

[37] In their view, the first condition of subsection 84(2) requires that the corporation impoverish itself for the benefit of its shareholders in order for there to be a distribution or an appropriation (Memorandum of the appellants, para. 37). To hold otherwise would result in a duplication of the paid-up capital (Memorandum of the appellants, para. 57) and would condone a form of double taxation (Memorandum of the appellants, paras. 59, 64 and 67).

[38] They argue that in this case, W4N and Virtuose continued to hold all of their assets after their shares were sold (Memorandum of the appellants, para. 45) and that the amounts that ended up in the appellants' hands through the hybrid sale came from the EMC group and not from W4N (Memorandum of the appellants, paras. 4, 70 and 80). It follows that W4N was not impoverished (Memorandum of the appellants, paras. 45 and 69–71, 75–77 and Appendix A). In support of this conclusion, the appellants rely on *McNichol v. Canada*, [1997] T.C.J. No. 5 (QL), [1997] 2 C.T.C. 2088 [*McNichol*], para. 11; *Vaillancourt-Tremblay*, paras. 34–35 and 40–41; *Descarries*, para. 28; *Geransky v. The Queen*, 2001 CanLII 480, [2001] T.C.J. No. 103 (QL) [*Geransky*], subpara. 21(c); and *Robillard (Estate) v. The Queen*, 2022 TCC 13 [*Robillard*], para. 50.

[39] On another note, the appellants contend that the notion of "excess cash" devised by the trial judge (TCC reasons, para. 60) excludes the $19,750,000 debt, with the result that W4N would have apparently distributed more funds than it had (Memorandum of the appellants, paras. 69 and 76).

[40] Turning to Virtuose, the appellants submit that in order for subsection 84(2) to apply, the Court must find that Virtuose's property or funds were distributed to Mr. Foix. However, Virtuose's only assets were shares of W4N, and no such shares were distributed to Mr. Foix as part of the hybrid sale (Memorandum of the appellants, paras. 72–73). In the appellants' view, it follows that there was no impoverishment or distribution (Memorandum of the appellants, para. 5).

[41] Of significance is that the appellants do not challenge on appeal the trial judge's finding that the EMC group acted as a third-party facilitator. Rather, they argue that the findings made by the trial judge in this regard are [TRANSLATION] "irrelevant" because in any event, the element of impoverishment, which must be present for subsection 84(2) to apply, is missing (Memorandum of the appellants, paras. 78–79). This is a dramatic change of course given that the appellants took the position before the trial judge that impoverishment is not a prerequisite when a [TRANSLATION] "third-party accommodator" is involved, but that it was not necessary to delve into this issue because according to their assessment of the evidence, the EMC group did not play this role (Transcript of the appellants' arguments at trial, Appeal Book, vol. 8, at 3526, lines 14–21 and at 3540, lines 3–10). It is not surprising, therefore, that the trial judge's reasons focus on the role that the EMC group played as a facilitator.

[42] Second, the appellants argue that the trial judge erred in finding that W4N's business was reorganized and that Virtuose's business was discontinued despite evidence showing that the EMC group assumed and pursued all of their operations (Memorandum of the appellants, para. 5).

[43] The appellants allege that the trial judge misapplied the test set out in *Kennedy* (FCTD) by disregarding the distinction between a corporate reorganization and the reorganization of the business carried on by that corporation (Memorandum of the appellants, paras. 81, 87, 90 and 98). According to them, no reorganization takes place for purposes of paragraph 84(2) when legal changes are brought to the corporate structure without any change being made to the manner in which the [TRANSLATION] "commercial activities" are conducted (Memorandum of the appellants, paras. 88, 90 and 94). Had the trial judge considered how W4N's business was continued by both EMC US and the Successor Corporation, he would have found that W4N's business was not reorganized (Memorandum of the appellants, para. 96).

[44] Applying this test to the facts of this case, the appellants maintain that they have established that W4N's business was continued [TRANSLATION] "with the same employees, the same offices, the same service and maintenance contracts, the same software, the same markets, the same resellers, the same technology partners and the same competitors" (Memorandum of the appellants, paras. 23 and 101). According to them, the trial judge's conclusion that a reorganization took place despite this evidence results from an improper allocation of the burden of proof (Memorandum of the appellants, para. 103).

[45] With respect to Virtuose, the appellants submit that the trial judge erred in law in finding that its business was discontinued after the amalgamation with W4N and EMC Canada without taking into consideration the legal effect of an amalgamation, which is to ensure the sustainability of the activities carried on by the amalgamated corporations (Memorandum of the appellants, para. 85).

