[ENGLISH TRANSLATION]

Docket: 2012-2142(IT)G

BETWEEN:

MARIO MONTMINY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Alberto Galego (2012-2144(IT)G), Serge Latulippe (2012-2145(IT)G), Rémi Dutil (2012-2146(IT)G), Éric Haché (2012-2147(IT)G), Philippe Beauchamp (2012-2148(IT)G) and Jacques Benoit (2012-2150(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Docket: 2012-2144(IT)G

BETWEEN:

ALBERTO GALEGO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Mario Montminy (2012-2142(IT)G), Serge Latulippe (2012-2145(IT)G), Rémi Dutil (2012-2146(IT)G), Éric Haché (2012-2147(IT)G), Philippe Beauchamp (2012-2148(IT)G) and Jacques Benoit (2012-2150(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Docket: 2012-2145(IT)G

BETWEEN:

SERGE LATULIPPE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Mario Montminy (2012-2142(IT)G), Alberto Galego (2012-2144(IT)G), Rémi Dutil (2012-2146(IT)G), Éric Haché (2012-2147(IT)G), Philippe Beauchamp (2012-2148(IT)G) and Jacques Benoit (2012-2150(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Docket: 2012-2146(IT)G

BETWEEN:

RÉMI DUTIL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Mario Montminy (2012-2142(IT)G), Alberto Galego (2012-2144(IT)G), Serge Latulippe (2012-2145(IT)G), Éric Haché (2012-2147(IT)G), Philippe Beauchamp (2012-2148(IT)G) and Jacques Benoit (2012-2150(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Docket: 2012-2147(IT)G

BETWEEN:

ÉRIC HACHÉ,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Mario Montminy (2012-2142(IT)G), Alberto Galego (2012-2144(IT)G), Serge Latulippe (2012-2145(IT)G), Rémi Dutil (2012-2146(IT)G), Philippe Beauchamp (2012-2148(IT)G) and Jacques Benoit (2012-2150(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Docket: 2012-2148(IT)G

BETWEEN:

PHILIPPE BEAUCHAMP,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Mario Montminy (2012-2142(IT)G), Alberto Galego (2012-2144(IT)G), Serge Latulippe (2012-2145(IT)G), Rémi Dutil (2012-2146(IT)G), Éric Haché (2012-2147(IT)G) and Jacques Benoit (2012-2150(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Docket: 2012-2150(IT)G

BETWEEN:

JACQUES BENOIT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeals of Mario Montminy (2012-2142(IT)G), Alberto Galego (2012-2144(IT)G), Serge Latulippe (2012-2145(IT)G), Rémi Dutil (2012-2146(IT)G), Éric Haché (2012-2147(IT)G) and Philippe Beauchamp (2012-2148(IT)G) on September 24, 25 and 26, 2014, and May 26 and 27, 2015, at Québec, Quebec

Before: The Honourable Madam Justice Johanne D'Auray

Appearances:

Counsel for the Appellant:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* for the 2007 taxation year is dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

[ENGLISH TRANSLATION]

Citation: 2016 TCC 110
Date: 20160503
Docket: 2012-2142(IT)G

BETWEEN:

MARIO MONTMINY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2012-2144(IT)G

BETWEEN:

ALBERTO GALEGO,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2012-2145(IT)G

BETWEEN:

SERGE LATULIPPE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2012-2146(IT)G

BETWEEN:

RÉMI DUTIL,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2012-2147(IT)G

BETWEEN:

ÉRIC HACHÉ,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2012-2148(IT)G

BETWEEN:

PHILIPPE BEAUCHAMP,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent,

Docket: 2012-2150(IT)G

BETWEEN:

JACQUES BENOIT,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

D'Auray J.

I. Background

[1] These appeals relate to the 2007 taxation year and were heard on common evidence.

[2] The appellants were all management employees of 9178-4488 Québec inc., formerly known as Cybectec inc. ("Cybectec").

[3] Cybectec is a company offering customers consulting and custom design services in relation to industrial IT systems.

[4] In 2001, Cybectec established a stock option plan (the "stock option plan") in favour of the appellants.

[5] Pursuant to paragraph 110(1)(*d*) of the *Income Tax Act* (the "Act"), a taxpayer may deduct half of the value of the taxable benefit under a stock option plan subsequent to the disposition of the taxpayer's shares. Certain conditions must be met in this regard.

[6] The appellants submit that they have fulfilled all the conditions imposed by paragraph 110(1)(*d*) of the Act and section 6204 of the *Income Tax Regulations* (the "Regulations"). Each of the appellants consequently deducted, under paragraph 110(1)(*d*) of the Act, half of the value of the taxable benefit he received subsequent to the disposition of his shares.

[7] The respondent argues that the appellants did not fulfil the conditions of paragraph 110(1)(*d*) of the Act and section 6204 of the Regulations and that, as a result, the appellants may not deduct half of the taxable benefit received under the stock option plan.

[8] In this case, the issue to be determined is whether the appellants fulfilled the conditions set out in paragraph 110(1)(*d*) of the Act, that is, whether the shares of Cybectec were prescribed shares under section 6204 of the Regulations. The appellants must further establish, as prescribed in paragraph 110(1)(*d*) of the Act, that the price paid for the security, $0.20 per share, was no less than the fair market value of the securities on the date the stock options were granted.

II. The facts

[9] At the hearing, the parties filed a partial agreed statement of facts, which is reproduced below in full:

A. [TRANSLATION] Partial agreed statement of facts

1 The appellants were employees of 9178-4488 Québec inc. (formerly Cybectec inc.) (the Company).

2 [Paragraph struck by the parties.]

3 Until December 1, 2003, the Company was controlled by Yves Racine and Jean-Louis Pâquet by way of the companies 2755-5945 Québec inc. and 2755-5952 Québec inc.

4 Effective December 1, 2003, all shares of the capital stock of the Company were held by 9135-8184 Québec inc.

5 On May 1, 2001, the Company established a stock option plan (the "Plan") for its officers and management employees.

6 Under section 7.2 of the Plan, the options granted could be exercised only upon the occurrence of one of the following events: (1) a public offering by the Company followed immediately by listing of Class A shares of the capital stock of the Company on a recognized stock exchange or (2) the sale of all shares of the capital stock of the Company issued in all classes and in circulation.

7 On December 16, 2001, the number of shares set aside for the purposes of the Plan was increased from 1,740,000 to 2,500,000 Class A shares of the Company.

8 On December 17, 2001, and January 18, 2002, the Company distributed stock options among eleven (11) employees as follows:

Date	Employee	Options
December 17, 2001	Rémi Dutil	130,500
December 17, 2001	Serge Latulippe	348,000
December 17, 2001	Jacques Benoît	261,000
December 17, 2001	Mario Montminy	261,000
December 17, 2001	Alberto Galego	261,000
December 17, 2001	Éric Haché	261,000
December 17, 2001	Philippe Beauchamp	43,500
December 17, 2001	Denis Corriveau	43,500
December 17, 2001	Paul Dionne	174,000
December 17, 2001	Claude St-Pierre	174,000
January 18, 2002	Manon Lessard	17,400
Total:		1,974,900

9 On January 10, 2007, the Plan was modified so that the sale of substantially all of the Company's assets to a third party, Cooper Industries (Electrical) Inc., be considered an event allowing the exercise of stock options granted under the Plan.

10 The Company set the fair market value of the share at the date of granting the stock options at $0.20 per share.

11 On January 28, 2007, some of the employees holding stock options exercised their right under the Plan.

12 On January 28, 2007, the Company distributed shares among nine (9) employees at $0.20 per share as follows:

Employee	Shares	Price/Share	Total
Manon Lessard	17,400	$0.20	$3,480
Denis Corriveau	43,500		$8,700
Philippe Beauchamp	43,500		$8,700
Rémi Dutil	130,500		$26,100
Mario Montminy	261,000		$52,200
Alberto Galego	261,000		$52,200
Jacques Benoît	261,000		$52,200
Éric Haché	261,000		$52,200
Serge Latulippe	348,000		$69,600
	1,626,900		$325,380

13 On January 28, 2007, these employees sold the Class A shares of the capital stock of the Company, which they held to 9135-8184 Québec inc. at a price of $1.2583 per share for a total of:

Employee	Shares	Price/Share	Total
Manon Lessard	17,400	$1.2583	$21,894
Denis Corriveau	43,500		$54,736
Philippe Beauchamp	43,500		$54,736
Rémi Dutil	130,500		$164,208
Mario Montminy	261,000		$328,416
Alberto Galego	261,000		$328,416

Jacques Benoît	261,000		$328,416
Éric Haché	261,000		$328,416
Serge Latulippe	348,000		$437,888
	1,626,900		$2,047,128

14 The Company sold all of its assets on January 26, 2007.

15 For the 2007 taxation year, the appellants received and reported a taxable benefit from employment computed based on proceeds of disposition of $1.2583 and an adjusted cost base of $0.20.

16 For the 2007 taxation year, the appellants claimed deductions corresponding to 50% of the taxable benefits in accordance with the provisions of paragraph 110(1)(*d*) of the Act, the taxable benefit and deduction claimed by each appellant being as follows:

Employee	Shares	Taxable benefit	110(1)(*d*) deduction
Philippe Beauchamp	43,500	$46,036	$23,018
Rémi Dutil	130,500	$138,108	$69,054
Mario Montminy	261,000	$276,216	$138,108
Alberto Galego	261,000	$276,216	$138,108
Jacques Benoît	261,000	$276,216	$138,108
Éric Haché	261,000	$276,216	$138,108
Serge Latulippe	348,000	$368,288	$184,144

17 During the audit phase, the Agency set the fair market value of the share at the date of granting the stock options at $0.415 per share.

18 On or about November 16, 2010, the Minister of National Revenue (the Minister) issued a reassessment for the 2007 year against the appellants, disallowing the deduction claimed under paragraph 110(1)(*d*) of the Act.

19 On or about December 10, 2010, the appellants filed notice of objection with the Minister concerning the reassessments issued for the 2007 taxation year.

20 During the objection phase, the Agency set the fair market value of the share at the date of granting the stock options at $0.3246 per share.

21 On February 27, 2012, the Minister upheld the reassessments.

B. Corporate status and capital stock of Cybectec

[10] Cybectec was created in 1980 by four individuals, including Jean-Louis Pâquet and Yves Racine. The two other founding shareholders of Cybectec left the Company shortly after its creation.[1]

[11] Up to the time of the Company's sale in 2007, Mr. Pâquet and Mr. Racine held equal shares of Cybectec. Mr. Pâquet was the president of Cybectec. He was an engineer and contributed actively to the technical aspects of projects. Mr. Racine was the vice-president of Cybectec and was responsible for business development and company operations.

[12] On May 2, 1998, Cybectec entered into a crystallization transaction so that Mr. Pâquet and Mr. Racine could use their capital gains exemptions. In 1998, prior to the crystallization transaction, Cybectec had issued 200 Class A common shares and 12 Class D shares.[2] As part of the transaction, Mr. Pâquet and Mr. Racine each disposed of 13 Class A shares in consideration of 13 Class C shares redeemable for $32,000 at the option of the holder.[3]

[13] Following at transaction, 174 Class A shares remained issued and in circulation. These 174 Class A shares were then split, resulting in 17,400,000 Class A shares. Taking into account the number of shares resulting from the split, each

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1 Transcription, volume 1, at page 16.

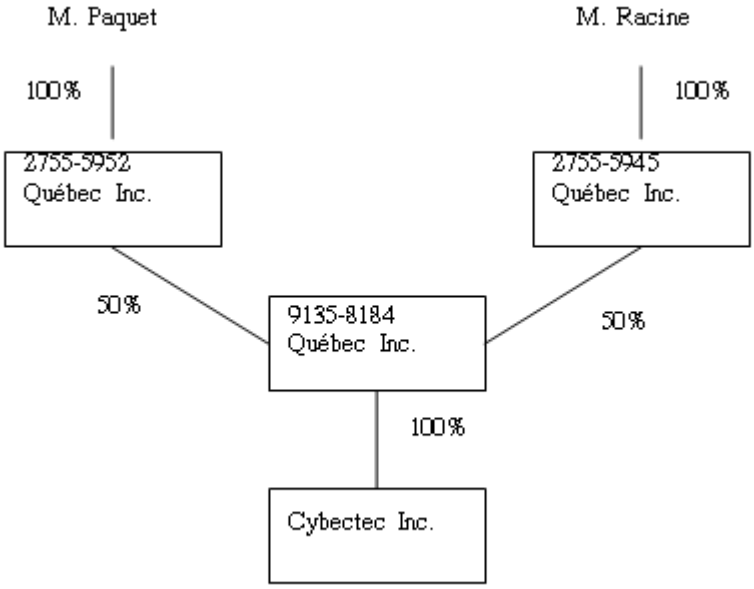
2 Notes to the financial statements for the year ended April 30, 1999, at note 7; List of schedules to the valuation report on Class A shares of Cybectec inc., at page 29.