– *The Crown*

[46] The Crown, for its part, submits that the trial judge correctly held that the two conditions precedent for the application of subsection 84(2) of the Act were met in this case with respect to both W4N and Virtuose.

[47] According to the Crown, it could be seen from the beginning that the Balance Note in the amount of $19,750,000 would be cancelled and that the debt evidenced by that note would never be paid, since that amount was redirected so as to end up in the hands of the appellants (Memorandum of the Crown, paras. 65, 67 and 78; Transcript of the Crown's argument, Appeal Book, vol. 8, at 3567, lines 21–24 and 27–28, at 3585, lines 21–28, at 3586, line 1, at 3595, lines 5–14 and at 3656, lines 23–26).

[48] The Crown further submits that contrary to the appellants' contentions, the trial judge, in the course of his analysis, did in fact consider that the $19,750,000 debt was part of the excess cash that was distributed to the appellants, this amount being, in the words of the trial judge, a "cash equivalent" (Memorandum of the Crown, paras. 69–70, referring to the second paragraph of subpara. 45(ii) and to para. 64 of the TCC reasons).

[49] Turning to Virtuose, the Crown asserts that the trial judge correctly found that funds belonging to W4N were distributed by Virtuose to Mr. Foix at the time of the hybrid sale. In the Crown's view, it would be unduly formalistic to hold otherwise (Memorandum of the Crown, paras. 73–74 and 79).

[50] Insofar as the second condition is concerned, the Crown maintains that the trial judge properly assessed the evidence before him and made no error in focusing on the continuation of W4N's activities carried on by the Successor Corporation rather than on the activities that were continued by the EMC group as a whole (Memorandum of the Crown, para. 82).

[51] Still with respect to Virtuose, the Crown argues that the business it conducted was discontinued following the hybrid sale since its sole function up to that time—holding W4N shares as a holding company for Mr. Foix—was thereby brought to an end (Memorandum of the Crown, subpara. 84(c)).

ANALYSIS

[52] The appeals as framed raise three issues:

1. Were funds or property of W4N and of Virtuose distributed to or otherwise appropriated by or for the benefit of their shareholders despite there allegedly being no corresponding impoverishment of the two corporations?

2. If so, is subsection 84(2) sufficiently large in scope to counter the type of distribution or appropriation that took place in this case?

3. If so, did these distributions or appropriations take place on the reorganization or the discontinuance of their respective businesses?

In my view, all three questions must be answered in the affirmative.

[53] Two preliminary comments are in order. Subsection 84(2) is one of the oldest anti-avoidance measures in the Act. It has appeared in the Act in terms similar to those used today since 1924 (*An Act to amend The Income War Tax Act, 1917*, 14-15 Geo.V, c. 46, s. 5), when it was adopted in response to English court cases holding that profits earned and taxed as dividends upon distribution to shareholders during the life of a corporation could be distributed without tax on that corporation's winding-up (*House of Commons Debates*, 14th Parliament, 3rd Session, vol. 3 (June 10, 1924), at 3047 (Hon. Mr. Baxter); see, e.g., *Inland Revenue Commissioners v. George Burrell*, [1924] 2 K.B. 52 (UK)). The dated existence of this provision explains the abundance of case law that has guided its application over the years, sometimes inconsistently. It is appropriate to first quote the actual text of this provision, with emphasis on its key words:

(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	(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 [*sic*] 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, exceeds	a) le montant ou la valeur des fonds ou des biens distribués ou attribués, selon le cas;
(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. [Emphasis added.]	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. [Non soulignés dans l’original.]

[54] It is also useful to recall at the onset of the analysis that questions of law are to be reviewed on a standard of correctness whereas findings of fact or of mixed fact and law cannot be overturned in the absence of a palpable and overriding error, absent an extricable question of law (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, paras. 8 and 26–37).

1. *Were funds or property of W4N and of Virtuose distributed to or otherwise appropriated by or for the benefit of their shareholders despite there allegedly being no corresponding impoverishment of the two corporations?*

[55] One must first ask: “What was purportedly distributed?” Indeed, the appellants take the position that the term “excess cash” as used by the trial judge [TRANSLATION] “seems to exclude

the notes" and, more specifically, the Balance Note (Memorandum of the appellants, para. 76, note 100, citing the TCC reasons, para. 64). According to them, the trial judge used this term only to refer to the amount of $4,505,288 constituted by W4N's cash, accounts receivable and investment tax credit (Memorandum of the appellants, para. 20, notes 50 and 75; see also W4N's financial statements as at May 31, 2012, Appeal Book, vol. 9, at 3773). Given that on the basis of their assessment, a total amount of $6,583,274 would have been distributed, the trial judge's finding results in a mathematical impossibility in that W4N could not distribute more funds than it had (Memorandum of the appellants, para. 20, notes 49 and 69).

[56] In so saying, the appellants overlook the trial judge's clear and unequivocal finding that the debt evidenced by the Balance Note was part of the excess cash that was distributed to the appellants (TCC reasons, para. 64 *in fine*). Indeed, the trial judge considered this debt to be "a cash equivalent owned by W4N as a result of selling its operating business assets" (TCC reasons, second paragraph of subpara. 45(ii)). Later on, he found that this cash equivalent was in fact excess cash—that is, an amount beyond what was needed to operate the business—and that both the extent of this amount and its distribution were approved by the EMC group (TCC reasons, paras. 35, 37, 60 and 64). The argument that W4N distributed more funds than it had must accordingly be rejected.

– *Was W4N impoverished?*

[57] Even though the appellants correctly assert that the target corporation must be impoverished to the benefit of its shareholders for there to be a distribution or an appropriation, which is to say that property or funds must at some juncture have left the target corporation to

end up in the hands of the shareholders (*Descarries*, para. 21, citing *Merritt* (Ex C) at 182, aff'd on this point by *Merritt* (SCC) at 274), they fail to overcome the fact that in this case, the trial judge found that W4N (and Virtuose) was impoverished for the benefit of the appellants.

[58] The trial judge did not elaborate on this issue, but this should not come as a surprise given the arguments made before him (see para. 41 above). Nevertheless, his conclusion that W4N was impoverished could not have been clearer.

[59] The appellants' argument that W4N was not impoverished presupposes that the debt evidenced by the Balance Note, which became payable to the Successor Corporation following the amalgamation, was paid. However, the trial judge's finding that the amount that was to be used to pay this debt was in fact used to pay for W4N's (and Virtuose's) shares excludes this possibility (TCC reasons, para. 64). As will become clear, the absence of impoverishment, being alleged for the first time before us, is nothing but a veiled attempt to overcome this otherwise unassailable finding of fact.

[60] This conclusion does not put into question the existence of the debt, but its payment. I note in this regard that this debt became, from the moment when it was contracted, payable on demand and subject to a three-year prescription (*Civil Code of Québec*, C.Q.L.R. c. CCQ-1991, arts. 1590 and 2925). Had payment been made in the interim, it would have been easy for the appellants to make that demonstration. I emphasize, as the trial judge did at the beginning of his analysis (TCC reasons, para. 15), that when the trial took place, EMC US and EMC Canada were

still operating in Canada, so that it would have been a simple matter to call a responsible officer in order to show what became of this debt.

[61] W4N's accountant did, however, address this issue. After indicating that the debt evidenced by the Balance Note still appeared in W4N's financial statements after the hybrid sale (Transcript of the cross-examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3261, lines 26–27), he expressed the view that it would never be paid (Transcript of the cross-examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3195, lines 27–28, at 3235, lines 10–14 and at 3241, lines 6–7). In so saying, he had in mind the fact that after the conversion of the share sale into a hybrid sale, the EMC group committed to disbursing slightly over $70,000,000 to the appellants, but that the nonpayment of the $19,750,000 debt meant that the amount actually disbursed remained in the vicinity of the price initially negotiated, i.e., $50,000,000 (Transcript of the examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3195, lines 23–28, at 3196, lines 1–3 and at 3215, lines 16–18; Transcript of the cross-examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3240, line 28 and at 3241, lines 1–10). This testimony is fully aligned with the numbers revealed by the evidence.

[62] The accountant was also mindful that after the hybrid sale, the debt became internal to the EMC group (Transcript of the cross-examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3234, lines 25–28, at 3235, lines 1–28, at 3236, lines 1–5, at 3242, lines 27–28 and at 3243, lines 1–20), and he undoubtedly considered that EMC US had no interest in paying into W4N's Successor Corporation $19,750,000 in cash given that this amount exceeded W4N's operational needs. In this respect, it is useful to recall that at the closing of the hybrid sale, W4N still had

cash and cash equivalents of $4,505,288 (see para. 55 above), which amount constituted the "net working capital" on which the parties were to agree in order to ensure the ongoing operation of W4N's business after the amalgamation (see the letter of interest of January 20, 2012, Appeal Book, vol. 4, at 1804–1806, reproduced in part at para. 13 above).