3 To conduct the transaction, Mr. Pâquet, Mr. Racine and the Company made use of the rollover provisions of subsection 85(1) of the ITA.

Class A share was valued at $0.32 at the time of the crystallization transaction.[4] It is important to note that at the time of the crystallization transaction, no official valuation of the fair market value of the shares had been carried out. The value of the shares had been determined internally by Cybectec's longtime accountant, Mr. Legros.[5]

[14] Prior to December 1, 2003, Cybectec was controlled by Mr. Pâquet and Mr. Racine through portfolio companies. Mr. Pâquet's portfolio company, 2755-5952 Québec inc., held 50% of the shares of Cybectec, and Mr. Racine's company, 2755-5945 Québec inc., held the other 50%.[6]

[15] Following this transaction and the creation of 9135-8184 Québec inc., the latter became holder of the shares of Cybectec effective December 1, 2003.[7] The corporate structure of Cybectec was as follows:



4 This value was calculated as follows: (174 X $32,000 / share) / 17,400,000.
5 Transcription, volume 1, at pages 115 to 117.
6 Partial agreed statement of facts, at paragraph 3.
7 Partial agreed statement of facts, at paragraph 1.

C. The evolution of the Activities and the customer base of Cybectec

[16] The breakdown of Cybectec's activities between the provision of custom software development services and semi-standardized product design has evolved over the years. Until 1999, Cybectec allocated 100% of its efforts to custom software development.[8] This ratio then began to decrease, falling to 80% by mid-2001.[9]

[17] Cybectec billed its customers on a flat-fee basis for its custom software development services and on an hourly basis for software maintenance tasks.[10] For larger projects extending over multiple years, Cybectec billed as it reached designated milestones as arranged in advance with each customer.

[18] Mr. Pâquet testified that between 1993 and 2000, Cybectec's contracts typically ranged in value between $10,000 and $100,000. The Company also won a smaller number of large-scale (more than $1,000,000) contracts, including contracts with its main customer, Hydro-Québec.[11] The majority of contracts were won through a bidding process.

[19] Around 1994, Hydro-Québec commissioned Cybectec to modernize the IT systems at several hundred control centres throughout its electricity network. Cybectec proposed an innovative system called a multiprotocol system (MPS) to modernize Hydro-Québec's IT infrastructure.[12] It is important to note that Hydro-Québec held the intellectual property rights to this MPS, while Cybectec was responsible for designing the system.

[20] Sometime during 1998, the supplier of the data processing hardware used to operate the MPS stopped manufacturing said hardware.[13] That was a devastating turn of events for Cybectec, as that data processing hardware was a critical

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8 Transcription, volume 1, at page 38.
9 Transcription, volume 1, at pages 42 and 43.
10 Transcription, volume 1, at page 25.
11 Transcription, volume 1, at pages 26 and 35.
12 Transcription, volume 1, at pages 30 to 33.
13 Transcription, volume 1, at page 34.

component for running the software Cybectec had developed. As a result of that setback, Cybectec had to develop new software for Hydro-Québec at its own cost.[14] In this context, Cybectec assumed ownership, for the first time, of the intellectual property rights to data processing hardware[15] operating with a system referred to henceforth as MPS2.

[21] In late 1999, Hydro One in Ontario expressed its interest to Cybectec in acquiring software similar to the MPS developed for Hydro-Québec. Subsequent to an international tender process, Hydro One awarded the contract to Cybectec. In 2000, Cybectec started working on this project for Hydro One.

[22] The primary difference between the contract signed with Hydro-Québec and that signed with Hydro One is that Hydro One was not willing to cover the entire cost of software development. Cybectec consequently agreed to deliver the software. This was in keeping with Cybectec's business plan in terms of growing sales and services relating to generic products in order to reduce its dependence on negotiating specific development contracts with its customers.

[23] Around the same time, that is, in late 1999 or early 2000, Hydro-Québec awarded Cybectec a large-scale contract to supply load control devices.[16] The role of a load control device in an electrical transmission system is to take stress off the system during peak demand periods to help prevent power outages. This type of system requires use of a specific hardware component along with software to link the component to the transmission system.

[24] In the light of the complexity of the integration software for the load control device, Hydro-Québec wanted Cybectec to also supply the hardware. Cybectec initially bought the hardware from GenTech, a load control device manufacturer,

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14 Transcription, volume 1, at page 35.

15 Transcription, volume 1, at page 36.

16 The need for this type of system became evident following the ice storm of 1998 in Quebec.

and resold it at a profit to Hydro-Québec for a fixed price including the development costs of the integration software.[17]

[25] The load control device supply contracts were signed for a renewable two-year period and involved the provision of 25 to 30 devices per year.[18]

[26] During his testimony, Mr. Pâquet stated that in 2001, Cybectec was not expecting to get any new large-scale contracts for custom software development.[19]

D. Stock option plan for Class A shares

[27] On May 1, 2001, Cybectec's board of directors, made up of Mr. Pâquet and Mr. Racine, adopted a resolution authorizing the establishment of a stock option plan for the Company's officers and management employees ("employees"). Fierce competition for workers specializing in industrial IT and issues with staff turnover led Cybectec to put this stock option plan in place to improve retention of key employees. Under this plan, Cybectec would issue Class A shares to its employees at the fair market value of the shares as determined by the board of directors at the time of granting the options.

[28] On December 17, 2001, Cybectec granted stock options to the appellants under the stock option plan.[20]

[29] All of the appellants, with the exception of Philippe Beauchamp, held technical positions and had been working for the Company for at least 10 years at the time of the granting of the stock options.[21] Mr. Beauchamp worked in the sales department and had been with the Company for only a few years. This explains the fact that he was granted a lesser number of stock options.

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17 Transcription, volume 1, at pages 40 to 42.
18 Transcription, volume 1, at page 40.
19 Transcription, volume 1, at page 44.
20 Partial agreed statement of facts, at paragraph 8.
21 Transcription, volume 1, at pages 104 and 105.

[30] The agreement adopted on May 1, 2001, governing the stock option plan stipulated that the stock options could not be exercised until the occurrence of either of the events described in sections 7.2 and 7.3, which provided as follows:

> 7.2 [TRANSLATION] Any options granted under the Plan may not be exercised until the occurrence of one of the following events:
>
> > 7.2.1 A public offering by the Company followed immediately by listing of Class A shares of the capital stock of the Company on a recognized stock exchange;
> >
> > 7.2.2 The sale of all shares of the capital stock of the Company issued in all classes and in circulation.
>
> 7.3 Any options granted under the Plan may also be exercised on the tenth anniversary of the date of their granting if neither of the events set out in articles 7.2.1 or 7.2.2 has occurred before the tenth anniversary. . . .

[31] Based on Mr. Pâquet's testimony, in the light of the absence of any plans for an initial public offering or to sell all shares of the capital stock, exercising the options after 10 years appeared the most likely route.[22]

[32] In 2007, Cybectec received an unsolicited offer from Cooper Industrial Electrical Inc. ("Cooper") to purchase all shares it had issued. For taxation reasons, however, Cooper sought to buy substantially all of Cybectec's assets. In the light of this situation, Cybectec's board of directors had to clarify the conditions governing the exercise of options. That clarification was necessary because article 7.2.2 of the Plan covered the sale of shares of Cybectec but not the sale of substantially all of its assets.

[33] Mr. Pâquet and Mr. Racine found it unfair not to allow management employees—the appellants—to exercise their stock options on technical grounds.[23]

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22 Transcription, volume 1, at pages 107 and 108.

23 Transcription, volume 1, at pages 143 to 145.

[34] On January 10, 2007, Cybectec's board of directors passed a written resolution authorizing employees with options under the stock option plan to exercise their options. Pursuant to this resolution, the sale of substantially all of Cybectec's assets to Cooper constituted an event enabling the exercise of options under article 7.2.2 of the Plan.

[35] Also on January 10, 2007, Mr. Pâquet and Mr. Racine, the officers of Cybectec, forwarded a letter to each of the appellants stating, in particular:

> [TRANSLATION] CYBECTEC INC.
> 730 Commerciale Street
> Suite 200
> St-Jean-Chrysostome, Quebec G6Z 2C5
>
> January 10, 2007
>
> Employee
> c/o CYBECTEC INC.
> 730 Commerciale Street
> Suite 200
> St-Jea[*sic*]-Chrysostome, Quebec G6Z 2C5
>
> Subject: Stock option plan for officers and management employees (the "Plan")
>
> Dear Sir,
>
> In accordance with the provisions of a resolution passed by the company's board of directors on January 10, 2007, the Company has deemed that subsequent to settlement of the transaction involving the sale of substantially all of the company's assets to Cooper Industries (Electrical) Inc. scheduled to take place on or about January 30, 2007, you will have the right to exercise the stock options granted to you under the Plan on December 17, 2001.
>
> Subject to successful completion of the transaction, you will consequently be able to exercise these options at the price and under the terms and conditions prescribed in the Plan.
>
> Upon issue of the shares underlying the options you have exercised, you undertake to sell these shares immediately pursuant to your commitments regard under the terms of the "Beneficiary Declarations and Commitments" document you signed on December 17, 2001, at the time of the granting of your options.

> The sale will be transacted with 9135-8184 Québec inc., which on that date will acquire all [number of shares] issued to you at the price of $1.2583 per share for a total of [amount].
>
> . . .
>
> Lastly, you hereby authorize 9135-8184 Québec inc. to withhold, from the sale price of the shares issued to you upon exercising your stock options, an amount corresponding to the strike price of your options and to forward it on your behalf to the company as payment of the share issue price.
>
> CYBECTEC INC.
> By: Jean-Louis Pâquet
> By: Yves Racine

[36] All of the appellants approved and signed this letter, thereby agreeing to sell their shares to 9135-8184 Québec inc., a company related to Cybectec inc.

[37] On January 28, 2007, Cybectec's board of directors passed a written resolution confirming that the employees had exercised their stock options on January 28, 2007, and that the shares had been issued to the appellants at a price of $0.20 per share in accordance with the terms and conditions of the Plan.

[38] On January 28, 2007, the board of directors of 9135-8184 Québec inc. passed a written resolution authorizing the company to purchase the Class A shares held by designated Cybectec employees—the appellants—at a price of $1.2583 per share for a grand total of $1,626,900.

III. Issues

[39] In computing their income for the 2007 taxation year, were the appellants entitled to deduct, under paragraph 110(1)(*d*) of the Act, half of the benefit received under the stock option plan?

[40] To address this question, we must examine the following two questions:

- Were the shares of Cybectec prescribed shares under section 6204 of the Regulations?
- Was the price paid by the appellants, or $0.20 per share, no less than the fair market value of the shares on the date the stock options were granted (December 17, 2001)?

IV. Applicable law and legal analysis

[41] The provisions applicable to the present case are subsections 7(1) and 7(1.1) and paragraphs 110(1)(*d*) and 110(1)(*d*.1) of the Act, and section 6204 of the Regulations.

[42] Subject to subsections 7(1.1) and 7(8) of the Act, subsection 7(1) is applicable to taxpayers where a corporation agrees to sell shares of its capital stock to its employees. Employees acquiring shares of their employer under a stock option plan in this manner are generally required to report, as employment income for the taxation year in which they received the shares, an amount corresponding to the benefit received.

[43] However, subsection 7(1.1) of the Act defers taxation for employees of a Canadian-controlled private corporation (CCPC), making the reference the taxation year in which they dispose of their shares. Therefore, taxpayers may defer taxation of the amount of the benefit received under the stock option plan to the time of disposition of the shares.

[44] The counterpart of section 7 is the deduction of half of the taxable benefit, which *simulates* the effect of a capital gain. Deductions relating to stock option plans are set out in paragraphs 110(1)(*d*) and 110(1)(*d*.1) of the Act. These

deductions significantly reduce the tax burden on employees, but employees are not automatically eligible.

[45] In the light of the facts of this case, paragraph 110(1)(*d*.1) of the Act is of no assistance to the appellants, since one of the conditions for application of this paragraph is that the appellants must have held their shares for at least two years subsequent to their acquisition. In this appeal, the shares of Cybectec were acquired by the appellants on January 28, 2010, and sold that same day. Insofar as the requirement concerning the holding period was not fulfilled, paragraph 110(1)(*d*.1) of the Act is of no use to the appellants.

[46] To be able to deduct half of the benefit, the appellants must consequently invoke paragraph 110(1)(*d*) of the Act.

[47] The conditions provided for under paragraph 110(1)(*d*) of the Act are as follows:

1. The securities must be prescribed shares under section 6204 of the Regulations at the time of their sale or issue;[24]

2. The amount paid by the taxpayer to acquire the shares must be no less than the fair market value of the shares at the time of their granting;

3. Immediately following conclusion of the agreement, the taxpayer must be dealing at arm's length with the employer or other corporation issuing the shares.

[48] In this case, the third condition under paragraph 110(1)(*d*) of the Act is satisfied. The appellants are dealing at arm's length with Cybectec.

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[24] In the present case, this is the date on which Cybectec issued the shares, or January 28, 2007.

[49] With respect to the first condition, the appellants must show that the shares of Cybectec are prescribed shares under subsection 6204(1) of the Regulations.

[50] Regarding the second condition, the appellants must establish that the price paid to acquire the shares of Cybectec, or $0.20 per share, is no less than the fair market value at the time of granting the options (on December 17, 2001).

1) Are the shares of Cybectec prescribed shares under subsection 6204(1) of the Regulations?[25]

A. Position of the parties

[51] The respondent argues that the shares in question are not prescribed shares because the appellants have not met the conditions set out in paragraph 6204(1)(*b*) of the Regulations, which provides that "*the corporation or a specified person in relation to the corporation cannot reasonably be expected to, within two years after the time the share is sold or issued, as the case may be, redeem, acquire or cancel the share in whole or in part.*" I will refer to the requirement in paragraph 6204(1)(*b*) as the "two-year reasonable expectation."

[52] The appellants acknowledge that the two-year reasonable expectation is not met because when Cybectec issued the shares, the corporation related to Cybectec, 9135-8184 Québec inc., had already agreed to purchase the appellants' shares. When the shares were issued, the related corporation consequently expected that the shares would be purchased.

[53] However, the appellants argue that in the light of the exception set out in paragraph 6204(2)(*c*) of the Regulations, the shares of Cybectec are prescribed shares. The appellants submit that they did not have to hold their shares for two years.

[54] The appellants submit in this regard that subsection 6204(2) of the Regulations allows exceptions and that these exceptions are applicable to all of

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[25] The pertinent statutory provisions are reproduced in Schedule A.

subsection 6204(1), including paragraph 6204(1)(*b*), not only to certain paragraphs of subsection 6204(1) as argued by the respondent. The appellants argue that their interpretation of subsection 6204(2) is confirmed in the opening provisions, which read as follows in English and French:

> 6204(2) Pour l'application du paragraphe (1) :
>
> 6204(2) For the purposes of subsection (1),

[55] According to the appellants, paragraph 6204(2)(*c*) of the Regulations disregards the two-year reasonable expectation prescribed in paragraph 6204(1)(*b*) of the Regulations. According to the appellants, if Parliament[26] had wanted to limit application of subsection 6204(2) to certain paragraphs of subsection 6204(1), then the introductory paragraph in subsection 6204(2) would have specified, "for the purposes of paragraph 6204(1)(*a*)."

[56] Therefore, the appellants argue that if taxpayers meet the conditions set out in paragraph 6204(2)(*c*) of the Regulations, they do not have to meet the condition set out in paragraph 6204(1)(*b*) with respect to the two-year reasonable expectation.

[57] In this regard, the appellants submit that they meet all conditions listed in subparagraphs 6204(2)(*c*)(i), (ii) and (iii) and clause 6204(2)(*c*)(ii)(B) of the Regulations. Consequently, the appellants assert that the shares of Cybectec are prescribed shares under section 6204 of the Regulations and that the first condition in paragraph 110(1)(*d*) of the Act is therefore met.

[58] The appellants argue further that the stock option plan was implemented to assist in retaining the officers and management employees of Cybectec; hence, there is no compensation in disguise. Thus, according to the appellants, the stock option plan does not infringe upon taxation policy governing stock option plans. In

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[26] Regulations made under the Act are approved by the Governor in Council.

this regard, the appellants cite Janette Pantry[27] concerning the purpose of section 6204 of the Regulations:

> [TRANSLATION] Section 6204 of the Regulations sets out the applicable requirements concerning prescribed shares. Essentially, the shares must be "plain vanilla common" shares. The purpose of section 6204 is to ensure that the employees granted stock options and qualifying for a tax rate corresponding to that applicable to capital gains acquire their stock options in circumstances where the value of the shares in question is not guaranteed to increase. For example, employees should not be eligible for the deduction for stock options where the salary or other compensation they would normally receive is replaced by options to acquire shares designed to increase in value . . .

[59] As for, the respondent, it is argued that the interpretation of subsections 6204(1) and 6204(2) of the Regulations offered by the appellants is incorrect.

[60] The respondent submits that subsection 6204(2) of the Regulations applies only to certain paragraphs of subsection 6204(1). According to the respondent, reading subsections 6204(1) and 6204(2) of the Regulations as a whole confirms that interpretation.

[61] For example, the respondent notes that paragraph 6204(2)(*a*) of the Regulations applies only to subparagraph 6204(1)(*a*)(i). Paragraph 6204(2)(*b*), meanwhile, applies only to subparagraph 6204(1)(*a*)(ii). The respondent notes further that none of the paragraphs in subsection 6204(2) apply to subparagraphs 6204(1)(*a*)(iii) or (v).

[62] With respect to paragraph 6204(2)(*c*) of the Regulations, the respondent argues that this paragraph applies only to subparagraphs 6204(1)(*a*)(iv) and 6204(1)(*a*)(vi). Paragraph 6204(2)(*c*) can be used to disregard the rights and duties provided for in subparagraphs 6204(1)(*a*)(iv) and 6204(1)(*a*)(vi). For example, if a corporation has the right to redeem shares under, paragraph 6204(2)(*c*) this

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[27] Pantry, Janette, "Paragraph 110(1)(*d*) – Stock Option Deduction – Unwarranted Application of Prescribed Share Provisions," 17(1) *Taxation of Executive Compensation & Retirement* (Federated Press) 563-66 (July/Aug 2005).

redemption right can be disregarded if all of the conditions prescribed in that paragraph are met.

[63] The respondent also notes that the relevant provisions, i.e., paragraphs 6204(1)(*a*) and 6204(1)(*c*) and subparagraphs 6204(1)(*a*)(iv) and 6204(1)(*a*)(vi) of the Regulations, all use the same wording. They all refer to rights or duties arising from the terms or conditions of the share or any agreement in respect of the share or its issue.

[64] According to the respondent, paragraph 6204(1)(*b*) of the Regulations makes no reference to rights or duties arising from the terms or conditions of the share or any agreement in respect of the share or its issue. The respondent submits that paragraph 6204(1)(*b*) raises a factual question: *could it be reasonably expected that the shares would be acquired or redeemed within two years following their issue?* As a result, paragraph 6204(2)(*c*) cannot be used to disregard the two-year reasonable expectation.

[65] The respondent argues that if the facts had established that Cybectec or 9135-8184 Québec inc. could not, at the date of issue of the shares, reasonably expect that the related corporation would purchase the appellants' shares within two years following the issue of the shares, then the criterion in paragraph 6204(1)(*b*) would be met.

[66] However, the respondent submits that in the circumstances at hand, neither Cybectec nor 9135-8184 Québec inc. could reasonably expect the shares not to be redeemed within two years following their issue by Cybectec. In this regard, the appellants had signed an agreement prior to the issue of the shares under which 9135-8184 Québec inc. committed to buying the appellants' shares on the same date as the issue of the shares, January 28, 2007.

[67] The respondent submits that in the present case, the appellants do not meet the criterion in paragraph 6204(1)(*b*) of the Regulations. The respondent argues that insofar as the shares of Cybectec were not prescribed shares within the meaning of subsection 6204(1) of the Regulations, the appellants are not eligible for the deduction provided for in paragraph 110(1)(*d*) of the Act.

B. Analysis

[68] The parties stated at the hearing that there was no case law concerning the interaction of paragraphs 6204(1)(*b*) and 6204(2)(*c*) of the Regulations as to whether paragraph 6204(2)(*c*) can be used to eliminate from consideration the two-year reasonable expectation in paragraph 6204(1)(*b*). To determine this question, I will turn to the doctrine of the Supreme Court of Canada as to the interpretation of tax laws.[28] In *Canada Trustco Mortgage Co. v. Canada,* [2005] 2 SCR 601, 2005 SCC 54 (CanLII), at paragraph 10, the Supreme Court of Canada sets out how the tax laws are to be interpreted:

> . . . The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

[69] At paragraph 13, the Supreme Court states that "the *Income Tax Act* remains an instrument dominated by explicit provisions dictating specific consequences, inviting a largely textual interpretation." On the other hand, "where the words of a statute give rise to more than one reasonable interpretation, the ordinary meaning of words will play a lesser role, and greater recourse to the context and purpose of the Act may be necessary."[29]

[70] I will first analyze subsections 6204(1) and 6204(2) of the Regulations and thereby use a textual approach and then use an approach placing greater emphasis on the context and purpose of the Act.

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28 Coté, Pierre-André, *Interprétation des lois*, paragraph 88: [TRANSLATION] The jurisprudential principles of the interpretation of laws are applied and applicable to the interpretation of statutory instruments, whether to determine their meaning or to clarify their scope.

29 *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20 (CanLII), [2006] 1 SCR 715, paragraph 22.

[71] On reading subsections 6204(1) and 6204(2) of the Regulations, it is noted that subsection 6204(2) is a rule of application. As such, subsection 6204(2) may be used to disregard certain rights, conditions and obligations set out in certain paragraphs of subsection 6204(1).

[72] Subsection 6204(1) of the Regulations defines what constitutes a prescribed share. It provides as follows:

> **6204 (1)** For the purposes of subparagraph 110(1)(*d*)(i) of the Act, a share is a prescribed share of the capital stock of a corporation at the time of its sale or issue, as the case may be, if, at that time,
>
> **(a)** under the terms or conditions of the share or any agreement in respect of the share or its issue,
>
> **(i)** the amount of the dividends (in this section referred to as the "dividend entitlement") that the corporation may declare or pay on the share is not limited to a maximum amount or fixed at a minimum amount at that time or at any time thereafter by way of a formula or otherwise,
>
> **(ii)** the amount (in this section referred to as the "liquidation entitlement") that the holder of the share is entitled to receive on the share on the dissolution, liquidation or winding-up of the corporation is not limited to a maximum amount or fixed at a minimum amount by way of a formula or otherwise,
>
> **(iii)** the share cannot be converted into any other security, other than into another security of the corporation or of another corporation with which it does not deal at arm's length that is, or would be at the date of conversion, a prescribed share,
>
> **(iv)** the holder of the share cannot at that time or at any time thereafter cause the share to be redeemed, acquired or cancelled by the corporation or any specified person in relation to the corporation, except where the redemption, acquisition or cancellation is required pursuant to a conversion that is not prohibited by subparagraph (iii),
>
> **(v)** no person or partnership has, either absolutely or contingently, an obligation to reduce, or to cause the corporation to reduce, at that time or at any time thereafter, the paid-up capital in respect of

> the share, except where the reduction is required pursuant to a conversion that is not prohibited by subparagraph (iii), and
>
> **(vi)** neither the corporation nor any specified person in relation to the corporation has, either absolutely or contingently, the right or obligation to redeem, acquire or cancel, at that time or any later time, the share in whole or in part other than for an amount that approximates the fair market value of the share (determined without reference to any such right or obligation) or a lesser amount;
>
> **(b)** the corporation or a specified person in relation to the corporation cannot reasonably be expected to, within two years after the time the share is sold or issued, as the case may be, redeem, acquire or cancel the share in whole or in part, or reduce the paid-up capital of the corporation in respect of the share, otherwise than as a consequence of
>
> **(i)** an amalgamation of a subsidiary wholly-owned corporation,
>
> **(ii)** a winding-up to which subsection 88(1) of the Act applies, or
>
> **(iii)** a distribution or appropriation to which subsection 84(2) of the Act applies; and
>
> **(c)** it cannot reasonably be expected that any of the terms or conditions of the share or any existing agreement in respect of the share or its sale or issue will be modified or amended, or that any new agreement in respect of the share, its sale or issue will be entered into, within two years after the time the share is sold or issued, in such a manner that the share would not be a prescribed share if it had been sold or issued at the time of such modification or amendment or at the time the new agreement is entered into.

[My emphasis.]

[73] For the purposes of the deduction described in paragraph 110(1)(*d*) of the Act, the opening words of subsection 6204(1) of the Regulations are what determine the relevant time at which a share is considered a prescribed share, that is, on the date of its sale or issue, as applicable. In that subsection, the sale of the share means the sale of the share by the corporation to its employee. In this case, the date of the sale and issue of the shares in favour of the appellants was

January 28, 2007. The relevant date under subsection 6204(1) is consequently January 28, 2007.

[74] A share is a prescribed share under subsection 6204(1) of the Regulations if the conditions in paragraphs 6204(1)(*a*), 6204(1)(*b*) and 6204(1)(*c*) are met.

[75] Under paragraph 6204(1)(*a*), the shares are prescribed shares if, under the terms or conditions of the shares or any agreement in respect of the shares or their issue, the shares do not have any conditions or restrictions attached thereto. One expression frequently used in defining prescribed shares is "plain vanilla common shares."