[63] The trial judge was aware of the accountant's testimony and of the fact that the debt evidenced by the Balance Note still appeared in W4N's financial statements as of May 31, 2012, even though it had been marked as "Cancelled" earlier on that same day. It is in this context that he wrote (TCC reasons, second paragraph of subpara. 45(ii)) that the question as to what became of the debt evidenced by the Balance Note "was put to the appellants but no satisfactory explanation or reason for this was given" (see, for example, the Transcript of the cross-examination of Mr. Foix, Appeal Book, vol. 7, at 3157, lines 11–28 and at 3158, lines 1–18; Transcript of the cross-examination of Mr. Souty, Appeal Book, vol. 7, at 3027, lines 7–28 and at 3028, lines 1–23; Transcript of the cross-examination of Mr. Thibodeau, Appeal Book, vol. 7, at 3234, lines 25–28, at 3235, lines 1–28, at 3236, lines 1–5, at 3242, lines 27–28, at 3243, lines 1–20, at 3261, lines 16–28 and at 3262, lines 1–12).

[64] During the hearing before us, counsel for the appellants explained that they chose not to call an EMC group officer to testify because Mr. Foix and Mr. Souty had severed ties with this group, they had signed a non-compete clause and they could not control the content of a potential testimony. I do not see how this can explain the appellants' failure to explain what became of the debt evidenced by the Balance Note given the question marks raised by the evidence. Either it

was paid or it was not. If it was, all that was needed is for the appellants to require the EMC group to produce the accounting entry confirming the payment.

[65] Given the absence of such evidence, it was open to the trial judge to find as a fact that the debt evidenced by the Balance Note was used to "fund" the cost of W4N's and Virtuose's shares (TCC reasons, para. 64), thereby impoverishing W4N, to whom the debt was owed. Needless to say, no palpable and overriding error is alleged in this regard.

[66] Given this finding, and contrary to what the appellants argue (Memorandum of the appellants, paras. 4, 44, 63, 80 and 107), it matters little that the money used to pay for the shares came directly from the EMC group. What does matter is that the nonpayment of the debt in the course of the hybrid sale freed up the necessary funds to defray the cost of W4N's and Virtuose's shares. This is what the trial judge found when he wrote that the excess cash "funded and was indirectly distributed in a roundabout manner to the appellants" (TCC reasons, para. 64).

2. Does subsection 84(2) have a sufficiently broad scope to counter this type of distribution?

[67] Contrary to what the appellants maintain, the scope of subsection 84(2) is sufficiently broad to counter this type of distribution when the property being distributed is fungible and a third-party facilitator is involved in the extraction process. In *MacDonald* (FCA), a case that also dealt with a share sale involving the participation of a third-party facilitator, this Court unanimously rejected a strict and narrow reading of subsection 84(2), favouring a broad interpretation. According to this interpretation, transactions leading to an alleged distribution or appropriation of funds or property are to be considered as a whole in a way that is temporally

flexible (*MacDonald* (FCA), para. 28). This Court summarized the broad interpretation as follows (*MacDonald* (FCA), para. 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.

[68] In devising this interpretation, this Court stressed the wording of subsection 84(2), which targets distributions or appropriations made "in any manner whatever" (*MacDonald* (FCA), para. 28). These far-reaching words are anchored in history as they have always been part of this provision, and they faithfully reflect its anti-avoidance purpose. *MacDonald* (FCA) gives effect to the legislative intent that emerges from the text, context and purpose of subsection 84(2) and is consistent with *Merritt*, *Smythe* and *RMM Equilease* (*MacDonald* (FCA), paras. 22–24 and 26–27).

[69] Notably, courts adopt the broad interpretation set out in *MacDonald* (FCA) when a third-party facilitator is involved because in such cases, the distribution or appropriation of the target corporation's funds or property can be carried out in a variety of different ways and take place through various steps that are organized so as to occur at different times. In these situations, it would be contrary to Parliament's intention to turn a blind eye to the existence of a distribution or appropriation for the sole reason that, for example, the shareholder received the target corporation's property as a creditor rather than as a shareholder (*MacDonald* (FCA)) or, as in the present case, that the funds received by the shareholder originate directly from a third party but indirectly from the target corporation. Indeed, in the presence of an orchestrated attempt to extract surpluses without tax or at a reduced rate, the intention of Parliament requires

a reading of subsection 84(2) that balances the words that are used, as an overly literal reading would defeat its anti-avoidance mission (see, e.g., the insistence that the assessed taxpayer be a "shareholder" at the precise moment when the distribution takes place in order for subsection 84(2) to apply in *MacDonald* (TCC), para. 50).