[76] The shares must also meet the criteria in paragraph 6204(1)(*b*) of the Regulations with respect to the two-year reasonable expectation. If, on the date of issue of the shares, it could not reasonably be expected, in the light of the facts found, that the shares would be redeemed by the corporation or a related corporation within two years following their issue, then the requirement in paragraph 6204(1)(*b*) is met.

[77] The requirement in paragraph 6204(1)(*b*) is also met if the corporation undertook an amalgamation of a subsidiary wholly-owned corporation, a winding-up under section 88 of the Act or a distribution subject to subsection 84(2) of the Act.

[78] As for Paragraph 6204(1)(*c*), it seeks to prevent circumvention of paragraph 6204(1)(*a*) by way of amendment of the terms and conditions of the share subsequent to its sale or issue. In other words, if, during the two years following the sale or issue of the shares, it can be reasonably expected that the terms or conditions of the share will be amended or that a new agreement will be negotiated such that the share would not have been a prescribed share had it been sold or issued on the date of amendment or of the new agreement, then the share is not a prescribed share. In the case at hand, the conditions of this paragraph are met in that the agreement governing the shares of Cybectec was not amended after the shares were issued.

[79] As stated previously, the appellants have acknowledged, and rightly so in my opinion, that they did not meet the two-year reasonable expectation under

paragraph 6204(1)(*b*) of the Regulations. The evidence has shown that when the appellants' shares were issued by Cybectec, the related corporation, 9135-8184 Québec inc., knew that it would be buying the shares. The agreements between the appellants, Cybectec and 9135-8184 Québec inc. do not leave any doubt. Despite this, the appellants argue that their shares are prescribed shares under paragraph 6204(2)(*c*), which the respondent contests.

[80] Before addressing the issue of whether paragraph 6204(2)(*c*) disregards paragraph 6204(1)(*b*), it is important to understand the interaction between subsections 6204(1) and 6204(2).

[81] For example, under subparagraph 6204(1)(*a*)(i) of the Regulations, a share is prescribed if "the amount of the dividends (in this section referred to as the 'dividend entitlement') that the corporation may declare or pay on the share is not limited to a maximum amount or fixed at a minimum amount." Paragraph 6204(2)(*a*) clarifies that condition by providing that the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be limited to a maximum amount or fixed at a minimum amount where it may reasonably be considered that all or substantially all of the dividend entitlement is determinable by reference to the dividend entitlement of another share of the capital stock of the corporation that meets the requirements of subparagraph 6204(1)(*a*)(i). Clearly, then, paragraph 6204(2)(*a*) serves to clarify the application of subparagraph 6204(1)(*a*)(i).

[82] As for, subparagraph 6204(1)(*a*)(ii) of the Regulations, it provides that a share is prescribed if the holder's liquidation entitlement on the dissolution, liquidation or winding-up of the corporation is not limited to a maximum amount or fixed at a minimum amount. Paragraph 6204(2)(*b*) clarifies that condition by providing that the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be limited to a maximum amount or fixed at a minimum amount where it may reasonably be considered that all or substantially all of the liquidation entitlement is determinable by reference to the liquidation entitlement of another share of the capital stock of the corporation that meets the requirements of subparagraph 6204(1)(a)(ii). Clearly, then, paragraph 6204(2)(*b*) serves to clarify the application of subparagraph 6204(1)(*a*)(ii).

[83] As for subparagraph 6204(1)(*a*)(iv) of the Regulations, it provides that a share is prescribed if the holder cannot cause the share to be redeemed, acquired or cancelled by the corporation or any specified person in relation to the corporation. Paragraph 6204(2)(*c*) may be used to disregard these rights or obligations by providing that "the determination of whether a share of the capital stock of a particular corporation is a prescribed share shall be made without reference to a right or obligation to redeem, acquire or cancel the share, or to cause the share to be redeemed, acquired or cancelled."[30] For example, even if a share has an attached term or condition whereby a holder may force the corporation to redeem the share, paragraph 6204(2)(*c*) may be used to disregard this redemption right if the conditions set out in paragraph 6204(2)(*c*) are met.

[84] As for subparagraph 6204(1)(*a*)(vi), it provides that a share is prescribed if neither the corporation nor any specified person in relation to the corporation has, either absolutely or contingently, the right or obligation to redeem, acquire or cancel the share. Paragraph 6204(2)(*c*), which provides that "the determination of whether a share of the capital stock of a particular corporation is a prescribed share shall be made without reference to a right or obligation to redeem, acquire or cancel the share, or to cause the share to be redeemed, acquired or cancelled," disregards these rights and obligations. For example, in the present case, despite the fact that the related corporation may acquire the appellants' shares under an agreement to that effect, paragraph 6204(2)(*c*) disregards that acquisition right. In other words, paragraph 6204(2)(*c*) may be used to esclude from consideration the corporation's right or obligation to redeem, acquire or cancel the share if the conditions set out in paragraph 6204(2)(*c*) are met.

[85] In the light of the foregoing, there is a logical connection, a central thread, between the paragraphs of subsection 6204(2) of the Regulations, which apply to the subparagraphs of subsection 6204(1).

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30 See analysis of the issue of securities to employees by McCarthy Tétrault. Paragraph 6204(2)(*c*) of the Regulations may be used to disregard certain rights and obligations for the purposes of subsection 6204(1) if all conditions in paragraph 6204(2)(*c*) are met.

[86] Contrary to the appellants' assertions, I am of the view that subsection 6204(2) of the Regulations does not apply to subsection 6204(1) as a whole. Here is my explanation.

[87] It is clear that paragraphs 6204(2)(*a*) and 6204(2)(*b*) do not apply to subparagraphs 6204(1)(*a*)(iii) and 6204(1)(*a*)(v). There is no logical connection between these provisions. It is also evident that paragraph 6204(2)(*c*) of the Regulations may not be used to disregard the conditions in subparagraphs 6204(1)(*a*)(iii) and 6204(1)(*a*)(v). Paragraph 6204(2)(*c*) may be used to disregard the right or obligation to redeem, acquire or cancel a share or to cause the share to be redeemed, acquired or cancelled, whereas subparagraph 6204(1)(*a*)(iii) refers to conversion rights and subparagraph 6204(1)(*a*)(v) refers to the reduction of paid-up capital. No logical connection exists between paragraph 6204(2)(*c*) and subparagraphs 6204(1)(*a*)(iii) and 6204(1)(*a*)(v).

[88] In the light of the foregoing, the paragraphs of subsection 6204(2) accordingly apply to the paragraphs of subsection 6204(1) through the existence of a logical connection.

[89] It is now to be determined whether paragraph 6204(2)(*c*) applies to paragraph 6204(1)(*b*), that is, whether it disregards the two-year reasonable expectation.

[90] The respondent has not disputed the appellants' fulfilment of the conditions set out in paragraph 6204(2)(*c*), specifically in subparagraphs 6204(2)(*c*)(i), (ii) and (iii), of the Regulations. In any case, I am of the view of that the evidence has shown that the conditions set out in subparagraphs 6204(2)(*c*)(i) and 6204(2)(*c*)(iii) and clause 6204(2)(*c*)(ii)(B) of the Regulations are met.

[91] As I have determined previously in paragraphs 83 and 84 herein, paragraph 6204(2)(*c*) may be used to disregard the conditions in subparagraphs 6204(1)(*a*)(iv) and 6204(1)(*a*)(vi), that is, the right or obligation to redeem, acquire or cancel the share or cause the share to be redeemed, acquired or cancelled.

[92] However, I am of the view of that paragraph 6204(2)(*c*) of the Regulations does not apply to paragraph 6204(1)(*b*). In other words, paragraph 6204(2)(*c*) cannot be used to disregard the two-year reasonable expectation. My reasons are as follows.

[93] In my opinion, although the French version of paragraph 6204(1)(*b*) is consistent with the English text of the Regulations, the English version is more explicit. In English, paragraph 6204(1)(*b*) provides as follows:

> (b) the corporation or a specified person in relation to the corporation cannot reasonably be expected to, within two years after the time the share is sold or issued, as the case may be, redeem, acquire or cancel the share in whole or in part, or reduce the paid-up capital of the corporation in respect of the share, otherwise than as a consequence of (i) an amalgamation of a subsidiary wholly-owned corporation, (ii) a winding-up to which subsection 88(1) of the Act applies, or (iii) a distribution or appropriation to which subsection 84(2) of the Act applies;
>
> [My emphasis.]

[94] I note upon reading paragraph 6204(1)(*b*) of the Regulations that it is not the rights or obligations to redeem, acquire or cancel the shares that trigger the application of this paragraph but rather the reasonable expectation that the shares will be redeemed, acquired or cancelled within two years following their sale or issue.

[95] Paragraph 6204(1)(*b*) of the Regulations raises a factual question: in the present case, did the related corporation, 9138-5184 Québec inc., expect, when the shares were issued to the appellants, to purchase the shares within two years following this issue? In this case, the agreements between Cybectec, 9135-8184 Québec inc. and the appellants leave no doubt.

[96] In view of its wording, the sole object of paragraph 6204(2)(*c*) of the Regulations is to disregard certain rights and obligations, notably to redeem, acquire or cancel the share, if all conditions of paragraph 6204(2)(*c*) are met. The wording in paragraph 6204(2)(*c*) therefore cannot be used to disregard a factual issue, this being the two-year reasonable expectation in paragraph 6204(1)(*b*).

[97] My conclusion that paragraph 6204(2)(*c*) of the Regulations does not disregard paragraph 6204(1)(*b*) is confirmed by the fact that paragraph 6204(1)(*b*) is applicable in cases where there is no right or obligation to redeem, acquire or cancel the shares at the time of their issue. For example, if, at the time of issue, a share is a common share without conditions, then the share is a prescribed share. However, if the facts show that the corporation knew that it would be redeeming its employees' shares within two years following the issue of the shares, then the share is not a prescribed share, since the expectation that the share will be redeemed is what triggers paragraph 6204(1)(*b*) regardless of whether the share has rights or obligations attached thereto. This shows that paragraph 6204(2)(*c*), used to eliminate from consideration certain rights or obligations, is not relevant to paragraph 6204(1)(*b*).

[98] Moreover, contrary to situations in which there is a logical connection between the application of subsection 6204(2) of the Regulations and certain subparagraphs of paragraph 6204(1)(*a*), it is difficult to find a logical connection between the factual issue in paragraph 6204(1)(*b*), the two-year reasonable expectation, and paragraph 6204(2)(*c*), the purpose of which is to disregard the right or obligation to redeem, acquire or cancel the share or to cause the share to be redeemed, acquired or cancelled.

[99] As indicated by Mr. Nickerson on November 26, 1984, during debate in the House of Commons,[31] the purpose of stock option plans is to encourage a corporation's employees to purchase shares so that they will have a vested interest in that business. In achieving this goal, I am of the view that employees who agree to participate in this type of plan must also agree to be exposed to a certain amount of risk, that is, the risk of fluctuation in the value of their shares.

[100] Parliament opted to extend the same treatment to employees who have purchased shares from their employer under a stock option plan as to taxpayers who purchase shares without recourse to a stock option plan and who, at the time of disposition, pay tax on 50% of the gain. However, the conditions of section 6204 of the Regulations must be fulfilled.

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[31] House of Commons Debates, November 26, 1984, p. 578.

[101] The tax policy underlying paragraphs 110(1)(*d*) of the Act and 6204(2)(*b*) of the Regulations is to prevent the turning of stock option plans into forms of additional remuneration and to ensure that the employees subscribing for these shares are exposed to a certain level of risk. In my opinion, I would have arrived at the same outcome following a contextual approach, since it is clear from the legislative context that the two-year holding period is associated with risk. Indeed, under a stock option plan, employees do not incur any risk until they exercise their stock options. Moreover, pursuant to paragraph 110(1)(*d*), the two-year reasonable expectation is not applicable if the evidence shows that at the time of issuing the share, the corporation or related corporation had no expectation to redeem, acquire or cancel the share as prescribed in paragraph 6204(1)(*b*).

[102] The appellants argue that some doctrinal authors have criticized the two-year reasonable expectation requirement in paragraph 6204(1)(*b*) of the Regulations. According to these authors, employees of public corporations do not have to retain their shares for the two-year period. I understand this criticism. That being said, the two-year period remains part of current legislation.

[103] The appellants have also shown that subsequent to the sale of the assets of Cybectec, if the latter had used a different strategy, the shares of Cybectec would have been prescribed shares. I agree. However, I must analyze the transaction conducted by Cybectec and brought before me.

[104] In the light of the wording of paragraphs 6204(1)(*b*) and 6204(2)(*c*) of the Regulations and the tax policy concerning stock option plans, I cannot conclude that paragraph 6204(2)(*c*) disregards the two-year reasonable expectation provided for in paragraph 6204(1)(*b*).