[70] The appellants call into question the line of cases that supports the broad interpretation of subsection 84(2) by relying on a second line of cases made up of, in particular, the Tax Court cases *McNichol* and *Descarries* (Memorandum of the appellants, paras. 44, 63 and 80).

[71] In considering these two conflicting lines of cases, it must be acknowledged that *MacDonald* (FCA) is not without ambiguity. At the end of its reasons, the Court in that case distinguished *McNichol* in the following way (*MacDonald* (FCA), para. 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.
>
> [Emphasis added.]

[72] This distinction presupposes that subsection 84(2) cannot apply to indirect distributions of property or funds because in such cases, the property distributed to the shareholders is not that of the target corporation, but property of the same quality and quantity. With respect, this

distinction is not binding on this Court because it ignores a series of precedents that hold to the contrary (*Miller v. Canada (Attorney General)*, 2002 FCA 370, para. 10). As the trial judge points out (TCC reasons, para. 58), three years before *MacDonald* (FCA), it was held by this Court in *Vaillancourt-Tremblay* that the indirect distribution of fungible property like cash, in contrast with non-fungible property, does not preclude the application of subsection 84(2) when said property can be traced back to the target corporation (*Vaillancourt-Tremblay*, paras. 38–40, citing *RMM Equilease*, paras. 18–19). This holding is not surprising when regard is had to the Supreme Court rulings in *Merritt* (SCC) and *Smythe* issued several decades earlier. In these rulings, the Supreme Court applied the previous versions of subsection 84(2) to deem as dividends funds received by shareholders in exchange for their shares despite the fact that these funds came directly from a third party (but indirectly from the target corporation) and that they had never been held by the target corporation (*Merritt* (Ex C) at 182, aff'd on this point by *Merritt* (SCC) at 274; *Smythe* at 64–65).

[73] When the passage cited above is read with these decisions in mind, it becomes evident that none of the factual elements that it refers to is distinctive with respect to the reasoning set out by this Court in *MacDonald* (FCA) (or its *ratio decidendi*, as it used to be called). Indeed, just as it did not matter that Dr. MacDonald received the funds of the target corporation as the creditor of the amount payable at a time when he was no longer a shareholder, nothing in *McNichol* follows from the fact that the distribution was funded by way of a bank loan. This is all the more obvious when regard is had to the fact that the bank agreed to the loan on the condition that the funds of the target corporation be pledged as security and that the loan was to

be repaid two weeks later with these same funds (*McNichol*, paras. 7 and 14; see, for example, *RMM Equilease*, paras. 17 and 22; *MacDonald* (FCA), paras. 26–27).

[74] The loan and its repayment being part and parcel of the planned distribution—made possible with the assistance of a third-party facilitator (*McNichol*, paras. 4, 6 and 7; see also *MacDonald* (TCC), para. 58)—it cannot be argued that the extraneous source of the funds and the two-week gap before the target corporation was impoverished resulted in no distribution being made for purposes of subsection 84(2). Ultimately, the Tax Court judge in *McNichol* committed the same error as the one committed by his counterpart in *MacDonald* (TCC) "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'" (*MacDonald* (FCA), para. 28; see also *RMM Equilease*, para. 19).

[75] Unfortunately, the distinction that was drawn in *MacDonald* (FCA) was subsequently used by the Tax Court to validate a formalistic and restrictive application of subsection 84(2) because, as was the case in *McNichol*, the impoverishment of the target corporation did not perfectly coincide with the alleged distribution (*Descarries*, paras. 26–28), even though this impoverishment and the shareholders' related enrichment were caused by a series of transactions spread over two years and made possible through the involvement of a third-party facilitator (*Descarries*, paras. 1–2). Relying on the distinction drawn in *MacDonald* (FCA) and the reasoning set out in *McNichol* and *Descarries*, the appellants submit that the trial judge erred in not adopting the same approach (Memorandum of the appellants, paras. 63 and 80).

[76] The principle of *stare decisis* required the trial judge to follow *MacDonald* (FCA), *Vaillancourt-Tremblay*, *Smythe* and *Merritt* (SCC) and, faced with an irreconcilable and unexplained difference between the distinction set out in *MacDonald* (FCA) and those precedents, he correctly disregarded this distinction as well as the decisions of the Tax Court inspired by it (see also *Robillard* at paras. 22 and 50, where the Tax Court judge, after criticizing the line of cases culminating with *MacDonald* (FCA), acknowledges that he is bound by the reasoning set out in that decision).

[77] Contrary to what is stated by the Tax Court in *Robillard* (at paras. 42 and 44; see also *MacDonald* (TCC), para. 82), the evolution of the context in which subsection 84(2) applies since its adoption in 1924—i.e., the decision to tax capital gains starting in 1972 and to adopt the GAAR in 1988—does not run counter to its broad interpretation. First, the fact that the application of subsection 84(2) generates less tax since capital gains became taxable is not a reason for narrowing its scope, particularly as it reflects essentially the same wording since 1924. Second, it is now well established that not only the GAAR, but every provision of the Act must be interpreted in a textual, contextual and purposive way (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, para. 11; see also *Canada v. Loblaw Financial Holdings Inc.*, 2021 SCC 51, para. 41). There is therefore no basis to affirm, as the Tax Court does in *MacDonald* (TCC), that the only way to contemporaneously give effect to both the GAAR and subsection 84(2) is to "read [subsection 84(2)] more literally in all cases" and apply the GAAR "in cases of abuse" (*MacDonald* (TCC), para. 80; see also paras. 59, 67 and 82).

[78] The appellants assert that the broad interpretation adopted in *MacDonald* (FCA) is also inconsistent with the logic behind the capital gains deduction set out in section 110.6 of the Act. For purposes of that deduction, cash and cash equivalents needed to ensure the proper operation of the business qualify as assets "used principally in an active business carried on primarily in Canada by the corporation or by a corporation related to it" (subparagraph (c)(i) of the definition of "qualified small business corporation share" of subsection 110.6(1) of the Act). According to the appellants, the effect of the trial judge's reasoning would be to deem each dollar of cash and cash equivalents owned by a corporation whose qualified shares are sold to be dividends, a conclusion that defeats the logic behind the deduction thereby authorized (Memorandum of the appellants, para. 66).

[79] Again, this is not the case because the trial judge's reasoning does not apply to each dollar of cash, but rather to the portion that exceeds what is needed to ensure the proper operation of the business. In this regard, one may turn to the Canada Revenue Agency's response to a question asked during a roundtable exercise (eleventh question, roundtable on federal taxation, 2009 conference of the Association de planification fiscale et financière, 2009-0330071C6 – *Actions admissibles de petite entreprise*). This response, referred to by the appellants themselves (Memorandum of the appellants, para. 66, note 94), specifies that qualifying assets for purposes of the capital gains deduction include cash [TRANSLATION] "mainly used within an active business", which excludes excess cash. In the present case, the trial judge found that the funds that were distributed to the appellants exceeded what was needed to operate the business (TCC reasons, subpara. 45(ii) and para. 60). It follows that his reasoning does not defeat the logic behind the capital gains deduction.

[80] In the appellants' view, the trial judge's decision is also contrary to the one reached by the Tax Court in *Geransky,* where it was found that subsection 84(2) did not apply to a share sale involving a third-party buyer who made the purchase "out of its own funds" (Memorandum of the appellants, paras. 80 and 107, citing *Geransky*, subpara. 21(c)). In my view, however, *Geransky* is of no assistance to the appellants. Unlike the corporations involved in *Smythe* and *RMM Equilease* as well as EMC US and EMC Canada in this case, Lafarge, the third-party purchaser in *Geransky*, did not act as a third-party facilitator because the "saving of tax" that the Geransky brothers were contemplating had no impact on the negotiations (*Geransky*, subpara. 15(b); see also subpara. 21(c)).

[81] When regard is had to these decisions, it cannot be argued, as the appellants do, that the presence of a third-party facilitator is immaterial (Memorandum of the appellants, para. 78). Rather, the involvement of a third-party facilitator to extract funds or property from a corporation is of paramount importance in guiding the courts' analysis of the transactions entered into in order to achieve this result. In the case at hand, the trial judge made unequivocal findings of fact that EMC US and EMC Canada acted knowingly as "the instrumentalities through which W4N's funds or property were distributed to … its shareholders" (TCC reasons, para. 63), in particular by approving the distribution, the amount thereof and the steps taken to give effect to it (TCC reasons, paras. 60–61).

[82] Lastly, the appellants argue that the trial judge's broad interpretation of subsection 84(2) makes the application of this provision unpredictable, uncertain and unfair, and that it should be rejected on that account (Memorandum of the appellants, para. 106). However, an anti-avoidance

measure will necessarily raise question marks in the minds of those who choose to test its limits. In the case of subsection 84(2), this uncertainty necessarily looms over taxpayers who, with the assistance of third-party facilitators, use the sale of their business to extract surpluses without tax or at a reduced rate.