[105] Before moving on to the second question, I want to point out that subsections 6204(1) and 6204(2) are complex technical provisions. I find it difficult to imagine how anyone running a business would be able to decipher the mechanism defined in these two subsections. With the growing popularity of stock option plans, surely the time has come for a reform of these subsections.

2) Fair market value of shares of Cybectec on December 17, 2001

[106] Despite my conclusion that the appellants' shares are not prescribed shares, I will nonetheless examine the second condition in paragraph 110(1)(*d*) of the Act as to whether, in this case, the price of $0.20 per share paid by the appellants was no less than the fair market value of the share on the date on which the stock options were granted, or December 17, 2001.

[107] In this regard, the appellants submitted an expert report prepared by Mr. Brisson and Mr. Fortin of Fortin Gaignard Groupe Conseil inc. (FGGC) dated March 24, 2011, hereinafter the "original report." Mr. Brisson provided expert testimony concerning the original report. The respondent, meanwhile, produced an expert report prepared by Ms. Demers of the CRA dated June 23, 2014. Ms. Demers testified as an expert for the respondent. In response to the respondent's report, the appellants produced a critical report prepared by Mr. Brisson and Mr. Fortin in August 2014, hereinafter the "critical report." Mr. Fortin provided expert testimony concerning the critical report.

[108] I note that the critical report addresses a number of key elements of the respondent's expert report. However, the critical report overlooks entirely certain adjustments made by the respondent. In this regard, the appellants emphasized that with the exception of the facts expressly acknowledged,[32] the critical report's lack of comments concerning any given fact does not constitute an admission. As a result, each point of divergence between the original report and the respondent's report must be analyzed to determine whether $0.20 per share corresponded to the fair market value of the Class A shares on December 17, 2001.

[109] In assessing shares of a corporation, the objective is to determine the fair market value of the share on a specific date. The phrase "fair market value" refers to the highest price, expressed in a cash equivalent, that could be obtained in an unrestricted, free-market transaction between a hypothetical buyer and seller who

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[32] For example, the adjustments concerning compensation of the officers or the fair market value of the investment, which was set at $212,574 in the computation of surplus assets.

were consenting, capable of entering into an agreement, dealing at arm's length with each other, free from constraint and reasonably informed of the relevant facts.

[110] The parties agree to use the representative cash flow capitalization approach. This valuation method involves determining:

- the corporation's representative cash flow
- an appropriate capitalization rate
- the discounted value of the undepreciated capital costs (UCC) of fixed assets and cumulative eligible capital amounts for intangible assets at the valuation date
- total surplus assets.

[111] To facilitate reading, Schedule 2 hereto sets out the details of each expert's valuation.

[112] The items on which the experts disagree are as follows:

1) rental income and rental costs
2) professional fees
3) the provision for future billing and the bill to Hydro One
4) additional scientific research and experimental development (SR&ED) expenses
5) SR&ED costs
6) payroll increases
7) representative cash flows used
8) interest on additional borrowing capacity
9) multiple used

10) present value of tax savings

11) surplus assets

12) value of development projects

[113] Schedule 3 sets out my findings concerning the disputed items. I also took the following facts into my analysis of the fair market value of shares of Cybectec on December 17, 2001:

- the sound financial health of Cybectec despite a decrease in its profit margin since 1998. It is noted that earnings before tax dropped from $1,245,358 in 1998 to $750,000 in 2001. A decrease in income from consulting services is consequently also noted;

- Cybectec's expertise and sound reputation in the market;

- Mr. Pâquet's and Mr. Racine's experience and expertise, although there is also risk associated with Cybectec's dependence on its two officers to run all aspects of Cybectec's operations;

- economic dependence on one client accounting for 60% to 70% of Cybectec's sales;

- the staff turnover rate, and resulting challenge in fulfilling certain commitments, and the pressure on certain employees' salaries;

- the size of the SR&ED tax credits and the foreseeable loss of these credits for potential buyers;

- the lack of a major contract in the Company's order book in 2001.

A. Analysis

1) Rental income and rental costs

[114] On testifying, Mr. Racine indicated that Cybectec was renting approximately 4,000 sq. ft. of space in Montréal. The corporation had a five-year lease. During the years 1999, 2000 and 2001, Cybectec leased a space approximately 150 sq. ft. in size to a French IT company. Cybectec had rental income of $4,000, $5,000 and $6,000 for the years 1999, 2000 and 2001 respectively.

[115] As for the rent Cybectec paid for its offices in Montréal and Québec, it increased over the same time frame: Cybectec paid $91,229, $121,258 and $148,415 for the years 1999, 2000 and 2001 respectively.

[116] In the original report, Mr. Brisson reduced earnings before interest, tax, depreciation and amortization (EBITDA) by $4,000, $5,000 and $6,000 for 1999, 2000 and 2001 respectively, these amounts corresponding to Cybectec's rental income. According to Mr. Brisson, rental income should be deducted from EBITDA since this is not a recurring item. According to Mr. Brisson, this income should be disregarded as it cannot be assumed that a potential buyer would also lease out surplus space to third parties.

[117] Mr. Brisson also adjusted EBITDA for the years 1999 and 2000 by adding $60,000 and $30,000 respectively to account for an increase in the rent paid by Cybectec. Mr. Brisson reduced EBITDA for the years 1999 and 2000 as, in his opinion, the rent paid by Cybectec did not reflect market rates; in other words, the rent paid by Cybectec in 1999 and 2000 was too low.

[118] I disagree with these adjustments. As Mr. Fortin stated during his testimony concerning a different matter, when assigning a value to shares of a corporation, prior years should be adjusted only if the adjustment is structural, which, in my opinion, does not apply in the present case.

[119] Moreover, the respondent's expert explained that in general, when a corporation rents an excessively large space, rent expenses should be decreased to reflect the amount of space actually used.[33] This adjustment increases EBITDA. In

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[33] Transcription, volume 2, at page 212, line 14.

this case, however, Cybectec rented out the surplus space.[34] The sublet income consequently offsets a portion of this excess rent expense. Rent would logically also have increased from 1999 to 2000 to 2001 since the number of employees increased: Cybectec grew from 38 employees in 1998 to 52 employees in 2001. As a result, no adjustments need to be made to rental income or rent costs.

2) Professional fees

[120] The respondent's expert, Ms. Demers, added $45,070 and $37,515 to EBITDA for professional fees in relation to the amendment of the shareholder agreement and establishment of a stock option plan. According to Ms. Demers, EBITDA should be increased since these expenses are not recurring and consequently lead to underestimation of earnings.

[121] At the hearing, Ms. Demers stated that she had relied on the conclusions of the audit report prepared by a colleague, Jean-François Paradis, in arriving at these adjustments for 2000 and 2001. It is to be noted that Mr. Paradis did not testify at the hearing. The expert report prepared by Ms. Demers also contains no reference to the fact that she relied on a colleague in establishing this adjustment. According to the appellants, the general ledger contained no record of these professional fees.[35] In *Drouin v. The Queen*, 2012 TCC 94, Bédard J. referred to *Taylor Estate v. Minister of National Revenue*, 90 DTC 1768 (TCC), in which Judge Couture stated as follows, at page 1775, concerning the reliability of expert testimony:

> [TRANSLATION] An appraiser may not, in preparing an appraisal to serve as evidence before a court, accept figures that he or she has not checked or assume the truth of facts whose accuracy he or she has not verified. An expert report should be the product of the expert's personal opinion based on established facts whose existence has been proved, not on conjecture or information received from third parties. . . .

[122] An expert may not, in preparing a complete report, rely on a third party without carrying out the necessary research to justify any adjustments. Moreover,

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34 Transcription, volume 2, at page 177, line 7.

35 Transcription, volume 3, at page 124, line 10.

Ms. Demers should have mentioned this fact in her report. During her testimony, Ms. Demers did not indicate whether the professional fees were confirmed subsequent to the audit.

[123] I am of the view that this adjustment concerning professional fees should be struck. It is impossible for me to determine whether the amounts that Ms. Demers added are valid. I further accept the appellants' assertion that these amounts were not recorded under expenses in the general ledger.

3) The provision for future billing and the bill to Hydro One

[124] In her report, Ms. Demers eliminated an adjusting entry reversing a provision of $22,052 recorded by Cybectec for billing to be generated on April 30, 2011.[36] Ms. Demers also added a bill to Hydro One dated June 20, 2001, for $64,252 for services rendered up to April 20, 2001.[37]

[125] Comments on these adjustments are provided by Ms. Demers in notes F and G in schedule IV to her expert report. On pages 28 and 29 of her report, Ms. Demers explained why she made these adjustments:

> [TRANSLATION] The financial statements reviewed were produced by chartered accountants at Ouellet & Legros as part of a review engagement. A reservation is noted concerning compliance with generally accepted accounting principles:
>
> > [TRANSLATION] Generally accepted accounting principles recommend the preparation of financial statements on a financial year basis. The corporation records revenue based on billing, and in this regard the financial statements depart from generally accepted principles. It is impossible to evaluate the effect of this departure. Impact on sales, corporate income tax, net earnings or work in progress consequently cannot be determined.
>
> Although it may be difficult to assess the financial effect of this departure at this time, it is important to determine any impact on the income statement and balance sheet.

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36 Respondent's expert report, at page 35.

37 Respondent's expert report, at page 36.

> In this case, outlays relating to contracts are expenses immediately as they are incurred, whereas sales of services are recorded only at the time of billing, meaning that the matching principle for recognizing revenue and expenses is not being respected. The result is understatement of income during the financial period, a reduced profit margin, understatement of earnings before tax and the lack of a short-term asset item for work in progress.
>
> We consequently need to take these aspects into account when following a valuation method with respect to determining earnings representative of the Company's operations.

[126] At the hearing, Mr. Fortin disagreed with these adjustments totalling approximately $86,000 ($22,052 and $64,252).[38] On page 13 of the critical report, he notes the following:

> [TRANSLATION] The CRA cannot arrive at such a conclusion, clearly suggesting that profits and assets are understated, when the accountant's report states that the impact cannot be measured.
>
> As a result of its reasoning, the CRA makes adjustments in Schedule 5, Table A, increasing earnings for 2001 by approximately $86,000. This adjustment is inappropriate. To proceed with an adjustment of this nature, complex calculations applied retroactively to the start and end of each financial year would have been required. In fact, a detailed analysis extending over multiple years would have been necessary in order to determine the impact of the departure.[39]

[127] Ms. Demers relied on the note to the financial statements to the effect that Cybectec was not following generally accepted accounting principles (GAAPs) and the fact that Cybectec had been notified previously by the CRA that it needed to begin complying with GAAPs. However, Ms. Demers never questioned Mr. Legros, Cybectec's accountant, Mr. Pâquet or Mr. Racine about this.[40] Ms. Demers did not take into account the fact that under the agreement with Hydro One, Cybectec could submit invoices to Hydro One only after the latter had

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38 Critical report from FGGC, at page 16, notes F and G.

39 Critical report from FGGC, at page 13.

40 Transcription, volume 3, at page 120, line 15.

approved them. Ms. Demers also did not take into account the fact that Cybectec had always used cash-based accounting.

[128] Moreover, as Mr. Fortin testified, in order to proceed with this adjustment, the respondent's expert should have reviewed the corporation's previous financial years to gauge the net effect of the departure at April 30, 2001.[41] It is indeed possible and even probable that similar departures occurred in relation to the year ended April 30, 2000. This would have affected the value of the adjustment to be made. The net effect of the entries is what should be considered in computing the proper adjustment.

[129] In the light of my comments, I am of the view that the adjustments made by Ms. Demers are not justified.

4) Additional SR&ED expenses

[130] In her expert report, Ms. Demers made adjustments to the additional scientific research expenses which, in her opinion, would have been incurred for new product development. These adjustments amounted to $402,665 in 2001 and $84,148 in 2000. These adjustments reduce Cybectec's operating expenses, which in turn increases EBITDA. According to Ms. Demers, all of these SR&ED expenses should have been capitalized.

[131] In her opinion, the facts are clear. Cybectec's earnings before tax fell from $1,581,000 in 1999 to $705,000 in 2001, despite the fact that the Company hired 10 new employees in 2001. According to Ms. Demers, the decrease in earnings is attributable to the hiring of 10 employees in the area of new product development.

[132] Also according to Ms. Demers, under paragraph 3450.21 of the Canadian Institute of Chartered Accountants (CICA) handbook in force in 2001, new product development costs are supposed to be capitalized. To determine the amounts of the adjustments to be made to the additional SR&ED expenses for new product development, Ms. Demers used the ratio of consulting income to direct labour

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41 Transcription, volume 4, at page 44, line 25.

costs. Using data from 1998, Ms. Demers concluded that direct labour costs represented 28% of consulting income. Ms. Demers used this value of 28% to arrive at the wage adjustments of $84,148[42] for the year 2000 and $402,665 for 2001.