[83] The trial judge was therefore correct in holding that W4N was impoverished as a result of the indirect distribution of its excess cash to the appellants and that the scope of subparagraph 84(2) is wide enough to counter this type of distribution.

– *What about Virtuose?*

[84] Because W4N was impoverished, so was Virtuose since the value of the shares that it held was based on the value of W4N. Nevertheless, the appellants maintain that subsection 84(2) does not apply in respect of Virtuose given that the shares that it owned in W4N were its only property and that no such property was distributed to or appropriated by its shareholder, Mr. Foix, during or after the hybrid sale (Memorandum of the appellants, paras. 72–73). According to the appellants, the fact that the $800,000 that was paid to Mr. Foix in exchange for the shares that he held in Virtuose came not from Virtuose directly, but from funds that were owed to W4N, precludes the application of subsection 84(2).

[85] As already explained (see paras. 66 and 69 above), it would be unduly formalistic to hold that subsection 84(2) does not apply to Virtuose and Mr. Foix solely because the funds that he received did not come directly from Virtuose. As is the case for W4N and Mr. Souty, Virtuose was impoverished for the benefit of Mr. Foix with the assistance of EMC US and EMC Canada,

with the result that the impoverishment of Virtuose and the enrichment of Mr. Foix are sufficiently connected to justify the application of subsection 84(2) with respect to Virtuose.

[86] It follows that the appeals, insofar as they turn on the two first questions, must be dismissed.

3. *Did the distribution or appropriation take place on the reorganization or the discontinuance of W4N's and Virtuose's respective businesses?*

– *W4N*

[87] As a preliminary observation, my reading of the case law suggests that the words "winding-up, discontinuance or reorganization" should be construed broadly rather than narrowly. The Exchequer Court's interpretation of these words in *Merritt* (Ex C), as confirmed by the Supreme Court in *Merritt* (SCC), supports this view. In that case, the Exchequer Court did not hesitate to conclude that there had been a winding-up of the target corporation even though no legal winding-up had taken place (*Merritt* (Ex C) at 182, aff'd on this point by *Merritt* (SCC) at 274). It is in this context that the Exchequer Court asserts that the terms "winding-up, discontinuance or reorganization" are "commercial and not … legal term[s]" (*Merritt* (Ex C) at 182, aff'd on this point by *Merritt* (SCC) at 274, citing *In re South African Supply and Cold Storage Company*, [1904] 2 Ch. 268 (UK); also cited in *Kennedy* (FCTD) at 6362). Far from restricting the scope of the term "winding-up", the Exchequer Court (and the Supreme Court) extends it to situations that, in fact, are comparable to a winding-up even though they do not meet that threshold from a legal standpoint (see also *Smythe* at 71). I do not see why the word "reorganization" should be interpreted from a different perspective: the reorganization of a

business, like its winding-up or discontinuance, is a process that can lead to distributions or appropriations (*MacDonald* (FCA), para. 28) and, when this is the case, none of these events should be construed so as to limit their scope.

[88] In the present appeals, the parties agree that the reorganization of a business within the meaning of subsection 84(2) requires, following the test set out in *Kennedy* (FCTD), the end of the conduct of a business in one form and its continuance in another (*Kennedy* (FCTD) at 6362, aff'd on this point by *Kennedy* (FCA), para. 8). According to the appellants, this test consists in determining whether a change was brought to the [TRANSLATION] "commercial activities" conducted by W4N, and the trial judge erred when he recognized that such a change occurred in this case (Memorandum of the appellants, paras. 88, 90 and 94). Indeed, they contend that if the trial judge had not limited his analysis to the activities conducted by W4N and its Successor Corporation, and had also considered those that EMC US continued to carry on after the hybrid sale, he would have been bound to hold that no change was brought to the commercial activities conducted by W4N's business (Memorandum of the appellants, paras. 83 and 92–98).

[89] I am of the view that the appellants misinterpret the test set out in *Kennedy* (FCTD). It is appropriate to review the facts that led to the formulation of that test in order to properly understand its scope. Interestingly, it was the taxpayer, Mr. Kennedy, who wanted to be assessed pursuant to subsection 84(2) (formerly subsection 81(1)), as the deemed dividend arising under that provision provided him with a more advantageous tax treatment than the taxable benefit that had been assessed in his hands pursuant to subsection 15(1) of the Act (formerly subsection 8(1)). The type of business carried on in that case was a car dealership, and the sole

change invoked by Mr. Kennedy was that the premises from which the business was conducted were no longer owned, but leased. The issue was whether this single change was sufficient to give rise to a reorganization within the meaning of subsection 81(1) (*Kennedy* (FCTD) at 6361 and 6362).