[133] According to Ms. Demers, these adjustments follow the guideline in paragraph 3450.21 of the CICA handbook. On page 29 of her expert report, Ms. Demers states as follows:

> [TRANSLATION] Another important aspect relates to development costs due to the change of direction undertaken by the Company in early 2000; significant costs were incurred during the year ended April 30, 2001, that were also likely to generate earnings the following year.
>
> In our opinion, the conditions concerning the application of paragraph 3450.21 of the CICA handbook were fulfilled and would have required the carryforward of certain expenses.
>
> Development costs must be carried forward to future periods if all of the following conditions are met:
>
> The product or process is clearly defined and the costs attributable thereto can be identified.
>
> The technical feasibility of the product or process has been established.
>
> The management of the enterprise has stated its intention to produce and market, or use, the product or process.
>
> The future market for the product or process is clearly defined or, if it is to be used internally rather than sold, its usefulness to the enterprise has been established.
>
> Adequate resources exist, or are expected to be available, to complete the project.

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42 (1,105,154 x 100 / 3,646,450) = 30.3% (wage adjustments of $84,148 to arrive at a rate of 28%).

[134] In my opinion, even if I accepted the basis of the adjustments, in other words, that paragraph 3450.21 of the CICA handbook were applicable and the method chosen for making these adjustments was justified, Ms. Demers should have considered the tax credits arising from an SR&ED application. This would have decreased the amounts of the adjustments made in 2000 and 2001 by 50% to 60%.

[135] Additionally, with respect to the method chosen for computing the amounts of these adjustments, Ms. Demers used the ratio of income from consulting services to direct labour costs for the year 1998. It is to be noted that 1998 was the most profitable year in Cybectec's history.[43] Therefore, the use of this single year as a reference year skews the valuation and the resulting adjustments. This is all the more true when one observes that the results for the year 1997 yield a ratio of consulting services to wages of 38% in comparison to 28% for 1998.

[136] Moreover, in arriving at the ratio of 28%, Ms. Demers assumes that Cybectec retains the intellectual property rights to all SR&ED projects it undertakes. Ms. Demers did not take into account the fact that Cybectec did not hold the intellectual property rights to most of the projects for which it had applied for SR&ED credits. The development projects were undertaken by Cybectec under the auspices of its consulting service activities, with its clients paying for the SR&ED carried out by Cybectec. In addition, the SR&ED credits were included in the amounts billed to clients.

[137] What is more, contrary to the claims of the respondent's expert, Mr. Racine stated that there was no team dedicated to new product development. All Cybectec employees worked simultaneously on multiple projects. In this regard, Mr. Racine stated that in 2001, 80% of the work performed by Cybectec employees was in product development for specific clients through consulting service activities. These clients retained the intellectual property rights to the products developed by Cybectec since the clients were covering the cost of product research and development.

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[43] Transcription, volume 1, at page 45, line 15.

[138] Mr. Racine testified further that although the SR&ED tax credit applications stated that 10 employees were assigned to a project, these 10 employees were not working full time on that project. The respondent's expert concluded based on the SR&ED tax credit applications that Cybectec had a team of 10 employees working full time on new product development projects.

[139] In the light of Mr. Racine's testimony, Ms. Demers's premise that Cybectec owned the intellectual property rights to all SR&ED projects is wrong. Ms. Demers's premise that 10 employees were working exclusively on new products is also wrong.

[140] Ms. Demers also focused on the Hydro One contract concerning new product development under which Cybectec apparently retained certain intellectual property rights. Mr. Pâquet testified that subsequent to a bidding process, Hydro One awarded a contract to Cybectec in late 1999. Mr. Pâquet noted that Cybectec spent a little more than a year on developing the prototype for Hydro One.[44] However, contrary to Ms. Demers's submission that Cybectec could lay off 10 employees if the focus on new product development were unsuccessful, Mr. Pâquet indicated that Cybectec did not have the option to lay off the 10 employees, as they were working on the Hydro One project and on other projects for specific clients.

[141] That being the case, it is important to note that in 2001, it was impossible to know whether Hydro One would confirm final approval of implementation of the project. The success of the project was not assured; Cybectec was taking a risk. The first deliveries of the prototype took place in April 2001, and some installations were performed in 2002.[45]

[142] Moreover, although Cybectec retained ownership of certain components of the product developed for Hydro One, in 2001, it was difficult to foresee what would come of the development undertaken under the Hydro One contract. Mr. Pâquet testified as follows:

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44 Transcription, volume 1, at page 50, lines 24 to 26.

45 Respondent's expert report, volume 1, at page 25.

> [TRANSLATION] . . . when we started talking with Hydro One, we didn't really know how things were going to go, but we couldn't pass up this contract because it was in our specialty at the time.

[143] With respect to paragraph 3450.23 of the CICA handbook, in reviewing the application conditions of paragraph 3450.21 of the handbook, the appellants submit that [TRANSLATION] "the CRA is not recognizing the reality of Cybectec or demonstrating as required that all conditions are met."

[144] I agree with the appellants for the following reasons. First, to capitalize the costs of research and development projects, a company must hold the intellectual property rights; otherwise, no perceived value is generated in relation to the Company's assets. Second, the guidelines in subparagraph 3450.21 (b) and paragraph 3450.23 of the CICA handbook specify as follows:

> [TRANSLATION]
> 3450.21 Product or process development costs must be capitalized if all of the following conditions are met:
>
> . . .
>
> (b) The technical feasibility of the product or process has been established.
>
> . . .
>
> 3450.23 Where a development project meets the conditions justifying capitalization as set out in paragraph 3450.21, the development costs must be capitalized up to the amount deemed with reasonable certainty to be recoverable.

[145] I have no evidence showing what amounts are recoverable for Cybectec if these expenses are capitalized. The evidence shows that also in 2001, the projects did not fulfil subparagraph 3450.21 (b) of the CICA handbook. Apart from the SR&ED tax credit applications, I have no evidence showing the feasibility of the development projects in 2001.

[146] In addition, Cybectec's accountant, Mr. Legros, opted not to recognize these amounts. Cybectec never capitalized these expenses. Moreover, if these expenses needed to be capitalized, amortization would have had to be taken into account.

[147] In the light of the evidence, I cannot accept the adjustments made by Ms. Demers. The method followed by Ms. Demers to arrive at adjustments of $402,665 in 2001 and $84,148 in 2000 is not justified in addition, I am of the view that if the CICA guideline were applicable, and that is not in the case here in, every SR&ED project undertaken would have to have been analyzed, which Ms. Demers did not do. Furthermore, the work in progress in the form of projects Cybectec was developing for specific clients could not be capitalized because Cybectec did not hold the intellectual property rights to these projects.

5) SR&ED costs incurred

[148] Ms. Demers also made adjustments to the SR&ED costs incurred in relation to new products amounting to $158,808 in 2001, $182,323 in 2000 and $187,695 in 1999.[46] The ratio of SR&ED costs to consulting service sales increased from 6.4% in 1998 to 13.5% in 2001. According to Ms. Demers, a portion of this increase is attributable to new product development.

[149] In this regard, she consulted Mr. Racine and Mr. Pâquet to assess the costs attributable to new product development. They apparently advised that 5% seemed like a reasonable amount.[47] Ms. Demers made adjustments accordingly of $158,808 in 2001, $182,323 in 2000 and $187,695 in 1999 in relation to SR&ED costs incurred on the assumption that these costs accounted for 5% of SR&ED costs.

[150] As in the case of additional SR&ED development expenses, I am of the view that a method founded on the ratio of consulting service sales to research costs tends to result in a random adjustment that is not representative. The SR&ED component may vary significantly from one project to the next. These costs were correctly deducted as expenses in computing gross earnings. What is more, these costs should not be capitalized, since as I determined previously with respect to additional SR&ED expenses, the guidelines in the CICA handbook are not applicable.

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46 Respondent's expert report, volume 2, schedule 5, notes I and J.

47 Transcription, volume 2, at page 198, line 5.

[151] Moreover, the method chosen yields a result that does not reflect reality. Indeed, Ms. Demers's reasoning suggests that the SR&ED costs for new product development were higher in 1999 ($182,323) than in 2001 ($158,808). In context, these costs should be higher in 2001 due to the Company's reorientation in 1999 and the fact that this reorientation accounts for an increasing portion of the company's operations over time.

[152] I consequently do not accept the adjustment made by Ms. Demers to this item.

6) Payroll increase

[153] The expert, Mr. Brisson, explained at the hearing why, in his original report, he had made an adjustment for the years 1999 and 2000 to increase the payroll of Cybectec. According to Mr. Brisson, the purpose of this adjustment was to ensure that the Company's employee wages were representative, given that they were unusually low in 1999 and 2000 in comparison with the market.

[154] In this regard, the wages item in the financial statements does not show that payroll increased significantly in relation to the number of persons working at Cybectec in the years 1999, 2000 and 2001.

[155] I find that the adjustment proposed by the appellants should not be accepted. Although it is clear that the wages of certain employees increased very significantly between 1999 and 2001, the evidence is insufficient to convince me that the overall payroll should be increased for previous years.

7) Representative cash flows used

[156] The representative cash flow is the operating cash flow that a company will be able to generate in the future. The representative cash flow is generally determined in terms of results based on recent financial statements and forecast results for one or more future years.

[157] In the original report from the appellants' expert, the use of a weighted average is proposed to determine cash flow. As for respondent's expert, she

proposes using EBITDA for 2001 to establish the bottom of the range and the average EBITDA for 1999 to 2001 to establish the top.

[158] I am of the view that the method used by the respondent's expert is reasonable. I consequently accept EBITDA of no less than $900,000 and no more than $1,321,667.

8) Interest on additional borrowing capacity

[159] The appellants' expert calculated additional borrowing capacity by comparing Cybectec's debt ratio (debt/equity) to that of the IT system design industry.[48] He arrived at an industry debt/equity ratio of 0.8 to 12.0 with a median value of 2.1.[49] The respondent's expert, meanwhile, assessed the same ratio over an unidentified period and arrived at a ratio of 1.0 to 1.9.[50]

[160] On the basis of the ratios identified previously, the appellants considered minimum and maximum adjustments to short-term borrowing capacity of $335,000 and $435,000 respectively. Ms. Demers, meanwhile, considered a single adjustment amount of $400,000. Insofar as the method used is based on an industry ratio and the parties have not explained the significant variances among their ratios, I find it appropriate to take a conservative approach.

[161] I will accept minimum and maximum values for short-term borrowing capacity of $335,000 and $435,000. Not only does this range include the $400,000 figure used by the respondent, but the post-adjustment debt/equity ratio also falls within the industry debt/equity ratio range proposed by the respondent. As for long-term borrowing capacity, I will set this item at $50,000.

[162] With respect to interest, note 6 to Cybectec's financial statements at April 30, 2001 states that Cybectec has an unused line of credit at the prime rate + 0.5%. In her valuation, Ms. Demers uses a commercial interest rate of 4.0% plus

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48 North American Industry Classification System (NAICS), no. 541511.

49 Original report from FGGC, Schedule 1.

50 Respondent's expert report, schedule, at page 7.2.

a premium of 0.5% for short-term borrowing or 1.0% for long-term borrowing. Upon review of this information, I find these rates to be reasonable and will use them to calculate interest on additional borrowing capacity.

[163] In the light of the foregoing, it is appropriate to use minimum and maximum amounts of $15,075 and $19,575 respectively for interest on short-term borrowing capacity. As for interest on long-term borrowing capacity, I will set this item at $2,750.

[164] Insofar as the remaining aspects of determination of representative cash flow are not in dispute, these being income tax and capital reinvestment, I will use minimum and maximum representative cash flow values of $546,701 and $809,546.

9) Capitalization rate (multiple)

[165] The multiple corresponds to the reciprocal or inverse of the rate of return that an investor finds acceptable for an investment in a company taking into account forecast growth, profitability and associated risks.

[166] The appellants propose using a capitalization rate calculated at April 30, 2001. The respondent's expert, meanwhile, proposes a capitalization rate calculated using market data dated November 30, 2001.

[167] It is to be noted that the variance between the appellants' and respondent's assumptions is minimal: the appellants propose using multiples of 4.75 and 4.50, while the respondent proposes multiples of 4.80 and 4.60.

[168] In his critical report, Mr. Fortin, for the appellants, finds fault with the respondent's expert report in its determination of the premium applicable to the Company.[51] Indeed, Mr. Fortin submits that the respondent did not take into account certain factors specific to the Company including the size of the SR&ED

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[51] Critical report from FGGC, at page 19.

tax credits, the decrease in consulting income in 2001 and the high employee turnover rate.

[169] I am of the view that the respondent did not take sufficient account of some of these factors, while the analysis of others was free of error. For example, the respondent reduced the Company's risk level based on its history of profitability. However, the evidence shows that earnings before tax dropped significantly between 1999 and 2001. The respondent also does not take into account the premium in relation to the size of the SR&ED tax credits. Meanwhile, with regard to staff turnover, the respondent rightly recognizes a risk; however, this risk was incorporated into the calculation of industry risk.

[170] That being said, even if I increased the premium for business risk from 3.75% to 4.00%, as the appellants did in the original expert report,[52] this would have no effect on the minimum multiple at the valuation date: increasing the business risk premium in the respondent's table brings the multiple to 4.79.[53] It would therefore be reasonable to recognize a multiple within the range of 4.6 to 4.8.

10) Present value of tax savings

[171] Following the cash flow capitalization approach, it is necessary to add to the going concern value the present value of future tax savings on tax balances insofar as income tax is calculated on EBITDA rather than taxable income. In his original report, Mr. Brisson used a present value of tax savings of $60,000. However, he did not provide any details to support his conclusions. In Ms. Demers's report, a value of $45,000 was calculated. To support this submission, the respondent supplied a table detailing future tax savings.[54]

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52 In this regard, refer to the premium for other risk factors at page 27 of the original report from FGGC and the business risk premium at page 7.1 of the schedule to the respondent's expert report.

53 Respondent's expert report, schedule, at page 7.1.

54 Respondent's expert report, schedule, at page 5.8.

[172] At the hearing, the respondent explained the difference between its figure and the appellants'.[55] As for the appellants, they did not provide any explanations concerning these variations and even considered them to be negligible.[56] Having reviewed the positions of the parties, I accept that of the respondent concerning the present value of tax savings.

11) Surplus assets

[173] A surplus asset is an asset that is not necessary to a company's daily operation. Cybectec's officers could dispose of such assets and withdraw the money from Cybectec in the form of dividends without significantly affecting the Company's level of activity or profitability.

[174] With respect to the calculation of surplus assets, the appellants and the respondent do not agree on short-term borrowing capacity or on the addition of $270,000 to cash on hand.

[175] Concerning borrowing capacity, I determined previously that short-term borrowing capacity fell within a range of $335,000 to $435,000. I set long-term borrowing capacity at $50,000.

[176] The expert valuations having been carried out at April 30, 2001, the respondent determined that apart from cash on hand, no adjustments were necessary to calculate fair market value at December 17, 2001. It consequently added $270,000 to cash on hand.[57] The respondent used CRA returns at April 30, 2002, to determine this amount.

[177] The appellants argue that this is contrary to the valuation principles according to which a retrospective review is not admissible other than to verify the

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55 Transcription, volume 2, at page 223, line 26.

56 Transcription, volume 2, at page 92, line 19.

57 Transcription, volume 2, at page 236, line 11, and transcription, volume 5, at page 230.

legitimacy of the assumptions made by the appraisers.[58] The appellants argue further and in my opinion, correctly, that if the year 2002 were to be considered, it should be considered for all calculations, including EBITDA, not simply for cash on hand, since Cybectec's gross earnings continued to decrease in 2002.

[178] This is not an after-the-fact review for the purpose of validating an assumption. Indeed, the respondent is squarely using a pro rata of the surplus cash generated by operations at April 30, 2002, to increase cash on hand under surplus assets. It does not use these data to validate a trend or an assumption. Therefore, the proposed adjustment should be dismissed.

[179] The breakdown of surplus assets is as follows:

Surplus Assets		
	Minimum	Maximum
Cash on hand	$102,700	$102,700
Term deposit	$600,000	$600,000
Investments	$212,574	$212,574
Short-term borrowing capacity	$335,000	$435,000
Long-term borrowing capacity	$50,000	$50,000
Total	$1,300,274	$1,400,274

12) Value of development projects

[180] For the value of development projects, the appellants used minimum and maximum values of $500,000 and $600,000. The respondent, however, increased the maximum value to $625,000. It is to be noted nevertheless that the avenues of reasoning followed to arrive at these figures are diametrically opposed.

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58 *Zeller v. The Queen*, 2008 TCC 426, at paragraph 42; *McClintock v. The Queen*, 2003 TCC 259, at paragraph 54.

[181] The appellants based their figures on the value of development projects according to Schedule C of the Ouellet & Legros report less the development costs for the load control devices, Pastec 2 and Consparam. As for the respondent, she considered a range corresponding to 40% to 50% of expenses incurred for new product development. In this regard, it considered marketing costs, additional SR&ED expenses and the SR&ED costs calculated for 1999, 2000 and 2001. It then used the total of these expenses to determine the range of values.

[182] The respondent's expert also reversed the minimum and maximum values for development projects. During her testimony, she replied that this was [TRANSLATION] "of no significant importance." She added that the purpose of this was to offset the risk associated with the provision of consulting services and new product development.[59]

[183] I find the method used by the appellants to be sounder and less haphazard than that used by the respondent. I consequently accept the method used by the appellants.

[184] The respondent also argued that on May 2, 1998, Mr. Pâquet and Mr. Racine had assigned a value of $0.32 per share to the shares of Cybectec as part of a share freeze. It is important to note that in 1998, Cybectec had yet to carry out any comprehensive valuation of its shares. In addition, earnings before tax decreased considerably after 1998. Earnings were $1,245,358 in 1998 and $705,489 in 2001. In the light of the decline in profit, it is reasonable to see a drop in the value of shares of Cybectec.

[185] Consequently, I am of the view that the fair market value of Class A shares at December 17, 2001, is $0.20 per share.

V. Decision

[186] Insofar as the conditions in paragraph 110(1)(*d*) of the Act were not all fulfilled, that is, the shares of Cybectec were not prescribed shares at the time of

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[59] Transcription, volume 2, at page 225, line 19.

issue of the shares, the appellants cannot deduct 50% of the benefit received arising from the disposition of their shares in computing their income.

[187] The appeals are dismissed without costs.

Signed at Ottawa, Canada, this 3rd day of May 2016.

"Johanne D'Auray"

D'Auray J.

Translation certified true
On this 11th day of January 2017

François Brunet, Revisor

SCHEDULE 1

APPLICABLE LEGISLATION

Agreement to issue securities to employees

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

> **(*a*)** if the employee has acquired securities under the agreement, a benefit equal to the amount, if any, by which
>
> **(i)** the value of the securities at the time the employee acquired them exceeds the total of
>
> **(ii)** the amount paid or to be paid to the particular qualifying person by the employee for the securities, and
>
> **(iii)** the amount, if any, paid by the employee to acquire the right to acquire the securities is deemed to have been received, in the taxation year in which the employee acquired the securities, by the employee because of the employee's employment;

. . .

Employee stock options

(1.1) Where after March 31, 1977 a Canadian-controlled private corporation (in this subsection referred to as "the corporation") has agreed to sell or issue a share of the capital stock of the corporation or of a Canadian-controlled private corporation with which it does not deal at arm's length to an employee of the corporation or of a Canadian-controlled private corporation with which it does not deal at arm's length and at the time immediately after the agreement was made the employee was dealing at arm's length with

> **(*a*)** the corporation,
>
> **(*b*)** the Canadian-controlled private corporation, the share of the capital stock of which has been agreed to be sold by the corporation, and
>
> **(*c*)** the Canadian-controlled private corporation that is the employer of the employee,

in applying paragraph (1)(*a*) in respect of the employee's acquisition of the share, the reference in that paragraph to "the taxation year in which the employee acquired the securities" shall be read as a reference to "the taxation year in which the employee disposed of or exchanged the securities".

DIVISION C

Computation of Taxable Income

Deductions permitted

110 (1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted such of the following amounts as are applicable

Employee options

(*d*) an amount equal to 1/2 of the amount of the benefit deemed by subsection 7(1) to have been received by the taxpayer in the year in respect of a security that a particular qualifying person has agreed after February 15, 1984 to sell or issue under an agreement, or in respect of the transfer or other disposition of rights under the agreement, if

(i.1) the security

(A) is a prescribed share at the time of its sale or issue, as the case may be,

(B) would have been a prescribed share if it were issued or sold to the taxpayer at the time the taxpayer disposed of rights under the agreement,

(C) would have been a unit of a mutual fund trust at the time of its sale or issue if those units issued by the trust that were not identical to the security had not been issued, or

(D) would have been a unit of a mutual fund trust if

(I) it were issued or sold to the taxpayer at the time the taxpayer disposed of rights under the agreement, and

(II) those units issued by the trust that were not identical to the security had not been issued,

(ii) where rights under the agreement were not acquired by the taxpayer as a result of a disposition of rights to which subsection 7(1.4) applied,

(A) the amount payable by the taxpayer to acquire the security under the agreement is not less than the amount by which

(I) the fair market value of the security at the time the agreement was made exceeds

(II) the amount, if any, paid by the taxpayer to acquire the right to acquire the security, and

(B) at the time immediately after the agreement was made, the taxpayer was dealing at arm's length with

(I) the particular qualifying person,

(II) each other qualifying person that, at the time, was an employer of the taxpayer and was not dealing at arm's length with the particular qualifying person, and

(III) the qualifying person of which the taxpayer had, under the agreement, a right to acquire a security, and

(iii) where rights under the agreement were acquired by the taxpayer as a result of one or more dispositions to which subsection 7(1.4) applied,

(A) the amount payable by the taxpayer to acquire the security under the agreement is not less than the amount that was included, in respect of the security, in the amount determined under subparagraph 7(1.4)(*c*)(ii) with respect to the most recent of those dispositions,

(B) at the time immediately after the agreement the rights under which were the subject of the first of those dispositions (in this subparagraph referred to as the "original agreement") was made, the taxpayer was dealing at arm's length with

(I) the qualifying person that made the original agreement,

(II) each other qualifying person that, at the time, was an employer of the taxpayer and was not dealing at arm's length with the qualifying person that made the original agreement, and

(III) the qualifying person of which the taxpayer had, under the original agreement, a right to acquire a security,

(C) the amount that was included, in respect of each particular security that the taxpayer had a right to acquire under the original agreement, in

the amount determined under subparagraph 7(1.4)(*c*)(iv) with respect to the first of those dispositions was not less than the amount by which

(I) the fair market value of the particular security at the time the original agreement was made exceeded

(II) the amount, if any, paid by the taxpayer to acquire the right to acquire the security, and

(D) for the purpose of determining if the condition in paragraph 7(1.4)(*c*) was satisfied with respect to each of the particular dispositions following the first of those dispositions,

(I) the amount that was included, in respect of each particular security that could be acquired under the agreement the rights under which were the subject of the particular disposition, in the amount determined under subparagraph 7(1.4)(*c*)(iv) with respect to the particular disposition was not less than

(II) the amount that was included, in respect of the particular security, in the amount determined under subparagraph 7(1.4)(*c*)(ii) with respect to the last of those dispositions preceding the particular disposition;

Charitable donation of employee option securities

(*d*.01) subject to subsection (2.1), if the taxpayer disposes of a security acquired in the year by the taxpayer under an agreement referred to in subsection 7(1) by making a gift of the security to a qualified donee, an amount in respect of the disposition of the security equal to 1/2 of the lesser of the benefit deemed by paragraph 7(1)(*a*) to have been received by the taxpayer in the year in respect of the acquisition of the security and the amount that would have been that benefit had the value of the security at the time of its acquisition by the taxpayer been equal to the value of the security at the time of the disposition, if

(i) the security is a security described in subparagraph 38(*a*.1)(i),

(ii) [Repealed, 2002, c. 9, s. 33(1)]

(iii) the gift is made in the year and on or before the day that is 30 days after the day on which the taxpayer acquired the security, and

(iv) the taxpayer is entitled to a deduction under paragraph (*d*) in respect of the acquisition of the security;

Idem

(*d*.1) where the taxpayer

(i) is deemed, under paragraph 7(1)(*a*) by virtue of subsection 7(1.1), to have received a benefit in the year in respect of a share acquired by the taxpayer after May 22, 1985,

(ii) has not disposed of the share (otherwise than as a consequence of the taxpayer's death) or exchanged the share within two years after the date the taxpayer acquired it, and

(iii) has not deducted an amount under paragraph 110(1)(d) in respect of the benefit in computing the taxpayer's taxable income for the year, an amount equal to 1/2 of the amount of the benefit;

Income Tax Regulations

6204 (1) For the purposes of subparagraph 110(1)(*d*)(i) of the Act, a share is a prescribed share of the capital stock of a corporation at the time of its sale or issue, as the case may be, if, at that time,

(*a*) under the terms or conditions of the share or any agreement in respect of the share or its issue,

(i) the amount of the dividends (in this section referred to as the "dividend entitlement") that the corporation may declare or pay on the share is not limited to a maximum amount or fixed at a minimum amount at that time or at any time thereafter by way of a formula or otherwise,

(ii) the amount (in this section referred to as the "liquidation entitlement") that the holder of the share is entitled to receive on the share on the dissolution, liquidation or winding-up of the corporation is not limited to a maximum amount or fixed at a minimum amount by way of a formula or otherwise,

(iii) the share cannot be converted into any other security, other than into another security of the corporation or of another corporation with which it does not deal at arm's length that is, or would be at the date of conversion, a prescribed share,

(iv) the holder of the share cannot at that time or at any time thereafter cause the share to be redeemed, acquired or cancelled by the corporation or any specified person in relation to the corporation, except where the redemption, acquisition or cancellation is required pursuant to a conversion that is not prohibited by subparagraph (iii),

(v) no person or partnership has, either absolutely or contingently, an obligation to reduce, or to cause the corporation to reduce, at that time or at any time thereafter, the paid-up capital in respect of the share, except where the reduction is required pursuant to a conversion that is not prohibited by subparagraph (iii), and

(vi) neither the corporation nor any specified person in relation to the corporation has, either absolutely or contingently, the right or obligation to redeem, acquire or cancel, at that time or any later time, the share in whole or in part other than for an amount that approximates the fair market value of the share (determined without reference to any such right or obligation) or a lesser amount;

(*b*) the corporation or a specified person in relation to the corporation cannot reasonably be expected to, within two years after the time the share is sold or issued, as the case may be, redeem, acquire or cancel the share in whole or in part, or reduce the paid-up capital of the corporation in respect of the share, otherwise than as a consequence of

(i) an amalgamation of a subsidiary wholly-owned corporation,

(ii) a winding-up to which subsection 88(1) of the Act applies, or

(iii) a distribution or appropriation to which subsection 84(2) of the Act applies; and

(*c*) it cannot reasonably be expected that any of the terms or conditions of the share or any existing agreement in respect of the share or its sale or issue will be modified or amended, or that any new agreement in respect of the share, its sale or issue will be entered into, within two years after the time the share is sold or issued, in such a manner that the share would not be a prescribed share if it had been sold or issued at the time of such modification or amendment or at the time the new agreement is entered into.