[90] The Federal Court, after recognizing that the word "reorganization" is defined as "a fresh organization" and that the verb "reorganize" means "to organize anew" (*Kennedy* (FCTD) at 6362–6363), held that no reorganization had taken place given the absence of any significant change made to the business (*Kennedy* (FCTD) at 6363, aff'd on this point by *Kennedy* (FCA), para. 8):

> In the circumstances of the present case there has been no "fresh" organization. The same Company continued the same business in the same manner and in the same form. The only difference was that by reason of the sale of its premises the Company operated the same business from the same premises which were rented by it rather than being owned by it.

[91] In the case before us, the change that took place as a result of the hybrid sale is of a different order: W4N's business as it existed before the sale was split into two, EMC US having acquired all ongoing contracts (except those concluded with customers located in Canada), the APG software and the associated intellectual property and goodwill, and EMC Canada having acquired the rest, specifically all contracts concluded with customers located in Canada, the machinery, the equipment, the furnishings, the supplies, the inventory, all accounts receivable, all claims, cash and cash equivalents, etc. (see para. 16 above). The day following the hybrid sale, W4N's source of income was transformed into two sources exploited by distinct entities.

[92] The appellants respond by asserting that W4N's business was continued by the EMC group as a whole and that, from this perspective, W4N's source of income remained intact (Memorandum of the appellants, paras. 95–96).

[93] I cannot agree with this reasoning. The EMC group is not a legal person, with the result that from both a factual and legal standpoint, it is not this group that would generate income from W4N's business after the hybrid sale, but the entities that make it up based on the interest that they each acquired in that business. Mr. Souty could not have had this fundamental distinction in mind when he indicated during his testimony that nothing in the conduct of W4N's former business changed after the hybrid sale. Applying the test set out in *Kennedy* (FCTD, at 6362), this separation of W4N's business and its continuation by two distinct entities was sufficiently important to ground the conclusion that W4N's business ceased to be conducted in one form and began to be conducted in another. The trial judge was therefore correct when he held that W4N's business was reorganized for purposes of subsection 84(2) (TCC reasons, para. 73).

[94] As this conclusion is drawn independently of the question as to which party bore the burden of proof on this issue, it is not necessary to address the appellants' argument that the burden was unduly imposed on them (see para. 44 above).

– *Virtuose*

[95] The question that must be answered with respect to Virtuose is whether its business was "discontinued" for purposes of subsection 84(2). Relying on the legal effect of an amalgamation, which is to ensure the sustainability of the amalgamated corporations' businesses, the appellants

argue that the amalgamation of Virtuose could logically not cause the discontinuance of its business (Memorandum of the appellants, para. 85).

[96] However, the evidence contradicts this logic. Indeed, taking into account the fact that Virtuose's only function before the hybrid sale was that of holding W4N shares for Mr. Foix, one can only conclude, as did the trial judge, that Virtuose's business was wholly discontinued as a result of the hybrid sale, as it no longer could act as a holding company on behalf of Mr. Foix or, after the amalgamation, anyone else (TCC reasons, paras. 23 and 50).

[97] It follows that the appeals, insofar as they turn on the third question, must be dismissed with regard to Virtuose as well as W4N.

DISPOSITION

[98] For the foregoing reasons, I would dismiss the three appeals, with one set of costs in the lead appeal.

"Marc Noël"
Chief Justice

"I agree.
Yves de Montigny J.A."

"I agree.
George R. Locke J.A."

Certified true translation
Melissa Paquette, Jurilinguist

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKETS:	A-234-21, A-235-21, A-236-21

APPEALS FROM THREE JUDGMENTS OF JUSTICE PATRICK BOYLE DATED AUGUST 16, 2021, DOCKET NOS. 2017-3809(IT)G, 2017-3810(IT)G AND 2017-3811(IT)G.

STYLE OF CAUSE:	MICHEL FOIX ET AL. v. HIS MAJESTY THE KING
PLACE OF HEARING:	MONTRÉAL, QUEBEC
DATE OF HEARING:	OCTOBER 20, 2022
REASONS FOR JUDGMENT BY:	NOËL C.J.
CONCURRED IN BY:	DE MONTIGNY J.A. LOCKE J.A.
DATED:	FEBRUARY 20, 2023

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