(2) For the purposes of subsection (1),

(*a*) the dividend entitlement of a share of the capital stock of a corporation shall be deemed not to be limited to a maximum amount or fixed at a minimum amount where it may reasonably be considered that all or substantially all of the dividend entitlement is determinable by reference to the dividend entitlement of another share of the capital stock of the corporation that meets the requirements of subparagraph (1)(*a*)(i);

(*b*) the liquidation entitlement of a share of the capital stock of a corporation shall be deemed not to be limited to a maximum amount or fixed at a minimum amount where it may reasonably be considered that all or substantially all of the liquidation entitlement is determinable by reference to the liquidation entitlement of another share of the capital stock of the corporation that meets the requirements of subparagraph (1)(*a*)(ii); and

(*c*) the determination of whether a share of the capital stock of a particular corporation is a prescribed share shall be made without reference to a right or obligation to redeem, acquire or cancel the share, or to cause the share to be redeemed, acquired or cancelled, where

(i) the person (in this paragraph referred to as the "**holder**") to whom the share is sold or issued is, at the time the share is sold or issued, dealing at arm's length with the particular corporation and with each corporation with which the particular corporation is not dealing at arm's length,

(ii) the right or obligation is provided for in the terms or conditions of the share or in an agreement in respect of the share or its issue and, having regard to all the circumstances, it can reasonably be considered that

(A) the principal purpose of providing for the right or obligation is to protect the holder against any loss in respect of the share, and the amount payable on the redemption, acquisition or cancellation (in this subparagraph and in subparagraph (iii) referred to as the "acquisition") of the share will not exceed the adjusted cost base of the share to the holder immediately before the acquisition, or

(B) the principal purpose of providing for the right or obligation is to provide the holder with a market for the share, and the amount payable on the acquisition of the share will not exceed the fair market value of the share immediately before the acquisition, and

(iii) having regard to all the circumstances, it can reasonably be considered that no portion of the amount payable on the acquisition of the share is directly determinable by reference to the profits of the particular corporation, or of another corporation with which the particular corporation does not deal at arm's length, for all or any part of the period during which the holder owns the share or has a right to acquire the share, unless the reference to the profits of the particular corporation or the other corporation is only for the purpose of determining the fair market value of the share pursuant to a formula set out in the terms or conditions of the share or the agreement in respect of the share or its issue, as the case may be.

(3) For the purposes of subsection (1), ***specified person***, in relation to a corporation, means

(*a*) any person or partnership with whom the corporation does not deal at arm's length otherwise than because of a right referred to in paragraph 251(5)(*b*) of the Act that arises as a result of an offer by the person or partnership to acquire all or substantially all of the shares of the capital stock of the corporation, or

(*b*) any partnership or trust of which the corporation (or a person or partnership with whom the corporation does not deal at arm's length) is a member or beneficiary, respectively.

(4) For the purposes of subsection (3), the Act shall be read without reference to subsection 256(9) of the Act.

SCHEDULE 2

CYBERTEC INC.

Original Evaluation Report

Fortin Gaignard Groupe Conseil Inc.

		2001	2000	1999
Earnings before tax		705,000	1,497,000	1,581,000
Adjustment				
Amortization		98,000	97,000	93,000
Rental income		- 6,000	- 5,000	- 4,000
Rent		-	- 30,000	- 60,000
Interest income		- 74,000	- 47,000	- 17,000
Loss on disposal of capital assets		1,000	5,000	
Executive life insurance		4,000	4,000	4,000
Executive remuneration		- 150,000	- 130,000	- 60,000
Professional fees				
Adjusted professional fees				
Provision for future billing				
Bill to Hydro One				
Sales and marketing costs		225,000		
Additional SR&ED expense				
SR&ED costs incurred				
Payroll increase			- 200,000	- 175,000
EBITDA		**803,000**	**1,191,000**	**1,362,000**
	Low		High	
Representative cash flows used		950,000	1,100,000	
Int. on additional borrowing capacity		- 4,000	- 4,000	
		- 20,000	- 26,000	
Income tax at low rate (22%)		- 44,000	- 44,000	
Income tax at high rate (31%)		- 225,060	- 269,700	
Capital reinvestment		- 80,000	- 105,000	
Representative cash flow		575,000	650,000	
Capitalization rate (multiple)		4.75	4.50	
Present value of representative cash flows		2,731,250	2,925,000	
Present value of tax savings		60,000	60,000	
Surplus assets		1,301,000	1,401,000	
Value of development projects		500,000	600,000	
FMV at April 30, 2011		4,592,250	4,986,000	
Rounded median value				
Less: 26 Class C shares		832,000	832,000	
12 Class D shares		244,200	244,200	
17,400,000 Class A shares		3,516,050	3,909,800	
FMV of 1 Class A share		0.202	0.225	

CYBERTEC INC.

Evaluation Report

CRA

	2001	2000	1999
Earnings before tax	705,489	1,497,421	1,581,208
Adjustment			
Amortization	98,537	97,302	93,017
Rental income			
Rent			
Interest income	- 74,082	- 47,405	- 16,532
Loss on disposal of capital assets	906	4,694	
Executive life insurance	4,000	4,000	4,000
Executive remuneration	- 130,000	- 40,000	- 42,000
Professional fees	45,070	37,515	
Adjusted professional fees	- 27,735	- 24,548	
Provision for future billing	22,052		
Bill to Hydro One	64,252		
Sales and marketing costs	225,000		
Additional SR&ED expense	402,665	84,148	
SR&ED costs incurred	158,808	182,323	187,695
Payroll increase			
EBITDA	**1,494,962**	**1,795,450**	**1,807,388**

	Low	High
Representative cash flows used	1,500,000	1,700,000
Int. on additional borrowing capacity	- 2,250	- 2,250
	- 22,000	- 22,000
Income tax at low rate (22%)	- 44,000	- 44,000
Income tax at high rate (31%)	- 395,483	- 457,483
Capital reinvestment	- 80,000	- 105,000
Representative cash flow	956,268	1,069,268
Capitalization rate (multiple)	4.80	4.60
Present value of representative cash flows	4,590,084	4,918,631
Present value of tax savings	45,000	45,000
Surplus assets	1,635,000	1,635,000
Value of development projects	625,000	500,000
FMV at April 30, 2011	6,895,084	7,098,631
Rounded median value	7,000,000	
Less: 26 Class C shares	832,000	
12 Class D shares	244,200	
17,400,000 Class A shares	5,923,800	
FMV of 1 Class A share	0.340	

CYBERTEC INC.

Critical Evaluation Report

Fortin Gaignard Groupe Conseil Inc.

	2001	2000	1999
Earnings before tax	705,000	1,497,000	1,581,000
Adjustment			
Amortization	99,000	97,000	93,000
Rental income			
Rent			
Interest income	- 74,000	- 47,000	- 17,000
Loss on disposal of capital assets	1,000	5,000	
Executive life insurance	4,000	4,000	4,000
Executive remuneration	- 130,000	- 40,000	- 42,000
Professional fees	45,000	38,000	
Adjusted professional fees	- 28,000	- 25,000	
Provision for future billing			
Bill to Hydro One			
Sales and marketing costs	225,000		
Additional SR&ED expense			
SR&ED costs incurred	70,000	67,000	63,000
Payroll increase			
EBITDA	**917,000**	**1,596,000**	**1,682,000**
	Low	High	
Representative cash flows used	770,000	1,100,000	
Int. on additional borrowing capacity	- 2,250	- 2,250	
	- 22,000	- 22,000	
Income tax at low rate (22%)	- 44,000	- 44,000	
Income tax at high rate (31%)	- 169,183	- 271,483	
Capital reinvestment	- 80,000	- 105,000	
Representative cash flow	452,568	655,268	
Capitalization rate (multiple)	4.80	4.60	
Present value of representative cash flows	2,172,324	3,014,231	
Present value of tax savings	45,000	45,000	
Surplus assets	1,635,000	1,635,000	
Value of development projects	500,000	625,000	
FMV at April 30, 2011	4,352,324	5,319,231	
Rounded median value			
Less: 26 Class C shares	832,000	832,000	
12 Class D shares	244,200	244,200	
17,400,000 Class A shares	3,276,124	4,243,031	
FMV of 1 Class A share	0.188	0.244	

SCHEDULE 3

CYBERTEC INC.

Final Evaluation

Tax Court of Canada

		2001	2000	1999
Earnings before tax		705,000	1,497,000	1,581,000
Adjustment				
	Amortization	99,000	97,000	93,000
	Rental income			
	Rent			
	Interest income	- 74,000	- 47,000	- 17,000
	Loss on disposal of capital assets	1,000	5,000	
	Executive life insurance	4,000	4,000	4,000
	Executive remuneration	- 130,000	- 40,000	- 42,000
	Professional fees			
	Adjusted professional fees			
	Provision for future billing			
	Bill to Hydro One			
	Sales and marketing costs	225,000		
	Additional SR&ED expense			
	SR&ED costs incurred			
	Payroll increase			
EBITDA		**830,000**	**1,516,000**	**1,619,000**
	Low		High	
Representative cash flows used		900,000	1,321,667	
Int. on additional borrowing capacity		- 2,750	- 2,750	
		- 15,075	- 19,575	
Income tax at low rate (22%)		- 44,000	- 44,000	
Income tax at high rate (31%)		- 211,474	- 340,796	
Capital reinvestment		- 80,000	- 105,000	
Representative cash flow		546,701	809,546	
Capitalization rate (multiple)		4.80	4.60	
Present value of representative cash flows		2,624,164	3,723,910	
Present value of tax savings		45,000	45,000	
Surplus assets		1,300,274	1,400,274	
Value of development projects		500,000	600,000	
FMV at April 30, 2011		4,469,438	5,769,184	
Rounded median value				
Less: 26 Class C shares		832,000	832,000	
12 Class D shares		244,200	244,200	
17,400,000 Class A shares		3,393,238	4,692,984	
FMV of 1 Class A share		0.195	0.270	

CITATION:	2016 TCC 110
COURT FILE NO.:	2012-2142(IT)G, 2012-2144(IT)G, 2012-2145(IT)G, 2012-2146(IT)G, 2012-2147(IT)G, 2012-2148(IT)G and 2012-2150(IT)G
STYLE OF CAUSE:	MARIO MONTMINY v. HER MAJESTY THE QUEEN ALBERTO GALEGO v. HER MAJESTY THE QUEEN SERGE LATULIPPE v. HER MAJESTY THE QUEEN RÉMI DUTIL v. HER MAJESTY THE QUEEN ÉRIC HACHÉ v. HER MAJESTY THE QUEEN PHILIPPE BEAUCHAMP v. HER MAJESTY THE QUEEN JACQUES BENOIT v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Québec, Quebec
DATE OF HEARING:	September 23, 24 and 25, 2014, and May 26 and 27, 2015
REASONS FOR JUDGMENT BY:	The Honourable Madam Justice Johanne D'Auray
DATE OF JUDGMENT:	May 3, 2016

APPEARANCES:

Counsel for the Appellants:	Anne-Marie Bonin Lavoie
Counsel for the Respondent:	Anne Poirier

SOLICITORS OF RECORD:

For the Appellants:	
Name:	Anne-Marie Bonin Lavoie
Firm:	DS Welch Bussières, Lawyers LLP
For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada